STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 08-E-0539 - 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.

CASE 08-M-0618 - Petition for Approval, Pursuant to Public Service Law, Section 113(2), of a Proposed Allocation of Certain Tax Refunds between Consolidated Edison Company of New York, Inc. and Ratepayers.

NOTICE OF SCHEDULE FOR FILING EXCEPTIONS

(Issued January 7, 2009)

Attached is the Recommended Decision of Administrative Law Judges Howard A. Jack and Gerald L. Lynch in the above-captioned proceedings. Briefs on exceptions are due to be submitted electronically to the Secretary at secretary@dps.state.ny.us and to be served electronically on all active parties by 4:00 p.m. on Tuesday, January 27, 2009, provided that the signed original and five (5) additional hard copies must also be deposited for delivery by First Class mail or courier service, on that same date, to Hon. Jaclyn A. Brilling, Secretary, Public Service Commission, #3 Empire State Plaza, Albany, New York 12223. A hard copy should also be mailed by that date to any active party requesting hard-copy service in addition to electronic service. Briefs opposing exceptions are due electronically to the Secretary and to all active parties by 4:00 p.m. on Wednesday, February 11, 2009, following the same procedures outlined above for filing and service of both electronic and hard-copy versions.

The parties’ briefs should adhere to the requirements of 16 NYCRR 4.10, 3.5 and 4.8, which address page limitations, font size, spacing, margins and other requirements that will be enforced. The page limitations of Rule 4.10(c)(4) apply unless modified by the Secretary in response to a party’s showing that its presentation would be prejudiced by enforcement of such limitation. Appendices of financial schedules and similar information in tabular form shall not be counted for purposes of the page limitation.

(SIGNED) JACLYN A. BRILLING
Secretary

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RECOMMENDED DECISION

Howard A. Jack and Gerald L. Lynch
Administrative Law Judges

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APPENDICES

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Howard A. Jack and Gerald L. Lynch, Administrative Law Judges:

INTRODUCTION

This is a Recommended Decision concerning primarily the disputed issues in the captioned proceedings pertaining to the Company's Rate Year cost of electric delivery service. The procedural history and information about the parties are set forth in Appendix I. A summary of the Company's capital construction program is Appendix II. A summary of public comments received is set forth in Appendix III. The calculation of the incremental cost of electric delivery service supported is set forth in Appendix IV.

To a great extent, the issues are discussed in accordance with the final briefing outline adopted following the conclusion of the evidentiary hearings.

As previously stated in a message to all active parties, we anticipate that a further Recommended Decision, concerning all other issues, will be issued at a later date. We also anticipate those issues will be processed to a Commission decision after the suspension date. It was not possible for us to address all those issues by today. However, all parties are reminded that the Secretary determines if and when any recommended decision is issued.

I. PRELIMINARY STATEMENTS

The standard briefing outline adopted provided for initial statements. Some, though not all, parties submitted such statements.

Consolidated Edison Company of New York, Inc. (Consolidated Edison or the Company) states that its witnesses have demonstrated that the requested and significantly ameliorated revenue increase of $819.024 million is the amount necessary for it to maintain a safe and reliable system and to address growth in customer demand and an aging infrastructure, exclusive of the possible effects if the current conditions in capital markets continue. Given that one effect of that turmoil was a sharp increase in capital costs--with some A-rated debt priced in the 9% range in September and October 2008, compared to 9.5% and 10% return on equity supported by DPS Staff and requested the Company, respectively--the $819.024 million might be insufficient.[1]

The Company argues that Commission action to support the Company’s financial integrity and a strong delivery system is more important now than ever before because of the importance of its system to the local economy and its relatively large capital needs. The Commission, it says, should reject short-term remedies--such as inadequate returns and further delays in cash recovery--because they will ultimately have long-term adverse impacts on the Company and its customers. As to the latter approach, the Company suggests such an approach could raise serious cash flow issues at a time when cash will already be very tight because of projected capital expenditures.

The Company disagrees with the suggestion by other parties that the Company’s rates are too high through some fault of the Company. It says that people who live and work in and

[1] The Company’s Initial Brief, pp. 5, 8, and 13.

near New York City recognize that they live in a high-cost area and that they bear some of these high costs through utility rates. It also explains that its service quality is very high. Annual interruption rates on its network and non-network systems are 20 outages and 460 outages, respectively, per thousand customers. To the extent this notion about rates being too high is emphasized by New York City and the County of Westchester, moreover, the Company criticizes their failure to acknowledge or do anything about the fact that combined property and other taxes they are forecast to levy on the Company exceed $1.3 billion in the Rate Year, approximately 29% of customer bills, and drive fully one-third of the incremental revenue increase sought in these cases.[2]

The Company emphasizes that hornbook utility law is that a utility is entitled to recover the reasonable costs of conducting its business, plus a reasonable return on its investment. In this light, the Company disagrees strongly with numerous proposed adjustments, including productivity imputations that are 200% and 300% greater than historic levels, that ignore the Company's likely actual costs, that suggest some reasonable costs of doing business should be borne by shareholders, or that come without any concomitant proposed reduction in operating programs or modifications of incentive

[2] The Company's Initial Brief, p. 7, n. 6. In this connection, the Company observes that $194 million of DPS Staff's proposed $346 million annual revenue increase merely recognizes actual increases in property taxes above levels currently included in rates even though DPS Staff makes no provision for further likely property tax increases of $66 million the Company expects to occur as soon as January 2009. If the 7% property tax increase occurs as the Company expects (the actual increase is now known to be 7.5%), this would mean that DPS Staff is supporting a revenue increase of only $86 million, property taxes aside. As to the 29% figure, we assume this is the percentage of the Company's electric revenues, net of fuel and purchased power.

mechanisms that reduce the Company's revenues if service quality measures fall below specified levels. The effect of adopting adjustments like these, it continues, is to deny it any real opportunity to earn its allowed rate of return.

Likewise, the Company disagrees with proposals that it believes would limit its flexibility to shift funds from proposed programs in the event unanticipated but higher priorities arise and with proposals to have it prove in its next rate case the reasonableness of all capital expenditures above a specified level in the Rate Year. It argues that such proposals turn on its head the normal presumption of prudence of utility expenditures absent some indication to the contrary.

Finally, the Company asserts that Department of Public Service (DPS) Staff's overall position in this case abandons in large part the forward-looking rate year as the focus for determining a utility's revenue requirement. Many adjustments proposed by DPS Staff, it says, assume that Rate Year costs will reflect historic Test Year costs as adjusted for inflation and only known future changes in circumstances and that this is contrary to the Commission's 1977 Statement of Policy on Test Years in Major Rate Cases.

For all these reasons, and in light of the specific reasons discussed below, the Company urges the Commission to approve its $819.024 million one-year electric delivery revenue increase in its entirety, or to adopt its alternative three-year revenue increase proposal.

DPS Staff characterizes Consolidated Edison as a company Standard & Poors (S&P) says has an excellent business profile, with debt ratings among the highest in the industry, rates among the highest in the nation, and significant shareholder earnings protections through numerous pass-through and true-up mechanisms. These protections include pass-throughs of volatile commodity costs, a Revenue Decoupling Mechanism

(RDM) that guards against lower than predicted sales, and true-ups for substantial costs of pension and retirement benefit programs, environmental remediation, and major storms.

DPS Staff says it recognizes the current economic downturn has created greater uncertainties about the Company's revenue requirement. It notes, however, that Consolidated Edison speculates about potential increases in the cost of doing business, while ignoring the many ways in which an economic slowdown would reduce its costs--such as lower inflation and reduced infrastructure work--and has proposed no consequent changes in its proposed programs. Given these economic uncertainties, DPS Staff contends, it is important that the Commission adopt its proposals, such as a proposed true-up of capital costs, that will protect customers' interests while still allowing the Company to ensure safe and adequate service and earn a reasonable return. It concludes by stressing that its proposals are grounded in sound ratemaking principles, consistent with Commission policy, practice, and precedent, and reasonable in current circumstances.

The New York City (NYC) Government Customers argue that the Company's rate request must be examined carefully in the following context:[3]

1. The Company's rates are already much higher than those of other large companies without even considering the electric revenue increase allowed in 2008.
2. These high rates make it harder for New York City and Westchester County to compete with other parts of the country.
3. The pending request follows on the heels of the Company's other requests to increase electric, gas, and steam revenues by 38%, 34%, and 35%, respectively.[4]

[3] The NYC Government Customers' Initial Brief, pp. 6-7.

[4] Tr. 4437. It is acknowledged that the resulting revenue increases were all smaller than the requests.

The County of Westchester (Westchester, or the County) states that the rate increase proposed is driven largely by Consolidated Edison's massive construction program, in the face of at best modest load growth, the highest reliability of any utility in the U.S., a greatly improved service record, and no other explanatory crisis. Westchester maintains that granting the Company's requested increase would result in a 65% increase in its delivery rates over the last four years, almost five times the actual rate of inflation, destroying the delicate balance between providing safe and adequate service and charging just and reasonable rates. These increases place an extraordinary burden on its customers, exacerbated by the recent large increases in the commodity cost of electricity. The County urges the Commission to place reasonable constraints on the Company's capital and other spending plans. Westchester also contends that much of the proposed rate increase is driven by events taking place only in New York City, including property tax increases, and by the Company's electric department's subsidization of its steam department, largely to the benefit of New York City. For these reasons, the County believes it is time to study whether the Company's delivery rates should be geographically differentiated.

The New York Energy Consumers Council (NYECC) observes that Consolidated Edison's electric rates are already the highest in the continental United States and that, beyond any increases from this proceeding, its ratepayers face significant incremental burdens from increases in System Benefits Charge collections—which will be affected by the Energy Efficiency Portfolio Standard (EEPS)—the Regional Greenhouse Gas Initiative (RGGI), and other demand-side management (DSM) costs.

Taking these overview arguments into account, our sense of the context of these cases at a high level is as follows:

1. All parties agree that reliability and service quality problems need to be minimized reasonably. Images of the old and infirm in high rise buildings for a week or more in July, with no air conditioning, no refrigeration, and no elevators, is just one of many mental snapshots that crystallize this point.

2. The Company continues to have a very large construction program. The need for this program is not questioned directly by any other party. Some elements of the Company's construction plan are contested, specifically or generally, based on questions about whether the planned work would all be done in time to affect the Rate Year, even if the necessary revenues were provided. Another general question is whether the Company is overspending on reliability (possibly as part of a concerted effort to avoid revenue disallowances under the terms of applicable incentive mechanisms).[5]

3. Forecasting sales, other revenues, labor and non-labor operation and maintenance expenses, non-income taxes and plant additions for a large company can be daunting in an 11-month schedule. This difficulty is compounded given the significant economic downturn that accelerated after the proceeding had been ongoing for several months. The record provides some insights into the costs of electric delivery service that have already or may yet increase on account of the economic downturn (the cost of capital, non-income taxes, and pensions and other post-employment benefits) and costs of electric delivery service that have or may yet go down for the same reason (vehicle fuel and rents, for example). Given the economic downturn, it should be assumed that the record in these cases is more stale than is typical because of the degree to which circumstances have changed and given that changes in forecasts (as opposed to known and easily verifiable cost changes), are not generally entertained after the evidentiary hearings.

4. Following the Commission's decision in the Company's last electric rate case, the Company's bond ratings were downgraded by two of three rating agencies (Standard & Poor's and Fitch) and put on a negative watch by Moody's. The impact on the incremental cost of debt was initially relatively small. However, it

[5] Applicable programs, for example, do not appear to be analyzed on a dollars per outage avoided or outage hour avoided basis.

is apparent that this will not continue. The 9.1% allowed equity return, the allowance of some revenues on a temporary basis, and adoption of a one-year rather than a multi-year rate plan are among the factors the rating agencies cited for their actions. An underlying concern in the present cases is whether the Commission will provide adequate regulatory support for the Company going forward.

5. The downgrading might also have been related in part to implementation of a revenue decoupling mechanism (RDM) following the Company’s last electric case. It seems clear that the Company was able to earn in excess of its allowed return on equity fairly consistently in past years, largely but not exclusively based on its ability to make sales in excess of those forecast for ratemaking purposes. The institution of an RDM minimized downside risk for the Company but it also removed a significant opportunity for the Company to earn more than its allowed rate of return on common equity. This reduction in upside earnings potential also may have affected the Company’s bond ratings.

6. The Company and DPS Staff agree that, at a minimum, a further downgrading below the Standard Poor’s "A-" bond rating should be avoided given the Company’s large capital needs going forward and recent sharp increases in the cost of debt.

7. The Commission adopted in August 2008 a maximum energy efficiency incentive for the Company of $9.92 million. This should be taken into account as a potential source of upside earnings potential for the Company.

8. The single most pervasive concern of parties other than the Company is whether revenues provided to fund operation and maintenance work and to support capitalized plant expenditures will be used by the Company for such general purposes or will be used by Consolidated Edison instead to generate equity returns in excess of the cost of capital, to fund expenses disallowed in rates, or to support anything else that only minimally or tangentially maintains or improves reliability or service quality.

   All of the causes of this basic lack of trust are not known but some that are evident include that:

   (a) the Company failed to fill numerous incremental positions that were fully funded in the Company's last electric rate case and the Company's basic position (with the exception of one witness) is that there is nothing wrong with this because it was "not required" to fill the positions by any date certain.

(b) The Company continues to propose that a portion of the compensation of its non-officer and officer managers be based very heavily on the Company's earned return on equity, with what others regard as woefully inadequate attention to reliability, service quality and the reasonableness of rates.

(c) In response to questions about why certain amounts allowed in the past were not used for their intended purposes, the frequent Company response is that the money was spent on something else with a higher priority and the something else may or may not be specified. This latter incomplete variation of the two leads many to doubt the Company's word.

9. Reduced to its essentials, other parties are concerned that the Company does not fairly balance its public service obligations and its profit motive, favoring the latter to a point acceptable only to it and addressing the former only with whatever is left over.

10. Many of the arguments presented on discrete issues in these cases are a mixture of: (a) the other parties' projections are wrong for the following specific reasons, and (b) the other parties' projections should not be adopted either because customers cannot afford it or investors will not stand for it. Our sense is that the former are completely proper and we focus on them. The latter arguments have nothing to do with the Company’s reasonable cost of providing electric delivery service and should be considered separately and one time only, taking into account the minimal but reasonable cost of electric delivery service and any other factors the Commission believes warranted.

11. While many parties express general concern about the impacts of the Company's proposals on ratepayers, the record does not provide any information about how customers are being affected by the current economic downturn. Similarly, there is no solid information offered about the Company’s customers' collective ability to pay higher rates for electric delivery service. This is not to suggest it is unlikely that customers are not being negatively affected by the current economic downturn. We simply have no clear

picture on this record of how and the extent to which they are affected.

12. The single largest element of the Company's cost of delivery service in the Rate Year is non-income taxes. As noted above, property taxes represent nearly 30% of the Company’s total cost of delivery service, and more than one-third of the incremental cost of delivery service for which higher rates are sought.

13. We are not aware of any large accumulation of deferred credits to ameliorate bill impacts. It is also apparent that the strategy of extending amortization periods for deferred amounts is pretty much exhausted as a regulatory option for this utility.

Given this overall context, and based on our evaluation of all the issues discussed in today’s Recommended Decision, we have focused on trying to come as close as reasonably possible to determining the Company's minimal but reasonable cost of providing electric delivery service in the Rate Year. Arguments based on what customers can or cannot afford and what investors will or will not accept have been given little weight in estimating that cost.

In addition to estimating the minimal but reasonable cost of electric delivery service in the Rate Year, our recommendations are collectively intended to further minimize the Company's downside earnings risk. The goal is to help minimize the risk of a further downgrade without giving away the store. We recommend this be accomplished by providing reasonable allowances and full reconciliation of some additional large, and potentially volatile, expenditures that are largely or completely beyond the Company's control (e.g. property taxes and the cost of debt). On the other hand, we do not intend to eliminate all chance of the Company’s earning somewhat, but not much more than, its allowed return on common equity. This is the primary reason why we recommend that a productivity adjustment of no more than 1% be adopted and that the Company be subject to an equity earnings sharing trigger and cap. The option of the Company earning more than the allowed return on common equity, by shifting or diverting dollars intended to support operation and maintenance expense or new plant investment, is an option that we believe should be foreclosed. It is for this reason that we are recommending a downward only reconciliation of carrying charges on planned capital investment.

At various points in the case, the Company has argued both that relatively high commodity costs should be ignored for the purposes of determining its cost of electric delivery service and that more recent and significant decreases in the cost of commodity should be relied upon as a basis for allowing a larger rate increase for electric delivery service. Our view is that changes in commodity prices can be temporary and it is also obvious that the Commission has no control over them. For these reasons, we recommend that the Commission determine the Company's cost of electric delivery service and set rates independent of what may or may not happen to commodity costs.

In light of the uncertainty about the future, we considered the possibility of recommending some other “safety valve” provisions that would come into play automatically if the current economic situation improves (protecting ratepayer interests) or deteriorates materially (protecting shareholder interests and ensuring access to needed capital on reasonable terms) during the Rate Year. In the end, however, we were not able to fashion a proposal within the time available. That the parties never had an opportunity to focus on the general desirability or specific parameters of such a mechanism, certainly contributed to this end result.

One final point is that numerous parties offer arguments to the effect that amounts allowed or disallowed by the Commission in the Company's last electric rate case for certain items must be similarly allowed or disallowed in this case. These arguments have been accorded little weight except to the extent the parties provide an explanation of the reasons for the Commission's prior decision. We believe that all of the issues presented in these cases should be resolved based on the evidence and arguments offered here and based on careful consideration of the law, rules, and the reasoning behind Commission policy and precedent.

II. SALES REVENUES

A. Sales Revenue Forecast

1. Sales Forecast ($14.7 Million)[6]

The Company initially forecast rate year sales of 59,027 GWH.[7] DPS Staff disagreed with the Company on six points, but proposed an upward adjustment of 239 GWH to the Company's sales forecast only with respect to the estimated effects of Demand Side Management (DSM) on the Company's Rate Year sales. Specifically, the adjustment was intended to reflect a delay in implementation of DSM programs related to the Energy Efficiency Portfolio Standard (EEPS) proceeding and a correction for the effects of the New York State Energy Research and Development Authority's (NYSERDA's) System Benefit Charge (SBC) 3 programs. The effects of this adjustment, all other things being equal, would be to decrease the Company's Rate Year revenue request by $14.7 million (the Company's calculation).[8]

In late September 2008, the Company filed update/rebuttal testimony and exhibits. The Company's updated sales forecast for the Rate Year is for 58,510 GWH, or 517 GWH

[6] Some of the captions include dollar figures. The amounts were specified as of the end of the hearings and are intended to call the reader's attention to all the larger dollar issues.

[7] Exhibits (Exhs.) 37-45.

[8] The Company's Initial Brief, p. 22. DPS Staff's Initial Brief, pp. 30-31.

lower than the original forecast. Among other things, the update addresses two of DPS Staff's concerns, by revising the forecast for employment updates and including the effects of the portion of DPS Staff's adjustment related to a delay in EEPS DSM programs. All other things being equal, this update increased the Company's overall revenue request by approximately $23 million per year.

On brief, the Company and DPS Staff continue to disagree on three points with respect to which DPS Staff did not propose any adjustment, as well as the DSM correction for the effects of NYSERDA's SBC 3 programs.

(a) DSM Adjustment

As to DPS Staff's proposed adjustment related to NYSERDA's SBC 3 programs, the Company argues as follows:[9]

1. The Company reflected NYSERDA's SBC 3 programs in accordance with a report NYSERDA gave to the Company.[10]
2. DPS Staff used a different NYSERDA report[11] at the urging of NYSERDA, a report that NYSERDA did not give to the Company.
3. The report relied upon by DPS Staff reflects SBC 2 program achievements and no adjustment was made for this overlap.[12]
4. The Company properly relied on the report given to it by NYSERDA that does not suffer from the same SBC program overlap issue.
5. Accordingly, the balance of DPS Staff's DSM adjustment should be rejected.

Although the Company also implied that the NYSERDA report DPS Staff relied upon contained other inconsistent or incorrect information, beyond the purported SBC 2 data overlap, it did not identify the nature of that information. The Company also cites testimony by its witness Ms. Craft that there are

[9] The Company's Initial Brief, pp. 29-30.

[10] Ex. 292.

[11] Ex. 426.

[12] Transcript page (Tr.) 2892.

"several problems logistically" with using the report DPS Staff relied upon, but neither in testimony nor brief did the Company describe the nature of that information, except to the extent Ms. Craft stated that the Company needs "a breakdown of the detailed data, including customer accounts and customer name, for all the NYSERDA programs" (Tr. 874-75). On the other hand, the Company states that none of the reports themselves provide the detailed data and "the Company performs this task manually since it does not get this information."[13]

DPS Staff defends the level of its adjustment to Consolidated Edison's DSM savings forecast to remove historical achievements associated with the SBC 3 program. In response to the Company's claims that the NYSERDA reports DPS Staff relied on (a) did not contain detailed data breaking down customer information, and (b) inflated SBC 3 achievements by including SBC 2 program achievements, DPS Staff contends:[14]

1. The system-wide level of DSM savings can be allocated among customer classes using the Company's formula (Ex. 427).
2. If DPS Staff's SBC 3 achievement estimate was inflated, it would be greater than the Company's. But, for example, for March 2007, DPS Staff's estimate is less than Consolidated Edison's (Tr. 870; Ex. 178, p. 3).
3. DPS Staff's estimate is based on quarterly reports and reflects the latest quarter ending March 31, 2008 (Tr. 2895), while the Company's is based on annual reports and reflects actual SBC 3 data only through March 31, 2007 (Tr. 21).

(b) Personal Income Variable

DPS Staff contends the Company's forecasting model input for Service Class (SC) 1 (residential customers) is flawed in using an employment variable rather than a personal income variable, because:[15]

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[13] The Company's Initial Brief, p. 30.

[14] DPS Staff's Initial Brief, pp. 16-17.

[15] DPS Staff's Initial Brief, pp. 18-21.

1. Based on economic principles, energy consumption of residential households is dependent on electricity price and personal income.
2. Residential forecasting models generally include a personal income variable, most New York electric utilities have used a personal income variable in the forecasting models in their recent rate cases,[16] and the Company agrees use of a personal income variable is theoretically sound (Tr. 862).
3. An employment variable is not a reasonable substitute for personal income because there is no record evidence that the impact on electricity usage of variations in employment is the same as that of variations in personal income.
4. In any event, the way the Company used the employment variable in its SC 1 model was improper, since:

   (a) Use of total employment as an explanatory variable in a model that predicts sales volume on an average use per customer basis (Tr. 875-78) fails to capture correctly the impact of total residential growth over the sampling period.

   (b) The employment variable used excludes public employment, including federal, state, and local employees (Tr. 878), while SC 1 customers include all employees from the Company's service territory.

The Company claims that the DPS Staff's use of the personal income variable is flawed, because:[17]

1. Actual personal income data are available only on an annual basis and only through 2006. Subsequent data are estimated.
2. Annual personal income data were converted to quarterly data by an arbitrary mathematical formula, which might not reflect actual personal income data.
3. Matching actual data on historic sales volume to estimated data on personal income might lead to inaccuracy in

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[16] Cases 05-E-0934 et al., Central Hudson Gas and Electric Corp. – Rates, Order Establishing Rate Plan (issued July 24, 2006); Case 05-E-1222, New York State Electric and Gas Corp. – Rates, Order Adopting Recommended Decision with Modifications (issued August 23, 2006); and Cases 03-E-0765 et al., Rochester Gas and Electric Corp – Rates, Order Adopting Provisions of Joint Proposal with Conditions (issued May 20, 2004).

[17] The Company's Initial Brief, pp. 24-25.

judging the sales impact of [sales reaction to] changes in personal income.

4. DPS Staff's willingness to use non-quarterly data for the personal income variable is inconsistent with its refusal to use data on population growth for the SC 2 model because it was not available on a quarterly basis. In that instance, DPS Staff used the number of SC 1 customers data as a proxy because it was available quarterly.

DPS Staff counters, stating:

1. Contrary to the claim that DPS Staff's method for converting annual figures to quarterly is arbitrary:

(a) DPS Staff's conversion methodology is built into the econometric software both it and Consolidated Edison used to develop their forecasts.

(b) The method is fairly standard and widely used in the forecasting profession.

(c) Quarterly patterns in personal income should not produce errors in the annual total sales volume estimate as long as annual personal income data are estimated accurately.

2. The quarterly personal income data for 2007 and beyond were provided by the Company itself, estimated by *Economy.com*; the forecast is available on a quarterly basis at the county level and updated monthly (Tr. 880-82) and thus reflects the latest economic changes. It deserves the same confidence that Consolidated Edison places in other economic data from *Economy.com*.

In its reply brief the Company makes these additional points:[18]

1. The software package DPS Staff used to convert annual data to quarterly is one the Company uses for forecasting purposes, not allocation.

2. DPS Staff's claim--that quarterly patterns of income are not important because annual total revenue is what matters in forecasting--overlooks the fact that different tariffs apply in summer months, making quarterly patterns necessary to forecast accurately.

3. DPS Staff fails to demonstrate why the absence of government employment or residential growth in the Company's private non-manufacturing employment variable is consequential. Moreover, the Company model has already

[18] The Company's Reply Brief, pp. 4-5.

accounted for residential growth through inclusion of the number of SC 1 customers as a variable. Employment was included to capture the state of the economy, which affects individual consumption decisions.

(c) SC 2 Employment

DPS Staff recommends that employment be replaced by the number of SC 1 customers in Consolidated Edison's model for SC 2, the small business customer class, because:[19]

1. Since growth of small business is driven by growth of population, using the number of SC 1 customers as a proxy improves the model's performance.
2. Contrary to the Company's argument that if employment does not rise, demand for goods and services will not rise:

(a) That increases in population create more demand for goods and service is common sense.

(b) The statistics of DPS Staff's SC 2 econometric model indicate that variations in electricity consumption by small businesses are better explained by variations in the number of SC 1 customers, not employment. Thus, the assumption that increasing population creates demand for goods and services holds true most of the time for the SC 2 class.

(c) The record shows that population in the Company's service territory grew at a rate similar to the rate of growth in the number of SC 1 customers since 1983 (Tr. 876-77), disproving the Company's claim that there is no support for using growth rate of SC 1 customers as a proxy for a population growth rate.

(d) The record in a recent rate case supports the proposition that the number of residential customers is related to population.[20]

The Company criticizes DPS Staff's use of SC 1 customer growth as a proxy for population growth on these grounds:[21]

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[19] DPS Staff's Initial Brief, pp. 21-23.

[20] Citing Case 07-E-0949, Orange and Rockland Utilities, Inc. – Rates, Ex. 50, p. 10.

[21] The Company's Initial Brief, pp. 25-27 and the Company's Reply Brief, pp. 6-7.

1. DPS Staff's reasoning for using number of SC 1 customers as a variable is circular. It claims the SC 2 model fits better using SC 1 customer growth data because many small businesses are driven by population; but also says the conclusion that small businesses are driven by population was inferred from the fact that the model fits better using SC 1 customer growth.
2. Increasing population will not create growth in demand for small business services unless accompanied by growth in employment, so employment is a better variable to use. Furthermore, employment is more relevant because small businesses are more susceptible to swings in the economy.
3. DPS Staff failed to calculate whether SC 1 customer growth is highly correlated with population growth, and thus a valid proxy, but merely assumed so.
4. For the Orange and Rockland case that DPS Staff cites, the service area and type of residential dwellings in it are very different from Consolidated Edison's circumstances. In addition, the Company did not accept the model to which DPS Staff refers and the Commission accepted the Company's sales forecast.

(d) Cooling Degree Days

DPS Staff challenges the Company's removal of actual non-summer months data from the forecast for normal cooling degree days (CDDs) in the course of smoothing and weather normalization as part of its sales forecasting. The Company applied subjective judgments about use of air conditioning appliances in the November through April period, assuming zero CDDs in those months. As a result, its estimate eliminated 24 CDDs on an annual basis, compared to the 30-year historical average (Tr. 2866). DPS Staff believes the 24 CDDs should be added back so that the estimates of normal CDDs agree with the 30-year average (Tr. 2868-69).

The Company makes the following points in support of its position:[22]

1. CDDs are intended to capture use of air conditioning, which normally occurs during May through October. Incorporation

[22] Ibid., pp. 27-28.

of CDDs into the normalized results when forecasting for other months is inconsistent with the practice of the National Weather Service Bureau (NWSB) (Tr. 866).

2. The 30-year average is smoothed so normal CDDs show a gradual increase entering the summer and a gradual decrease entering the fall. This smoothing leads to negligible CDDs outside the May through October period; e.g., the 30-year daily average for the month of April is only 0.5 CDD (Tr. 866).
3. The normal historical average temperature in April is at least 5º lower than the average reference temperature of 57.5º used to determine CDDs (Tr. 867).
4. DPS Staff argues that CDDs should be increased by 14 for April, seven for November, one for December, and three for March, months in which heating degree days (HDDs) are 306, 429, 746, and 617, respectively. It is reasonable to assume, then, that customers are using heating in those months, not reacting to minimal CDDs and turning on air conditioning.
5. The Commission rejected DPS Staff's method in the last Company rate case.[23]

In response, DPS Staff contends:[24]

1. By definition and use, the CDD variable is intended to capture the impact of warmer weather on customers' use of electricity generally, not just use for air conditioning. To be consistent with the purpose of the CDD variable, the normal CDDs must be developed on a purely mathematical basis, without subjective adjustment.
2. The Company's CDD variable covers a wider range of temperatures than NWSB's, with the Company's based on an average hourly temperature of 57.5° and NWSB's on 65°.
3. Historically, a significant number of CDDs have occurred in non-summer months, according to the Company's data. For example, in 1991 and 2002, respectively, 45 and 89 CDDs occurred in April and the weather was as warm as or warmer than an average "summer" month in October (Ex. 178, p. 1).

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[23] Citing Case 07-E-0523, Consolidated Edison Company of New York, Inc. – Electric Rates, Order Establishing Rates for Electric Service (issued March 25, 2008) (2008 Rate Order), p. 32.

[24] DPS Staff's Initial Brief, pp. 23-27.

4. On average over the 30-year historical study period, 24 CDDs per year fall in March, April, and November (Tr. 2866). The effect on sales of including these additional CDDs in the forecasting model is significant (Ex. 178, p. 2).
5. The Company's "smoothing" of CDDs in a month is not even relevant for sales forecasting. Smoothing is relevant only in tracking daily peak loads or day-by-day energy consumption as daily temperature gradually changes. For the sales forecast what is relevant is the average annual number of CDDs over the study period. Yearly normal CDDs must equal the 30-year average of actual CDDs, or the sales forecast will be understated.
6. The Company confuses average CDDs with average temperature. Positive CDDs are recorded whenever the average hourly temperature in a day exceeds 57.5°, even if the monthly average temperature is below 57.5°. If average hourly temperature for a day is between 57.5° and 62°, both a CDD and an HDD level will be recorded. Thus, there is nothing surprising about data records showing both CDDs and HDDs in some non-summer months.
7. The Company's argument about use of heating appliances is invalid because, as noted earlier, its CDD variable must be calculated on a purely mathematical basis, without subjective judgment, and is a variable intended to capture weather impact on electricity use for more than just air conditioning.

The Company makes these additional arguments in reply:[25]

1. DPS Staff fails to explain what further, broader impact warmer weather would have on consumers than to induce use of cooling appliances like fans and air conditioners.
2. The difference between NWSB and Company reference temperatures for CDDs is the result of the Company's use of wet bulb temperature to reflect the effect of humidity. Consumers are not likely to use cooling devices in response to a few CDDs in non-summer months when humidity levels are low.

(e) Update Upon Commission Decision

DPS Staff's sales forecasting witness recommended that--except for his DSM adjustment--the Company's sales volume

[25] The Company's Reply Brief, pp. 8-9.

forecast be accepted as filed. On brief, however, DPS Staff proposes that the inputs to the forecasting model be updated, using its methodology and modified inputs (including employment update, personal income variable, SC 2 employment variable substitute, and revised cooling degree days), when the Commission makes its decision.[26] In support, DPS Staff notes the continuing changes in the economy. The Company objects to updating the sales volume and revenue forecasts at that time, for the same reasons that it has generally stated against updates after conclusion of hearings (excepting several specific items):[27]

1. Many items of revenue or expense are moving up or down.
2. Evidentiary requirements associated with calculating the effect of an updated element pose challenges; e.g., there might be reasonable differences of opinion about what information is “known” at the proposed time of an update and what information should be considered in making the update.
3. How and when to address changes, and which changes to address, present important questions of equity and evenhanded regulation.

(f) Discussion

With respect to the DSM adjustment, both the Company and DPS Staff appear to have made good faith efforts to base their forecasts on the best available information, unfortunately relying on two different NYSERDA reports. The Company has suggested that the report DPS Staff used contained incorrect and inconsistent information, yet identifies none but the alleged inclusion of SBC 2 data. In addition, the Company’s allusion to a lack of detailed data in the report DPS Staff employed appears to be a red herring, since it mentions that none of the reports includes that information. The only remaining asserted deficiency in the report DPS Staff used is the inclusion of SBC

[26] DPS Staff’s Initial Brief, p. 28.

[27] The Company’s Reply Brief, pp. 92-93.

2 data. As DPS Staff points out, however, if SBC 2 data were in fact included *sub rosa* in the DSM data on which it relied, its estimate of SBC 3 DSM achievement for March 2007 would be greater than the Company's, but is lower. The Company has not disputed DPS Staff's point.

We find that the NYSERDA report DPS Staff used did not include SBC 2 data and has no other known flaws. Inasmuch as the data it provides are compiled on a quarterly, rather than annual, basis and are one year more current than data in the report on which the Company relied, it is more reliable for forecasting in this case. Accordingly, we recommend DPS Staff's proposed DSM adjustment of 239 GWH to the Company's sales forecast.

On the other hand, we do not recommend DPS Staff's call for the sales volume and revenue forecast to be updated at the time of the Commission's decision. DPS Staff's own witness recommended that, except for his DSM adjustment, the Company's sales forecast should be accepted. There is also no risk of ratepayers paying too much or too little on account of sales variations, because of the RDM. Moreover, notwithstanding that the economy remains in an unsteady state, the Company's points in opposition have some merit. We will keep them in mind as we consider Company proposals for subsequent updates of other items affecting its cost of electric delivery service.

We decline to decide the remaining three issues, concerning personal income variable, SC 2 employment, and cooling degree days, because they have no associated cost of electric delivery service effect and are academic in the absence of an update. In the event the Commission disagrees, however, it will be helpful to know the extent to which the parties agree or disagree with our understanding of the arguments on each of these disputes set forth above.

B. Low-Income Program Funding

1. Positions of the Parties

The Company currently has a low-income program under which eligible residential customers (those receiving public assistance, supplemental security income, food stamps, or a Home Energy Assistance Program benefit in the prior 12 months) pay a monthly customer charge of $6.50, for a discount of $5.92 per month off the customer charge paid by other residential customers. As will be discussed in RD, Part II, the Company proposes to increase the customer charge in this case from $12.42 to $14.90. It also proposes to maintain the $5.92 per month low-income discount, meaning the low-income customer charge would increase by the same $2.48 per month as it would for all other residential customers.

The cost of providing the current low-income discount to 245,000 customers is approximately $17.4 million per year. The current level of funding reflects an increase from the $12.5 million annual cost prior to the Company's last electric rate case (Case 07-E-0523).

DPS Staff and the Consumer Protection Board (CPB) both propose that the Company's low-income program discount be increased so that the low-income monthly customer charge will remain at $6.50 even if the basic residential customer charge increases. The effect of this alternative proposal alone is that the annual cost of the program would rise from $17.4 million to $24.7 million, an increase of $7.3 million on top of the $4.8 million increase authorized by the Commission in the 2008 Rate Order.

In support of this proposal, DPS Staff offers the following reasons:[28]

[28] DPS Staff's Initial Brief, pp. 28-29. See, also, CPB's Initial Brief, p. 17.

1. It would exempt economically disadvantaged households from the proposed general increase in customer charges, although they would still bear volumetric charge increases and any commodity cost increases.
2. The impact of recovering the forgone revenues from the general body of ratepayers would only be about $0.0005 per kWh (Tr. 4700).

The Company's current and proposed low-income programs do not contemplate any program element for arrears forgiveness. CPB proposes that a collaborative process be initiated to develop a targeted arrears forgiveness program, similar to those in effect today for other New York utilities, and that $5 million be set aside to fund this proposal in the Rate Year. CPB suggests that the absolute minimum to be set aside for this purpose is the $1.9 million previously provided for customer charge discounts that was not used for that purpose in the historic Test Year (the 12 months ending December 31, 2007).[29]

Reasons offered in support of CPB's collaborative and low-income customer charge proposals include the following:[30]

1. CPB is concerned about the ability of low-income customers to pay their utility bills, particularly given the current economy and the likelihood of a further downward economic spiral.
2. This concern is warranted in light of evidence to the effect that:
    - Disconnections for non-payment through September 2008 are up 13% over the prior year.
    - Company accounts needing field collections (the last step in collecting on bills in arrears) increased 2% from 2004 to 2005, 7% from 2005 to 2006, and 7% from 2006 to 2007, and are estimated by the Company to increase by 9% from 2007 to 2008.
3. A decision to keep the monthly low-income discount at $5.92 and, thus, to allow an increase in the low-income residential customer charge from $6.50 to $8.98, would have

[29] $17.4 million authorized minus $15.5 million of actual discounts equals $1.9 million.

[30] CPB's Initial Brief, p. 17.

> a disproportionate effect on low-income customers whose energy costs are a high percentage of their total income.

The Company’s basic position is that low-income customers already receive significant benefits from the Company’s other customers in the form of the $17.4 million Low-Income Program, $38 million per year in SBC programs intended to help low-income customers, and the uncollectibles expense allowance used to set rates.[31] It argues any further benefits for low-income customers would place an unwarranted burden on the Company’s other customers. Further, the Company arguments in opposition include:[32]

1. DPS Staff provides no support for its claim that $24.3 million is a reasonable amount, taking into account the rising cost of electricity, impacts of such increases on low-income customers, and the potential for offsetting benefits.
2. CPB provides no support for its proposal to maintain a low-income customer charge of $6.50 per month, other than noting that low-income persons are affected disproportionately by market price increases. This is not an adequate basis, as all customers must bear the same increases in the market price of electricity.
3. The effect of increasing the customer charge discount as proposed would be to increase by 100% the customer charge discounts in effect prior to April 1, 2008.

DPS Staff does not oppose CPB’s call for a collaborative to consider and develop design parameters for an arrears forgiveness component to enhance the low-income program, but agrees with the Company that part of the discussion must include a funding mechanism for such an enhancement. The Company states that it is willing to participate in such a collaborative and specifies the issues it believes should be discussed. It believes, however, the program must be developed

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[31] The latest forecasts of uncollectibles expense are $56.104 million for the Company (Ex. 403, Schedule 3 of 11) and $53.485 million (Ex. 420, Schedule 3) for DPS Staff.

[32] The Company’s Initial Brief, pp. 32-33.

before any dollar amount is specified. To the extent CPB argues $1.9 million of the funding for this program should come from an amount allowed in a prior electric rate case for purposes of funding low-income customer discounts, but not actually spent for such purposes, the Company argues that CPB's $1.9 million figure is based on unsupported assertions and, moreover, that the prior allowance was not subject to reconciliation.[33]

DPS Staff offers these responses to the Company's arguments:[34]

1. The necessity for the increase in the discount rests on the Company's proposed increase in the customer charge. The reasonability of the increase is the *de minimis* impact on other customers' rates and bills. DPS Staff did not claim a low-income program would benefit all customers and denies such a showing is necessary.
2. The Company's claim that DPS Staff's recommended level of discount places an unreasonable burden on all other customers rests solely on the belief of the Company's Customer Operations Panel, without a shred of supporting evidence (Tr. 1434).
3. The Company's suggestion that its customers subsidize low-income customers with $38 million in annual SBC low-income programs is false, because that is the statewide funding level, not the Company's (Tr. 4700).

Responding to the Company's objections to holding the low-income customer charge constant at $6.50, CPB maintains:[35]

[33] The Company's Initial Brief, pp. 33-34. In note 27 on p. 31 of the same brief, however, the Company states that it expects to spend about $16 of $17.4 million allowed for this purpose in the current rate year. There are no arguments about how this difference came about. In any event, the Company's Reply Brief, p. 11, now predicts less than $500,000 will remain by March 31, 2009.

[34] DPS Staff's Reply Brief, pp. 16-18.

[35] CPB's Reply Brief, pp. 5-6.

1. That Consolidated Edison's customers help to fund NYSERDA SBC low-income programs is irrelevant, because those are statewide programs funded by all utilities to promote low-income energy efficiency, which have no bearing on utility-specific low-income programs.
2. The Company has provided no data to support its argument that uncollectible levels for the Company's low-income customers are higher than for any other corresponding category of Company customers.
3. CPB did provide support for its proposal, citing deteriorating economic conditions and increasing numbers of disconnections.
4. With respect to the Company's denial that $1.9 million available under the Company's current low-income discount program is not being used to assist low-income customers; and its claim that the $17.4 million in program funding is, in any event, not subject to reconciliation:

   (a) The Company's response to CPB-68 (Ex. 194) indicates it is serving only 219,026 customers, not the requisite 245,000, leaving about $1.9 million of intended funding unused.

   (b) In contradiction of itself, the Company acknowledges that the $17.4 million target level for the low-income discount program is, in fact, subject to reconciliation.[36]

CPB does not, however, disagree with the Company's suggestion that funding for the CPB-suggested arrears forgiveness program be kept separate and that the recovery method be determined as part of a collaborative, so long as:[37]

1. The full $17.4 million for the low-income discount program is used to provide assistance to the maximum number of participants.
2. The discount program funding level is increased if the monthly customer charge is increased.
3. An additional $5 million is allocated to establish an arrears forgiveness program.

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[36] The Company's Initial Brief, p. 31, n. 27. See also 2008 Rate Order, supra, pp. 138-39.

[37] CPB's Reply Brief, pp. 6-7.

On reply, the Company states:[38]

1. DPS Staff's argument that low-income customers will also face increases in the volumetric charge and commodity costs does not warrant additional assistance from the Company's other customers. That assistance, if needed, should come from the state or federal government. Moreover, increases in commodity market prices should not drive an increased subsidy by the Company's other customers who also must bear that increase.
2. If DPS Staff views this $7 million increase to customers as *de minimis*, it should apply the same perspective to every other Company program and DPS Staff adjustment in this case.
3. With respect to CPB's contention that $1.9 million will remain from the current year low-income program allowance, as a result of under-serving the target audience by about 25,000 customers:

   (a) The Company now projects a very small amount, less than $500,000, will not be provided in discounts by the end of the current rate year.

   (b) Generally, the only way the Company enrolls customers in the low-income discount program is through referrals from NYC's Human Resources Administration or Westchester's Department of Social Services, because eligible customers must be receiving public assistance, Supplemental Social Security Income, or food stamps or Home Energy Assistance Program benefits.

2. Discussion

The Company's basic arguments for increasing the monthly customer charge for low-income customers and holding the line on the discount come down to two. First, low-income customers already get significant benefits through several different mechanisms and any more would place an unwarranted burden on other customers. Second, DPS Staff and CPB have failed to support their proposals for maintaining the current monthly charge applicable to low-income customers.

CPB and DPS Staff have shown that the Company's first argument is seriously flawed. The amount the Company claims is being spent on SBC low-income programs applies statewide, not

[38] The Company's Reply Brief, pp. 9-12.

just to the Company's service territory. The Company has made no attempt to quantify the amount applicable only to its own service territory. Moreover, CPB points out that the SBC low-income programs are intended to promote energy efficiency, which provides benefits for all customers, not just the direct recipients. As CPB notes, neither has the Company made any effort to quantify what portion of its uncollectibles are related to low-income customers or how that portion relates to other customer classes' uncollectibles.[39]

By its second argument, the Company attempts to shift the burden of proof from itself[40] to CPB and DPS Staff. CPB in particular has made the case that the Company's low-income customers are being stressed by the adverse turn in the economy and having increasing difficulty paying their bills and avoiding disconnection. It was incumbent on the Company to offer counter evidence overcoming CPB's testimony and justifying its own position, which it did not seriously attempt to provide. We find that the Company has failed to meet its burden of proof with respect to the proposed increase in the monthly customer charge applicable to low-income customers and therefore recommend that the charge remain at $6.50. Given our recommendation that incremental revenues be allocated and all rates be increased on an across-the-board percentage basis at this time, the revenue impact on other customers would be much less than $7.3 million. Our cost of electric delivery service recommendation assumes, as a placeholder only, an adjustment equal to 25% of DPS Staff's proposal.

No party disagrees with CPB's proposal for a collaborative effort to try to develop an arrears forgiveness

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[39] We do not, however, endorse DPS Staff's suggestion that the total amount that might be borne by other customers would be *de minimis*.

[40] Public Service Law §66(12)(i); 16 NYCRR §61.1.

program, which we recommend be adopted. We find merit, however, in the positions of the Company and DPS Staff that it would be premature to determine a level of funding for such a program at this time or to designate whatever amount of funds might remain from the current rate year's low-income discount program allowance for that purpose. The level and manner of funding of an arrears program are matters that should be considered after more information is developed on the nature and potential audience for the program. This includes the question about whether any low-income discount revenues leftover in the current rate year should be used for the purposes proposed by CPB.

C. Billing and Payment Processing/Merchant Function Charge/Metering Revenues

The Company and DPS Staff agree on the method that should be used to determine the Rate Year increase in rates that generate the Company's competitive service revenues. These rates include the Merchant Function Charge, Competitive Metering Charges, and Billing and Payment Processing Charges. However, DPS Staff and the Company support different sales forecasts and this affects the level at which the above-referenced competitive rate elements should be set. On brief, the Company notes that there should be adjustments to these charges once the sales issue is resolved.[41] DPS Staff agrees with the Company[42] and we concur. These changes should be set based on our sales forecast recommendations above and should be specified in the parties' briefs on exceptions.

[41] The Company's Initial Brief, p. 34.

[42] DPS Staff's Initial Brief, p. 343.

III. OTHER OPERATING REVENUES

A. Purchase of Receivables (POR) Discount

The Company’s initial filing was based in part on the assumption that Rate Year revenues resulting from its POR Program would match the historic Test Year level of $6.880 million. According to the Company, DPS Staff argued these revenues would be $730,000 higher based on actual data for the first six months of 2008.

On brief, however, DPS Staff argues in support of an upward net adjustment of $830,000 to the Company’s $6.880 million forecast, on the grounds that:[43]

1. Consolidated Edison projected no growth in POR revenues for the Rate Year over the 2007 historic Test Year, although POR revenues have continued to grow (Tr. 2649).
2. Given this growth trend, annualizing the latest available year-to-date 2008 discount revenues would serve as a better proxy for forecasting Rate Year revenues (Tr. 2650).
3. Annualizing the latest available actual POR revenues of $8.459 million as of August 31, 2008 (Ex. 272), would produce a POR revenue forecast of $12.689 million, which, after accounting for uncollectibles and financial risk (Tr. 2650), yields a net Rate Year forecast of $7.710 million, $830,000 more than Consolidated Edison’s forecast.
4. Consolidated Edison did not rebut the principle behind DPS Staff’s forecast method or the August 31, 2008 rate data used in DPS Staff’s forecast.

The Company argues that DPS Staff’s adjustment is overstated as a matter of fact by $277,000 and that it otherwise accepts DPS Staff’s adjustment.[44]

Based on our review of Ex. 272, Response to Consolidated Edison Request 92, Part B, we conclude that the correction referenced by the Company does not apply to the actual revenues through August 31, 2008. We recommend adoption

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[43] DPS Staff’s Initial Brief, pp. 31-33.

[44] The Company’s Initial Brief, pp. 34-35.

of DPS Staff's projection based on data through August 31, 2008. This forecast should be further updated, however, only if the Commission is willing to consider other updated forecasts. In accordance with the express terms of the 1977 Statement of Policy on Test Period in Major Rate Cases,[45] the Commission typically permits updates beyond this point only for known changes in cost rates or other similar information that is readily verifiable.

B. Imputed Levels of Proceeds from Sale of SO_2 Allowances

The Company's initial filing projects it would sell 22,000 SO_2 allowances in 2008, 2009, and 2010 at $350 per allowance, resulting in annual revenues of $7.7 million. The Company's update/rebuttal filing noted that a July 11, 2008 decision of the D.C. Circuit Court of Appeals resulted in a drop in the price of SO_2 allowances to around $90, leading the Company to suspend its sale of such allowances. As of September 2008, the allowances were worth about $150 each (or $3.3 million in total) and this is the amount the Company proposes be reflected,[46] subject to the proviso that this forecast should continue to be subject to reconciliation. On brief, the Company argues that its latest proposal is well explained and should supersede DPS Staff's outdated testimony supporting the Company's original $7.7 million forecast.[47]

DPS Staff states that it does not object to Consolidated Edison's projection of total SO_2 allowance sales proceeds of $3.3 million per year for 2009 and 2010, with future reconciliation for any over or under variation of actual sales proceeds from the forecast level.[48]

[45] 17 NYPSC 28-R.

[46] At the time of the hearings, SO_2 allowances were selling in the $130-$140 range. Tr. 169.

[47] The Company's Initial Brief, pp. 35-36.

[48] DPS Staff's Initial Brief, pp. 33-35.

NYECC challenges the Company's $3.3 million estimate, because:[49]

1. The forecast allowance is at the low end of the historic range of $90 to just over $1,500 per allowance (Tr. 157, 166-167).
2. The Commission's recent order adopting a two-year rate plan for Consolidated Edison's steam operations imputes $2.075 million per year in 2009 and 2010 allocable to steam, implying an imputation of $13.01 million per year allocable to electric operations, subject to two-way true-up.[50]

The Company replies that there is nothing on the record to support NYECC's proposal and that NYECC is ignoring significant changes in the SO_2 allowance market.[51]

We recommend that the Commission set rates assuming SO_2 allowance revenues of $3.3 million per year, subject to bilateral reconciliation proposed by the Company and DPS Staff. NYECC does not contest recent actual information and its proposal that rates be set ignoring that information is not reasonable.

1. Environmental Excellence Fund

The Company proposes to use up to $2 million of SO_2 allowance sale proceeds per year to establish an Environmental Excellence Fund. The fund would be used to provide grants to organizations in the Company's service territory for projects that would improve the environment and promote sustainability. Examples of projects that would qualify include: improvements in air and water quality, waterfront preservation and restoration, park restoration, renewable energy and others. To the extent $2 million of SO_2 allowance proceeds are used for such

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[49] NYECC's Initial Brief, pp. 6-9.

[50] Ibid., pp. 6-7, citing Case 07-S-1315, Consolidated Edison Co. of New York, Inc. - Steam Rates, Order Establishing Rate Plan (issued September 22, 2008,) p. 4, n.9; Joint Proposal, p. 14; and Appendix D, p. 1.

[51] The Company's Reply Brief, pp. 12-13.

purposes, they are not available to help offset the Company's costs of providing electric delivery service. The Company argues its proposal is in the public interest and should be approved. Its initial brief offers no argument in anticipation of DPS Staff's contrary position.[52]

Although DPS Staff does not dispute the goals of the Company's proposal, it opposes that proposal as not the best use of the proceeds, because:[53]

1. Consolidated Edison's ratepayers are once again confronted with a significant increase in electric rates.
2. The current adverse economic climate in the State and the nation is having harsh negative impacts on the Company's customers.
3. In these circumstances, the SO_2 allowance sales proceeds would be better captured for the immediate benefit of ratepayers (Tr. 544).

NYECC opposes Consolidated Edison's Environmental Excellence Fund proposal, because:[54]

1. The Company's proposal is inconsistent with the Commission's directive in Case 07-E-0523 that it demonstrate as part of its filing in this case "that it has considered all the potential means available for mitigating the size of any rate increase…."[55]
2. As DPS Staff maintains, the proceeds should be provided to Consolidated Edison's ratepayers because it is their money and a grant program is not the best use of such funds (Tr. 544).

A review of the record as a whole suggests there are very few avenues for ameliorating rate increases on a cost-of-service basis. In this light, and given that some of the purposes of the proposed program are targeted to the Company's

[52] The Company's Initial Brief, p. 37.

[53] DPS Staff's Initial Brief, pp. 35-36.

[54] NYECC's Initial Brief, pp. 8-9.

[55] 2008 Rate Order, p. 11.

provision of electric delivery service, we recommend against the Company's proposal.

C. NYC Water Meter Reading Revenues

The Company reads water meters for New York City and receives revenues from the City for such service under the terms of a contract. New York City is planning to install Automated Meter Reading (AMR) devices in the period January 1, 2009 through April 2011 and the Company projects this will gradually reduce revenue from this source, starting with an $817,000 decrease in the Rate Year. The Company argues that the final revenue requirement calculation should reflect this loss of revenue.[56]

DPS Staff opposes the Company's updated forecast because Consolidated Edison did not offset the revenue decrease with any resulting cost savings.[57]

The Company replies that any cost savings would be de minimis because the Company will need to maintain all of its existing meter reading routes and will still need to read all of its own gas and electric meters.

We disagree with both parties. It does not seem reasonable to conclude, as DPS Staff's proposal suggests, that all New York City lost revenues will be matched dollar for dollar by avoided costs. Meanwhile, it is not believable, as the Company suggests, that the total time devoted to meter reading will not decrease by more than a de minimis amount in light of decreased meter readings for the City. We recommend that a revenue decrease of $417,000 be reflected in the Rate Year.

[56] The Company's Initial Brief, pp. 37-38. The Company's projected revenue losses in subsequent rate years are $2.12 million and $3.43 million, respectively.

[57] DPS Staff's Initial Brief, pp. 36-37.

D. Site Investigation and Remediation (SIR)

In its last electric rate case, the Company was directed to address its Site Investigation and Remediation (SIR) bidding process, management practices, and efforts to operate a cost-effective SIR program. It is undisputed that the Company complied fully with this directive in these cases.[58]

The Company agrees with DPS Staff’s projected SIR Program costs of $17.218 million, which reflects a 10-year amortization of SIR costs incurred during the Linking Period and to be incurred in the Rate Year.[59]

The Company and DPS Staff also agree that the Company should report on its actual SIR costs and explain variances between actual and forecast cost. However, the Company proposes an annual report, after the end of the Rate Year, that would cover variations only to the extent they exceed $1 million each. DPS Staff, meanwhile, supports quarterly reporting on all SIR cost variations. The Company opposes DPS Staff’s proposal insofar as an explanation of all variations, even those that are insignificant, is burdensome and of little value. Moreover, the Company argues, quarterly variations are to be expected and, thus, an annual report would be more meaningful.[60]

DPS Staff continues to recommend that Consolidated Edison be required to provide quarterly reports on SIR program expenditures (Tr. 545).[61] It offers no reason for this in its initial brief.

DPS Staff should have access to whatever information it reasonably needs. Based on the arguments presented, however,

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[58] Tr. 21-114; 519-542; and 547.

[59] Ex. 147, Sched. 2. The Linking Period, or the period between the end of the historic Test Year (calendar 2007) and the Rate Year (the 12 months ending March 31, 2010.)

[60] The Company’s Initial Brief, pp. 38-40.

[61] DPS Staff’s Initial Brief, pp. 37-39.

DPS Staff has not explained why it needs quarterly reports on all variances between forecast and actual SIR costs. The Company's proposal seems to be the more reasonable of the two in this context.

IV. EXPENSES – COMPANY LABOR O&M

A. Staffing Requests ($23.7-$29.7 Million)

For context, the Company points out that it has been hiring about 1300 new employees a year for several years. After counting employees leaving, this activity resulted in an average annual net increase of employees of more than 360 over the last several years. The Company suggests its labor expense forecast properly reflects this trend, while DPS Staff proposes adjustments the Company describes as confiscatory. Adoption of DPS Staff's proposals, it says, would make it more difficult for it to attract or retain qualified employees for the provision of safe and adequate service.

1. DPS Staff's Historic Hiring Practices Adjustment

(a) Positions of the Parties

The Company's updated rate request reflects its request for incremental labor for new and existing operation and maintenance (O&M) expense programs sponsored by the Company's Infrastructure Investment Panel (IIP). DPS Staff's counterpart panel proposed that 60% of the Company's request, or $16.658 million, be disallowed based on an analysis of the overall lag in the Company's hiring of 346 new employees, for which total annual costs were reflected in the Company's rates in its last electric rate case. That analysis rested in part on a Company response to a DPS Staff discovery request that the Company updated and corrected (Ex. 441) only after DPS Staff had filed its testimony and exhibits.

On brief, DPS Staff continues to propose a 60% downward adjustment to the Company's request for incremental labor supported by the Company's IIP, because:[62]

1. In its budget, Consolidated Edison assumes that incremental positions are occupied at the beginning of the Rate Year and funded for that entire year.
2. The Company's actual historic hiring practices show significant slippage in its filling of incremental positions authorized and funded by the Commission.
3. Halfway through the current rate year, 141 of 346 positions funded to be filled at its start remain unfilled and another 53 have been filled by existing employees whose former positions have not been backfilled, for which the Company is incurring little or no increased cost, resulting in a windfall that is grossly unfair to ratepayers and should not be repeated in this case.
4. DPS Staff's 60% adjustment is conservative because:[63]
   (a) it assumes backfilled positions from which existing employees transferred to incremental positions were filled immediately, although the average time to backfill is 57 days; and the data provided do not reveal whether backfilled positions themselves were filled by new or existing employees;
   (b) DPS Staff's analysis did not consider actual salaries/wages for the filled positions, although it appeared that those tended to be less than allowed in rates;
   (c) its analysis did not consider rate of hiring versus level of skill, although the available pool should be smaller and the hiring rate slower as skill level and corresponding pay level increase;
   (d) its analysis included all Company departments in order to maintain the ability to apply the adjustment on a global basis, although limiting analysis to infrastructure related positions would have resulted

[62] DPS Staff's Initial Brief, pp. 39-40, 48-49. The adjustment totals $16.658 million, with $13.629 million in labor and $3.029 million in associated costs. Ibid., p. 41, Ex. 171.

[63] Ibid., pp. 44-45.

in a greater adjustment (Ex. 461, Testimony, pp. 9-11[64]).

DPS Staff initially based its analysis on Consolidated Edison's late July response to interrogatory DPS-45, which is Ex. 169 (Tr. 3009-10). In response to the Company's argument that DPS Staff's calculations were erroneous because based upon erroneous data in Ex. 169, DPS Staff argues that its analysis of the subsequent Company corrections (rebuttal/update testimony and Ex. 273) yields the same 60% adjustment factor [Ex. 461, Testimony, pp. 9-10; Ex. 462, Table SIIP-8]; as does DPS Staff's analysis on brief of the further Company update on hiring through September 2008 (Ex. 441).[65]

In anticipation of Consolidated Edison's argument that avoided expenses from unfilled positions are offset by increased expenses for contract labor or increased overtime, DPS Staff contends that the Company provided no supporting justification or data and in effect admitted its inability to hire skilled employees quickly enough to complete its program staffing needs (Ex. 461, Testimony, p. 6).[66]

The Company contends DPS Staff's adjustment should not be applied to associated equipment costs, inasmuch as those costs are not necessarily incurred only on a piecemeal basis simply because not all positions are filled simultaneously. DPS Staff responds that:[67]

1. Its adjustment for labor associated costs was not global, but applied in light of expectations for specific programs.
2. The Company agreed that associated support costs for unfilled positions should not be funded (Tr. 260).

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[64] Some prefiled testimony for which there was no cross-examination is in evidence under oath as exhibits. Transcript references are not given for any such testimony.

[65] DPS Staff's Initial Brief, pp. 42-43, 44-46, 48-49.

[66] Ibid., pp. 44, 47-48.

[67] Ibid., pp. 46-47.

DPS Staff stresses that the objective of its broadly based historic hiring practices adjustment is to adjust the overall budget, not micromanage specific projects or programs. DPS Staff says its purpose is to set a limit on the rate allowance to reflect the Company's historically demonstrated actual spending, compared to its budget forecasts, without placing specific limitations on the Company's ability to manage its business and spend at whatever level on projects or programs it deems appropriate to provide safe and adequate service (Tr. 2988).[68] On the other hand, DPS Staff does admit that "it may be true that Staff applied the 60% slippage adjustment for employees already hired in limited instances."[69]

For the following reasons, the Company argues that DPS Staff's historic hiring practices adjustment should be rejected:[70]

1. DPS Staff's adjustment assumes incorrectly that the Commission's decision in the last case required that all new positions funded in that case be filled as of April 1, 2008, six days after the Commission's order. But the Company never said it could fill all the new positions by that date and the Commission never established such a requirement. The last point is obvious because DPS Staff would be recommending an 8% disallowance in this case even if all the incremental positions funded in the Company's last case were filled by April 30, 2008.

2. The fact that new positions funded in the last case were not filled by April 1, 2008 does not mean that expenses were not incurred to get the work done. The Company "could" have used contractors—as it certainly did for its five-year underground inspection program—or paid overtime for that purpose. DPS Staff acknowledges that its adjustment does not consider the Company's use of such temporary measures.

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[68] DPS Staff's Reply Brief, pp. 19-20.

[69] DPS Staff's Reply Brief, p. 21.

[70] The Company's Initial Brief, pp. 44-47; the Company's Reply Brief, pp. 14-17.

(a) The Company focused on completing the programs it anticipated would be approved through a combination of hiring in advance of receiving funding, overtime, and use of outside contractors in conjunction with actions to fill open slots.

(b) Of the 346 positions used by DPS Staff as a basis for adjustment, the Company had filled 30% (107) by the first day of the current rate year, hired outside contractors to cover the functions of another 30% (Tr. 2297), and filled another 100 positions during the first six months of the rate year, accounting for more than 315 (91%) of the positions in issue.

3. DPS Staff's adjustment does not reflect that the Company absorbed the costs of the 107 of the incremental 346 positions filled prior to April 1, 2008.

4. Adoption of DPS Staff's adjustments would have unreasonable impacts on service quality. For example, funding for Feeder Engineers and Overhead Line Inspectors would be below the recent three-year average. The enhanced portion of the Manhole Inspection Program would be effectively eliminated, undermining the goals of improving reliability and preventing dielectric fluid releases in the environment. The Company's trench-feet goal for its Coating Refurbishment Program, which is designed to help reduce dielectric fluid leaks, would be cut by one-third.

5. The Company expects that by the end of the current calendar year, it will have filled all the new positions funded in the last rate case, excluding the 108 positions for which it says it has substituted outside contractors to carry out its five-year underground structure inspection program. If this is reflected, DPS Staff's proposed disallowance factor drops from 60% to 42%. If the use of contractors and the hiring of approximately 100 employees prior to April 1, 2008 are considered, DPS Staff's adjustment drops to 18%.

6. Application of DPS Staff's adjustment to program changes is not reasonable because it effectively reverses expense allowances reflected in the Commission's decision in the Company's last case.

7. The Commission should reject the claim that DPS Staff's 60% adjustment is conservative, based on the argument that many of the 346 positions funded in the Company's last case were filled internally followed by periods in which the vacated position remained open. The Company argues this contention rests on the un-founded belief that the Company fills vacated positions "too slowly." Meanwhile, it says, the record shows that it had an approximate net increase of 1,123 positions during 2005-2007, an annual average for the

most recent three years of about 374 new employees (Tr. 2299), more than the 346 positions that are the subject of DPS Staff's analysis and adjustment, increasing the Company's labor costs concomitantly.

8. In any event, if the Commission does decide to apply a historic hiring adjustment factor, it should apply to staffing only for new programs, not to the 346 positions for programs approved in Case 07-E-0523. Those positions are described as program changes in this case only because they were not captured in the historic year (because the programs had not yet been approved and spending had not commenced then). These positions are on track to be filled by the beginning of the Rate Year, when full funding is needed.

Supporting DPS Staff's historic hiring practices adjustment, NYECC argues in response to the Company:[71]

1. The 2008 Rate Order anticipated an analysis like DPS Staff's, when, for example, it denied additional funding for emergency preparedness and called for better support and analysis clearly differentiating incremental costs from those costs reallocated from existing resources.[72]
2. The Commission did not recognize any so-called "natural lag" in back-filling positions or in any way suggest the Commission funded 346 additional positions in the 2008 Rate Order without a mandate or expectation that the Company would fill them on a net and timely basis.
3. The Commission's adoption of a CPB-proposed adjustment in the 2008 Rate Order (to remove funding for positions filled during only part, or none, of the historic Test Year, because the Company did not account for vacancies occurring during the Rate Year),[73] shows the Commission does not intend that ratepayers fund vacant positions.
4. The Commission, in the 2008 Rate Order, did not limit itself to an issue-by-issue analysis, but took a panoramic view, taking into account the need to ameliorate the negative impacts on customers who find it difficult to pay the Company's increased delivery price,[74] which it should also do here.

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[71] NYECC's Reply Brief, pp. 3-6.

[72] 2008 Rate Order, p. 62.

[73] Ibid., p. 55.

[74] Ibid., p. 10.

5. Any additional amount the Commission authorizes here, together with the Company’s substantial current revenues, will provide the resources the Company needs to continue to meet its requirements.

(b) Discussion

To begin, we find no merit in the Company’s argument that DPS Staff’s adjustment should be rejected because the 2008 Rate Order did not expressly require that the Company fill all the 346 positions funded there by April 1, 2008. The fact that neither the parties nor the Commission focused then on the issue of how quickly the Company might fill new positions and the implications of its hiring rate for its cost of service for the current rate year in no way precludes addressing the issue when raised in this proceeding with respect to the Rate Year cost of electric delivery service. As a matter of principle, we conclude that the cost of delivery service should be calculated assuming some ramp-up of payroll and benefits expenses for new positions, taking into account the lag in filling new positions, the lag in backfilling positions vacated to fill new positions, and the use of contractors and overtime. Whether or not this procedure was followed in the last case, it should be here insofar as the record permits. If the Company seeks more, it necessarily argues for ratepayers to bear phantom costs.

We also reject the Company’s suggestion that a proper adjustment (not necessarily that recommended by DPS Staff or NYECC) based on the principle we have just stated would have unreasonable impacts on the Company’s service quality. Setting aside the legitimate question of the extent to which work gets done through contractors or overtime, what the adjustment seeks to do is match funding through rates to the probable level of time-weighted positions the Company will have filled, and for which it will have borne pay and benefit expenses, over the course of the Rate Year. The Company obviously will get no work from positions that, although funded, remain vacant.

The Company declares in brief that it estimates it will fill all positions funded in the last case by the end of the current calendar year. This claim expressly excludes the 108 positions for its five-year underground inspection program and ignores backfills. It deserves little weight compared with assessing the Company's actual current performance in filling the positions funded in the last electric rate case and what that portends for the Rate Year in this proceeding. With respect to the Company's contention that positions funded in the last case should not be unfunded in the next case, we believe that the Company should get funding for positions needed and reasonably likely to be hired in excess of the Test Year levels. For the most part, DPS Staff's adjustments based on historic hiring practices seem to have been applied only to positions newly proposed in this proceeding, not to program changes in this case that were approved in Case 07-E-0523 but not reflected in the Test Year for this case.

Next we consider the Company's contentions that any adjustment must reflect "the Company's incremental expenditures for outside contractors" on its five-year underground inspection program and that DPS Staff has not shown that the Company has not hired contractors to perform the work.[75] In fact, the record contains no evidence of such expenditures other than a cursory statement by its Accounting Panel that they occurred, without any supporting documentation (Tr. 2297). The Company claims that it determined "it would not be able to hire that level of skilled employees quickly enough to perform this work,"[76] but has failed to give any indication of when it hired the alleged contractors or what expenditures it has supposedly made on them. Nor has it proffered any proof of the extent to which it has

[75] The Company's Reply Brief, pp. 15 n. 12, 58-59.

[76] The Company's Initial Brief, p. 43.

used overtime to substitute for positions funded in Case 07-E-0523. Thus, we have no record basis for determining the extent to which it has made “incremental expenditures” to substitute either outside contractors or overtime for the positions in question. The Company has failed to make a *prima facie* case in support of its contentions and failed to meet its burden of proof, regardless of whether any other party did or did not pursue the Company’s bald declarations with interrogatories. With respect to the staffing for the five-year underground inspection program, in fact, the only evidence the record contains is that, halfway through the current rate year and more than six months after the Commission approved funding for the positions, the Company had not hired a single person (Ex. 441).

The Company has pointed to an approximate net increase of 1,123 positions during 2005-2007, an annual average of more than the 346 positions in issue under DPS Staff’s proposed historic hiring practices adjustment. The record does not, however, show what the year-to-year changes might have been over this period or whether the average might have been skewed by an extraordinary year or unusual circumstances. Moreover, DPS Staff notes that the Company’s actual labor O&M expenses for its electric operations were $476.7 million in 2005, $468.6 million in 2006, and $481.3 million in 2007.[77] We are unable to reconcile these figures on this record. The only apparent way to reconcile them is to conclude that the Company’s figures include non-O&M labor, which is irrelevant to the DPS Staff’s proposed historic hiring practices adjustment for O&M labor.

The issue then comes down to how many newly funded positions the Company will have filled on an average basis for the current rate year, to use as a guide to forecast a

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[77] DPS Staff’s Initial Brief, p. 72.

reasonable percentage of the incremental positions requested in this case that will be filled for the coming Rate Year. In its briefs, the Company has made various claims about how many of the positions it filled before April 1, 2008, the beginning of the current rate year—sometimes 99, sometimes 103, sometimes 107. It also studiously avoids considering whether filled positions were filled by internal transfers, without backfilling the vacated positions. In fact, the record shows that the Company filled 104 positions by March 31, 2008, the day before the current rate year began (Ex. 441). Thirty-two of those positions were filled by transferees, without backfill having occurred by that time. Thus, the Company had 72 net filled positions at that point. By the end of September, six months later, it had filled a total of 205, of which 152 were net filled positions (either filled from outside or internally with backfills)[id.]. Thus, it made 80 net fills over six months, or an average of 13.3 per month. Projecting over the remaining six months of the current rate year at that rate of filling, it will have filled another 80 net positions. The approximate average number of net filled positions for the full current rate year would be: 80 filled during the first half plus 80 filled during the second half, divided by two, or 80; plus the 72 net filled positions at the beginning; for an average annual total net fill of 152, out of the 346 positions funded. That represents just under 45% of the funded positions filled on a net full-year-equivalent basis.[78] Accordingly, we will adopt DPS Staff’s historic hiring practices adjustment, but recommend a downward adjustment of 55%, rather than its recommended 60%. This

[78] As DPS Staff notes, this percentage is conservative because it assumes that vacated positions backfilled by internal transfers are themselves promptly filled from outside the Company. It also does not take into account the extent to which those positions might be vacated before the end of the current rate year.

adjustment does not eliminate any particular position or program the Company has proposed. It simply adjusts funding of incremental positions, collectively, to reflect a realistic level of actual hiring the Company can reasonably be expected to complete through the end of the Rate Year.

2. DPS Staff's Department-Specific Adjustments

(a) Substation Corrective Maintenance

The Company proposed a $1.4 million normalization adjustment, of which $0.848 million was for labor and $0.559 million for associated non-labor costs, to reflect that the Company spent relatively more on capital programs and relatively less on corrective maintenance programs in the Test Year than it had planned. It argues that the reasons for its proposal have been fully explained.[79]

On brief, DPS Staff urges disallowance of the Company's normalization of corrective maintenance expense on the grounds that:[80]

1. The Company claims 2007 actual O&M expenditures were understated by this amount due to a shift from corrective maintenance to support higher priority capital work (Tr. 3792).
2. Consolidated Edison's Rate Year forecast of capital expenditures represents a 26% increase from the historic Test Year (Tr. 2667).
3. It is not credible that the Company would shift back to corrective maintenance expense work in the Rate Year at the same time it continues its ambitious capital construction program (Tr. 2666-67 and 2689).
4. The Company did not reflect any reduction in its forecast of capital expenditures to account for the claimed shift back to O&M expense (Tr. 2667).

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[79] The Company's Initial Brief, pp. 49-52, citing Ex. 194; Tr. 3791-92; Tr. 4192-95; and Tr. 4254-55.

[80] DPS Staff's Initial Brief, pp. 79, 116-117.

The Company disputes this DPS Staff contention, arguing:[81]

1. The Company is not reclassifying costs from capital to O&M.
2. Because it devoted 10,000 hours of time to capital programs in the Test Year instead of corrective maintenance O&M, it has a 10,000-hour backlog of O&M work to eliminate. It is asking for additional O&M labor funding to address work that was not performed in the Test Year.
3. This work should be performed to reduce the Company's corrective maintenance backlog and keep its equipment in good operating condition.
4. The fact that the Company has a large construction program is not a reason to defer needed O&M work any longer.

In a further reply, the Company argues that DPS Staff's contention that the Company will not undertake the O&M work has no basis in the record and that:[82]

1. The Company's testimony fully supported the need to carry out the work and its intention to do it.
2. The Company does not need to make a corresponding reduction in capital work in order to perform this O&M work because its budget reflects the need to undertake both.

The record supports the Company's position that it under-spent on corrective maintenance O&M in the Test Year and developed a backlog of maintenance work as a result. Perhaps unfortunately, it used the term "shifted back" to refer to its plans to work on cutting that backlog and carrying out a higher level of corrective maintenance O&M in the Rate Year. Nonetheless, there is nothing inherently inconsistent with its testimony that it will carry out a higher level of corrective maintenance work in the Rate Year at the same time that it continues to increase spending on its ambitious capital program. DPS Staff has not argued either that this corrective maintenance work is not needed or that any particular element of the Company's planned capital expenditures should be cut back to

[81] The Company's Initial Brief, pp. 49-51.

[82] The Company's Reply Brief, pp. 38-39.

accommodate it. DPS Staff's belief that the Company would not do both at once is not an adequate basis for disallowing the Company's requested level of funding. We support the Company's normalization and recommend that DPS Staff's adjustment not be adopted.

(b) System and Transmission Operations

The Company proposed to increase O&M labor costs by $2.322 million in this category. DPS Staff disagreed during the hearings, arguing it is unimaginable that there will be such a substantial shift to O&M expenditures given the Company's large capital budget. DPS Staff also proposed denial of a portion of $100,000 sought by the Company for a third district operator and a portion of $30,000 sought by the Company for a compliance/ trainer position, based on the reasoning for its generic historic hiring practices adjustment.

On brief, the Company explains that $1.4 million of the $2.322 million is for new positions that have mostly been filled, but that did not exist in the historic Test Year. The other $900,000 disputed by DPS Staff is intended to reflect an anticipated shift from capitalized expenditures in the historic Test Year to expensed O&M dollars in the Rate Year. The Company points out that a brand new energy management system was being installed in 2007, for example, and that capital project is completed. Despite DPS Staff's protestations to the contrary, the Company maintains that its system must be maintained even though it expects to have a large capital program.

As to DPS Staff's proposal to disallow 60% of the costs for the two new positions, the Company observes that the district operator position is filled and was funded in the Company's last rate case; and that the trainer/compliance monitor position is needed to meet North American Electric

Reliability Corporation (NERC) requirements and is expected to be filled prior to the start of the Rate Year.[83]

We decline to recommend DPS Staff’s $900,000 adjustment for the same reasons that we recommended against its adjustment to Substation Corrective Maintenance O&M. There is no reason why the Company would have to show an offsetting reduction in capital expenditures if its capital program is continuing to grow, even as it has additional need for maintenance O&M. Moreover, as it adds to its capital facilities, it would be expected to see O&M work grow over time somewhat to keep those additional facilities in proper condition.

The district operator position is already filled and was previously funded for the current rate year. There is no suggestion that it will not continue to be required and thus need funding in the Rate Year commencing April 1, 2009. Therefore, we do not recommend DPS Staff’s adjustment. Nor has DPS Staff challenged the Company’s need for the trainer/ compliance monitor position that will be new in the Rate Year. We do not think it unreasonable to believe the Company can fill the position in the next nearly three months and recommend DPS Staff’s proposed adjustment not be adopted.

(c) <u>Electric (Distribution) Operations—Various</u>

The Company’s proposed electric operations expense allowance is opposed in part by DPS Staff.[84] As to the remaining proposed disallowances of amounts sought by the Company for some new engineers and engineering personnel, based upon the rationale for Staff’s historic hiring practices adjustment, the Company argues as follows:[85]

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[83] The Company’s Initial Brief, pp. 52-54.

[84] DPS Staff’s Initial Brief, pp. 352-53.

[85] The Company’s Initial Brief, pp. 54-56.

1. DPS Staff's proposal to disallow $66,000 of $110,000 requested for new distribution engineering positions, based on historical hiring practices, lacks any justification, undermines the Company's ability to complete specified work, and ignores that three of the five positions were filled before the Company filed its update/rebuttal testimony (on September 29, 2008).
2. DPS Staff's proposal to disallow $60,000 of $100,000 requested for a new civil engineer lacks any support and ignores that the position is needed to help the one existing civil engineer in the Company's Distribution Engineering Department meet various NYC DOT requirements.

Contrary to the Company's argument, DPS Staff's proposed adjustments are not based on whether or not the positions in question are needed, but on the Company's demonstrated pace in hiring, discussed above, which affects its need for funding from ratepayers. We recommend full funding for the three distribution engineering positions already filled and, consistent with our recommended historic hiring practices funding recommendation, 45% of the amount requested for the other two distribution engineering positions. On the same basis, we recommend 45% funding for the new civil engineer position.

(d) Electric (Distribution) Operations—Enhanced Project Planning

The Company spent about $7.8 million on enhanced project planning for Electric Operations in the Test Year. It seeks an allowance that would be $1.5 million higher in the Rate Year. The incremental costs are for new positions to enhance project planning in aspects such as ensuring work is completed based on priorities and identifying opportunities for efficiencies.

DPS Staff proposes that the $1.5 million be disallowed on the grounds the Company failed to show that such expenditures would not duplicate those of other Company programs. Specifically, it argues:[86]

1. The Company's response to interrogatory request DPS-219 (Ex. 169) failed to demonstrate how an increase in personnel would not result in duplication of roles and responsibilities, detracting from the increased productivity the Company claims (Tr. 3072-73).
2. The Company's update/rebuttal testimony--which states that this program focuses on improving system reliability and the decreased transformer failure rate is an example of how it has helped to improve reliability (Tr. 4026-29)--supports only the current funding level and does not show how new employees will provide additional benefit, rather than duplicate existing staff work.

The Company opposes DPS Staff's proposal for the following reasons:[87]

1. DPS Staff was unable to identify how any of the new work would duplicate existing work.
2. The Company explained the efforts it was making to reduce or eliminate the potential for duplication of roles and responsibilities (Ex. 169, p. 769).
3. DPS Staff's proposal would limit the Rate Year allowance to Test Year expenditure levels, denying the Company the ability to optimize equipment performance.

It would be difficult for the Company to prove that personnel proposed to be added to existing activities will not duplicate existing work. We believe the Company has provided sufficient evidence of the need for the additional positions requested and that it is taking steps to avoid duplication of effort (Tr. 4027-29, Ex. 169, pp. 761-69). Accordingly, we recommend funding of the additional positions, subject to the general 55% downward adjustment ($825,000) for historic hiring practices.

[86] DPS Staff's Initial Brief, pp. 111-112.

[87] The Company's Initial Brief, pp. 160-161.

(e) Shared Services

The Company's revenue request reflects the following: (1) 11 new career path instructors; (2) eight new positions to strengthen the Company's human resources department; and (3) seven new programmers. DPS Staff applied its general 60% labor adjustment, discussed above, to the Company's Shared Services Workforce Strategy Program for reasons previously discussed. DPS Staff also opposes the Company's request for two additional Conflict Resolution Specialists at a cost of $206,000, for these reasons:[88]

1. The Company currently has one Conflict Management Specialist, but only one two-day and one three-day conflict management courses, as well as a Conflict Resolution program to help employees resolve differences through an informal process (Tr. 2470-72).
2. There were only 22 cases involving 46 people where conflict resolution through mediation was conducted in the Company in 2007 (Tr. 2472).
3. The one current Conflict Resolution Specialist should be sufficient, given the degree of training provided and the number of conflict cases (Tr. 2472).

With respect to each of these proposals, the Company argues as follows:[89]

1. The Career Path Instructors are needed to ensure advancement of new employees. Moreover, seven of the 11 positions were filled (of which some were filled before April 1, 2008) and the same seven positions were funded in the Company's last electric rate case. The Company has been using overtime or contractors to meet additional training needs and the Company expects to fill the other four positions before January 1, 2009, long before the start of the Rate Year. The 60% adjustment should be rejected.
2. The Company's Workforce Strategy Program is designed to strengthen human resources in a variety of ways. To implement the program, the Company requested funding for eight employees. As of the update/rebuttal filing, four of

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[88] DPS Staff's Initial Brief, pp. 52-54.

[89] The Company's Initial Brief, pp. 56-59, 193-94.

the eight positions were about to be filled and a fifth was expected to be filled by the end of 2008. DPS Staff does not question the merits of these positions, except in very small part related to conflict resolution.

3. Based on recent activity and an increasingly diverse workforce, the Company expects it will have more conflict management issues. The Company needs to pay attention to this area before costs are being incurred from these issues and resources to manage the process become inadequate. DPS Staff has not established that the program is not necessary.
4. The Company seeks funding for seven new programmers in addition to seven new programmer positions funded in the Company's last electric rate case. The seven positions allowed in the last case were all filled within 90 days and, as such, the 60% adjustment should be rejected.

With respect to the 11 Career Path Instructors, Exhibit 346 shows that seven were funded in the last case, three of which were filled before April 1, 2008, and another four subsequently. Consistent with our recommendation for the district operator position for System and Transmission Operations, supra, since these seven positions have been filled, we recommend their funding and disagree with DPS Staff's proposed adjustment. The Company's suggestion in brief that it has been using contractors or overtime to do the work of the other four, newly requested positions is inconsistent with the record, which indicates that use of contractors or overtime was claimed only for the positions funded in Case 07-E-0523 (Tr. 453-56). With accordingly reduced confidence in the Company's representations, and a lack of record basis for its claim about expecting to fill the four newly requested positions before the beginning of the Rate Year, we recommend funding for only 45% of the request for those four.

Turning to the eight positions in the Company's Workforce Strategy Program, we deal first with the two additional conflict management specialists it seeks. Contrary to the Company's argument, DPS Staff has not proposed to eliminate the Conflict Management Program, only to disallow funding for the two additional positions. The Company's mere expectation that there will be more conflicts to resolve is an inadequate basis for its proposal to triple the current conflict management staffing level. We recommend that funding for the two additional requested positions be disallowed.

For the remaining six positions, there is no record support for the Company's claims in brief that filling the positions is nigh. Nor, in any event, does the Company say whether, in fact, the six it mentions include the disallowed conflict management specialists; or whether the positions are about to be filled by internal transfers with no backfilling imminent. We recommend application of the historic hiring practice adjustment to allow only 45% funding for the six positions other than the conflict management specialists.

The seven programmer positions funded in the last rate case are already filled and we recommend they be funded in full for the Rate Year. The remaining seven positions newly requested in this case should be treated according to the recommended historic hiring practices adjustment and receive 45% funding.

(f) Law Department

The Company's original revenue request reflects the cost of 14 new positions, six of which were funded in the Company's last electric rate case, including three record retention positions, an attorney, a regulatory attorney, and a paralegal. The Company's original filing explained the need for four more positions (an additional regulatory attorney, two administrative clerks, and a litigation support manager); and its July 2008 informal update noted that the 2008 Rate Order, in fact, had allowed a total of nine new positions.

DPS Staff proposes that nine of the 14 positions not be funded in this case (which would reduce funding from the requested $922,000 to $397,000), because:[90]

1. Nine of the 14 positions were approved in the 2008 Rate Order, including five approved in the 2006 Consolidated Edison gas rate case.
2. Through September 2008, the Company had filled only five of the nine approved positions (Ex. 441).
3. Consolidated Edison's Law Department has experienced significant delay in filling vacant positions. One position approved in the 2006 gas rate case[91] remains unfilled after one year.
4. Customers should not be required to fund positions the Company fails to fill and for which customers derive no benefit.

The Company opposes DPS Staff's proposed adjustment for the following reasons:[92]

1. DPS Staff did not question the need for any of the legal positions sought by the Company in this or in the Company's last rate case, including the four new positions requested here.
2. While it is true that the Company had filled only five of nine previously-funded positions, this was not for lack of trying. The Company's salaries are below the national average and this makes it hard to hire and retain qualified individuals. Equally important, these positions cannot be filled by others in the Company. DPS Staff's proposed adjustment ignores the Company's ongoing efforts to fill the positions and the adjustment should be rejected.

The Company admits it is having difficulty filling its legal positions. As DPS Staff points out, the average staffing level in the Company's Legal Department has fallen by more than 20 positions since 2005 (Ex. 407, response to CPB-111). These do not impress us as reasons to deny the Company funding for the

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[90] DPS Staff's Initial Brief, pp. 61-62.

[91] Case 06-G-1332, Consolidated Edison – Gas Rates, Order Adopting in Part the Terms and Conditions of the Parties' Joint Proposal (issued September 25, 2007).

[92] The Company's Initial Brief, pp. 60-61.

nine positions in issue entirely. We recommend that the 55% downward adjustment for historic hiring practices be applied to those nine positions.

(g) Other Normalizations

On brief, the Company refers to other DPS Staff proposed disallowances of normalization amounts sought by the Company for Public Affairs, Strategic Planning, Tax, and Environmental Health and Safety (EH&S) positions. It refers generally to the update/rebuttal of its Accounting Panel and another witness and apparently assumes that is an adequate basis for us to reject DPS Staff's proposed adjustments.[93] It is not. The Company has failed to present any reasoned argument in opposition to DPS Staff's proposed adjustments. We thus recommend adoption of those adjustments.

(h) NYISO

The Company seeks funding for three new positions to meet increased workload expected to result from a change in the NYISO's settlement process from monthly to weekly. During the hearings, DPS Staff proposed to disallow 60% of the request based on historic hiring practices.

Reasons offered in support of DPS Staff's position on brief are as follows:[94]

1. The billing change will not occur until the summer of 2010, beyond the Rate Year (Tr. 690).
2. Even assuming hiring would have to occur sometime before the summer of 2010, recovery of labor costs for the entire rate year is excessive.
3. Allowing 40% funding for three positions for the Rate Year gives the Company plenty of time to address new employee training before the NYISO billing change occurs.

[93] The Company's Initial Brief, p. 61.

[94] DPS Staff's Initial Brief, pp. 62-63.

The Company argues that DPS Staff's proposed adjustment should be rejected for the following reasons:[95]

1. There is substantial evidence that the referenced NYISO change will significantly increase workload.
2. The timing of the change is completely up to the NYISO; indications are that FERC will act in early 2009 and that implementation will take place by the summer of 2010.
3. The negative consequences of the Company not being prepared to meet the new workload are serious, including overpayment of NYISO invoices, late payment of such invoices and the incurrence of interest charges, and an increased possibility that miscalculations between lower cost spring and fall periods and the higher cost summer period will occur.
4. Even if one assumes DPS Staff's 60% adjustment is reasonable for some issues, this is not the case here because the Energy Management Department fills vacancies much more quickly than programs sponsored by the IIP and as the Company is only seeking three new positions even though four could be justified absent Company operating efficiencies.

The Company obviously does not need these positions for actual operational purposes during the Rate Year. The only real issues are whether and when it must fill the three positions in advance during the Rate Year for training purposes. The Company's Reply Brief (pp. 20-21) says it needs to have employees trained and ready to go by day one of the billing change and training will take one year, which would indicate that it needs to hire about one quarter into the Rate Year. The Company provides no citation to the record to support the alleged one-year training period. Nothing in Company Witness Oates's testimony supports the one-year training contention. That testimony makes no mention of how long training will take. We therefore find the Company has failed to rebut DPS Staff's proposal for an adjustment based on the Company's historic hiring practices, although we recommend allowance of 45% of the

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[95] Ibid., pp. 61-64.

Company's requested amount rather than DPS Staff's proposed 40%, for the reasons explained above.

(i) State Regulatory Affairs

The Company proposes to create a new State Regulatory Affairs Department comprising seven new positions, of which six would be located in New York City and the other one in Albany. DPS Staff's prefiled direct testimony stated that the Company had neither justified the proposed expense nor identified reductions in other areas where the work of this group is currently being performed. On that basis, DPS Staff proposed that the Company's incremental request for this initiative be denied.

On brief, DPS Staff states that it opposes the Company's request for $775,000 for labor and $73,000 for other O&M Expense to fund this new department, because:[96]

1. The Company failed to provide a clear description of how the new group would be coordinated with its existing Public Affairs Group, which includes a Government Relations Section, or its Energy Market Policy Group (Ex. 364, pp. 3-17).
2. The Company has not provided sufficient information on coordination of the new group activities with outside firms the Company usually retains to represent its interests in State and local matters and other regulatory activities (Tr. 3588-89).
3. Consolidated Edison has not justified the additional staffing, or identified staffing reductions or the rationale for maintaining use of outside firms, in areas where work is currently being performed (Ex. 364, pp. 3016, Tr. 3588-89).

The Company argues DPS Staff's proposal should be rejected for the following reasons:[97]

[96] DPS Staff's Initial Brief, pp. 54-55.

[97] The Company's Initial Brief, pp. 64-67; the Company's Reply Brief, pp. 22-23.

1. The work to be performed by this group has been encouraged by State regulatory stakeholders—in fact, based on feedback from DPS Staff—in order to improve communication and information sharing.
2. DPS Staff's objection is not based on any substantive disagreement with the Company's proposal, but rather on a concern that adequate support had not been included in the Company's original request. This concern was addressed in the Company's update/rebuttal presentation (Ex. 364, pp. 3 and 12-13.)
3. Of nine other utilities studied by the Company, six had a program of the type it proposes.
4. The work of the new group is incremental and is not currently performed to the same degree by others in the Company, including the Company's Public Affairs, Law, and Rate Engineering departments, or by the Company's current outside lobbyists. The role of the new group will not overlap, but will be synergistic.

As the Company notes, DPS Staff has not disputed that the proposed group is being developed in response to feedback DPS Staff gave the Company. Company Witness Nachmias gave detailed testimony in support of the proposal. We find the Company's proposal for funding new positions for a State Regulatory Affairs Department, and related O&M expense, to be well supported on the record and decline to recommend DPS Staff's proposal to eliminate all funding. In light of our earlier discussion of the historic hiring practices adjustment, however, we recommend funding only 45% of the Company's request.

(j) Municipal Infrastructure Support

The Company seeks funding for 15 new positions for Municipal Infrastructure Support. During the hearings, DPS Staff proposed that 60% of the Company's request be disallowed, based in part on the historic rate at which the Company filled positions that were funded in the Company's last electric rate case and in part on the salary levels the Company assumed in its expense forecast.

On brief, DPS Staff recommends disallowing 60%, or $702,000, of the funding requested for 15 new positions in the Public Improvement Department, because:[98]

1. The Company's slippage in filling positions authorized in the 2008 Rate Order suggests that only 85% will be filled by the end of the current rate year and, thus, averaged over a year, the Company will incur only about half of the costs of those employees.
2. DPS Staff's recommendation is even more conservative because the average salary the Company used to price out the new positions exceeds or is virtually equal to the maximum pay rates for the positions in question (Ex. 333, p. 2; and p. 5, responses 1-3).
3. The Company will not incur the incremental costs forecast for internal transfers, because it has demonstrated slow performance backfilling vacated positions (Ex. 441).

The Company opposes DPS Staff's general 60% disallowance for reasons discussed above. Additional reasons why the Company opposes such a disallowance here include the following:[99]

1. DPS Staff concedes the new positions are needed.
2. Five of the 15 positions have already been posted and the balance are to be posted before March 2009. Accordingly, some or all of the new positions may be filled without rate support prior to the Rate Year.
3. For its expense forecast, the Company used the average pay rate of union employees in the Public Improvement Department; it expects the new positions will be filled at salaries both above and below the average.
4. The Company uses the same average pay rate for purposes of calculating overtime, and DPS Staff's opposition to that approach should be rejected for the same reason.

The Company's contention that it has posted some of the positions already and will post more before the Rate Year begins provides no particular assurance that it will be able to fill the positions at a pace other than that reflected in our

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[98] DPS Staff's Initial Brief, pp. 64-66.

[99] The Company's Initial Brief, pp. 67-68.

recommendation on historic hiring practices. Thus, we see no reason not to apply the 55% downward adjustment recommended above. Our recommendation is reinforced by the Company's overestimation of the pay rates for the requested positions. The Company's argument that it used the average rate for positions in the Public Improvement Department as a whole fails to meet DPS Staff's criticism. The problem with use of that average rate for the entire department is that it equals or exceeds the maximum rates for the positions in question. It is unreasonable to believe the Company will hire at or above the maximum rates of pay.

(k) Emergency Management

The Company's request for incremental Emergency Management programs was denied in its last electric rate case. However, the Commission said at the time that it would be willing to consider a better-supported analysis. On March 3, 2008, the Company filed a Master Implementation Plan in Case 06-M-1078. That plan and the Company's May 2008 tariff filing support funding for an additional 16 employees.

DPS Staff and the Company have effectively demonstrated the need for the new positions (Tr. 193-214, 2849-50). However, DPS Staff supports funding for only 3 of them. On brief, DPS Staff reiterates that it opposes the funding of all but three of the 16 incremental positions (and associated equipment) the Company proposes to add, notwithstanding its agreement that the Company needs to increase emergency management positions from 16 to 32, because:[100]

1. In its 2008 Rate Order, the Commission declared that additional funding for the Company's emergency management organization would depend on clearly differentiating incremental costs from those reallocated from existing sources.

[100] DPS Staff's Initial Brief, pp. 56-61.

2. Through September, the Company had filled only three of the 16 new positions, all through internal transfers, and had backfilled only two of the vacated positions (Tr. 244-54).

DPS Staff suggests that Consolidated Edison be allowed to update its case for the actual level of incremental hires (including transfers for which vacated positions have been backfilled) by the December 8, 2008 due date for reply briefs.

In anticipation of the Company's argument that personnel it has hired to date and will hire by the beginning of the Rate Year are unsupported by rate relief, DPS Staff contends:[101]

1. Echoing DPS Staff's argument in support of its general 60% downward reduction to Company labor, the Company has not hired the full complement of new employees on a Company-wide basis currently being funded in rates.
2. The Company concedes that, even if it did not receive its incremental request of $4 million for emergency management in its last rate case, it is not relieved of its responsibility to provide safe and adequate service.
3. If the Company is truly committed to the emergency management program, it will fill all the incremental positions by December 8, 2008.

For the following reasons, the Company argues that DPS Staff's proposed disallowance should be rejected:[102]

1. DPS Staff's concern about delay in hiring the (currently funded) positions is based on recollections of a July 8, 2008 meeting between the two parties and that the Company's witness has no recollection of anyone from the Company giving any such indication. The Company's plan is to fill the positions before the start of the Rate Year (Tr. 194, 243, and 2847).
2. The record shows that the Company is moving aggressively to fill the new positions. As of the hearings, four positions were filled, offers were made for five others, four applications were being processed, one position was expected to be posted soon, and postings for two remaining positions were expected to be made within one month.

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[101] Ibid., pp. 59-60.

[102] The Company's Initial Brief, pp. 68-72.

Moreover, two of three positions that opened up by filling the new positions internally have also been backfilled.

3. With so many positions actually or likely to be filled prior to the Rate Year, it would be grossly unfair to disallow any of the requested expense even if one or two positions are not filled at the beginning of the Rate Year.
4. A related DPS Staff proposal, that the Commission fund new positions only if they are filled by December 2008, is likewise unreasonable. Such a “hire-now-or-get-no-funding” mentality is contrary to the Company’s plan to hire the best possible candidates for the positions.

At the hearings, NYECC also opposed any funding of the new positions based on the magnitude of the pending revenue request. NYECC endorses DPS Staff’s adjustment to disallow funding for 13 of 16 new Emergency Management positions (and associated support costs), including a weather analysis position, three benchmarking positions, and one filled by a transferee whose former Company position was not back-filled. NYECC’s grounds for the proposed disallowance are:[103]

1. The Company proposes to double its positions in this department, but had filled only 3 of the 16 positions by the time of filing its update/rebuttal testimony, half-way through the current rate year.
2. Unfilled positions translate into lower expenditures than reflected in rates, which assume all positions are filled and in place for the entire Rate Year.
3. In the 2008 Rate Order, the Commission found the Company’s justification for a meteorologist insufficient, given available weather services and reports and knowledge and expertise of its current staff.[104] The same reasons still apply (Tr. 270-271).
4. The Company does not need additional benchmarking positions, in light of its existing resources and capabilities, including participation in industry benchmarking (Tr. 217, 271-273).
5. If the positions are not filled by the beginning of the Rate Year, it is grossly unfair to ratepayers to fund them and associated support costs, and Consolidated Edison

[103] NYECC’s Initial Brief, pp. 10-13.

[104] 2008 Rate Order, p. 16.

cannot guarantee hiring will be complete by April 1, 2009 (Tr. 256, 279).

The Company argues on brief that the magnitude of the rate increase should have no bearing on whether to fund positions necessary to implement a plan required by the Commission in a January 17, 2008, order in Case 06-M-1078. What would be unreasonable, the Company concludes, is to establish new regulatory requirements and deny the Company the funds it needs to meet them.[105]

In its reply brief, the Company adds these responses to DPS Staff's and NYECC's arguments:[106]

1. DPS Staff's generic hiring adjustment to 346 previously approved positions excludes consideration of factors such as staffing organizations like Emergency Management in advance of the Rate Year. It cannot then reasonably attribute the availability of funds not yet spent on those 346 positions to organizations like Emergency Management.
2. Based on the Management Implementation Plan, the number of positions filled and in the process of being filled before any rate relief is received, and continuing efforts to fill all positions before the beginning of the Rate Year, the possibility of there being one or two positions still open at that time provides no basis for disallowing the funding level requested (Tr. 246).
3. Although it also opposes DPS Staff's alternative proposal to allow funding for positions filled by December 8, 2008, the Company notes that as of that date 12 of the 16 positions had been filled (in place or offer accepted) and the remaining four were in the interview stage.

The need for the proposed incremental positions is well established in the record. The Company had made substantial progress toward filling the positions in conformance

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[105] In this connection, the Company discusses Mr. Torres' statement that it would be grossly unfair for the Company to accept funding for new positions that would not be filled. The Company summarizes his clarification of this response on redirect. The Company's Initial Brief, p. 71.

[106] The Company's Reply Brief, pp. 26-27. (Point 3 is an extra-record update of a forecast, but one that seems unobjectionable to--in fact, invited by--DPS Staff.)

with its Management Implementation Plan by the time of the hearings. Given the progress the Company has made, it seems reasonable to conclude that the positions are likely to be filled by the beginning of the Rate Year.[107] In light of the potential importance of adequate staffing for improved emergency management operations, we recommend against DPS Staff's proposed adjustment and support full funding for the 16 incremental Emergency Management positions requested.

(l) GOLD Program

The Growth Opportunities for Leadership Development (GOLD) Program is designed to provide newly hired college graduates an opportunity to become future Company leaders by offering rotational work. The Company states that its rate request reflects an incremental $1.8 million to expand the program by 72 participants.

DPS Staff recommends reducing the allowance for the entire GOLD program, including the incremental positions, to $5.61 million, an adjustment of $727,275, because:[108]

1. The Company's proposed amount does not reflect any attrition, but represents full participation throughout the 18-month program.
2. The six-month average attrition rate for the GOLD program is 9% (18% annual), based upon Company provided historical data (Tr. 2468-69; Ex. 358).
3. The Company's claim that DPS Staff applied an attrition rate of 27% is incorrect (Tr. 450-52).
4. The Company's claim that recent changes to the program and the current state of the economy will decrease attrition rates is merely an assumption and based on no historical data (Tr. 451-52).

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[107] The Company's extra-record update invited by DPS Staff supports its continuing progress, although we are troubled by the lack of information on the extent to which the positions have been filled by internal transfers that have then been backfilled.

[108] DPS Staff's Initial Brief, pp 50-52.

5. The 8.3% attrition rate the Company suggested as an alternative is unsupported by any data or methodology (Tr. 451).

The Company opposes the proposed adjustment for the following reasons:[109]

1. DPS Staff assumes the attrition rate experienced in 2005 and 2006 will recur, but the attrition rates in those years were among the highest.
2. DPS Staff is inconsistent to propose use of five-year averages in many instances and a two-year average here.
3. The Company's proposal already reflects a loss of six employees annually, an 8.3% attrition rate, which is more comparable to results for the past five years (Tr. 451; Ex. 190).
4. The Company made changes to the program to retain GOLD employees that are hired.
5. In the current economy, more employees are expected to stay in their current positions.

DPS Staff is correct that the Company's suggested attrition rate for the GOLD program is unsupported by any data or methodology. In fact, the number was first added to its Shared Services Panel's update/rebuttal testimony at the hearing (Tr. 451), and no basis was offered to verify the claim. The Company's contention that the state of the economy and recent changes to the program will lower the attrition rate does not provide sufficient support for its proposed attrition rate. On the other hand, DPS Staff clearly cherry-picked the two highest years' available data in developing its own attrition rate. The record supports an average attrition rate over the period 2003 through 2007 of 21% for the full 18-month program, or 14% over 12 months (Ex. 190, pp. 67-68; Ex. 358). We believe this five-year average attrition rate more reasonably projects likely attrition during the Rate Year than either the Company's or DPS Staff's proposed rates. Accordingly, we recommend application

[109] The Company's Initial Brief, pp. 192-193; the Company's Reply Brief, pp. 71-72.

of a 14% downward adjustment to the Company's request for the GOLD program, to account for likely attrition over the course of the Rate Year.

B. Productivity Adjustments ($10.6-$75 Million)

The Company's rate case filing assumes a productivity factor of 1% even though, it says, this is not a requirement.[110] The effect is that its original and updated revenue requests are $10.6 million lower than they otherwise would be. It argues that this approach is consistent with testimony of a DPS Staff witness in the Company's last electric rate case. The gist of that testimony is that the productivity adjustment is a surrogate for expected overall productivity gains, regardless of their source. With this as backdrop, the Company turns to competing productivity adjustment proposals by DPS Staff (2%), the NYC Government Customers (3%), and Westchester ($75 million).

The arguments concerning the three adjustment proposals are summarized first, followed by one discussion.

1. DPS Staff – 2%

DPS Staff proposes to increase the Company's productivity imputation from one to two percent, to reflect the significant recent historic and proposed levels of investment in Consolidated Edison's electric system infrastructure, because:[111]

1. These continual, substantial investments to upgrade and reinforce its system will provide for increased reliability and produce operational efficiencies (Tr. 3054).
2. Reinforcement of the system and its resulting operation under less stressful conditions will reduce the likelihood

[110] As is typical for the Company, this factor is 1% of labor expenses for the Linking Period and the Rate Year. Productivity imputations for other companies are often based on 1% of labor and benefits for the Rate Year.

[111] DPS Staff's Initial Brief, pp. 66-70.

of unforeseen events and more costly repairs in reaction to an acute problem (Tr. 3054).

3. The current one percent productivity imputation is no longer sufficient to reflect the productivity savings that should be expected from the substantial increases in both capital and O&M projects and program expenditures the Company has made over the last five years and plans for the next five years.
4. The Company failed to identify or quantify any savings associated with its capital and O&M programs (Tr. 3055-567, 4157, 4161).

The Company argues that DPS Staff's proposal should be rejected for the following reasons:[112]

1. There are no new or changed circumstances that warrant any increase in the productivity adjustment.
2. DPS Staff provides no examples of prior cases in which the Commission adopted a productivity factor greater than one percent in times that were not normal.
3. DPS Staff is unaware of any Commission rule, order, or other standard that requires utilities to include a productivity adjustment in their rate filings, but the Company nevertheless did so. The manner in which the Company calculates the 1.0% equates to an adjustment of 2.6%[113] and doubling it would equal 5.2% (Tr. 2305-06).
4. DPS Staff criticized the Company for failing to identify and quantify savings associated with proposed programs. This criticism is unfounded. In discovery responses, the Company gave reasons for all of the programs and the extent to which quantifiable Rate Year savings are expected, if any (Ex. 322). While savings were acknowledged, they were not of the magnitude envisioned by DPS Staff. DPS Staff did not disagree with any specific aspect of that exhibit.
5. DPS Staff's adjustment basically rests on the premise that increased plant investment and an increase in personnel collectively increase productivity; but DPS Staff did not prove that this premise is accurate. The Company's technical experts believe the new programs proposed do not provide the opportunities for material productivity

[112] The Company's Initial Brief, pp. 73-77.

[113] The Company's Initial Brief, pp. 82-83. This calculation includes the Company's reflection of productivity for the Linking Period and the Rate Year, but does not take into account that the 1% is not applied to benefits.

increases anticipated by DPS Staff. Again, DPS Staff did not challenge any of the Company experts' conclusions (Tr. 4157-58).

6. The continued influx of new Company employees materially decreases the probability of productivity gains.
7. A substantial portion of recent capital investments has been made to meet load growth and will increase maintenance responsibilities, due to more facilities to inspect, maintain, and repair. A significant portion of those investments also represents increases in costs of materials, which produce no productivity gains (Tr. 4159-61).
8. The Company's filing does reflect productivity gains associated with programs instituted under prior rate plans, and some new programs, in addition to the Company's proposed 1% productivity adjustment. To the extent any O&M project in the Rate Year is expected to reduce costs for an activity, the Company's rate request reflects the cost reduction. (Tr. 4161, 4271-73.)
9. DPS Staff double counts when it simultaneously proposes to increase the productivity adjustment and separately recommends significant disallowances of the costs of new programs and associated new positions within the Company.

In its discussion of the NYC Government Customers' proposed productivity adjustment of three percent, the Company offers additional objections to DPS Staff's productivity proposal as follows:[114]

1. DPS Staff is inconsistent. It criticizes as too general the Company's process for projecting capital expenditures, but has no trouble proposing a material adjustment based on unquantified and unidentified productivity savings.
2. In a context in which there will likely be a one-year rate case determination, there is no need to speculate about any productivity beyond 1% as any incremental savings actually achieved will automatically redound to the benefit of the Company's customers in the next rate case.

[114] The Company's Initial Brief, pp. 82-83.

In its reply brief DPS Staff makes the following points in response:[115]

1. The Company's claim that the 2% imputation will result in a 5.6% adjustment in the Rate Year is not correct. Here, the Company applied its productivity only to labor expense, rather than the frequently employed approach of applying it to rate year labor and benefits. DPS Staff did not object to that approach and its 2% productivity adjustment would equate to an almost 4% adjustment following the Company's method, but only a 2.8% Rate Year adjustment following the Commission's more common method.
2. DPS Staff's adjustment was not, nor was it required to be, based on an analysis. The imputation is intended to capture all types of savings, specific enhancements producing operational efficiencies as well as cost reductions that cannot be specifically foreseen or quantified at the time rates are set (Tr. 3055).
3. DPS Staff's historic hiring adjustment reflects the level of labor expense that will likely be incurred during the Rate Year and is an entirely separate issue that has no effect on the Company's productivity.

The Company adds these contentions in reply:[116]

1. DPS Staff's claim that its adjustment relates to cost savings that can be expected from infrastructure investments over the past five years reinforces the Company's argument that any savings DPS Staff predicates on that investment are reflected in the historic Test Year.
2. The Company's IIP explained fully how Company interrogatory responses had addressed what cost savings could be expected in various programs during the Rate Year (Tr. 4157-58).
3. Contrary to DPS Staff's assertion that a productivity adjustment is needed to encourage Company efficiency, a utility's ability to retain productivity savings until rates are reset gives it the incentive to operate efficiently and gives ratepayers 100% of the long-term benefits after rates are reset.

2. <u>New York City – 3%</u>

The NYC Government Customers support a general productivity adjustment of three percent of Company labor, or an

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[115] DPS Staff's Reply Brief, pp. 26-28.

[116] The Company's Reply Brief, pp.29-31.

incremental adjustment of $20.1 million over the Company's one percent adjustment, as a proxy for all sources of productivity.[117] Their reasons are as follows:

1. The record shows that the current one percent productivity adjustment does not reflect on a gross basis the technology, operations, and labor savings that will result from the Company's unprecedented spending on capital and O&M programs in the past few years and through the Rate Year.[118]
2. Plain language portions of the exhibits of the Company's IIP establish on a detailed basis that approximately $500 million and $100 million of that panel's proposed capital and O&M projects, respectively, are expected to provide increased productivity opportunities.[119] Any portion of that productivity achieved in the Rate Year would be in addition to productivity achieved in the 15 month Linking Period between the end of the historic Test Year and the beginning of the Rate Year.
3. A productivity adjustment of 3.0% is very conservative as it is based solely on the exhibits of the Company's IIP. Meanwhile, other Company witnesses and panels likewise support capital and O&M programs that should also generate productivity savings.[120]

In anticipation of the Company's contrary arguments, the NYC Government Customers argue as follows:[121]

1. The above conclusions rest primarily on the exhibits of the Company's IIP. The Company should not be allowed to justify capital and O&M programs in whole or in part based on resulting productivity opportunities while simultaneously disavowing these opportunities when discussing a proper productivity adjustment.
2. The IIP's update/rebuttal challenge to $130.6 million of the $500 million of capital projects discussed above, concerning 25 substation projects, addresses only 21.8% of

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[117] The NYC Government Customers' Initial Brief, pp. 8-11. If 1% represents $10.6 million, 3% represent $31.8 million, or an increment of $21.2 million.

[118] Tr. 4466.

[119] Ex. 221 and Tr. 4471-74.

[120] Tr. 4474-75.

[121] The NYC Government Customers' Initial Brief, pp. 11-15.

the $500 million and, moreover, ignores that the Company's justification of each of 25 projects (Ex. 58) included an express claim that there would be increased productivity.

3. That these projects would provide benefits other than productivity savings is not contested. However, such other benefits do not undermine the anticipated productivity benefits.
4. The Company also reflected the difficult working environment it faces in its update/rebuttal rate request, as corrected, of $819.024 million. That working environment, accordingly, is not a valid basis as well for understating productivity savings.
5. The Company has not prepared any study to support its assertion that the loss of experienced workers will reduce productivity. The Company's claim is unsupported and should be rejected.
6. It is not a double count for parties to propose specific downward adjustment to revenue requirement and to support a larger productivity adjustment.

DPS Staff states that although it believes a single percentage point increase in the productivity imputation should be sufficient, it did not base its recommendation on any studies or supporting data (Tr. 3056). It, thus, has no objection to the Commission considering the three percent imputation that the New York City Government Customers propose.[122]

The Company opposes the proposed three percent adjustment for the following reasons:[123]

1. The Commission rejected the same proposal in the Company's last electric rate case.
2. Given that a 1% productivity adjustment equals 2.6% per year the way the Company calculates it, a 3% proposal is the equivalent of an 8% adjustment.
3. The 3% proposal rests on a superficial analysis of the Company's "white paper" explanations of the costs and benefits of capital and O&M programs for which the Company seeks support in the Rate Year and broader criteria than the proponents applied in the last case for determining if a project provides an opportunity for productivity.

[122] DPS Staff's Initial Brief, p. 71.

[123] The Company's Initial Brief, pp. 77-83.

4. The Company presented update/rebuttal evidence concerning a sample of the programs relied upon for the 3% productivity proposal (the sample concerns 25 substation projects) of which 11, costing $45.5 million, would provide minimal productivity opportunities in the Rate Year. As to the other 14 projects in this sample, costing $130 million, the rebuttal explained project-by-project why there would be minimal if any potential O&M savings (Tr. 4164-68).
5. Cross-examination of the Company's experts, by counsel for the NYC Government Customers, concerning 3 of the latter 14 projects, confirmed that those programs offered no basis for imputing additional productivity.
6. Contrary to the claims of the expert for the NYC Government Customers, the Company's experts testified that the Company's Rate Year request does reflect efficiencies from investments made in prior rate years and in the Linking Period for this case (January 1, 2007 through March 31, 2009).
7. Even assuming that the NYC Government Customers' expert is correct that trained new hires can be just as productive as more experienced workers who are leaving the Company, the proposed productivity adjustment ignores that training new hires is a long-term rather than an instantaneous process.
8. The 3% productivity adjustment ignores barriers to increased productivity faced by the Company, including increased construction and traffic in the City (including underground congestion) and tighter noise and parking restrictions.
9. As in the case of DPS Staff's productivity proposal, the 3% productivity adjustment is inconsistent with contentions that the Company should be more precise in its projections of future costs and ignores that any actual productivity achieved in the Rate Year will be automatically captured for the benefit of ratepayers in the Company's next rate case. This is something the Company describes as a relative ratepayer benefit from one-year rate cases that is not enjoyed to the same extent in multi-year rate cases.

The NYC Government Customers respond:[124]

1. The Company's claim that the NYC Government Customers' 3% adjustment amounts to 8.0% in the Rate Year because of the way the Company calculates the productivity adjustment is simply an unsupported assertion of its Accounting Panel, which did not explain how the adjustment is calculated. In

[124] The NYC Government Customers' Reply Brief, pp. 4-9.

addition, the productivity adjustment is calculated solely on Company labor; it was never meant to capture only gains through reductions in labor expense, but those in all cost elements (Tr. 4476, 4478).

2. Consolidated Edison's IIP in fact was unable to identify any specific, quantifiable productivity gains that reduced the revenue requirement here from its proposed capital or O&M programs.

The Company in its Reply Brief (p. 33) adds that it acknowledges that over time its capital and O&M programs do produce productivity savings, but that there is no basis for assuming that the amount of productivity that can be achieved in the Rate Year will be triple what has historically been imputed in setting its rates.

3. Westchester – Additional Imputation

Westchester proposes a "Productivity and O&M Performance Adjustment" (PPA) of $75 million, to give ratepayers a 75% share in a level of cost savings Westchester maintains the Company has achieved over the last three years and can likely achieve during the Rate Year. It grounds its proposed adjustment on these contentions:[125]

1. In each of the calendar years 2005 through 2007, the Company's actual net income exceeded the level forecast in Case 04-E-0572 for the closest rate years by $100 million or more, enabling it to earn 11.4%, 10.76%, and 10.96% returns on equity for the 2005 through 2007 rate years, respectively, compared to the 10.3% allowed equity return implicit in the Commission's decision in that case.
2. Many factors can contribute to over-earning, including productivity improvements, efficiency gains, under-forecasting of revenues, and the unavoidable imperfection of rate case review of forecasts, models, and input data.
3. The Commission traditionally uses a one-percent productivity imputation to reflect additional efficiency gains not expressly captured in the regulatory review process.
4. The one-percent productivity adjustment has generally applied only to labor, and in this case would equate to

[125] Westchester's Initial Brief, pp. 6-9.

only $5.7 million in the rate year, which pales in comparison to the $100 million or more in over-earnings the Company has realized each year over the 2005-2007 period.

5. Ratepayers should be permitted to capture a share of the $100 million or more in annual excess earnings the Company has demonstrated it has been able to achieve in recent years.
6. The Commission has used various sharing mechanisms for incentives to find efficiency gains in the past, such as the 80% ratepayer/20% shareholder allocation used to augment utilities' fuel adjustment clauses. In Case 04-E-0572, the Commission approved a 75%/25% ratepayer/ shareholder sharing trigger for Company earnings above 13%.
7. A similar 75%/25& sharing of productivity savings provides a reasonable balance between the interests of ratepayers and shareholders, and leaves the Company with an incentive to be aggressive in seeking cost reductions or revenue enhancement.
8. Applying the sharing mechanism to the $100 million over-earning levels yields a $75 million PPA reduction in O&M expenses.

Westchester counters the Company's argument that past over-earnings were a result of understated retail sales forecasts that would be obviated by the new revenue decoupling mechanism, because:[126]

1. The Company offered no evidence to support the claim.
2. Assuming the claim is true, then Westchester's PPA adjustment has even more validity because it shows Consolidated Edison's meager sales growth is seriously understated.

DPS Staff has no objection to the Commission considering the more aggressive $75 million productivity and O&M performance adjustment that the County proposes.[127]

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[126] Westchester's Initial Brief, p. 9.

[127] DPS Staff's Initial Brief, p. 71. We are disappointed DPS Staff did not take a firm position concerning a reasonable productivity imputation. Its stated positions on the NYC Government Customers' and Westchester's proposals, and apparent willingness to abandon the 2% it supports on brief, undermine its role as the party to the ratemaking process that can consistently be expected to be the most objective.

The Company opposes what it describes as Westchester's proposed seven-fold increase in the productivity adjustment for the following reasons:[128]

1. As discussed above, there are no new circumstances that warrant any increase in the productivity adjustment used historically to determine the Company's revenue requirement.
2. The County's proposed $75 million productivity adjustment is inherently flawed:
   - Higher returns in the three years ending March 31, 2008 were the result of above-average sales, due to warmer than normal weather, at a time when there was no Revenue Decoupling Mechanism (RDM)(Tr. 2330-31), and of property taxes below the forecast and within the bounds of a dead-band under the applicable bilateral reconciliation term.[129] Thus, the higher earnings did *not* result from productivity above the forecast.
   - There are no proposals in this case to eliminate the RDM instituted in the Company's last electric rate case.
   - The County's analysis showed that the higher returns resulted even though O&M expenses were higher than forecast when the three-year rate plan was adopted in early 2005. This level of expense is consistent with the Company's overall position here that its opportunities to achieve efficiencies are dwarfed by material increases in expenses beyond its control.
   - The County erroneously assumes the Company's proposed productivity adjustment of 1% is worth only $5.7 million. The correct figure is $10.6 million.
   - The fact that the Company's revenue request is based in part on a decrease in sales compared to the Test Year is not a basis for an increased productivity

[128] The Company's Initial Brief, pp. 83-86.

[129] This statement is identified as a correction to previous Company testimony that the high earnings for each of the three years resulted solely from sales greater than had been forecast. The "dead-band" refers to the extent to which actual property taxes could be above or below the forecast level without being subject to full reconciliation of forecast versus actual.

adjustment. DSM assumed in this case is permitting the Company to defer $1.2 billion in capital investment and is consistent with Westchester's energy efficiency policies.

In response to the Company's argument that there are no new or changed circumstances to justify the County's proposed productivity adjustment, the County contends:[130]

1. The proposed rate increase in this case coupled with those in the Company's last rate case could result in a 65% increase in delivery charges in just four years, unprecedented and clearly a new and changed circumstance in terms of impacts on the economy of its service territory.
2. Assuming the Company's claim that its higher than allowed returns in 2005-2007 were due to unusually warm weather is true, its revenue forecasts in the absence of an RDM were clearly understated, consistent with its lack of an RDM incentive. Now, with an RDM, it has an incentive to focus on the expense side to manage its net income level for the benefit of shareholders.
3. The Company has demonstrated its ability to improve net income significantly over past productivity adjustments. The County's proposal is realistic because it reflects only a fraction (3/4) of the average net income gain the Company has achieved in recent years.

4. <u>Discussion</u>

At the outset, we disagree with the Company's contention that DPS Staff's historic hiring practices adjustment is somehow duplicative of DPS Staff's or other parties' proposals to increase the productivity imputation. DPS Staff correctly notes that these are entirely separate issues that do not overlap or result in double counting. DPS Staff's historic hiring practices adjustment addresses only the projection of how quickly the Company will fill positions over the course of the Rate Year. It does not focus in any way on how efficiently the Company will employ its labor force or its facilities.

On the other hand, we believe the Company has sufficiently explained on the record how expected savings from

[130] Westchester's Reply Brief, pp. 4-5.

its capital and O&M programs in the Rate Year have been identified and quantified to the extent practical, as well as why opportunities for additional material productivity increases beyond the 1% imputation are not likely from its new programs. In addition, its points about much of its investments in new programs reflecting increased material costs or adding new facilities that themselves will demand greater inspection, maintenance, and repair are well taken. The Company's argument that the productivity of significant numbers of new employees can be expected to be lower initially, especially pending training, also seems reasonable. (Tr. 4157-68.)

Nor do we see the lack of Company quantification of additional savings from its increased capital and O&M programs over the last five years as a reason to increase the imputed productivity percentage. The imputation is a surrogate for productivity gains that remain unquantified, regardless of source, as DPS Staff recognizes (Tr. 3055). We agree with the Company that most of the productivity gains realized from program expenditures over the last five years would be captured in Test Year spending levels.

In addition, we find Westchester's proposed productivity and O&M performance adjustment unwarranted. Westchester's adjustment is based upon the assumption that the Company has been over-earning in recent years and that the over-earnings will continue in the future and the lion's share should be captured for ratepayers. As the Company maintains, it is unlikely that higher than forecast earnings in recent years were due to productivity gains, because its actual O&M expenses have been higher than forecast. The more likely sources of the over-earnings are those the Company has identified: increased sales flowing from higher than average temperatures and lower than forecast property taxes that were not subject to full reconciliation. Sales levels above forecasts will not produce higher earnings in the future because of the RDM put in place in the Company's last electric rate case. Furthermore, actual property taxes lower than forecast here will not be a potential source of over-earnings in the Rate Year under our recommendation, below, for a full property tax reconciliation mechanism that would ensure any over-collection for property taxes would be captured and deferred for the benefit of ratepayers. The County's suggestion that, with an RDM in place, the Company will now focus on manipulating the expense side is one that properly should be addressed in considering specific Company proposals for capital and O&M expenditure allowances in this and future rate cases.

We do not find sufficient basis in the record to conclude that productivity gains of double, triple, or greater multiples of the normal imputation of 1% are likely to occur over the course of the Rate Year. We agree with the Company's point that, if there are some additional opportunities for productivity gains above 1% to be realized in the Rate Year, the Company will have an incentive to capture and retain them in the short run, which will then redound to the benefit of ratepayers for the long term in the future.[131] Moreover, retention of a 1% productivity imputation leaves the Company some minimal upside earnings potential. As discussed in Section I, a rate plan that recognizes minimal reasonable costs, reasonably minimizes the Company's downside exposure, and does not eliminate all upside earnings potential seems to be a proper approach in light of economic uncertainty, relatively high capital costs, and the Company's large construction program. Accordingly, we recommend adoption of a productivity imputation of 1% of the Company's labor expense for the Linking Period and the Rate Year.

[131] Whether that would occur in the next rate case seems doubtful. The test year for a filing in May 2009, for example, would likely be calendar 2008.

C. Labor Escalation

The Company's revenue request reflects the cost of wage progression increases of $0.56/hour for all employees in one union and $0.52/hour for all employees in another union. The progression amounts within each union do not vary with the position or title. Such increases are given twice each year as union employees move up to the maximum pay for their respective job titles. Once a person hits the job title maximum, he or she receives no further progression increases unless he or she moves into a different, higher-paying position, in which case progression payments are renewed. The Company states that it is obliged to make these payments under collective bargaining agreements so long as eligibility criteria are met by the employee.

The Company also prepared its labor escalation rate in this case by comparing total salaries at the end of the Rate Year with total salaries at the end of the historic Test Year. The result is 7.7%, according to the Company.[132] The Company states that it has used this same estimation method without any question in prior cases, including, since 2003, two electric cases, three steam cases, and two gas cases.

DPS Staff disagrees with the Company's proposed labor escalation for the following reasons:[133]

1. The Company has improperly included wage progression increases for all union employees ($6.998 million).
2. The Company used the end of Test Year employee count as the starting point to calculate Rate Year payroll costs.

DPS Staff maintains that its adjusted labor escalation rate is closer in line with the actual growth rate for the Company's O&M labor expense, which, DPS Staff says, has

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[132] The Company's Initial Brief, p. 8. As noted below, this statement is incorrect.

[133] DPS Staff's Initial Brief, pp. 71-72.

increased by less than one percent on average over calendar years 2005-2007.[134]

1. Wage Progression Increases

Anticipating the Company's criticism of its prediction that cost savings from experienced employees leaving will offset wage progression increases, DPS Staff argues:[135]

1. Although employees hired over the last several years are not yet at the top of pay grade and will receive progression increases, many employees have reached the top of grade and no longer receive them. The Company's use of average union salary levels in its calculation (Ex. 5, Sched. 2, p. 4) includes salaries of many employees at the maximum pay rate—including, it can reasonably be assumed, most retirement eligible employees, who comprise 33% of its workforce (Tr. 2674)—and thus overstates rate year payroll costs.
2. Even if Consolidated Edison has been hiring more employees in recent years than have left the Company, and not all who leave or retire are at the top of grade, retirement of an employee at the top of grade and replacement by a new entry level employee offsets annual progression increases for 12 employees.
3. The Company's forecast of two annual progression increases per year to the historic average salary for all union employees thus overstates Rate Year payroll costs.
4. The terms of the joint proposal the Commission adopted in Consolidated Edison's recent steam rate case (Case 07-S-1315) excludes wage progression increases from the calculation of the labor expense growth rate.

The Company opposes DPS Staff's proposed wage progression adjustment for the following reasons:[136]

1. The vast majority of employees hired by the Company over the past few years are not near their maximum pay and receive progression increases. Between 2004 and 2006, the Company hired 3,000 new union employees and they all continue to receive progression payments.

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[134] Ibid., p. 72.

[135] DPS Staff's Initial Brief, pp. 72-75.

[136] The Company's Initial Brief, pp. 86-88.

2. The Company's average number of union employees has moved up 10% from a level of 8,328 in 2004 to 9,158 now (Ex. 273) and these new employees create incremental progression payment costs. It is reasonable to assume, however, that employees leaving the Company for retirement are no longer receiving progression payments.
3. DPS Staff's proposal rests on the unsupported assumption that savings from employees that retire will offset progression payments.

DPS Staff responds to the Company with these additional points:[137]

1. The Company's claim that the vast majority of employees hired in the last several years are not near their maximum pay grades has no record basis. When it asserts that it has hired about 3,000 new union employees over 2004-2006, it neglects to provide the number of union employees at the top of grade and not receiving progression increases.
2. The Company's statement that "it is far from illogical to assume that many of the retirees are at the top of their pay scale and no longer receive progressions" [the Company's Initial Brief, p.88] supports DPS Staff's position.
3. The Company's argument that "Staff's theory that there are not [*sic*] savings [from retirees leaving and being replaced by lower paid employees] is not based on any study nor is it intuitive" [id., "not" is presumably not what the Company intended] attempts to shift the burden of proof away from the Company. The Company has the burden to perform a study with the best information to support its position.

The Company, on the other hand, claims:[138]

1. DPS Staff cites no data and has performed no study to support its assertion that many employees no longer receive progression increases.
2. DPS Staff does not provide any support for its hypothetical calculation that one top-of-grade employee leaving the Company provides enough savings to offset progression increases for 12 employees, which the Company asserts is incorrect.

[137] DPS Staff's Reply Brief, pp. 28-32.

[138] The Company's Reply Brief, pp.36-37.

3. There is nothing in the record of the recent Company steam rate case that indicates any adjustment was made to wage progressions as part of the joint proposal there; the joint proposal reflects give and take on many issues; and the Commission made no affirmative determination that the manner in which wage progressions were treated was proper on a stand-alone basis.

DPS Staff has clearly established that the Company has overstated its costs of wage progression increases by applying them to all union employees, even though many of those employees indisputably are at the top of their wage scales and do not receive progression increases. The Company's arguments in effect admit this point. DPS Staff has also plausibly demonstrated how savings from one retirement can offset wage progression increases for a number of employees not yet at the top of grade. Thus, it was incumbent on the Company—not DPS Staff—to prove that wage progression increases collectively exceed the cost savings from retirements and to provide evidence of a reasonable level of progression increases to include in its cost of service, in order to meet its burden of proof. The Company did not even attempt to do so, although it is inconceivable that it lacks sufficient payroll information to have done so. We therefore disagree with the Company's position and recommend DPS Staff's proposal to eliminate wage progression increases from the calculation of the labor escalation rate.

2. End of Test Year Employment Count

To counter Consolidated Edison's objection to DPS Staff's adjustment based on use of average number of employees over the 12 months of the 2007 Test Year, rather than the Company's one-month end of the Test Year count, DPS Staff contends:[139]

1. Using the average number of employees in 2007 represents an average or normal year (Tr. 2675).

[139] DPS Staff's Initial Brief, p. 75.

2. The goal of a rate case forecast is to project costs for the Rate Year, not a particular month. Use of a snapshot month will not reflect Rate Year expense.
3. Consolidated Edison will continue to experience employee turnover in the Rate Year. Use of an average Test Year employee count, rather than the Company's single month count, will more accurately reflect Rate Year labor expense.

The Company opposes DPS Staff's average annual employee count proposal for the following reasons:[140]

1. The change effectively reduces the labor escalation rate from 7.7% to 3.04%.
2. Since 2003, the Company has used the same method to develop the escalation rate in two electric, three steam, and two gas rate cases, without challenge by DPS Staff.
3. Contrary to DPS Staff's claim that use of the 2007 average is a fairer presentation, the use of the number of employees at the end of the Test Year is more representative of the number of employees that will continue in the Rate Year, especially as the number of employees has been going up for several years.
4. By using the average number of employees in the Test Year, the Linking Period is effectively extended back to the middle of the Test Year, resulting in a further unwarranted productivity imputation beyond that usually adopted by the Commission.
5. DPS Staff gives no other good reason for its proposed adjustment or its sudden change in position.

On reply, DPS Staff states:[141]

1. The Company incorrectly says it applied a 7.7% labor escalation rate. In fact, its update increased the escalation rate to 8.21% (Tr. 2273)
2. None of the Commission decisions in the seven rate cases the Company mentions prescribed a labor forecast methodology. That DPS Staff did not question a position in an earlier case does not preclude review in a future case, especially when the forecast methodology results are greater than actual experience. The Company's labor forecast of $605.354 million (Ex. 265, Sched. 3) in the Rate Year represents a 25.8% increase from the $481.297

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[140] The Company's Initial Brief, pp. 88-89.

[141] DPS Staff's Reply Brief, pp. 32-34.

million in the historic period, significantly greater than the average annual labor expense increase of less than 1% from 2004 to 2007.

3. DPS Staff's adjustment would not extend the Linking Period back to the middle of the Test Year. Use of average 2007 employee count mirrors the average employee count in the Rate Year. Comparing the middle [*sic*] of the historic Test Year to the middle [*sic*] of the Rate Year does not extend the Linking Period to impute higher productivity.

The Company adds in reply that it is logical to assume that using the end of Test Year union employee count understates costs, as more union employees are hired each year; and DPS Staff has not demonstrated why using the end of Test Year employment level is incorrect or laid a foundation for use of the level from a different month.[142]

We have little confidence in the validity of the Company's arguments in support of its position on this issue. For one thing, the Company has cited the wrong figure for its own proposed escalation rate, which is 8.21%, not the claimed 7.7% (even the 7.7% figure represents improper downward rounding from the actual 7.78% original rate—Ex. 5, Sched. 2). In addition, the Company pretends that DPS Staff's use of the average Test Year employee count is solely responsible for the difference between the Company's original escalation rate and DPS Staff's 3.04% rate, when, in truth, the percentage quoted for DPS Staff's rate is the result of the combination of its elimination of wage progression increases, use of average Test Year employee count, elimination of variable pay awards from Test Year and Rate Year payroll costs, and proposed 2% productivity imputation.[143] We do not follow the Company's argument that DPS Staff has failed either to show why using the end of Test Year employment level is incorrect or to lay a

[142] The Company's Reply Brief, p. 36.

[143] Compare the Company's Initial Brief, p. 88, with DPS Staff's Initial Brief, pp. 71-72.

foundation for use of the level from a different month. DPS Staff has obviously argued that use of the average count for the Test Year is preferable to the Company's use of a spot month to determine the escalation rate applicable to the Rate Year. Moreover, DPS Staff has not proposed to use the count from "a different month," but the average for the entire Test Year.

More substantively, since the cost of delivery service we are trying to determine and any resulting rates would be set for the entire Rate Year, not just the ninth month (December) of the Rate Year, the use of the average employee count for the Test Year seems inherently more plausible as a basis for determining the labor escalation rate than use of the one-month average from only the last month of the Test Year. (The Company's claim that use of the average employee count for the Test Year in effect somehow extends the Linking Period back to the middle of the Test Year, allegedly resulting in a further unwarranted productivity imputation, is opaque.) We also find persuasive DPS Staff's point that the Company's labor expense request for the Rate Year represents nearly a 26% increase over the Test Year level and is far out of line with the Company's average annual labor expense increase of less than 1% from 2004 to 2007. We find that DPS Staff's adjustment to use the average Test Year employee count in developing the labor escalation rate is more reasonable than the Company's proposal.

3. Overtime

As to overtime, no disputes are raised about this topic in the initial trial briefs. Accordingly, there is no need to consider the Company's arguments in opposition to arguments it reasonably anticipated.[144] The Company's forecast expenses for overtime and compensatory time should be included

[144] The Company's Initial Brief, pp. 89-91.

in the Commission’s calculation of the cost of electric delivery service.

D. Normalization (Vacancy) Adjustment

The Company’s rate request rests in part on an estimate of its number of Rate Year employees before any program changes or escalation. This estimate assumes that all employees at the end of the historic Test Year remain employed and that some but not all positions vacant at the end of the Test Year will be filled.

DPS Staff opposes the Company’s normalizing adjustment, proposed to account for positions vacant or partially vacant during the historic Test Year, because vacancies will also occur in the Rate Year. In response to the Company’s update/rebuttal contention that it would seek to fill vacancies immediately in the future and that it is not practical to try to forecast duration for any particular vacancy, DPS Staff contends:[145]

1. Consolidated Edison will not be able to fill vacancies immediately in the future, when it has demonstrated no ability to do so in the past and continues to experience significant delays currently, including delays of up to 17 or 18 months, for example, in backfilling for transfers (Ex. 441).
2. The Company takes two months on average to fill a vacant position; it loses about 1,000 employees per year; and it has an annual payroll of about $77 million. Based upon these figures, Consolidated Edison saves $12.865 million in payroll costs each year as a result of vacancies, significantly greater than the Company's proposed $7.307 million ($7.875 million after escalation) vacancy normalization adjustment.
3. Although the Company admittedly has filled some positions its normalization addresses, it is undisputed that positions will be vacant or partially vacant during the Rate Year.

[145] DPS Staff’s Initial Brief, pp. 76-79.

4. Exhibit 441 demonstrates that Consolidated Edison is overly optimistic in projecting its ability to fill vacancies, since, by the mid-point of the current rate year, it had filled only 205 new positions, including transfers, of 346 funded for the current rate year.

The Company criticizes DPS Staff’s proposed disallowance for the following reasons:[146]

1. DPS Staff agrees that the Company’s revenue requirement should reflect the expected number of Company employees.
2. There is no need to adjust the Company’s revenue request for Rate Year vacancies as vacancies are already reflected to the extent they existed in the historic Test Year and as the Company assumes that only some of those vacant positions will be filled.
3. DPS Staff is not correct in its assertion that the average number of vacancies in the historic Test Year is more representative of vacancies in the Rate Year, for the following reasons:
   - A review of the list of normalizations (Tr. 2308) confirms that the Company assumes that only certain vacant positions will be filled.
   - DPS Staff’s approach ignores the ever-increasing number of Company employees as well as the Company’s efforts to retain more employees.
   - DPS Staff’s proposed adjustment does not account for the changing economy, which the Company expects will lead to many staying in their positions for longer periods.

On reply, Staff contends:[147]

1. Staff did not assume a level of attrition. The Company’s Shared Services Panel testified that on average about 700 union employees and 300 management employees leave the Company each year (Tr. 370-71). The cost savings in the Rate Year from these vacancies is greater than the Company’s normalizing adjustment.
2. There is no list of normalizations at Tr. 2308, which the Company claims shows the amount requested for normalization is less than the actual level of vacancies during the historic year.

[146] The Company’s Initial Brief, pp. 91-93.

[147] DPS Staff’s Reply Brief, pp.34-36.

3. DPS Staff’s adjustment does take into account the increasing number of Company employees. The historic payroll costs reflected the increased number of employees during the Test Year and the expected Rate Year increase in the number of employees is reflected by the Company’s labor program changes. Staff’s adjustment only reflects expected attrition in the Rate Year, which mirrors historic experience.
4. Although the Company claims that the changing economy will lead more employees to stay in their positions longer, the Company’s rate request is loaded with costs to attract and retain employees.

To counter DPS Staff’s contentions, the Company reiterates that its normalization adjustment is not made for all vacant positions. It further explains that its Rate Year forecast does not request funding for various positions that were vacant for a period of time in 2007 if they were not filled by December 2007.[148]

We find telling the Company’s last point. It boils down to an admission that the Company does seek funding for positions that were vacant for up to 11 months of the Test Year, so long as they were not vacant in the final month. We have already concluded that it is not reasonable for ratepayers to fund non-existent costs of vacant positions. We agree with DPS Staff that average attrition in the Test Year should be reflected in the attrition forecast for the Rate Year. The record demonstrates that approximately 1,000 vacancies can be expected to occur during the Rate Year and continue two months on average before refilling. The Company’s normalizing adjustment fails to take nearly enough of the expected attrition and vacancies into account. The best evidence on the record shows that the Company saves significantly more over the course of a year from vacancies than the amount it seeks to add to expenses through its normalization. We are not convinced that the effects of the economic downturn and the Company's efforts

[148] The Company’s Reply Brief, p. 38.

to attract and retain employees are sufficient to eliminate or reverse that differential. We therefore recommend rejection of the Company's normalizing adjustment for vacancies.

E. Variable Pay ($15.9 Million Plus Removal of Capitalized Variable Pay)

1. Positions of the Parties

Several parties oppose ratepayer funding of the variable pay and long-term compensation elements of the Company's overall management compensation package. These arguments are considered in this and the next section. The Company argues that the proper context for considering these issues includes the following:[149]

1. The Company's compensation package for non-officer management employees--salary, variable pay, and long-term compensation--is consistent with prevailing business practice and the associated costs are a reasonable business expense.
2. This package is also consistent with the goals of attracting and retaining qualified persons so that the Company can succeed.
3. The Company's total compensation for non-officer managers is below the median compensation of national utilities and peer organizations [Tr. 2015 and Ex. 400, p. 13 (direct) and p. 4 (update/rebuttal)]. This analysis ignores the relatively higher cost of living in the New York Metropolitan area.
4. The Company disputes the suggestion that funding for these compensation elements would be inconsistent with Commission policy.
5. If the Commission denies funding for compensation elements on the grounds that they are incentive related, the Company might have to offer better basic pay and this could cost more and provide fewer benefits to ratepayers.

Turning to the variable pay plan, the Company describes it as the pay-for-performance component of its non-officer management compensation package. An eligible manager can receive a payment each year that is based on the Company's

[149] The Company's Initial Brief, pp. 93-94.

income (10%), his or her organization's conformance with its budget (15%) and performance targets (35%),[150] and his or her individual performance (40%). Payments can range from 4.5% to 15% of base pay.

The Company argues that this plan is reasonable for the following reasons:[151]

1. Specific performance stretch targets are set each year at challenging yet achievable levels. The targets are limited to corporate goals for safety, environmental, reliability, and customer service.
2. The performance indicators make clear to managers that their actions affect the Company's overall performance in meeting operational goals. This continues from year to year.
3. The Company's compensation consultant testified that more than 90% of organizations surveyed for 2007 have moved from a base-salary-only approach to a base salary with a performance incentive, in order to reduce fixed costs, relate pay more closely to performance, remain competitive, and attract and retain employees.
4. The Company's overall level of compensation for non-officer management employees is well below the median of comparable companies, even though its base salaries are only slightly below the median for comparable companies.
5. The Company has determined that base-pay-only compensation is not as effective in encouraging specific types of behavior.

DPS Staff and NYECC propose denial of all $15.9 million for this element of non-officer management compensation (plus removal of capitalized variable pay). DPS Staff argues:[152]

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[150] Performance targets concern OSHA Incidence Rates, Electric Network System Availability, Electric Non-Network System Availability, Respond to Gas Odor Complaints Within 30 Minutes, Workable Gas Leaks Year-End Backlog, Steam System-Nominal Pressure Operations, Generation Stations-Forced Outages, PSC Complaints, Customer Calls Answered, Customer Satisfaction Surveys, Environmental Index, and Employee Development Index.

[151] The Company's Initial Brief, pp. 95-105.

[152] DPS Staff's Initial Brief, pp. 80-83.

1. The goal of realizing a return for equity investors dominates the performance indicators for variable pay awards, since none are made unless the Company's adjusted net income exceeds 90% of the target level (Tr. 1998); thus, the program constitutes an incentive pay program.
2. The Commission has a longstanding policy against charging incentive pay expense to customers rather than shareholders (citing, among others, the 2008 Rate Order).
3. The Company's comparison of compensation levels for its management employees with those of comparable companies is flawed because it does not take into account benefits, such as pensions, health insurance, and matching funds for savings plans.
4. The Company did not meet its burden of proof that the variable pay plan is not an incentive program, because it failed to demonstrate that any savings from achieving the goals of the program are reflected in its revenue requirement.

Anticipating the Company's claim that a two percent productivity imputation and disallowance of variable pay are duplicative, DPS Staff states that the productivity imputation increase is based upon the Company's massive investment in capital and O&M programs (Tr. 3054), and in no way intended to reflect gains resulting from effective management or innovation in the Rate Year.[153]

NYECC agrees with DPS Staff, because:[154]

1. The Commission made clear in Consolidated Edison's last electric rate case that the variable pay plan has attributes of an "incentive compensation" program and, absent justification by specific, quantified productivity-associated gains, should not be allowed.[155]
2. The Company specifically referred to variable pay as an "annual incentive" (Tr. 2051).
3. The Company characterizes any specific identification of incremental savings associated with variable pay as "mysterious" (Tr. 2012, 2017), and thus has failed to meet its burden of justifying this compensation.

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[153] DPS Staff's Initial Brief, p. 84.

[154] NYECC's Initial Brief, pp. 13-15.

[155] 2008 Rate Order, pp. 37, 39, and 41.

4. Making a reasonable return for investors and rewarding total shareholder return are objectives for variable pay (Tr. 2053-54), and these are not objectives that foster any additional value for ratepayers.

The Company objects to the proposed disallowances for the following reasons:

1. DPS Staff does not assert that the amounts that could be paid are excessive and does not dispute that most other companies use variable compensation.
2. Claims by DPS Staff and NYECC, concerning the Company's failure to prove "efficiency gains," "specific results," and "quantified productivity" ignore that some of the Plan's goals are identical to those set by the Commission for the Company. Moreover, efforts to increase safety, protect the environment, and provide good customer service do not reasonably lend themselves to productivity offsets.
3. There is no Commission policy that favors disallowance of the costs of variable pay plans. DPS Staff's reliance on a 1991 rate decision for National Fuel Gas Distribution Company[156] is misplaced, for example, because all of the goals of that plan were financial, as distinct from the many performance indicators included in the Company's plan. Likewise, a 2003 Commission decision concerning executive incentive payments by Rochester Gas and Electric Corporation[157] is inapt as the Company is not requesting funding for its comparable program in this case. (The Company acknowledges the non-executive variable pay was disallowed in that case, but says the basic Commission concern expressed was with executive compensation.) Moreover, the Commission has adopted rate plans that allow funding for variable pay, as in the Commission's 1992 order adopting a rate plan for the Company.
4. While the Company requests funding that assumes the maximum payout will be made in the Rate Year, it is likely, in circumstances where the full amount is not paid out, that the Company will be incurring offsetting expenses beyond those forecast.

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[156] Cases 90-G-0734 et al., National Fuel Gas – Rates, Opinion 91-16 (issued July 19, 1991).

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

DPS Staff in reply states:[158]

1. There is no merit to the Company's suggestion that failure to fund variable pay might compel it to adopt a different, more costly compensation package providing fewer ratepayer benefits in attracting and maintaining qualified employees and maximizing performance. The 2008 Rate Order denied recovery of the program's cost, but the Company made no changes and says it fully expects its employees to stay given the state of the economy (the Company's Initial Brief, p. 193).
2. The Company's attempt to distinguish the National Fuel Gas case, where the variable pay goals were financial, is of no avail. Rate of return on investment dominates the performance indicators in the Company's plan, because no awards are made unless its net income exceeds 90% of the performance target.
3. Consolidated Edison has also failed to distinguish the 2003 RG&E rate case, where the Commission rejected a variable pay plan that lacked any identified customer benefits. The Company has failed here to show that the savings from achieving the goals of its variable pay plan are reflected in its revenue requirement.

On reply, NYECC maintains:[159]

1. Contrary to the Company's suggestion, other parties have no obligation to show certain performance goals should not be part of the Company's variable pay plan or to explain why the Company must show cost savings associated with achieving those goals. The Company, not other parties, has the burden of proving variable pay is justified by specific or quantified productivity gains, a requirement just reemphasized when the Commission rejected the Company's variable pay plan in its last rate case.
2. The Company has made no such demonstration in this case.

The Company's reply offers these arguments:[160]

1. Return on equity is a goal of any business and benefits not only investors but, in the long run, customers and thus is a proper goal of an incentive pay plan.

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[158] DPS Staff's Reply Brief, pp. 36-39.

[159] NYECC's Reply Brief, pp. 7-8, citing the 2008 Rate Order, supra, pp. 37, 39, and 41.

[160] The Company's Reply Brief, pp. 39-42.

2. Return on equity is not a performance indicator under the variable pay plan. The program is focused on twelve operating targets linked to goals such as safety, environment, reliability, and customer service, and achievement of a pre-determined level of net income and performance within an operating budget.
3. DPS Staff wrongly suggests that the Company should have taken benefits into account in its comparison of its compensation package with those of other companies. The Company's compensation consultant testified that it is very unusual to include benefits in the compensation comparison analysis for non-officer employees (Ex. 400, Rebuttal Testimony, pp. 5-6).
4. Many of the performance indicators for the variable pay program establish goals that provide benefits for ratepayers, such as reliability and high quality customer service, which do not lend themselves to measurement by productivity savings. Moreover, the goals related to net income and operating budgets are operating efficiencies tied to keeping costs down, which will help keep down future rates.
5. Unlike the National Fuel Gas plan, the Company's variable pay plan includes many performance indicators that are tied to operating targets, not "financial parameters." The RG&E case involved an "ill-defined" bonus plan for executives, not a pay-for-performance plan for non-officer management.
6. Requiring the Company to show savings from the variable pay plan is duplicative of DPS Staff's proposed two percent productivity adjustment, because DPS Staff identified the latter as intended to: "generically capture broad savings in all areas that are typically not identifiable and quantifiable at the time rates are set" (Tr. 3055); and "capture the Company's as yet unacknowledged operational efficiencies related to all aspects of the Company's business … and encourage the Company to continually seek to operate in the most cost effective and efficient manner possible" (Tr. 3056).

2. <u>Discussion</u>

Any variable pay plan can be characterized as an "incentive" program. However, we see nothing inherently unjust or unreasonable about incentive pay plans from the ratepayers' point of view. The very nature of a variable pay incentive plan is to create a financial incentive for better performance that produces improved operating results for a company. The Company has sufficiently established that performance incentive plans are a common means to improve corporate performance and competitiveness.[161] The real issue is how the Company's incentive plan is designed and what are its implications for the interests of ratepayers *vis-à-vis* those of shareholders.

We find illogical and unreasonable the argument that a variable pay incentive plan must be justified by specific, quantifiable productivity-associated savings reflected in the Company's cost of electric delivery service. This proposition is inconsistent with the productivity imputation, discussed above, which is justified on the assumption that many types of cost efficiencies occur in a regulated utility's operations that are inherently difficult or impossible to identify and quantify specifically. Moreover, the Company correctly points out that several of the performance indicators for its variable pay plan—such as goals for safety, environmental protection, and customer service—cannot readily be measured in terms of dollar savings.

The Company also properly observes that a number of the performance targets in its variable pay plan further goals of reliability and customer service, for example, that clearly serve the Commission's performance requirements for the Company and its customers' interests. We would have no difficulty endorsing the Company's variable pay plan if those sorts of performance targets dominated.[162] The real problem with the

[161] Incentive plans arguably are just as important for regulated monopoly service providers, like the Company, that lack the pressure of competition, but face corporate performance standards for which they are held accountable financially.

[162] This statement assumes that the Company's total compensation packages (including all forms of compensation and benefits) are reasonable. Regardless of the advice of the Company's consultant, a total package that is 10%, for example, below that for a comparable group on pay seems unobjectionable if the difference is made up in value of benefits.`

Company’s variable pay plan is its enormous emphasis on the net income threshold target.

Unless the Company achieves 90% of its annual net income target, no manager receives a dime in incentive variable pay. The Company merely plays semantic games when it argues that return on equity is a proper “goal” of an incentive plan, although not a “performance indicator” under its plan, but that achievement of a pre-determined level of net income is one of the “operating targets” on which the plan focuses. Even granting the Company’s argument that return on equity is a goal that in the long term benefits customers, its predominant benefit flows to shareholders, particularly to the extent that it exceeds the allowed cost of capital, and not just in the long run. In the Company’s plan, the net income factor overwhelms all other aspects of performance and provides near-term and long-term tangible benefit to shareholders, with rather ephemeral benefit to customers possibly lying somewhere down the road.

In addition, if the Company’s rates include an allowance for the variable pay plan, but the Company misses its net income target, all of the unspent funds inure to the benefit of shareholders. The Company argues that in circumstances where the full amount is not paid out it will probably incur “offsetting” expenses beyond those forecast. Why that should be assumed true is not obvious and the Company provides no explanation. It seems particularly questionable in terms of failure to hit the net income threshold, which the Company sets internally and might have no relationship to expenditure forecasts in this rate case.

We find that, as currently structured, the Company’s non-officer management variable pay plan is designed to benefit shareholders primarily.[163] Its costs should therefore be funded by shareholders, not ratepayers, and we recommend that those costs not be reflected in the Company's cost of electric delivery service. We encourage the Company to reexamine the plan and modify it to focus predominantly on goals or targets that will benefit ratepayers more directly, if it wishes ratepayers to bear the costs.

F. Other Incentive Compensation (Non-Officer and Officer Long-Term Compensation)[164]

The pertinent considerations for the Company's long-term compensation for non-officer managers are very similar to those just discussed. One key difference, however, is that long-term compensation is tied to the achievement of future growth and success of the Company.

At this point, this long-term compensation is provided in the form of performance-based restricted stock (PBRS) units (the right to receive one share of stock or the cash equivalent, subject to the satisfaction of pre-established long-term performance goals) and time-based restricted stock units. Performance targets for the PBRSs are based 50% on adjusted net income, operating budget compliance, and operating performance goals; and 50% on the incremental value an equity investor receives by holding one share of common stock over a period of time.

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[163] Even those performance targets in the Company's plan that relate to the Commission's reliability and customer service performance mechanisms benefit shareholders, it should be noted, because meeting them decreases the probability of missing a performance mechanism standard and the resulting revenue disallowance.

[164] No issues are presented about the base salaries and annual cash awards to the Company's officers. As to the second of these, there is no chance of there being an issue as the Company is not seeking recovery of the costs of the cash awards here, even though it believes they are a legitimate cost of doing business.

In opposition to the Company's requested allowance for costs of its long-term compensation plan, DPS Staff maintains that Commission policy, expressed recently in the Company's last electric rate case, is that incentive plans must be self-supporting and matched with associated efficiency gains.[165] NYECC argues that $6.021 million in long-term incentive compensation should be disallowed for the same reason it opposes variable pay for non-officer management.[166]

The Company objects to DPS Staff's proposed disallowance for the following reasons:[167]

1. The cost of this compensation element is part of total non-officer compensation and the Company's total non-officer compensation is 24.8% and 23.1% below the median for peer and national utility groups, respectively (Ex. 400).
2. Accordingly, the associated costs are a reasonable cost of doing business and should be allowed.

The third element of officer compensation is long-term compensation, which is similar to that offered to non-officer managers. Differences include that long-term compensation for officers depends on recommendations of the Company's Chief Executive Officer, a general assessment of each officer's performance of his or her responsibilities, and target levels for each officer position based on benchmark information for officers in a peer group of 20 utility companies of comparable size and scope.[168]

The Company argues the costs of long-term officer compensation are reasonable and should be allowed in rates for the following reasons:[169]

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[165] DPS Staff's Initial Brief, pp. 83-85.

[166] NYECC's Initial Brief, pp. 13-15.

[167] The Company's Initial Brief, pp. 105-106.

[168] Tr. 1977; Ex. 112.

[169] The Company's Initial Brief, pp. 107-09.

1. There is evidence that the Company's total compensation for officers is competitive with median levels in the comparable group with some falling below and some falling above the median. For the top five officers, however, total compensation was well below the median because the long-term incentive component was substantially lower.
2. The long-term compensation is intended to drive the long-term success of the Company and to assist it in retaining quality employees.

As in the case of the Company's non-officer variable pay plan, we see nothing inherently wrong with having a long-term incentive component in the compensation packages for its officers or non-officer managers. We disagree with the idea that such a form of incentive compensation must be self-supporting, based upon a showing of associated productivity or efficiency savings, for the same reason we disagreed with that theory for the variable pay plan. As a practical matter, however, we note the Company's long-term incentive plans allow for only half the effect of non-monetary performance indicators as its variable pay plan does for elements like safety, environmental protection, and customer service that cannot readily be measured in terms of dollar savings. Fifty percent of any award is based on the same factors as the variable pay plan, while the other 50% is linked exclusively to shareholder return.

Since the long-term incentive plans for officers and non-officer managers are based 50% on the variable pay plan factors and 50% on shareholder return, it would be even more objectionable to impose their costs on ratepayers than in the case of the variable pay plan. The long-term incentive plans are designed to benefit shareholders far more than even the variable pay plan is. Thus, we recommend that the long-term incentive pay plan expense not be included in the Company's cost of service. Again, we suggest that the Company redesign the long-term incentive plans in ways that emphasize reliability and customer service quality and deemphasize achieved return on equity.

G. Directors' Compensation

The Company currently compensates each Board member with 1,500 shares annually, which is required to be deferred until the member leaves the Board. The associated annual cost is $0.690 million and DPS Staff and NYECC propose that this cost be disallowed. The Company disagrees for the following reasons:[170]

1. Comparable companies have a similar compensation package, the Company's compensation aligns with the median level (taking into account meeting fees, retainer fees, and an equity based component), and this is a reasonable cost of doing business.
2. Compensation should not be denied solely because it is paid in the form of stock shares; it is an expense of maintaining a corporate board.
3. The compensation is provided in exchange for services and, thus, is not an incentive plan.

In opposition to the Company's claim that stock awards to directors are compensation for services, rather than an incentive plan, DPS Staff contends:[171]

1. Directors must hold the stock until they no longer serve and this form of compensation is directly tied to shareholders' interests: if stock price rises, the value of directors' compensation rises, and *vice versa*.
2. The purpose or goal of the compensation is thus to give directors an incentive to increase stock price.
3. Consolidated Edison's SEC Form 10-K for the fiscal year ended December 31, 2007, identifies the directors' deferred stock compensation plan awards as "covered by the LTIP," where "LTIP" stands for Long Term Incentive Plan.

NYECC argues that costs for board of directors' stock awards be disallowed for the same reasons it opposes variable

[170] The Company's Initial Brief, pp. 109-110.

[171] DPS Staff's Initial Brief, pp. 86-87.

pay for non-officer management.[172]

Once again, we do not see that the issue with respect to this compensation mechanism is whether it constitutes an incentive plan or not. The issue is whether the form of compensation or the terms under which it is awarded are keyed to benefit flowing in the main to shareholders or to ratepayers. The Company could easily provide compensation to its directors in a form other than shares of stock, and in particular stock that must be held until a director no longer serves. Indeed, it used to do so. Now it has adopted a directors' compensation mechanism that is clearly aligned with furthering the interests of shareholders and has no direct relationship to provision of reliable, reasonably priced service. Thus, ratepayers should not bear the expense. The Company is free to redesign its compensation for directors in some other form that is either neutral to the interests of shareholders or that addresses ratepayers much more directly. Until then, we recommend that the directors' compensation expense be disallowed.

V. EXPENSES – OTHER O&M

A. Pensions/OPEBs Expense Level ($30.2 Million)

The Company initially projected pension and other post-employment benefits (OPEBs) expense in the Rate Year of $112.2 million. There is no objection to this amount. In an authorized update, the Company sought an additional $2.8 million based on new collective bargaining agreements. DPS Staff recognizes this as a known change and has no objection.

Another Company update submitted simultaneously, as corrected, seeks another $30.2 million (or a total of $145.2 million for the Rate Year) based on a pension fund return at mid-2008 that was a negative 7% or 15.5 percentage points below the forecast (Tr. 2692).

[172] NYECC's Initial Brief, pp. 13-15.

DPS Staff opposes the $30.2 million update because:[173]

1. The update is based on a hypothetical, not an actual 2008 experience.
2. The Commission's Policy Statement on Pension and OPEBs[174] fully protects the Company from differences between the actual and expected return on pension plan assets, since the rate allowance for Pension and OPEBs is subject to full true-up.
3. The Pension and OPEBs Policy Statement has a systematic method for treating the difference between actual and expected market returns once the actuarial gains and losses are known.
4. Consolidated Edison's pension costs are determined annually based on a number of actuarial assumptions (Tr. 2141). The Company's $30.2 million update considers only one variable--investment return--and a number of subjective assumptions to project its annual pension cost; and ignores the potential impact of the latest available information on various other assumptions, such as discount rate, mortality rates, compensation levels, and employee turnover.
5. The Company is uneven, seeking to update only those items that increase revenue requirement.

For the following reasons, the Company disagrees with DPS Staff's proposed disallowance:[175]

1. The Pension and OPEBs Policy Statement does provide a systematic approach to account for actuarial gains and losses. However, this is separate and apart from establishing the appropriate amount to be included in rates. The rates set here should be based on the best information available because the Company will be presented with immediate cash requirements that must be met over the next few years.
2. The $30.2 million update is not barred by the Commission's Statement of Policy on Test Years in Major Rate Cases as it

[173] DPS Staff's Initial Brief, pp. 88-90.

[174] Case 91-M-0890, Development of the Pension Policy Statement, Statement of Policy Concerning the Accounting and Ratemaking Treatment for Pensions and Postretirement Benefits Other Than Pensions, 33 NYPSC 1107 (issued September 7, 1993) (Pension and OPEBs Policy Statement).

[175] The Company's Initial Brief, pp. 112-115.

reflects a material change in economic conditions since its May 2009 filing.

3. Circumstances have worsened since September 2008, with the Company reporting in its November 13, 2008 10Q Report that its pension plan assets on 10/31/08 were 25% lower than they were on December 31, 2007. Thus, the Company’s $30.2 million update should be viewed as conservative.
4. The Commission should not ignore what is happening in the financial markets as it is clear that rates will have to rise once the final 2008 pension results are in. (Presumably, this refers to pension accrual rates.) The Commission indicated on p. 8 of the Pension and OPEBs Policy Statement that it would not ignore such information.

The Company advises as well that it will update its forecast in January 2009, based on updated information to be provided to the Company at that time by its actuarial, Buck Consultants.

In its reply brief, DPS Staff reiterates that it would be proper to permit a pension expense update for actual, known results but not for any hypothetical circumstances. DPS Staff insists that the Company’s proposed update is improper because it is not based on the known results for all the pertinent variables for calendar 2008. Without a comprehensive update, DPS Staff believes no adjustment should be made for the single factor advanced by Consolidated Edison. Finally, DPS Staff asserts that the Pension and OPEBs Policy Statement, and other regulatory practices, fully protect Consolidated Edison from prevailing unfavorable market conditions by allowing the Company to defer the difference between its actual pension expense and the amount included in rates.

Consolidated Edison, in its reply brief, addresses three points raised by DPS Staff. In response to DPS Staff’s reliance on the Pension and OPEBs Policy Statement, and the use of established practices to meet the pension requirements, the Company insists that the referenced Policy does not preclude an update using the procedure it has proposed in this case. It believes that an update should be made to reflect the asset values that are now emerging. Second, Consolidated Edison states that a January 2009 update can reflect the pension expense for all the factors DPS Staff has raised, including the applicable discount rate, mortality rates, compensation levels, and employee turnover. Such information was not previously available for 2008 but it will soon be provided. Finally, the Company denies that it has not updated its rate case filing to reflect cost decreases. Consolidated Edison states that it has provided cost reductions for such items as vehicle fuel, health care costs, and insurance, among others. However, Consolidated Edison states that it is unwilling to project a long-term decline in commodity prices (such as the price of copper and steel) when it is unclear whether the current decreases will continue into the Rate Year.

When all is said and done, it appears that DPS Staff has no objection to a further update for pensions and OPEBs, provided all pertinent variables are updated for 2008, and the Company seems to be prepared to provide all the necessary information, presumably not later than its brief on exceptions.

No further analysis or recommendation is required at this time other than to note that it appears the final updates in these cases have the potential to be more contentious and to have greater impacts than might be typical. Pending a proper update, our overall cost of electric delivery service recommendation reflects the $30.2 million as a placeholder.

B. Municipal Infrastructure Support Expense Level ($19.9 - $21.6 Million)

The Company incurs costs to support and protect its facilities whenever necessary as a result of municipal work such the installation or repair of water mains, sewers, and drainage facilities, or reconstruction of roadways, curbs, or sidewalks. As updated and corrected, the Company projects total Rate Year non-labor O&M costs for such work of $74.4 million outside of lower Manhattan and $14.4 million in lower Manhattan.[176] Arguments concerning a reasonable O&M expense allowance and competing reconciliation proposals are summarized first, followed by one discussion.

1. DPS Staff's Proposed Adjustment

The Company understands DPS Staff to be proposing that the $74.4 million for work outside lower Manhattan be reduced by $17.8 million (to $56.6 million). On brief, however, DPS Staff proposes a $21.648 million reduction to the Company's forecast O&M expense for the Rate Year outside lower Manhattan.

The Company's general approach to forecasting this expense relies on use of the average "commitment target"[177] published by NY City in January of 2003 through 2007 and the average of actual subsequent expenditures to commitment target level expenditures (Ex. 330). DPS Staff's approach is to use the City's average actual expenditures for 2003 through 2007, adjusted for general inflation (Tr. 2513). DPS Staff contends its approach is more reliable because:[178]

1. Although the average ratio of actual NY City fiscal year expenditures to the prior January commitment plan target is 99%, the ratio varied from 110% to 89% over 2003-2007, and dropped significantly from 110% to 89% between 2006 and 2007; for City Fiscal Year (FY) 2008, the ratio dropped farther, to 82%, a 17% variance from the average (Ex. 360).
2. A 17% variance would reduce Consolidated Edison's interference expense forecast by $12 million.

[176] Two separate forecasts are made as the Company's infrastructure support O&M costs in lower Manhattan are generally higher because more removal work is usually required.

[177] The "commitment target" is the percentage of the City's overall projected infrastructure expenditures expected to be engineered, bid, and awarded each July-June NY City fiscal year, out of its total commitment plan, recognizing that not all projects in the plan will be undertaken. Tr. 583.

[178] DPS Staff's Initial Brief, pp. 93-96.

3. The City’s actual expenditures do not display variations of similar magnitude. Over the same period, the City’s actual annual expenditures averaged $663 million; its actual expenditures for City FY 2008 were $667 million, only a 0.63% increase from the average (Ex. 330, 360).
4. Consolidated Edison’s historic Test Year electric interference expense was $51 million (Tr. 661, Ex. 5, Sched. 1, p. 3), while its updated Rate Year forecast is $78.233 million, a 52% increase. In contrast, the City’s actual expenditures increased only 3.6% from FY 2007 to 2008 (Ex. 330, p. 2; Ex. 360) and occurred for the most part in more normal economic conditions. In the current downturn, it is not reasonable to expect the City to increase its capital expenditures by 40% to 50%.

Anticipating the Company's claim that using the City’s May 2008 budget would have produced a higher interference expense forecast than the Company’s current request, DPS Staff argues that:[179]

1. Using Consolidated Edison’s methodology and the City’s April 2008 commitment plan released in May 2008 would reduce the Company’s interference expense in calendar year 2009 by $14 million.
2. Although the City’s May 2008 commitment plan sets a commitment target ratio of 87% for FYs 2009-2012, which would project higher City expenditures in 2010, the commitment target ratios historically are much higher in May, before the City’s fiscal year begins, but drop dramatically by September, three months into the fiscal year, and somewhat more by January, six months in.
3. This variation in City commitment targets from overly optimistic before a fiscal year starts to more sober as it progresses is one of the main reasons DPS Staff developed an alternative methodology.

DPS Staff goes on to contend that Consolidated Edison’s criticism of DPS Staff’s use of Gross Domestic Product (GDP) indices for its escalation rates (2.20%-2.33%), rather than the General Contractors Association (GCA) payment method (4.5%-5.0%) (Tr. 611, 618) is not well taken because:[180]

[179] DPS Staff’s Initial Brief, pp. 96-98.

[180] DPS Staff’s Initial Brief, pp. 98-99.

1. The City's actual annual infrastructure expenditure increase from 2003 through 2008 was 1.62% (Ex. 330, p. 2).
2. Consolidated Edison's average annual interference cost increase over 2003 through 2007 was 0.45% (Ex. 181, p. 7).
3. Thus, DPS Staff's application of a general inflation factor is in line with the City's past actual expenditure trend, while GCA escalation is not.

DPS Staff anticipates as well a Company criticism to DPS Staff's exclusion of waterway bridge projects in developing the five-year average of NY City expenditures, by stating:[181]

1. Consolidated Edison itself did not include the waterway bridge category in the City's actual expenditures in developing the Company's interference expense as a percentage of the City's actual expenditures (Tr. 2514-15).
2. Inclusion of individual projects in the different City infrastructure categories would change how Consolidated Edison interference expense correlated with the City's actual expenditures.
3. Consolidated Edison's past interference expense included in DPS Staff's calculation already reflected the impact of specific waterway bridge projects (Tr. 2515), because some of those projects included in the Company's forecast existed in the City's 2005-2007 plans, which affected Consolidated Edison's 2006-2008 interference expenses.
4. Even excluding the impact of waterway bridge projects, Consolidated Edison's historic actual interference costs showed good correlation with the City's actual expenditures in the other City infrastructure categories considered (Tr. 2515-16).

To rebut Consolidated Edison's position that DPS Staff's $59.961 million estimate for calendar year 2008, which is higher than DPS Staff's Rate Year forecast of $59.3 million, is out of line with the annualized 2008 expense of $64.035

[181] DPS Staff's Initial Brief, pp. 99-100.

million based on actual interference expense through September 2008 (Tr. 613), DPS Staff states that:[182]

1. It agrees the Company's interference expenditures do not occur evenly throughout the year.
2. Although DPS Staff's annualized estimate for 2008 might not reflect the Company's actual experience, Consolidated Edison's own internal estimate of $69.963 million (Tr. 613) likely will suffer from the same defect.
3. The Company did not provide any information on how its internal estimate was developed or why it is more reliable than DPS Staff's.

Reacting to Consolidated Edison's argument that DPS Staff's methodology for forecasting interference expense has been a moving target over prior rate cases, DPS Staff maintains:[183]

1. The 2006 Consolidated Edison gas rate case[184] involved Commission adoption of a joint proposal for a three-year rate plan in which DPS Staff did not propose any adjustment to the Company's interference forecast.
2. In the Company's last electric rate case, DPS Staff did not object to the Company's methodology, but corrected some errors and recommended using the commitment rates from the City's September commitment plans.
3. In Consolidated Edison's 2007 steam rate case, DPS Staff proposed a methodology essentially similar to what it proposes here, after evaluating the City's actual expenditures and the Company's forecast, which the Company agreed to in a joint proposal.
4. The Commission has not prescribed a specific forecasting methodology and DPS Staff is not bound by any, especially when the proposed Company methodology results in a significant variation from actual experience, which is demonstrated here by the Company's over-collection of $5.72 million in interference expense for the first quarter of the current rate year.

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[182] DPS Staff's Initial Brief, pp. 100-101.

[183] DPS Staff's Initial Brief, pp. 101-102.

[184] Case 06-G-1332, supra.

5. Thus, DPS Staff continues to refine its methodology to produce a more accurate forecast.

The Company argues that DPS Staff's proposed adjustment should be rejected for the following reasons:[185]

1. The DPS Staff's proposal ignores that the City is in the best position to project the construction work it will do. This is the same reason why the Commission rejected, in the Company's last electric rate case, a proposal by CPB similar to DPS Staff's proposal here.
2. There has been a 99% correlation between the City's January projections and the actual results thereafter and information the City provided to the Company at the time of the hearings indicated the City's plans have not changed from those relied upon by the Company. (In past cases, DPS Staff expressed a preference that the City's January forecast be used rather than other City projections made at other times each year.)
3. While DPS Staff points to a May 1, 2008 news release about a possible NYC reduction in construction, there is no proof that this will affect water, sewer, highway, and bridge work that impacts the Company's system and no effort was made to show which work by the City would likely be financed with bonds and go forward despite changes in the economy.
4. DPS Staff uses different approaches to forecast the Company's interference expense in different rate cases. This shifting approach makes it hard to discern a consistent and reasonable method and suggests DPS Staff is motivated by the results of an approach more than its reasonableness.

In its response to Consolidated Edison, DPS Staff insists that it need not follow any specific approach from any previous case to estimate the amount of municipal infrastructure support expenses. In this instance, it has expanded its review of the expense category and improved its understanding. It observes that the previously-used expense estimate methodologies produced inaccurate results and exhibited significant variances from actual experience. From its review of the amount of municipal interference work performed and expenditures incurred

[185] The Company's Initial Brief, pp. 117-120.

in recent years, DPS Staff has concluded that the Company consistently recovered in rates more than the actual amount expended for such work. Given this trend and experience which has continued into early 2008, DPS Staff believes that its forecast methodology provides a better estimate and fit to the capital expenditures experienced on average in a recent five-year period.

In its reply brief, Consolidated Edison addresses the arguments that it did not cover in its initial brief. The Company agrees that the basic dispute between it and DPS Staff concerns the forecast methodology that the Company employed. The parties do not dispute the factors that are subsequently applied to the forecasted amount of interference expenditures. Consolidated Edison does not believe that DPS Staff's estimate of the municipal infrastructure expenditures is better than the one provided by NY City. It claims that DPS Staff has ignored important information bearing on future expenditures and that there is no support for DPS Staff's view of the impact that the recent economic conditions are having on City expenditures. While DPS Staff has claimed that its five-year average is more accurate, the Company states that expenditure variances also affect DPS Staff's data to about the same degree as they have affected the Company's estimates. Moreover, the Company doubts that DPS Staff has taken into account future plans for municipal infrastructure spending in its forecast.

Addressing the possible use of the City's April/May 2008 budget for the interference expense forecast made in this case, Consolidated Edison believes, contrary to DPS Staff's position, that the April/May budget would produce higher expenses than the amount included in the Company's rate request. This would occur due to the use of the April/May target ratios rather than the January target ratio.

Consolidated Edison also believes that the GCA escalation rate is preferable to the GDP escalator because the former is based on costs incurred in the New York City area. The Company states that the GCA is the benchmark recognized by the interference industry in New York and it has been in use for over ten years.

As to the category of waterway bridge expenditures, Consolidated Edison continues to oppose the exclusion of waterway bridge work from the municipal infrastructure expenditure forecast. Also, the Company does not necessarily fault use of different methods to forecast interference expense, as it recognizes that the outcomes in some cases were the product of negotiations. Its criticisms are directed to the different litigation positions that DPS Staff has taken, on the grounds that this tends to show that DPS Staff may be results-oriented. The Company urges the Commission to be consistent, fair, and predictable in the method selected to estimate these costs.

2. Reconciliation - Company (Symmetrical) vs. DPS Staff/CPB (Asymmetrical)

The Company supports bilateral or symmetrical reconciliation of municipal infrastructure support expense for the following reasons:[186]

1. Interference O&M costs are largely outside of the Company’s control.
2. Full reconciliation was allowed up until the Company’s last electric rate case.

During the hearings, DPS Staff supported a continuation of a one-way true up mechanism adopted in the Company’s last electric rate case, under which the Company absorbs any actual costs in excess of the Commission’s forecast

[186] The Company’s Initial Brief, p. 122.

and the Company defers for the future benefit of ratepayers any actual cost savings compared to the Commission's forecast.

DPS Staff stands by that proposal on brief, denying that its proposed expense allowance and one-way reconciliation would deny the Company recovery of reasonable costs. DPS Staff argues:[187]

1. DPS Staff's Rate Year forecast is based on the City's actual expenditures during normal economic conditions.
2. With the current economic downturn in the City and the nation, the City is more likely to delay or eliminate capital projects.
3. DPS Staff's proposal gives the Company incentive to minimize interference expense by controlling costs to the extent possible.
4. Consolidated Edison cannot reasonably expect a true-up of every expense, especially in a one-year rate case.

The Company opposes one-way reconciliation for the following reasons:[188]

1. One-way reconciliation ignores the Company's aggressive action to minimize those costs over which it does have some control.
2. Even no reconciliation would be superior to one-way reconciliation as it would provide an even greater incentive to minimize costs it can control so that such savings can be captured for the benefit of ratepayers in its next rate case.
3. There is no reason to provide a negative incentive for the Company to work closely with the City because it already does so and there is no evidence to the contrary.
4. The economic circumstances cited by DPS Staff could actually cause the City to do more work.
5. There is no good reason to believe that a reconciliation mechanism that is reasonable in the context of a multi-year rate plan is unreasonable in the context of a one-year rate plan.
6. Adoption of DPS Staff proposals to forecast expense based on five years of historic activity and to provide one-way

[187] DPS Staff's Initial Brief, p. 103.

[188] The Company's Initial Brief, pp. 122-124.

> reconciliation only are bound to result in rates that underestimate costs. When costs are lower than forecast, ratepayers benefit. When costs are higher than the forecast, the Company incurs the costs and, all other things being equal, cannot earn its allowed rate of return.

In its reply brief, DPS Staff states that it considers its estimate of the municipal infrastructure expenditures to be reasonable, comparing well with the five-year actual historic average. According to DPS Staff, there is no reason for believing that its method either underestimates the costs or precludes the Company from receiving sufficient funds. In contrast, DPS Staff states that the Company's method has consistently overestimated the expense amount. For this reason, DPS Staff believes that the estimate of interference costs should be the subject of a one-way true-up and the Company's proposals either to have a two-way true-up or to use no true-up should be rejected.

In response to DPS Staff's assertion that a one-way true-up provides the Company an incentive to minimize interference expense and to control costs, Consolidated Edison states that it requires no such incentive because there is no evidence that it has not been controlling interference costs. The Company asserts that it has sought to minimize these costs whenever possible. Consolidated Edison states that it is not asking for a two-way true-up for every expense incurred and it believes such a true-up is proper for the interference cost category because the costs are beyond its control and are related to municipal infrastructure support. It observes that the Commission has previously authorized the use of a bilateral true-up for these costs and it believes that this approach remains valid in the context of a one-year rate proceeding.

3. Discussion

As we see it, the key considerations seem to be as follows:

1. There are no disputes about the Company's forecast of interference O&M expense for lower Manhattan.
2. On average, the City’s January construction projections have been very close to actual results though there was an 18% deviation in the City’s fiscal year ending June 30, 2008.
3. Using the City’s most recent January construction projection, the Company is forecasting a relatively large increase in Rate Year interference O&M outside of lower Manhattan compared to historic growth rates and its 2007 Test Year actual.
4. Projecting municipal infrastructure interference costs is not easy in the best of circumstances. The economic downturn could decrease the City’s expenditures and it could increase them. There is no evidence about which is more likely.
5. If the Commission adopts DPS Staff’s proposal, and a downward-only reconciliation term, and the Company’s forecast is correct, the Company would be out more than $20 million per year subject to possible future recovery if a deferral petition is filed and granted.
6. If the Commission adopts the Company’s proposal and no reconciliation and DPS Staff's forecast is correct, ratepayers would unfairly be out more than $20 million and a way to make them whole is not obvious.
7. The Company’s actual level of municipal infrastructure will be largely driven by the City. However, the Company can influence the efficiency with which its work will be done.

In light of all of the above, we recommend against DPS Staff’s expense adjustment but for its proposed one-way reconciliation term. This approach renders moot the disputes about escalation rates and the inclusion or exclusion of bridges.

If other updated forecasts will be considered at the time of the Commission’s decision, it might be reasonable as well to reflect the City’s January 2009 construction plan forecast. This could be done whether or not this O&M expense allowance is subject to reconciliation.

C. T&D Non-Labor Program Expenses ($15 - $20 Million)

The Company's testimony and exhibits support an increase in non-labor operation and maintenance expenses from substations, system and transmission operations, and electric (distribution) operations of $108.8 million. This compares with the $104.5 million increase the Commission allowed when it last set electric delivery rates for the Company. The Company states that it provided substantial support for its request in testimony, exhibits, work papers, and numerous discovery responses. Nevertheless, some parties propose adjustments to the Company's requests and these are discussed in turn.

1. Five-Year Underground Inspection Program

The Company states that it is required to inspect in detail approximately 282,000 underground structures, including manholes, service boxes, and transformer vaults.[189] If all the inspections are not completed properly within a 5-year period (ending in late 2009), the Company is subject to a revenue disallowance of up to 75 basis points.

The Company initially requested program support of $11.5 million in the Rate Year to meet these inspection requirements, based on an increased number of inspections (59,000). The Company's update/rebuttal filing brought the Company's request up to $47.1 million in the Rate Year and lower amounts in the two subsequent years. Components of the updated $47.1 million figure include the following:

1. $6.6 million - to reflect a June 2008 requirement that defects be repaired in a certain timeframe.
2. $22.8 million - to reflect the need to complete 94,000 (rather than 59,000) inspections in the Rate Year.
3. $11.5 million - to reflect a modification of the inspection process for additional safety measures and additional repair work that must be completed.

[189] The Company's Initial Brief, pp. 127-129.

4. $6.2 million - to reflect that the number of underground facilities requiring flushing is about 25% instead of the 8% previously assumed.

The Company says that the entire update is attributable to information that was not available when it made its May 2009 rate case filing.

DPS Staff opposes the Company's update request for $6.6 million for repairs, which Consolidated Edison says is intended to satisfy DPS Staff's proposal in Case 04-M-0159[190] to require all utilities to prioritize and make repairs resulting from conditions found in underground inspections. DPS Staff states that the Company's request is not properly filed in this rate case, because:[191]

1. The additional request is not a change in actual expenses that would be permitted under the Commission's Statement of Policy on Test Periods in Major Rate Cases.[192]
2. DPS Staff's proposal in Case 04-M-0159 was put out for comments, with no Commission decision on it. The Company's request is premature.

DPS Staff says it opposes the Company's update request for an additional $16.7 million to perform the additional 35,000 inspections, which Consolidated Edison attributes to a recent reconciliation of the required number of inspections to the actual unique inspections completed (Tr. 3946). DPS Staff opposes the additional funding because:[193]

1. The Company testified it has at least two systems, and maybe more, that store inspection data and manual reconciliation between them is necessary (Tr. 4369).
2. Lack of linkage and automatic reconciliation between data systems is likely to have led to duplicate inspections

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[190] Case 04-M-0159, Electric Transmission and Distribution Safety, Notice Soliciting Comments (issued July 8, 2008).

[191] Staff's Initial Brief, pp. 106-107.

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

[193] DPS Staff's Initial Brief, pp. 104-110.

and double counting of unique inspections remaining to be performed, as a result of over-counting routine inspections and under-scheduling unique inspections.

3. Consolidated Edison addressed the 35,000 additional inspections only in its rebuttal/update testimony, and then only briefly.
4. The Company provided no supporting details to substantiate the claimed need for additional inspections, safety measures, and structure flushing.

CPB’s witness supported a downward adjustment of $3.761 million during the hearings. However, CPB submitted no arguments on this issue in its initial brief.

In its reply brief, Consolidated Edison observes that it is bound by the Commission’s Electric Safety Standards to inspect all underground structures every five years. The Company believes that the program changes presented as an update with its rebuttal testimony are entirely justified. With respect to the additional repair costs Consolidated Edison has identified and DPS Staff has opposed, the Company asserts that the Commission is expected to address revisions to the Electric Safety Standards in December 2008 and these additional costs can be factored into the rate case to provide the funds needed for it to comply with the safety standard revisions that the Commission adopts.

Next, with respect to the 35,000 additional inspections that are proposed for 2009, Consolidated Edison details its support for this revision showing a computational error, an increase in the total number of distribution system structures, and a recalculation of the inspections conducted through 2007. The Company denies DPS Staff’s assertion that the new figure is driven by over-counts of routine inspections and the under-scheduling of unique inspections. Instead, the Company explains the details related to the three factors listed above and states that the 35,000 additional inspections should be recognized for ratemaking purposes (Ex. 324).

Addressing the portion of the update that tripled the underground structures that require flushing, Consolidated Edison states that the new figure is due to a recent inspection of the structures that had not been visited recently (rather than the review of structures routinely flushed that was used for the original estimate). The new figure reflects the amount of work that can be expected, and the inspection costs are higher due to additional safety measures that must be implemented during the inspection process.

Finally, concerning DPS Staff's allegation that the management of the inspection program may be inadequate, Consolidated Edison denies any mismanagement. It observes that the underground inspection program is relatively new and substantial efforts have been made to inspect all 282,000 underground structures in the five-year timeframe. In the first program cycle, the Company states that it has developed and implemented practices for performing and keeping track of the inspections. In the last two years, it has made improvements in mapping secondary structures, gathering test data for stray voltage, and reconciliation of the number of inspections so as to avoid duplicate inspections. Consolidated Edison believes that its program efforts should be commended and not criticized. The Company stands by its calculation of the number of inspections remaining for 2008 and 2009.

DPS Staff's Initial Brief is not entirely clear on this subject.[194] Although it criticizes the Company on the adequacy of its support for additional costs due to additional inspection and repair procedures and flushing, its proposed adjustment is only stated to be based on denying funding for the 35,000 additional inspections; it does not mention the additional costs associated with additional procedures and

[194] DPS Staff did not address the Five-Year Underground Inspection Program in its reply brief.

flushing.[195] We therefore consider its arguments against the additional inspections. The Company has provided a detailed explanation of how those additional inspections were determined, as a result of correcting a computational error, reconciling and updating the total number of structures requiring inspections, and reconciling from several databases the number of inspections already performed. DPS Staff's rejoinder simply expresses the belief that the Company double counted when manually reconciling two databases on the number of inspections performed. It fails to address the computational error or the update of the total number of structures requiring inspections, which account for 22,000 of the inspections in question. We accept the Company's explanation of those revisions. With respect to the remaining 13,000 structures, the Company explained that it had reconciled its databases. DPS Staff's mere statement of belief that the Company erred in its reconciliation is insufficient for us to find the Company's number unreasonable. With respect to the additional procedures and flushing, we find that the Company has provided sufficient justification to support the increased costs (Ex. 324).

Finally, we note that the Commission did consider additional requirements for completing repairs of defects in its deliberations in Case 04-M-0159 at its December 10, 2008, session. As a result, the Commission extended the times for completion of Level II and Level III priority repairs, doubling the time allowed for Level II and increasing the time for Level III by 50% over the times DPS Staff had proposed.[196]

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[195] DPS Staff's Initial Brief, pp. 109-110.

[196] Case 04-M-0159, Safety of Electric Transmission and Distribution Systems, and Case 06-M-1467, Orange and Rockland Utilities, Inc., Petition to Modify Stray Voltage Testing Program, Order Adopting Changes to Electric Safety Standards (Safety Standards Order) (issued December 15, 2008), pp. 15-18.

The Company's request for an additional $6.6 million for its five-year underground testing program was predicated on having to meet the shorter DPS Staff-proposed timeline for repairs. We are not in a position to evaluate the effect the Commission’s adoption of longer repair times might have in reducing the Company's need for additional funding. Therefore, we decline to recommend that portion of the Company's request. We recommend against DPS Staff's additional adjustment to this program.

2. Danger Tree Trimming

(a) Distribution Danger Trees

The Company seeks $632,000 in the Rate Year, the same amount allowed in the Company’s last case, to remove off-right-of-way danger trees. On brief, the Company discusses an adjustment not briefed by CPB.[197]

(b) Transmission Danger Trees

The Company’s filing did not include a program change for this work. However, DPS Staff proposes that $670,000 be disallowed. DPS Staff opposes the Company’s entire request for $670,000 because:[198]

1. The Company states it will hire a contractor to conduct a danger tree survey in the last quarter of 2008, but currently has no reliable estimate of the number of trees requiring action (Tr. 4050, Ex. 180, Response to DPS-364, p. 2).
2. The number of trees on which work would be done also depends on the willingness of neighboring property owners to grant permission to work and the compensation necessary to require the right to do the work (Ex. 180, Response to DPS-364, p. 2).
3. Thus, the amount of work to be done and the cost are totally uncertain (Ex. 445, Testimony, p. 3).

[197] The Company’s Initial Brief, pp. 165-166.

[198] DPS Staff’s Initial Brief, pp. 113-115.

The Company argues that DPS Staff’s proposal is without merit for the following reasons:[199]

1. The proposal reverses the Commission’s decision in the Company’s last case.
2. The Company’s response to a discovery request did not say that the amount of work to be done is not known.
3. Removing all funding will impact public safety and transmission system reliability and would prevent the Company from complying with Commission directives in Case 04-E-0822.
4. The Company is in the process of hiring a contractor to update a 2004 survey. The Company expects a minimum of 1,300 danger trees to be identified for removal at a cost of $500 per tree ($500 x 1,300 = $650,000).

In its reply brief, Consolidated Edison states that the 2004 survey results provide a proper basis to estimate the transmission danger tree program costs for the Rate Year. It notes that this work is required by the Commission’s management rules for transmission right-of-ways and it will be performed during the Rate Year. It points out that another survey will be available in late 2008 and suggests that instead of rejecting all the program costs, DPS Staff could have applied an average of several past years’ worth of danger tree work. According to Consolidated Edison, there is no record support for eliminating the transmission danger tree program and it urges the Commission to reject DPS Staff’s adjustment.

DPS Staff’s proposal to allow zero funding for danger tree removal is unreasonable. DPS Staff does not and could not dispute that the Company will have to remove transmission line danger trees during the Rate Year in order to meet its obligation to provide safe and reliable service. The Company has provided sufficient record evidence reasonably supporting its estimate of $670,000 for danger tree removal, consistent

[199] The Company's Initial Brief, pp. 166-167.

with recent costs (Tr. 4049-4050; Ex. 445, response to DPS-364). We do not recommend adoption of DPS Staff's adjustment.

3. Structural Integrity/Station Betterment

The Company seeks $2.475 million in the Rate Year, and slightly lower amounts in the two subsequent years, for a total of almost $7 million for structural integrity/station betterment work to be done at its substations. This is something the Company had addressed in the past on a case-by-case rather than programmatic basis.

Meanwhile, in response to a DPS Staff discovery request,[200] the Company provided an explanation of $4.69 million to be spent over three years for these purposes. DPS Staff supports recovery of the latter amount. The result is that $0.765 million would be disallowed in the Rate Year and slightly smaller amounts would be disallowed in two later years.

DPS Staff's arguments are as follows:[201]

1. The Company's request totaled $6.795 million for the three-year period.
2. In response to DPS Staff's interrogatory DPS-476, the Company identified specific projects totaling only $4.690 million for the three years (Ex. 169).
3. Staff's adjustment would bring funding down to the $4.690 million Company budget for the three-year period.
4. The Company's update/rebuttal testimony provided no evidence contrary to what was provided in its interrogatory response.

The Company opposes DPS Staff's proposed disallowance for the following reasons:[202]

1. The discovery response detailed certain work to be done and noted that detailed estimates for other work were still being prepared.

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[200] The Company's Initial Brief, pp. 130-134.

[201] DPS Staff's Initial Brief, p. 110-111.

[202] Ibid., pp. 134-135. CPB did not brief this issue.

2. The response was never intended to be comprehensive as work under the program is continually identified.
3. DPS Staff’s proposed adjustment would result in a 31% cut and would reduce the expense allowance below that granted in the Company’s last electric rate case.

In its reply brief, Consolidated Edison adds that it has made a good faith cost estimate of the amount expected to be spent in the Rate Year.

In its reply brief, DPS Staff states that it considers the Company’s response to the information request to be an accurate statement of the expected level of future costs. DPS Staff does not consider the response to be incomplete or as providing any basis to allow an amount that is greater than is supported by the list contained in the response.

DPS Staff’s position is too limited. The Company’s interrogatory response (Ex. 169, pp. 867-870) clearly lists a substantial amount of work that it considers necessary, but for which estimates are not yet available, including painting at 17 stations and concrete work at a dozen. DPS Staff does not contest the need for the additional work, or the Company’s explanation in its interrogatory response that facility maintenance and repair work is continually being identified and additional projects will be identified during the Rate Year. This stands to reason. On the other hand, it seems to us that the Company should have done a considerably better job of developing estimates for the identified painting and concrete repair work. To balance these considerations, we recommend an adjustment of $375,000 for the Rate Year, which would reduce the allowance for structural integrity/station betterment O&M to $2.1 million.

4. <u>Mobile Stray Voltage Testing</u>

Since 2005, the Company has been using mobile stray voltage testing in its effort to increase public safety. Vehicles mounted with the proper equipment moving at 20 miles per hour can detect stray voltage 30 feet away, whether or not the stray voltage comes from Company-owned facilities. Between the inception of the program and May 2008, more than 7,440 stray voltage conditions were detected, many of which were unrelated to Company facilities.

Over time, there has been an increase in the number of mobile scans performed per year. The Commission decided in the Company's last electric rate case that Consolidated Edison should perform one scan per month and do additional scans, as well, after storms or before special events such as parades and New Years Eve.

The Company seeks approximately $9 million over historic program costs, to increase from 5 to 12 the number of regular scans, while continuing special scans at prior levels.

DPS Staff proposes to disallow $414,000 based on historic spending (average spending in the first 5 months of 2008).

In anticipation of the Company's criticism that DPS Staff's $414,000 downward adjustment to the Company's request for mobile stray voltage testing was erroneously "fixed by scan," DPS Staff states:[203]

1. Its adjustment was derived from an average cost per month based on actual expenditures for the first five months of 2008 (Ex. 432).
2. By using this methodology, DPS Staff recognized that the cost to implement the program varies on a monthly basis and cannot be "fixed by scan."

The Company disagrees with DPS Staff's proposal for the following reasons:[204]

1. The Rate Year forecast reflects a $3.64 million savings over Test Year costs because competitive bidding reduced the per-scan cost by about $250,000.

[203] DPS Staff's Initial Brief, p. 112-113.

[204] The Company's Initial Brief, pp. 151-154. Adjustments not briefed by CPB are also discussed by the Company.

2. DPS Staff’s proposal fails to account for variations in the number of vehicles required for each scan. The costs vary by month and those incurred in the first five months of 2008 are not a reasonable basis for forecasting annual costs.
3. The costs per scan reflected in the Commission’s last decision were inadequate.
4. It is imperative that the reasonable costs of the Company’s stray voltage testing be allowed so that problem conditions can be detected and corrected timely.[205]

DPS Staff’s support for its proposed adjustment is not compelling. DPS Staff’s does not credibly counter the Company's criticism that DPS Staff's estimated Rate Year cost fails to account for monthly variations in the number of vehicles required for each scan. The Company’s own estimation method rests upon its competitively-bid costs for scans to be carried out over the full year 2008. In addition, the Company points out that the Rate Year forecast is significantly lower than it would have been if based upon the Test Year costs because competitive bidding reduced the per-scan cost (Tr. 4261-22). We recommend approval of the Company's request as better supported by the record.

5. Coating Refurbishment

The Company requests $1.5 million per year for a proactive program to reduce dielectric fluid leaks and increase the availability of transmission feeders that are cooled by such fluid. This kind of work has been done in the past on a smaller scale.

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[205] The Company has before the Commission a request to increase its use of mobile stray voltage testing in lieu of visual inspection and testing of all facilities. The Commission’s recent Safety Standards Order appears to have in effect approved the Company's request. Case 04-M-0159, supra, pp. 5-6. We lack record information on how this development might affect the Company's cost of electric delivery service.

DPS Staff proposes that the allowance be reduced by 30%, or $478,000, based on historic spending ($222,000) and historic hiring practices ($256,000) (Ex. 171, p. 2).

The Company objects to the proposed disallowance for the following reasons:

1. The adjustment would result in funding adequate to complete only 500’ of a planned 750’ coating refurbishment in Manhattan.
2. As of August 2008, pipe corrosion has resulted in 14,000 gallons of dielectric fluid leaks from the Company’s cable system.
3. DPS Staff’s proposed disallowance is not adequately explained or supported.[206]

Our earlier recommendation for a 55% adjustment for historic hiring practices [(IV)(A)(1) above] applies in lieu of DPS Staff’s 60% or $256,000 adjustment for that purpose. DPS Staff's support of its proposed historic cost adjustment in brief is cursory. The Company has provided substantial evidence of its plans to expand this program and to conduct operations on feeders that include more pipes per trench, which increases incremental work and costs. We recommend against DPS Staff's $222,000 proposed historic cost adjustment.

6. Feeder Emergencies

The Company seeks $7.8 million for the Rate Year, an increase of almost $3 million over the Test Year, to address feeder emergencies. Such emergencies can involve failure of cables or joints or leak repairs on high-pressure feeders and have to be handled immediately and remediated properly. The amount requested is based on a three-year average cost.

Historic failures are as follows:

[206] The Company’s Initial Brief, pp. 138-139. A proposed adjustment not briefed by CPB is also discussed.

	Cable Failures	Feeder Leaks	Total
2003	3	18	21
2004	3	18	21
2005	-	15	15
2006	4	21	25
2007	3	7	10

DPS Staff proposes to disallow $2.214 million based on the Company’s historic costs and hiring practices.

The Company objects for the following reasons:[207]

1. Through August of 2008, the Company already had 18 feeder emergencies. It expects to spend about $10 million this calendar year, or approximately $2.4 million over budget.
2. The proposed disallowance ignores the age and recent history of the Company’s underground infrastructure.

In its reply brief, DPS Staff states that it does not believe that recent low-budget years are anomalies and proposes that they be used to construct a proper average expense level.

We have previously addressed the historic hiring practices adjustment [(IV)(A)(1) above]. Our conclusion there applies here and requires no further adjustment. As for DPS Staff’s adjustment to non-labor O&M based on average historic cost, we believe the record adequately shows that Test Year and 2005 experience for feeder leaks and cable failures, respectively, was atypically low. Accordingly, we find the Company’s request more reasonable and recommend that DPS Staff's adjustment not be adopted.

7. Overhead Line Inspections

The Company seeks a total allowance of $278,000 per year for overhead line inspections, an increase of $133,000 over the Test Year level. The total sought is the same as that

[207] The Company’s Initial Brief, pp. 139-140. A proposed adjustment not briefed by CPB is also discussed.

allowed in the Company's last electric rate case. The costs are for helicopter, emergency, and other unscheduled patrols of the overhead transmission system. Such inspections are made to obtain information on facility conditions and identify problems to be fixed.

DPS Staff proposed to disallow $78,000 based on the Company's historic spending and $33,000 based on the Company's historic hiring practices.

The Company disagrees with the proposed disallowances for the following reasons:[208]

1. The effect of DPS Staff's proposal would be to reduce the allowance to the Company's three-year average spending.
2. Even if an historic hiring adjustment is adopted over the Company's objection, it should not be applied to program expenditures allowed in the Company's last case for positions to be filled in the current rate year and before the start of the new Rate Year.

Again, our earlier recommendation on the historic hiring practices adjustment [(IV)(A)(1) above] applies here and requires no further adjustment. DPS Staff fails to support its proposed adjustment to non-labor O&M based on average historic cost in brief. We recommend against that adjustment.

8. <u>Tower Painting</u>

The Company paints transmission towers as essential to structural integrity and aesthetically important. For the Rate Year, it requests $140,000, the amount allowed in the Company's last electric rate case, so that it can paint the towers for one specific line and portions of two others. DPS Staff proposes to disallow $40,000 based on the Company's historic spending levels. The Company opposes DPS Staff's proposed adjustment for the following reasons:[209]

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[208] The Company's Initial Brief, pp. 140-141. A proposed adjustment not briefed by CPB is also discussed.

[209] The Company's Initial Brief, pp. 141.

1. Funding would be reduced below the amount allowed in its last case.
2. DPS Staff provides no other support for this adjustment.

In its reply brief, DPS Staff states that the support for its adjustment lies in the average expenses that the Company incurred from 2004 to 2007. According to DPS Staff, using this average supports the $40,000 downward adjustment it has proposed.

DPS Staff's proposed adjustment is de minimis. We recommend against DPS Staff's adjustment.

9. Manhole Inspections

The Company seeks an increase of about $450,000 over the Test Year, or a total of $950,000, to enhance its current transmission manhole inspection program. The inspection of each manhole, once every four years, is a component of the Company's efforts to reduce dielectric fluid leaks. The specific work currently done during such inspections is in evidence.[210]

The Company's proposed program change would fund the removal of coating, allowing a thorough inspection of the fluid-filled pipe encasing the conductor and increasing the probability of detection of corrosion before a dielectric fluid leak.

DPS Staff proposes to disallow $499,000 based on Test Year spending.

The Company opposes DPS Staff's proposed disallowance on the grounds that:[211]

1. It would effectively eliminate the enhanced portion of the program.
2. DPS Staff provided no explanation of why the enhanced part of the program, which is intended to improve reliability and reduce fluid leaks, should not be undertaken or funded.

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[210] Ex. 62, p. 4.

[211] The Company's Initial Brief, pp. 141-142. A CPB adjustment not supported on brief is discussed as well.

In its reply brief, DPS Staff states that its adjustment is supported by the Company’s average actual expense amount from 2004 to 2007. DPS Staff notes that the Company’s actual expenses through April 2008 do not reflect any increased expenditures for an enhanced program.

As the Company notes, DPS Staff's proposed adjustment would eliminate the enhancement of this program to remove coatings, allow improved inspections, increase the probability of corrosion detection, and decrease the probability of dielectric fluid leaks. DPS Staff provides no good reason why the Company's proposal to fund this program improvement should not be adopted. We recommend against DPS Staff’s proposed adjustment.

10. Unit Substation and Repairs

The Company seeks $1.1 million to repair foundations, concrete pads, containment areas, driveways, and sidewalks in its service territory. DPS Staff proposes a $137,000 disallowance based on historic spending levels.

The Company argues that DPS Staff’s proposal should be rejected as it is contrary to Ex. 169, p. 11, which shows historic spending in excess of $1.1 million since 2003.[212]

In its reply brief, DPS Staff states that the 2004 to 2007 average expense level is 13.11% less than the budget amounts for these years. On this basis, DPS Staff supports its proposed adjustment.

The Company correctly observes that DPS Staff’s proposed adjustment would reduce the allowance for this program not only below the Test Year actual expense level, but below the actual spending level for any of the last five years. We recommend that the Company's request be approved.

[212] The Company’s Initial Brief, p. 143.

11. Electrical Engineering Support

The Company initially sought $1.9 million to increase engineering resources in electric (distribution) operations. This would cover the cost for 4 new supervisors and 21 engineering technicians. DPS Staff proposed to disallow $936,000 of this amount, based on historic hiring practices. Thereafter, the Company corrected its initial request, noting that it included both O&M and capitalized dollars. The corrected expense amount is $308,000.

On brief, the Company objects to DPS Staff's proposed disallowance, arguing the additional resources are needed in light of the significant capital and O&M programs it expects to undertake. It notes that there is no demonstration that the program is not needed. [213]

Our earlier recommendation on the historic hiring practices adjustment applies.

12. O&M Vault Repairs

The Company projects a $1.557 million higher cost for vault repairs in the Rate Year based on an increase in such repairs resulting from the five-year safety and reliability program. Repairs, among other things, are made to vault grates, transformer roof slabs, and vault walls and beams. Such repairs extend the life of a vault and make vaults ready for transformer upgrades.

DPS Staff recommends disallowance of $1.175 million based on its historic hiring practices adjustment. The Company opposes that generic adjustment and says that DPS Staff's proposed disallowance lacks any other basis in this instance.[214]

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[213] The Company's Initial Brief, p. 144.

[214] The Company's Initial Brief, p. 145-146. A CPB adjustment not supported on brief is also discussed by the Company.

Our prior recommendation on the historic hiring practices adjustment applies.

13. Dissolved Gas in Oil

As part of its effort to mitigate the public safety threat of potentially violent transformer failures, the Company proposes to increase by about $200,000 per year, to about $4 million per year, the costs of testing 25,000 transformers for dissolved gas. Such gas is an early indication of a transformer fault problem. Since the Company started sampling transformers in 2006, 101 transformers were taken out of service before failing and the number of transformer failures dropped.[215]

DPS Staff proposes to disallow $241,000 based on historic spending levels. The Company objects as follows:[216]

1. DPS Staff’s adjustment would reduce the allowance below the Test Year actual and the amount allowed in the Company’s last case.
2. The adjustment would reduce by 400 per year the number of tests the Company could perform.
3. The adjustment would have the effect of extending the duration of the 5-year sampling program, which it believes is contrary to DPS Staff’s intention (Tr. 4046).

In its reply brief, DPS Staff states that its proposed adjustment is supported by a 6.08% difference in the expenses incurred and the amounts budgeted for 2005 to 2007. We find that the degree of variation between actual and budgeted expenses for 2005-2007 that DPS Staff cites as the sole basis for the proposed adjustment – which would reduce the allowance below Test Year actual spending – is insufficient for us to recommend its adoption. We support the Company's request.

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[215] The Company’s Initial Brief, p. 145-146. A CPB adjustment not supported on brief is also discussed by the Company.

[216] Ibid., pp. 147-148.

14. Annual Stray Voltage Testing

The Commission previously required the Company to perform annual stray voltage testing on approximately 742,000 facilities that are accessible to the public. If a stray voltage condition is discovered, the Company is required to guard the condition until it is made safe.

The Company requests $9 million for this purpose, or an increase of $1.5 million in the Rate Year over the Test Year. The request is lower than the $12 million allowed in the Company's last electric rate case.[217]

DPS Staff proposes to disallow about $1 million because the Company under-spent its budget by about 11.32% in a four-year period.

The Company objects for the following reasons:

1. DPS Staff relies on a discovery response that was limited to O&M.
2. Costs of database development incurred in the past were capitalized.
3. Now that the database development is concluded, inspection costs are O&M related. DPS Staff's proposed adjustment fails to reflect this.
4. Any failure to fund the amount needed exposes the Company to revenue disallowances if it fails to complete work required by the Commission.

Neither DPS Staff nor CPB addresses this issue in brief. We recommend approval of the amount the Company requests.

15. Network Transformer Vault Cleaning Program

The Company has been developing a program to inspect on a five-year cycle all outside transformer vault locations. The basic premise is that decreased debris equals decreased moisture and decreased corrosion. The Company seeks $6.9

[217] The Company's Initial Brief, pp. 149-150. A CPB adjustment not supported on brief is also discussed.

million in the Rate Year, an increase over the $4.4 million allowed in the Company’s last electric rate case.

DPS Staff proposes a $1.6 million disallowance based on historic hiring practices and associated costs.

The Company objects to the proposed disallowance for the following reasons:[218]

1. The historic costs in this category appear low only because such work was done as part of other programs, either using Company labor or outside contractors. Accordingly, historic costs in this category alone should not be used as a benchmark.
2. While it is true that the Company has not yet filled all the positions in this category funded in the Company’s last electric rate case, the work is currently being performed by outside contractors.
3. The program will reduce transformer failures, and increase reliability and public and employee safety and the associated costs should be fully recoverable in rates.

There is no record support for the Company’s contention in brief that the work that would have been performed by employees funded in the last electric rate case, but not yet hired, is instead being performed by outside contractors. The update/rebuttal testimony of the Company’s Infrastructure Investment Panel indicates only that historically this work has been performed by both Company and contractor crews. It says nothing about contractors substituting for the positions approved in Case 07-E-0523 but not yet filled (Tr. 4223-24). Our recommendation on the historic hiring practices adjustment again applies here.

16. Central Quality Assurance

The Company is creating a centralized quality assurance group for all electric operations. The group would conduct approximately 4,000 field inspections, to determine if

[218] The Company’s Initial Brief, pp. 154-155. Adjustments not briefed by CPB are also discussed by the Company.

work is performed in accordance with Company construction standards, and 60 in-depth reviews concerning compliance with Company procedures. The Company supports this proposal, stating that the Commission previously ordered the development of such programs to ensure compliance with its safety standards; and that the Commission solicited comments in a July 8, 2008 notice in Case 04-M-0159 concerning whether the quality assurance program ought to be independent of the stray voltage and equipment testing programs.

The Company requests $4.5 million for this group which, it says, is already functioning. In simple terms, it views these as necessary dollars to ensure the safety of the public and its employees. It notes as well that no party questions the reasons for this program.[219]

DPS Staff proposes a nearly $2 million disallowance based on the Company's historic hiring practices. Our earlier recommendation on historic hiring practices applies. The Commission's recent Safety Standards Order does require independence of quality assurance programs from stray voltage and equipment testing programs.[220] We see no direct impact of that decision on our recommendation here, but the parties may address on exceptions any implications the Safety Standards Order might have for this issue.

17. Line Clearance Program

Starting in 2007, the Company developed an enhanced program for integrated vegetation management along distribution rights-of-way in Westchester County. The program is designed to minimize safety problems and improve reliability by reducing tree-related outages by 50%, through increased line clearances, tree and brush removal, and growth retardant stump treatment.

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[219] The Company's Initial Brief, pp. 155-158. Adjustments not briefed by CPB are also discussed by the Company.

[220] Case 04-M-0159, supra, pp. 22-23.

As the Company is in the first trimming cycle with the new program, workload has increased. Accordingly, the Company requests an increase of $2 million or a total of $15.4 million for this program.

DPS Staff proposes to disallow $256,000 based on historical hiring. The Company opposes DPS Staff's proposal for the following reasons:[221]

1. DPS Staff's proposed disallowance is the equivalent of eliminating 50 miles of line clearance work.
2. DPS Staff's proposal is based solely on its general hiring adjustment, which the Company opposes for reasons already discussed.

Our recommendation on the historic hiring practices adjustment applies.

18. Maintenance Associated with Capital Work

The Company's preliminary update and update/rebuttal testimony noted that it had inadvertently failed to include a $6 million program change to increase to about $9.5 million per year maintenance costs associated with capital spending levels. Examples of this work include the reattachment of existing equipment to a pole and switching activities.

DPS Staff proposes that $3.1 million be disallowed but, according to the Company, gives no reason (Ex. 173, p. 5). The Company argues DPS Staff's unsupported adjustment should be rejected.[222] DPS Staff does not address this issue in brief. We recommend that the Company's full requested funding be approved.

19. Programming Resources for Electric Operations

The Company seeks $540,000 to enhance its information technology support and DPS Staff proposes to disallow $216,000

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[221] The Company's Initial Brief, pp. 158-160. A CPB adjustment not supported on brief is also discussed.

[222] The Company's Initial Brief, p. 162.

based on its historic hiring adjustment. Our recommendation on the historic hiring practices adjustment applies.

20. Perfluorocarbon Tracer Patrol

No issue is presented on brief concerning the Company's request for $600,000 to patrol high-pressure transmission feeders in order to detect lower level leaks of the nine million gallons of dielectric fluid in its transmission system. However, the Company discusses a proposed adjustment not briefed by CPB.[223]

21. Smart Electric Technologies

The Company has a Smart Electric Technologies Program and seeks a $592,000 annual increase to promote customer use of energy efficient and environmentally friendly electro-technologies. On brief, the Company anticipates an issue that is not briefed by CPB.[224]

22. Overhead Inspection Program

The Commission has required the Company to perform visual inspections of 282,000 Company-owned and jointly-owned wooden poles. The Company projects a cost per inspection of $53 per pole and seeks a rate allowance based on that projection. The Company disagrees with a proposed adjustment not briefed by CPB.[225]

23. Customer Assessment Team

The Company wants to undertake a new program to support emergency response efforts during heat events, storms, and other emergencies. The program is referred to as the Customer Assessment Team. The Company opposes an adjustment not briefed by CPB.[226]

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[223] The Company's Initial Brief, pp. 142-143.

[224] The Company's Initial Brief, pp 162-163

[225] The Company's Initial Brief, p. 164.

[226] The Company's Initial Brief, pp 164-165.

24. Double Wood Program

In its initial brief, the Company discusses an adjustment not discussed by CPB on brief.[227]

25. Process Improvement Programs

In its initial brief, the Company discusses an adjustment not discussed by CPB on brief.[228]

26. CPB's Documentation Claim

In its brief, the Company discusses an adjustment not discussed by CPB on brief.[229]

27. Bus Enclosure

No dispute is presented on brief under this topic heading. A summary of the Company's position with respect to this topic is set forth in its brief.[230]

D. Electric Production Non-Labor Program Expenses

The Company projects $54 million of electric production O&M expenditures in the Rate Year, net of escalation, an increase of approximately $11 million over the historic Test Year and of approximately $3.2 million over what the Commission allowed in the 2008 Rate Order. Expenses in this category include water, boiler cleaning, scheduled overhauls, gas turbines, facilities maintenance (including compliance with Local Law 11[231] and stack repairs) and major turbine maintenance.

The Company understands DPS Staff to be proposing that $812,000 of the Company's $1.64 million request to comply with Local Law 11 be disallowed and that the $828,000 balance be amortized over two years with interest not to exceed $250,000.

[227] The Company's Initial Brief, pp. 168-169.

[228] The Company's Initial Brief, pp. 169-170.

[229] The Company's Initial Brief, pp. 130-134.

[230] The Company's Initial Brief, p. 137.

[231] City Local Law 11 mandates the periodic inspection and repair of buildings greater than six stories.

On brief, DPS Staff recommends that the Company be allowed to recover $1.028 million for the Local Law 11 cycle over a two-year period, or $0.514 million per year, because:[232]

1. DPS Staff’s recommendation comports with the amount estimated in a detailed 382-page consultant’s report the Company provided as the basis for the Company’s request (Tr. 2712-13).
2. In rebuttal, the Company claimed its own estimate is more accurate than the consultant’s because it is based upon more detailed and current information on the scope of work and consideration of similar work done in the past.
3. The Company’s internal support for its higher estimate consists of a single-page summary (Ex. 150, Att. A, p. 9).
4. The Company provided no facts to support its incredible claim that the consultant’s exhaustive report should be ignored in favor of the Company’s asserted experience.

To the extent DPS Staff’s adjustment rests on a discrepancy between the Company’s use of a consultant report in this and in a recent steam case, the Company states that its estimate here is more accurate as it is based on more detailed current information on the scope of work and the actual cost of similar repairs in the past.

In its reply brief, Consolidated Edison states that it has fully explained its cost methodology and how the consultant’s estimates were adjusted (in both directions) for work scope, similar work performed in the past, the consultant’s history, and new and additional project information. The Company notes that the consultant’s report is not in the record and it cannot be considered. Consolidated Edison also believes it is too late for DPS Staff to provide an expert opinion on the extra-record report and it questions whether DPS Staff analyzed the consultant’s report fully and adequately.

[232] DPS Staff’s Initial Brief, pp. 117-120. A related issue, concerning carrying charges on the unamortized balance, is discussed in Section (IX)(E).

For its part, Consolidated Edison states that it did not ignore the consultant's report. It states that it used the report (with other information) to develop its forecast. Addressing DPS Staff's contention that the Company did not provide support for its claim that the report estimated lower costs than those incurred in the past for similar work, Consolidated Edison asserts that DPS Staff should have pursued any such interest in this matter with discovery and, having failed to have done so, DPS Staff has no basis for the adjustment it has proposed.

To the extent DPS Staff's proposal is based on a consultant's estimate that a contractor will seek $200,000 related to mobilization costs and profits, the Company argues that these costs are properly includable as they are part of the costs the Company will incur for the repairs.[233]

We recommend against DPS Staff's proposed disallowance. Contrary to its fourth argument listed above, the relevant Company panel explained that it routinely departs from consultants' estimates because some consultants are consistently too high relative to its experience while others are consistently too low.[234] DPS Staff basically asks the Commission to assume the Company's witnesses are not telling the truth. However, there is no basis offered to support such a conclusion.

NYECC opposes what it describes as Consolidated Edison's request for an allowance of $500,000 per year for environmental, health, and safety (EH&S) emergent work for

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[233] The Company's Initial Brief, pp. 170-172. (An adjustment not briefed by CPB is also discussed (pp. 172-174). In its Reply Brief, Consolidated Edison states its understanding that the $200,000 for overhead mobilization expenses is no longer in dispute (p. 65).

[234] Tr. 956-958.

electric production. It maintains that the allowance should be reduced to between $0 and $250,000, because:[235]

1. The $500,000 requested for EH&S emergent work is more than double the 2003-2007 average for all electric production EH&S work (Ex. 360).
2. The Company could not identify what portion of EH&S electric production costs in any year from 2003 through 2007 was for EH&S emergent work; the annual shares could have been anywhere from none to all (Tr. 988-89; Ex. 366).
3. The Company failed to explain how the $500,000 per year for electric production EH&S emergent work was calculated or why a 100% increase over the five-year average amount for all EH&S work was justified for unspecified emergent work (Exhs. 368, 369; Tr. 990-994).

Anticipating this argument, the Company states that the increase for emergent EH&S costs reflects that all projects related to compliance with regulatory and environmental (air and water quality) requirements for the Company's facilities are now included in that general category.

In light of the change in circumstances,[236] NYECC's adjustment is not recommended.

E. Shared Services Non-Labor Program Expenses

The Company forecasts Rate Year O&M expenses of $31.2 million in this category, a $22.4 million increase over the historic Test Year. This includes increases for vehicle fuel costs ($4.9 million), information technology personnel ($1.5 million), and increased training costs ($4.9 million). These expenses also extend to the Company locations such as 4 Irving Place, regional facilities, future substation locations, and the security operations center.

There are proposals to disallow some of the amount sought and the issues in dispute on brief are discussed in turn.

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[235] NYECC's Initial Brief, pp. 23-25.

[236] See Ex. 367, p. 2, §(b)(4).

1. West 28th Street

The Company's West 28th Street Work-Out Services Center currently houses 500 employees and 200 vehicles for various Company operations. It is possible the facility will have to be relocated on account of a New Jersey Transit plan to construct two new rail tunnels from Secaucus, NJ to West 34th Street. This center is in operation 24-7 and its proximity to the West Side Highway is critical to prompt responses to emergencies.

The Company's rate request includes a placeholder for rental expense during the Rate Year and notes that any reimbursement received would be an offset to the rental expense.

DPS Staff proposes a disallowance of $6.828 million, reasoning that:[237]

1. The Company says it is still working with New Jersey Transit to find an alternative solution and is unsure what will happen at the facility (Tr. 339). If less than all of the functions at the facility must be relocated, the O&M rental cost could be lower for an equivalent sized facility (Tr. 434).
2. The Company's update/rebuttal testimony is that it would seek compensation for its loss and costs, but at this time does not have any estimate of potential reimbursements (Tr. 433-34).
3. No definite plan or timeline has been presented to remove uncertainty. The situation is speculative as New Jersey Transit is less likely to proceed with the project given the budgetary constraints government agencies are facing in the current economic conditions.

The Company objects, noting that it has always been clear that ratepayers would be credited with any offset, including in the event that any portion of its West 28th Street facility is taken.[238] Given the high probability that it will incur actual rental costs starting in early 2009, the Company

[237] DPS Staff's Initial Brief, pp. 120-122.

[238] The Company also discusses "sharing" such reimbursement. The Company's Initial Brief, p. 177.

argues the associated costs should be reflected in its revenue requirement subject to full reconciliation.[239]

In its reply brief, DPS Staff states that the proposal to recover rent costs for replacing the West 28th Street facilities is speculative and premature. DPS Staff points to confusion in the Company's statements as to whether reimbursements will be shared with customers or be provided to them in full. Rather than allow rate relief in advance, DPS Staff believes it is better for the Company to have an incentive to pursue a full reimbursement before customers are asked to pay any such costs. Further, DPS Staff points to open questions about environmental impacts of the project that could delay it beyond the Rate Year.

In its reply brief, Consolidated Edison continues to propose deferral accounting for the costs and the reimbursements it obtains. The Company denies that there is any great uncertainty about the project. It states that it is moving ahead and is expected to receive Federal Transit Administration approval in the near future. With the expectation that all necessary approvals will soon be obtained, a ground breaking would occur in 2009. With its plans to vacate West 28th Street and to relocate, Consolidated Edison believes it should receive its costs in rates to continue to perform the work that is provided from the West 28th Street location.

We do not agree with DPS Staff's argument that the New Jersey Transit project is too speculative at this time. It is certainly possible that there might be delays, but issuance of the final environmental impact statement represents clearance of a major hurdle in the forward progress of the project toward Federal Transit Administration approval. The best evidence at this time indicates that the project is likely to go forward in

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[239] See the Company's Initial Brief generally, pp. 175-178. An adjustment not briefed by CPB is also discussed.

2009 and that the Company will incur substantial associated costs. In addition, although we find bothersome the Company's apparent waffling on "sharing" reimbursements with ratepayers, versus crediting them with the full amount of reimbursements, we find no basis in the record for concluding that the Company would not pursue cost reimbursement aggressively. We recommend adoption of the Company's request for a $6.828 million allowance, subject to deferral of all reimbursements for the benefit of ratepayers.

2. Facilities

(a) Capitalizing Facilities Costs

In its initial brief, the Company discusses an adjustment not discussed by CPB on brief.[240]

(b) Other Topics

The Company's Initial Brief also discusses three related topics that do not appear to be in dispute by any party at this point.[241] The first is a request for $2 million in the Rate Year for repairs at Astoria docks A-11 and A-12. The second relates to Rate Year security costs, as adjusted by DPS Staff. The third is the updated request for $905,000 in the Rate Year for maintenance of property held for future substation use.

3. Central Field Services

(a) Vehicle Fuel

The Company has a fleet of 4,100 vehicles which consumed 3.6 million gallons in 2007 at a cost of $10.3 million Company-wide (Ex. 135, p. 1). The electric department's share

[240] Id., pp. 178-185.

[241] The Company's Initial Brief, pp. 185-86.

was approximately $4.069 million.[242] The record includes information about the Company’s efforts to keep fuel costs low. Relative to the historic amount, the Company’s projected incremental Rate Year electric department vehicle fuel cost at various times has been:

Original Filing	+ $0.719 million[243]
July Update	+ $1.358 million[244]
September Update	+ $1.090 million[245]

DPS Staff raised an issue about whether the July update was based on information available to the Company in May 2008. The Company says that claim is moot, among other reasons, because the September update is based on information that was not available to the Company in May 2008.

DPS Staff also raised an issue about whether it is appropriate for the Company to use the Energy Information Administration’s (EIA) Short-Term Energy Outlook (STEO) reports as the basis of a forecast, on the grounds that the Company pays wholesale fuel prices. The Company responds saying that it pays 25-35 cents less than retail per gallon, which is not the same as “refinery” wholesale prices.

Finally, as to DPS Staff’s proposal to use fuel prices in the first six months of 2008 to forecast for the Rate Year, the Company states that fuel prices in the January through March quarter are traditionally lower than for the full year.

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[242] $4.788 million (Tr. 2735), less $0.719 million (Ex. 5, Sched. 6, p. 5). DPS Staff states that Test Year electric department share of vehicle fuel cost was $3.833 million. DPS Staff’s Initial Brief, p. 148. We do not know how that amount was determined.

[243] Ex. 5, Sched. 6, p. 5.

[244] Tr. 2736.

[245] Ex. 265, Sched. 11, p. 3; Ex. 403, Sched. 11, p. 15.

The Company concludes, arguing the September 2008 update is the best information on the record and should be relied upon in this case.[246]

The Company's updated forecast for vehicle fuel expense of $5.878 million is based upon a six-month weighted average of $4.223 per gallon in the September 2008 EIA STEO report. DPS Staff opposes that forecast and proposes a Rate Year allowance of $4.031 million, based on the historic Test Year level of $3.833 million adjusted for the general inflation rate of 5.19%, on the grounds that:[247]

1. Consolidated Edison operates its own private-fill fuel stations and has purchase agreements that allow it to buy fuel in bulk at a price lower than retail (Tr. 347-348).
2. The Company admitted that its fuel cost is about 25 to 35 cents lower than what the average retail consumer in its service territory would pay for vehicle fuel (Tr. 449).
3. Relying on the EIA STEO report, which projects future retail fuel prices, thus is not comparable or reliable for determining the rate year allowance for Consolidated Edison (Tr. 2736-37).
4. DPS Staff originally recommended a Rate Year allowance of $5.045 million based on the Company's actual six-month average weighted fuel costs, January-June 2008 of $3.777 per gallon (Tr. 2738).
5. The Company's criticism that DPS Staff's original recommendation for average fuel price per gallon was not reflective of annual average fuel prices because January through March of each year typically has the lowest fuel prices is not well taken, because:
   (a) the Company based its claim only on the change in fuel prices from January through September 2008, one of the most volatile periods in the history of fuel prices (Tr. 447).
   (b) Consolidated Edison offered no factual analysis to support its claim that January through March of any given year typically have the lowest fuel prices.

[246] See the Company's Initial Brief, pp. 187-190.

[247] DPS Staff's Initial Brief, pp. 148-153.

6. Since the time when DPS Staff made its original recommendation for an allowance of $5.045 million based on the Company's actual January-June 2008 weighted average fuel cost of $3.777 per gallon, fuel prices have dropped dramatically and are projected to remain lower:
    - (a) The American Automobile Association's November 14, 2008 "Daily Fuel Gauge Report" shows gasoline prices have dropped by $0.96 per gallon and diesel fuel prices by $0.418 per gallon, as a national average, from the year before.
    - (b) EIA's "Gasoline and Diesel Fuel Update" for November 10, 2008, shows national average gasoline prices have dropped by $0.887 per gallon to $2.224 per gallon and diesel fuel prices by $0.481 per gallon to $2.944 per gallon since a year ago.
    - (c) EIA's STEO report for November 2008 projects annual average retail gasoline and diesel fuel prices of $2.37 and $2.73 per gallon, respectively, for 2009, based on the weak economy continuing through most of 2009 and lower projected crude oil prices.
7. Consequently, DPS Staff's earlier recommendation of $5.045 million for vehicle fuel expense is undoubtedly overstated.

In its reply brief, Consolidated Edison responds to the DPS Staff proposal to limit the fuel cost allowance to $4.031 million and states that the proposal is new and it lacks record support. The Company insists that it updated vehicle fuel costs properly and its update should be used.

Consolidated Edison states that the DPS Staff vehicle fuel cost estimate would provide only between $2.68 and $3.02 a gallon, which is below the average price it paid in 2008. The Company denies DPS Staff's assertion that it can reasonably be expected to pay fuel prices of $2.37 and $2.73 in 2009 and it claims that DPS Staff incorrectly quoted the prices in the DOE report. Consolidated Edison believes that we have already seen the lowest prices and that vehicle fuel prices are headed back up.

In support of its updated figure, Consolidated Edison continues to believe that vehicle fuel costs are generally lowest in the January to March period and that the seasonal nature of gasoline prices has been adequately demonstrated. The Company also states that its vehicle fuel price calculations took into account its contract prices that are 25 to 35 cents below retail. It did so by looking at the relative percentage increases from year to year as reported by DOE. The Company disagrees with DPS Staff’s use of a national price average because the New York region is subject to additional costs. It supports the use of the regional prices reported by DOE that reflect pertinent differences in the types of diesel fuel used and other price trends. If the Commission were to reject both DPS Staff’s new proposal and the Company’s update, Consolidated Edison urges the Commission to reject DPS Staff’s original proposal and to use instead the vehicle fuel price forecast that was included in the Company’s original rate filing.

We have no confidence in any of the vehicle fuel cost estimates in the record. All are completely unreliable in light of the extraordinary, precipitous fall of oil and vehicle fuel prices over the last several months of 2008, which are open and notorious and of which all parties, including the Company, are well aware. The Company itself has emphasized the reliability of the EIA STEO monthly reports for projecting retail vehicle fuel prices, so long as used on a regional basis. DPS Staff’s only criticism of those reports has been that they represent retail, rather than wholesale, prices. The Company confirms that its own vehicle fuel costs are $0.25 to $0.35 per gallon less than retail prices as a result of its bulk purchasing. We recommend that the vehicle fuel cost allowance in the Company’s cost of electric delivery service be set based on the latest EIA STEO monthly report projections of annual average regional retail vehicle fuel prices for 2009 available at the time of the

Commission's decision in this case, adjusted downward by $0.30 per gallon to reflect the Company's bulk fuel purchase savings. To develop a placeholder in the absence of any better information available to us at this time, we will use the November 2008 EIA STEO report prices quoted in DPS Staff's initial brief of $2.37 per gallon and $2.73 per gallon, for gasoline and diesel fuel, respectively, less $0.30 per gallon. The resulting vehicle fuel allowance placeholder is $3.000 million, a $2.878 million adjustment from the Company's formal update request of $5.878 million.[248]

4. <u>Information Resources</u>

Based on the Company's initial brief, it appears there are no contested issues for the Rate Year in this category.

5. <u>Human Resources</u>

The Company initially proposed amortizing its strike contingency costs over three years, but accepted DPS Staff's proposal for four-year amortization instead, because the new union contracts signed last summer cover four years. The Company also adjusted its original request upward by $130,000 to reflect actual spending on its contingency plan in excess of what had been projected. No party objects to the Company's request and we recommend that it be allowed.

6. <u>Purchasing</u>

Based on the Company's initial brief, it appears there is no issue in the category of Shared Services O&M expenses.

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[248] Calculated as: [[1,798,639 gal. diesel x ($2.73 – 0.30/gal.)] + [1,806,636 gal. gasoline x ($2.37 – 0.30/gal.]] x 37.0%. For gallons of diesel and gasoline fuel see Ex. 343; electric department share of 37.0% derived from Ex. 5, Sched. 6, p. 5.

F. Customer Operations Non-Labor Program Expenses

1. Mandatory Hourly Pricing

According to the Company's initial brief, there are no contested revenue requirement issues.

2. Automated Meter Reading

The Company requests $34,000 of O&M expenses associated with its plans for strategic use of AMR outside of Westchester County. The underlying dispute and a recommendation on the O&M issue are set forth below in Section XI(G).

3. Bill Redesign

The Company initially requested an increase in O&M costs of $1.9 million over the Test Year and it later reduced the amount by $227,000, to $1.673 million. The incremental expenses are for larger bill paper and envelopes from recycled paper, equipment maintenance and software license fees, and bill archiving and retrieval.

DPS Staff opposes $800,000 of incremental funding the Company seeks for bill archival and retrieval costs and incremental system software and maintenance fees, arguing that:[249]

1. Fees for software should simply displace similar fees experienced with the previous bill generation system.
2. Since customers paid for a completely new bill generation system, there should be offsetting O&M savings that obviate the need to recover these incremental costs separately (Tr. 4701-02).
3. Bill image functionality was implemented in 2005 in conjunction with the previous bill format, and provided as a free service by the vendor, even if unreliable and slow. These facts show the capability is unneeded and not essential to serving customers.

The Company disagrees, stating:[250]

[249] DPS Staff's Initial Brief, p. 122-124.

[250] The Company's Initial Brief, pp. 197-198. An issue not briefed by CPB is also discussed.

1. The $300,000 in incremental funding for equipment maintenance and software licensing fees represents new, ongoing costs associated with the additional equipment and software that were purchased to support the Company's new bill design. The new equipment and software were not replacements to existing equipment and software; they operate in conjunction with the Company's existing equipment and software to produce the newly redesigned bills (Tr. 1426).
2. With respect to the $500,000 for bill imaging functionality:
   - (a) before 2005, customer service representatives had to have customers read their bills to them;
   - (b) the current system is better and is provided to the Company without charge, but is unreliable and slow;
   - (c) the new system will enable customer service representatives to respond to customer inquiries more efficiently;
   - (d) this functionality is more important now with the additional bill complexity involved with unbundling.

In its reply brief, Consolidated Edison adds that the new bill imaging functionality will improve its ability to address customers' questions about their bills. With a handy image of the customer bill, customer service representatives will be able respond to all such inquiries. The Company's previous bill imaging system operated slowly and it could not provide effective and efficient responses to customer inquiries. Consolidated Edison notes that the new system was selected in September 2008 and only then was the information about it available.

The Company has demonstrated satisfactorily that the amount requested for equipment maintenance and software licensing is incremental, for new equipment and software that is needed to operate specifically with its newly redesigned bill but in conjunction with existing equipment and software. Thus, it will not displace similar fees for the prior bill generation system. Concerning the bill imaging function, we do not agree with DPS Staff's implicit suggestion that an unreliable and slow system is acceptable for the Company’s customers making bill inquiries. We consider the Company’s effort to improve its ability to respond to bill inquiries, especially as bills have become more complex, to be reasonable. Although the new bill imaging system can be expected to produce efficiencies that the Company has not quantified, we believe it is premature, with the new system just deployed, for the Company to be in a position to specify any offsetting savings. Such savings are of the sort covered by the productivity imputation. We recommend against adoption of DPS Staff’s adjustments to the Company’s request in connection with bill redesign.

G. Informational & Institutional Advertising ($10.9 Million)

The Company seeks $17.573 million for its Rate Year informational and institutional advertising campaign. Based on Ex. 403, Schedule 1, that would be .211% of total electric operating revenues or .338% of total electric operating revenues less fuel and purchased power expense. The four key themes of the proposed campaign include energy conservation tips ($8.8 million), infrastructure developments ($4.642 million), emergency preparedness ($1.839 million), and the Company’s Supplier Diversity Program ($1.839 million).[251] These funds are over and above the Company’s request for Outreach and Education funds of $3.63 million in the Rate Year.[252]

The Company notes that in its last electric rate case, the Commission allowed it to seek advertising funding in this case in excess of the amount allowed under the Commission’s 1977

[251] The Company’s Initial Brief, pp. 199-208 and Ex. 83, Table 3.

[252] The latter figure is uncontested except as to whether it should be increased by up to approximately $1.6 million to restore some “Power Your Way” dollars expended in the Historic Test Year. That issue is discussed in Section (XI)(F).

Statement of Policy on Advertising[253] if the Company believes the standard allowance (.04% to .10% of operating revenues) is insufficient for it to accomplish proper objectives. The Company believes the advertising plan it filed in this case (Ex. 83, Table 3) does precisely that. In that vein, its initial brief summarizes and explains the importance of each of the four key thematic messages.

Moreover, even if the Commission had not previously indicated a willingness to deviate from the Statement of Policy on Advertising, the Company contends there are numerous reasons why that Policy is out of date and should no longer be applied in light of numerous facts and circumstances as follows:

1. The New York Metropolitan Area is the world's noisiest advertising market and it takes more effort for the message to get through.
2. Price deregulation of the electric commodity market has substantially reduced total revenues to which the Statement of Policy percentage would apply.
3. The cost of advertising has risen annually by 8%, a rate greater than the (unstated) rate of increase in the Company's revenues.
4. New York City's population is very diverse, requiring the delivery of advertising in many languages.
5. There are new advertising media that were not contemplated in the Statement of Policy on Advertising.
6. The Commission has directed the Company to address certain topics through advertising, including the environment and energy conservation, reporting service problems, and emergency preparedness.
7. The cost of advertising in the City is much higher than it is elsewhere in New York. For example, a full page ad in the *New York Times* costs $136,000 and the same ad in the Albany *Times Union* costs $11,000. As another example, it costs the Company up to $300,000 to run one ad in 100 community and ethnic newspapers. A billboard in the City

[253] 17 NYPSC 1R, Statement of Policy on Advertising and Promotional Activities of Public Utilities (issued February 25, 1977) (Statement of Policy on Advertising).

costs $18,000 per month and the same billboard costs $2,500 per month in Buffalo.

DPS Staff proposes that $10.8 million of the Company's $17.5 million request be disallowed,[254] arguing as follows:[255]

1. The Commission’s Statement of Policy on Advertising generally allows 0.04-0.10% of revenues to be directed to informational advertising, and DPS Staff’s proposal is consistent with this range.
2. Although the Company argues the Statement of Policy on Advertising should either not be applied or should be modified to exempt programmatic advertising in areas important to the Commission (Tr. 1255-56), the Commission sufficiently distinguished between informational advertising and outreach and education; properly recognized the subjective nature of evaluating advertising content; and allowed the Company latitude in the future to request additional funding for advertising it deemed warranted (Tr. 4709-10).
3. DPS Staff’s proposal is comparable to Company spending levels in recent years (Tr. 4711), proving false Consolidated Edison’s claim that DPS Staff’s proposal would provide inadequate informational advertising funds.
4. Although Consolidated Edison claims all of its advertising programs were expanded significantly in the historic Test Year, its supporting discussion focuses only on the Energy Tips Program, by far the largest component (Tr. 1274-79).
5. The Company seeks a record funding level exceeding even the prior record level of $16.7 million the Company spent in 2007 after the devastating outages in Long Island City and Westchester.
6. If, as Consolidated Edison says, assessing the importance of an advertising program based on the amount of money assigned to it is wrong (Tr. 1282), the Company should have no reservations about accepting DPS Staff’s proposed funding level.

The Company disagrees, making the following arguments:

[254] The resulting allowance would still be greater than the percentage of revenues discussed in the Statement of Policy on Advertising.

[255] DPS Staff’s Initial Brief, pp. 124-126.

1. The funding level proposed by DPS Staff is inadequate. All messages would have to be pared back or some would have to be eliminated entirely.
2. DPS Staff did not rebut the Company's direct testimony on the proposed subject matter, recipients, and costs of the Company's proposed campaign or explain how the 62% cut should be made.
3. Rather, DPS Staff asserted only that emergency preparedness is the most important theme and that expenditures in that category should be increased over that proposed by the Company.
4. DPS Staff's proposed allowance is arbitrarily based on the Company's average spending in two of the last four years.

CPB proposes a greater disallowance of $12.501 million, for an allowance of $4.99 million. On brief, CPB states that:[256]

1. The $17.5 million to $21.1 million requested by the Company is excessive in comparison with the 0.06% of total revenue (i.e., excluding commodity revenues for retail access customers) allowance CPB says is contemplated by the Statement of Policy on Advertising.
2. The referenced Policy is still relevant and should continue to be relied upon. Among other things, that Policy will not interfere with any communications with customers on public safety issues.
3. The Company has not met the standards set by the Commission in the Company's last electric rate case.[257]

The Company disagrees with CPB for the following reasons:

1. CPB has not established that any part of the Company's campaign is unnecessary or would pertain to services that are not price regulated.
2. CPB ignores that if the revenue base under the Statement of Policy on Advertising decreases, the allowed percent of revenues should increase to allow the same level of advertising expenditures.

[256] CPB's Initial Brief, pp. 17-18.

[257] CPB neither specifies nor discusses the standards to which it refers.

3. CPB ignores that the Commission expressly invited the Company to make a filing, indicating a willingness to deviate from the Statement of Policy on Advertising in the right circumstances.

In its reply brief, DPS Staff maintains that it has provided a full and proper analysis of the issues concerning informational and institutional advertising. It firmly believes that the Statement of Policy on Advertising should continue to be used to limit the amount allowed in rates. Thus, DPS Staff supports an allowance in the range of $3 million to $7.5 million and no more. DPS Staff says it has considered the factors that have emerged since the time the Statement of Policy on Advertising was adopted and it does not believe that any of them provide a sufficient basis for modifying its application to Consolidated Edison.

In its reply brief, Consolidated Edison stresses that its communication program provides significant information to the public about energy conservation, emergency preparedness, infrastructure improvement, diverse energy suppliers and workforce diversity. None of this should be curtailed, according to the Company. Consolidated Edison believes that it has provided a proper basis for the Commission to modify the application of the Statement of Policy on Advertising given current needs for public and customer education, particularly about energy conservation and the negative effects of greenhouse gases. The Company believes that it is spending a proper amount for emergency preparedness and it does not believe that its advertising is excessive. Consolidated Edison asserts that there has been a greater need to communicate with customers since 2005 and it considers proper the amount it seeks for advertising.

Our evaluation of the arguments leads us to the following findings and conclusions:

1. The discreet costs of different types of advertising methods are higher in the Company's service territory than they are elsewhere in the State.
2. However, no information has been presented that permits comparison of the per capita cost of delivering an advertising message in the Company's service territory versus elsewhere in the State.
3. We agree that advertising messages in the Company's service territory have to be presented in a far greater number of languages relative to other parts of the State. We do not know what impact that has on the per capita cost of delivering an advertising message in the Company's service territory compared to the rest of the State.
4. We are not sure what to make of the Company's claim that its service territory is a relatively noisy market, making it hard for the message to get through. It stands to reason that the capacity of individuals to receive and absorb advertising messages is the same everywhere in the state.
5. *Vis-à-vis* other electric utility service territories, the Company serves a relatively greater number of people who frequently come in and out of its service territory for business and recreation. Some of the Company's advertising message properly needs to get through to these persons. We do not know if this creates incremental costs compared with advertising directed solely to those who live in the Company's service territory.
6. In sum, it is not obvious to us that the Statement of Policy on Advertising is in or out of date in the Company's service territory more than it is anywhere else in New York.

Turning to the four basic themes, the Company plans to spend the largest amount ($8.8 million) providing energy conservation tips. It appears DPS Staff and CPB both support significant cuts in that budget. The only substantive reason offered is that it costs too much. Energy conservation is an important message that the Commission supports and it is hard to reconcile Commission support for that message and the cuts DPS Staff and CPB support with no explanation other than that the result is consistent with the pertinent Statement of Policy.

We are also aware that a consideration in the EEPS case is the extent to which dollars should be allowed for program-specific marketing. Again, we have no information about whether any of the Company's planned expenditures on energy would be duplicative of those being considered in EEPS.

The Emergency Preparedness theme for which the Company budgets $1.839 million is one that DPS Staff expressly supports and suggests deserves increased funding. As we understand it, however, this and the proposed overall disallowance would result in cuts for the other themes, but no suggestions are made about how that ought to be done.

The Company budgets $1.839 million for its Supplier Diversity program. This program is intended to encourage minority and women-owned businesses to become Company vendors. Neither DPS Staff nor CPB identify specific cuts they recommend for this program or explain why such cuts would be reasonable in the current economic downturn.

The Company, finally, budgets $4.642 million to help inform customers and the public about how utility rates underwrite improvements in infrastructure. The notion that customers would want to pay almost $5 million per year to hear about where their money is going in an average economy is hard to accept. In an economic downturn, such an expenditure appears to be a luxury.

Taking all of the above into account, we recommend that ratepayers not be called upon to support any portion of the $4.642 million or any other amount for infrastructure development advertising. The Company's other three themes seem harmonious with Commission or good public policy and appear to be “proper objectives” as the Commission used that term in the Company's last electric rate case. Thus, the allowance would be $12.931 million. If any portion of the amount budgeted for energy efficiency tips duplicates funding anticipated in the EEPS case, we would endorse a larger downward adjustment here.

H. Employee Benefit Expense

1. Health Care Escalation

The Company projects an 8% increase in health care costs instead of an increase based on the general inflation rate. DPS Staff objects, arguing that precedent requires application of the gross domestic product (GDP) inflation index to health care costs, resulting in a disallowance of $1.557 million. That factor would be applied to actual 2008 employees as a proxy for the Rate Year. DPS Staff argues this factor would be reasonable because:[258]

1. Although the Company argues actual health care costs increased by 9.62% between 2005 and 2006 and by 8.45% between 2006 and 2007, and referenced surveys showing a greater than GDP escalation rate, its known 2009 premiums were reduced from the 2008 level (Tr. 773-74).
2. The Commission reaffirmed its policy of using the general inflation rate to escalate health care costs in Consolidated Edison’s last electric rate case, and warned utilities to accept the standard practice and apply their resources more productively to other matters.[259]

The Company argues that its proposal should be adopted and the DPS Staff’s approach should be rejected for the following reasons:[260]

1. The Company’s health care costs actually increased 12.7% from 2005 to 2006 and by 8.4% from 2006 to 2007.
2. Health care costs for the Company and the region have increased well over the Consumer Price Index and this is expected to continue.
3. DPS Staff does not dispute that health care costs are growing faster than inflation.
4. Contrary to Commission precedent, a general inflation factor does not provide a reasonably accurate estimate of this expense.

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[258] DPS Staff’s Initial Brief, pp. 127-129

[259] The 2008 Rate Order, pp. 42-43.

[260] The Company’s Initial Brief, pp. 208-212. An adjustment not briefed by CPB is also discussed.

5. There is very little the Company can do to control these costs more than it already does. (In this connection, the Company lists its cost control strategies.)

On a related matter, the Company defends its estimate of employees' contributions to health care costs. Under its approach, the Company would use the 2009 contribution amount for management employees and escalate it by 2%. The Company argues this approach is more accurate and reflects that the Company continues to increase the employees' share of health care costs. Currently, for example, management employees pay nearly 25% of their health care costs, an 83% increase per capita since 2004.

In its reply brief, DPS Staff states that it has not proposed that Consolidated Edison collect more health care costs from employees. DPS Staff notes that it applied the general inflation rate to the latest known levels contained in the forecast of Rate Year employee contributions and it did so consistent with its forecast of the health care costs.

In its reply brief, Consolidated Edison recognizes that the sole dispute between it and DPS Staff is the appropriate escalation index. Rather than DPS Staff's 2.2% GDP price deflator, the Company supports an 8% escalator based on the medical inflation trends and projections identified by its health care carrier. It considers its own factor to be a more accurate forecast of health care cost increases. It also believes that the Commission should re-examine its established policy and should put aside the over-25-year-old approach in favor of today's reality which shows that the general price inflator does not track health care costs well.

The Commission considered precisely this issue in the Company's last electric rate case, less than a year ago. It explained that health care costs are grouped with a number of other categories of costs that might be subject to increase and that the Company is expected to manage the cost increases in the entire group as a whole. The Commission concluded that use of the general inflation factor for health care costs in the complete ratemaking context treats the Company (like other utility companies) fairly.[261] Accordingly, we support DPS Staff's proposed application of the general inflation rate to the Company's health care costs and recommend adoption of its adjustment.

2. Employee Welfare Programs

The Company proposed three program changes for its employee welfare programs with a total incremental cost of $808,000. These would cover, among other things, asbestos-, lead-, and hearing-related testing ($265,000), emergency child or elder care ($26,000), and a wellness program ($517,000).

DPS Staff proposes that all the incremental costs be disallowed because:[262]

1. The Company failed to reflect any savings from the programs, such as reduced employee absence or enhanced productivity.
2. The savings should at least offset incremental costs.

Anticipating the Company's claim that child and elder care consulting services may not reduce employee absences because many now use vacation days to handle unexpected changes in caregiver arrangements, DPS Staff contends:[263]

1. Having some vacation enhances overall employee well-being and makes them more productive.
2. The Company admits this program contributes to employee retention and provides quality of life benefits; and does not dispute that there are associated cost savings.

Although the Company maintains DPS Staff missed the point of the occupational supplemental benefit programs, DPS Staff counters that:[264]

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[261] 2008 Rate Order, supra, pp. 42-43.

[262] DPS Staff's Initial Brief, pp. 130–134.

[263] DPS Staff's Initial Brief, pp. 131-132.

[264] DPS Staff's Initial Brief, pp. 132–133.

1. The Company states these programs are designed to detect issues before they become problems and before the Company is exposed to sick-related absences and increased health care costs from illnesses (Tr.786).
2. Thus, there clearly are savings associated with fewer employee absences and illness-related health care costs that have not been reflected in the Company's filing.

In anticipation of the Company's contention that the home wellness programs might not reduce disease and medical expenditures until many years after risks have been reduced, DPS Staff argues:[265]

1. The literature the Company cites (Ex. 342) indicates a median study period of 3.25 years for health care claims and evaluation periods ranging from one to ten years (Tr. 790); and an average $4.30 savings from reduced health care costs and absenteeism for each dollar spent on wellness programs (Ex. 342, Table 6, p. 308).
2. Assuming a 2008 introduction of the program, the Rate Year ends in the third year after introduction. Thus, the Company should realize savings on health care costs and absenteeism in the Rate Year.

The Company objects to DPS Staff's proposed disallowance for the following reasons:[266]

1. The programs provide important benefits other than cost savings, including the Company's ability to attract and retain employees, increased availability of critical employees during unexpected events (from the child and elder care program), and implementation of the New York State Health Department's Best Practices for screening programs.
2. DPS Staff made no study to establish there will be cost savings.
3. The Company's witness gave specific examples of why short-term savings should not be expected, but that there could be long-term benefits in the form of avoided health care costs.
4. DPS Staff's position on this issue is inconsistent with (or duplicative of) its support for a productivity adjustment.

[265] DPS Staff's Initial Brief, p. 133.

[266] The Company's Initial Brief, pp. 212-215.

In its reply brief, DPS Staff states that there will be savings produced by the employee benefit programs that have not been reflected in the rate case. According to DPS Staff, it is unfair for customers to pay program costs and not receive the benefits they produce. In the State’s current economic condition, DPS Staff does not believe that additional employee benefits are needed to retain workers. Given the difficult economic times, DPS Staff does not believe the Company should proceed with any such discretionary programs.

In its reply brief, Consolidated Edison states that it agrees with DPS Staff that customers should not fund programs without also receiving the benefits and cost savings. In this instance, the Company asserts that customers will receive immediate benefits from the employee welfare programs because critical employees will remain available during system emergencies. Pointing to the higher increases in health care costs occurring at other companies and in other industries, Consolidated Edison states that the cost increases it is seeking are lower by comparison. The Company expects the programs to improve employee health and wellness and thereby reduce future costs and absenteeism.

According to Consolidated Edison, the cost savings available from the programs will not match or exceed the program costs during the Rate Year. There has not been any study performed which demonstrates any such full cost offset. Nonetheless, Consolidated Edison states that the program benefits will be achieved over time and it believes that the existing programs could have contributed to the lower health care costs that were reflected in the September 2008 update to the rate case filing. Consolidated Edison considers DPS Staff’s proposal to disallow the employee welfare program costs as being contrary to the DPS Staff’s proposed productivity adjustment, which required that savings be captured throughout the Company’s operations. Consolidated Edison believes that the programs should be funded to provide it the ability to obtain the kinds of productivity that DPS Staff expects to see.

We believe a selective approach to the proposed welfare programs is in order. Among the three proposed programs, that for emergency child or elder care is an extremely small amount ($34,000) which will have no significant effect on the overall cost of electric delivery service and is supported by a major increase in usage in 2007 (Tr. 751). We recommend providing the requested funding. We also believe it is important to provide protection through expanded occupational screening for the health and safety of field employees at risk for asbestos-, or lead-related diseases and hearing injuries. Ratepayers should reasonably be expected to pay for the additional Rate Year expense for the purpose of safeguarding the health of those Company employees put at risk in providing electric delivery service to them. In our judgment, moreover, an occupational screening program is less likely to show short-term offsetting savings in the Rate Year, especially since this is a new program. We recommend the $265,000 requested for occupational screening.

On the other hand, we agree with DPS Staff that the Company's work home wellness program should produce offsetting savings in the nearer term. The requested increase applies not only to new program elements, but to expansion of existing program elements to serve more employees. The Company should have been able to project offsetting savings in the Rate Year from this program in our judgment. In the absence of any attempt by the Company to estimate those savings and offset program costs, we recommend the $517,000 program change request not be approved.

I. Material & Supplies

The Company's final updated request for materials and supplies O&M expense is $31.116 million.

For the following reasons, the Company argues that various disallowances proposed by DPS Staff should not be adopted and that its $31.116 million request should be granted in full:[267]

1. The $775,000 disallowance proposed by the DPS Staff Infrastructure Investment Panel should be rejected for the reasons offered by the Company in opposition to DPS Staff's historic hiring practices adjustment (Issue (IV)(A)(1)).
2. The $12,000 disallowance proposed by the DPS Staff Emergency Management Panel should be rejected for the reasons offered by the Company with respect to positions DPS Staff believes should not be funded (Issue (IV)(A)(2)).
3. The $483,000 disallowance proposed by DPS Staff, related to the Company's bill redesign program, should be rejected for the reasons offered by the Company on that topic. (Issue (V)(F)(3)).
4. The incremental amount sought beyond the Company's initial filing is reasonable. Of that total, $3.2 million reflects an increase from 149,000 to 169,000 in the number of underground structures to be inspected between 2008 and 2009. Another $472,000 is related to the Company's enhanced project planning.[268]

While this had been identified as a separate issue in the common briefing outline, it appears DPS Staff did not follow the outline.

We recommend as follows:

1. The $775,000 disallowance proposed by DPS Staff is recommended, subject to it being adjusted downward to reflect our support for a 55% rather than a 60% historic hiring adjustment.
2. The $12,000 disallowance proposed by DPS Staff is not recommended given our support for full funding of 16 incremental emergency management personnel.

[267] The Company's Initial Brief, pp. 215-218.

[268] See Ex. 403, Schedule 11, p. 14 of 15, and Tr. 2272.

3. In light of our conclusions on bill redesign, we recommend against DPS Staff's proposed $483,000 disallowance of related M&S Costs.
4. We recommend the Company's $4.009 million update with two exceptions. The $472,000 for enhanced project planning should be reduced by 55% based on our historic hiring practices recommendations. The $3.213 million update for the underground inspection program should be reduced to reflect the $6.6 million recommended disallowance in light of the Commission's Safety Standards Order.

J. Insurance

1. Directors and Officers Liability Insurance

The Company seeks $4 million for insurance coverage that it says will do the following:[269]

1. Protect officers and directors against unreasonable risk of personal liability for claims based on good-faith business decisions (but not against claims for fraud or malicious or illegal acts).
2. Enable the Company to attract and retain qualified officers and directors.

The Company also offers reasons as to why the amount of expense is reasonable:

1. Premium levels and insurance coverage amounts are comparable to those of similarly situated companies.
2. More than 99% of companies have Directors and Officers Liability (D&O) insurance.
3. None of the other parties affirmatively state that D&O insurance costs are not reasonable business expenses.

Accordingly, it argues the costs of this insurance should be fully recoverable.

A DPS Staff panel testified in support of a 90% disallowance on the grounds that the cost of insurance for litigation costs is about 10% of the total amount and it alone

[269] The Company's Initial Brief, pp. 218-222. The Company cites Ex. 403 but we do not find the $4 million figure. We understand this to be a correction reflecting only the electric department portion of the total cost. An issue not briefed by CPB is also discussed.

should be allowed in rates. On brief, DPS Staff says it supports a disallowance of $4.137 million because:[270]

1. The Company's witness erroneously claimed that D&O insurance does not cover liability for proven wrongful acts; it does.
2. If the Company did not carry D&O insurance, shareholders, not customers, would be held financially responsible for wrongful acts committed by the Company's directors or officers.
3. A long-held ratemaking principle is that the burden should follow the benefit. Therefore shareholders should bear the cost of insurance against directors' or officers' wrongful acts; it is for their direct benefit.
4. In the 2008 Rate Order, the Commission noted that it would entertain a cap on the amount of basic liability insurance ratepayers should bear, based upon proper justification.[271]
5. The Company should, however, be permitted to recover the portion of the D&O insurance premium related to legal defense of directors and officers, which DPS Staff estimates to be about 10% of the total premium (Tr. 2721), because:[272]
   (a) Plaintiffs may bring lawsuits regardless of whether their claims of wrongful acts have any merit; and
   (b) Defense costs can be significant even if claims are without merit.

The Company objects for the following reasons:

1. D&O insurance coverage is the same as any other type of liability insurance, like fire insurance.
2. DPS Staff's support for 10% of the costs shows that all of the costs are reasonable.

On brief, NYECC contends that Consolidated Edison's requested $5.0 million rate allowance for the cost of D&O

[270] DPS Staff's Initial Brief, pp. 134–137. This figure is the same as in Ex. 147, Sched. 9, p. 3, Adj. (4)(r)(3). That figure was filed prior to the Company's correction.

[271] 2008 Rate Order, pp. 51–52.

[272] DPS Staff's Initial Brief, p. 137.

insurance coverage is excessive and should be limited to $2.5 million, because:[273]

1. Consolidated Edison uses a stale 2006 Towers Perrin study in support of its proposed amount of coverage and associated premium.
2. The 2007 Towers Perrin study shows that, in carrying $300 million of D&O insurance coverage, the Company is over-insured on average by $131 to $154 million, compared to other public companies with assets or market capitalization greater than $10 billion (Ex. 260).
3. Even compared to a Consolidated Edison-selected peer group of 22 companies, the Company is over-insured by an average of $76 to $150 million.
4. The average annual premium for 21 similarly situated public companies in the 2007 Towers Perrin study is about $2.5 million (Tr. 1941-42; Ex. 260, p. 34).
5. Consolidated Edison's claim frequency and claim susceptibility over the last ten years have been zero, a highly favorable record, which should be reflected in the premium it pays.

On brief, the Company responds that NYECC inappropriately relies on the Company's survey results to determine a reasonable coverage allowance and that it ignores that the purpose of liability insurance is to transfer to a third party the risk of future claims.

In reply, NYECC argues:[274]

1. NYECC does not argue that D&O insurance is not necessary because of a lack of recent claims. NYECC maintains only that the lack of claims shows there is no basis for the requested increased allowance for the Company's premium, and as a basis for comparing the Company with other companies with zero claim frequency and zero claim susceptibility.

[273] NYECC's Initial Brief, pp. 16-23. NYECC's $5 million figure is the same one used by CPB's witness, Tr. 4858 and DPS Staff's Accounting Panel, Tr. 2721. They do not reflect the Company's correction.

[274] NYECC's Reply Brief, pp. 12-14.

2. The Company falsely claims that no party demonstrated the level of D&O insurance coverage it seeks is unreasonable. That is exactly what NYECC has demonstrated.

In its reply brief, Consolidated Edison claims it has shown that the level of coverage and the cost of the D&O insurance are reasonable. It does not believe that there should be any reduction in the ratepayers' share of these costs. In response to DPS Staff's parsing and criticism of coverage provided for "wrongful acts," the Company states that the policy expressly excludes all types of criminal and fraudulent acts from reimbursement. Consolidated Edison believes it is proper for the policy to provide insurance for any good faith errors that are made during the discharge of corporate duties and responsibilities. The Company asserts that the entire policy, and the premium incurred, is a legitimate expense that provides benefits for ratepayers.

In response to NYECC, Consolidated Edison states that it has used a thorough approach to determine the right level and cost for D&O insurance which includes steps used to review the price. It notes that it makes limited use of the Towers Perrin study and relies on other measures for its decisions.

In its reply brief, Staff asserts that D&O insurance is not like other types of liability coverage, such as fire insurance. If officers or management engage in wrongful acts, DPS Staff does not believe that ratepayers should pay for the insurance.

The two basic issues presented concern whether the Company's $300 million of D&O coverage is excessive and, based on a reasonable coverage amount, the proper allocation of premium costs between ratepayers and shareholders.

As to the first issue, the record shows that the Company's coverage increased to $300 million in 2005 and that the Company's coverage was $275 million in 2004, at a time when four other electric utilities had coverage in excess of $300 million.[275] This information is uncontested.

Where the parties’ part has to do with what peer group data should be relied upon for purposes of determining whether the Company's coverage amount is reasonable. The Company relies in part on survey results summarized in Ex. 294, while NYECC relies on Ex. 260. While the Company dismisses the latter, it does not persuasively explain why its coverage is $76 to $150 million higher than its 2004 peer group data and why it has coverage about $131 to $154 million greater than other public companies with assets in excess of $10 million. Based on our review of this information, and the passage of time since 2004, we conclude the Company has established a basis for allowing a reasonable, but conservative, coverage limit of only $200 million.

Turning to the proper allocation of premium costs, we believe that DPS Staff's proposal to allocate 10% of the cost of D&O insurance to ratepayers focuses too much on where money would flow in the event of a successful claim and on the possibility that a covered act might be so close to illegal or fraudulent that ratepayers should not be responsible for such costs either directly or through rate support of insurance premiums. This, in our view, gives inadequate attention to the facts that more then 99% of all public, private, and not-for-profits purchase this kind of insurance, that it can cover acts of officers and directors that are less than perfect, but not imprudent, and that it is beneficial to ratepayers that the Company have competent officers and directors.

Accordingly, we recommend that the Commission allow recovery in rates of 90% of the electric system costs for $200 million of D&O insurance. Using the total electric system cost

[275] Tr. 1820.

of $4.007 million for $300 million of insurance, we estimate the allowance should be approximately $2.404 million. An appropriate adjustment to prepaid insurance (in rate base) would also need to be made.[276]

2. Property Insurance Escalation Rate

The Company used a 5% escalation factor to estimate its Rate Year costs for other insurance, e.g., property, workers' compensation, business travel, and crime. The Company argues this escalation rate is reasonable because it reflects market risk today, in light of the AIG bailout, as well as the effects of recent hurricanes and the current financial situation.[277]

Observing that the trend for insurance costs over the last three years has been down, DPS Staff proposes use of the GDP inflation rate of 2.7%. It argues:[278]

1. The Company's proposed escalation rate is nearly twice the rate of inflation.
2. The Company's 5% figure is based solely on internal Company "discussions" and "feelings," without any underlying data or evidence.
3. The Company's insurance premiums have actually decreased for the last three years (Tr. 2715).
4. By allowing the latest known premium level, much of the actual rate year premium expense is known and the forecast period drastically shortened.
5. For the remaining unknown portion of insurance premium expense, using the GDP deflator to forecast growth is conservative in light of the recent three-year declining trend.

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[276] Tr. 2721-2722.

[277] The Company's Initial Brief, pp. 222-223. An uncontested issue related to an excess liability cap is also discussed. This issue was resolved in Case 08-S-1053, Consolidated Edison Steam Pipe Rupture, Order Adopting Joint Proposal (issued November 18, 2008).

[278] DPS Staff's Initial Brief, pp. 137–138.

The Company objects, arguing its forecast is more reasonable to the extent it reflects the input of its insurance brokers, market conditions, and historic loss experiences.

In its reply brief, Consolidated Edison states that the Commission's recent acceptance of the terms of the joint proposal entered in Case 08-S-0153 (addressing the steam pipe burst that occurred on July 18, 2007 at the intersection of East 41st Street and Lexington Avenue) eliminates any issue concerning excess liability insurance, but it does not eliminate the disagreement with DPS Staff concerning the proper property insurance escalation rate.

In its reply brief, DPS Staff points out that Consolidated Edison's insurance rates have decreased over the last few years and the escalation rate and forecast it has proposed are conservative. DPS Staff does not believe that the hurricane activity that occurred over three years ago should have a material effect on the insurance premiums the Company currently pays. And, DPS Staff states, there is no basis on the record for considering the Company's 5% escalation rate proposal superior to the GDP inflator that it supports.

We disagree with DPS Staff's suggestion that the absence of hurricanes for three years would lead insurers to ignore the risk of hurricanes in the future. With so much focus on global warming and the concomitant probability of increased hurricane heat potential in equatorial Atlantic waters, DPS Staff's contention is counterintuitive.

Meanwhile, the basis for the Company's projections are explained in sworn testimony that is on the record. Among other things, it accounts for the current financial situation of the insurance industry and historic loss experience. We recommend the Company's escalation rate.

K. Research & Development

The Company seeks the same level of funding as it did in its last electric rate case, or $20.025 million, an increase of $8.1 million over the historic Test Year. It contends that there are no changed circumstances since the last case that require a program change and that the amount requested is as reasonable now as it was when the Commission last considered the issue.

DPS Staff proposes a $2.731 million disallowance on the grounds that such costs should be capitalized, a $400,000 disallowance on the grounds that such costs are related to energy efficiency and should be considered in the EEPS case, and Commission adoption of a new reporting requirement. The latter proposal concerns reporting on the Company's "Third Generation (3G) System of the Future" program, starting with a report one month after the Commission's decision and every six months thereafter. The Company opposes all of DPS Staff's proposals.

1. Capitalization Adjustment

DPS Staff proposes to capitalize $2.731 million of the Company's R&D costs for successful projects (Tr. 2728-30), because:[279]

1. The Company admits that historically about 40% of its R&D projects are successful (Tr. 2729) and that accounting rules require it to capitalize credits received in such instances, but says it wants to use the credits for additional R&D projects (Tr. 3460).
2. The Company has not identified or provided record support for what the additional projects might be.
3. The Commission just rejected the Company's position in its last electric rate case.[280]

[279] DPS Staff's Initial Brief, pp. 139-140.

[280] 2008 Rate Order, p. 59.

4. All of the Company's current R&D projects are the same as those addressed in the last Company electric rate case, so the same capitalization rate should be applied here.

The Company argues that DPS Staff's proposal is unreasonable and should be rejected for the following reasons:[281]

1. DPS Staff's proposal is based on a capital expense ratio adopted in the Company's last case, based on different facts.
2. The amount of R&D expenses actually capitalized in the last five years averaged $465,000 per year, or a total of $2.3 million (Tr. 3463).
3. DPS Staff proposes to disallow capitalized costs but proposes no increase in rate base to reflect this.
4. Of the eight projects DPS Staff asserts could be capitalized, five of them will not be completed in the Rate Year and, thus, have no chance of being capitalized during that time. DPS Staff has not demonstrated that the remaining three projects will be completed in the Rate Year or that their costs should be capitalized.

In its reply brief, DPS Staff states (contrary to the Company's assertion) that it included in rate base an amount for the items removed from the expense category. DPS Staff also states it has followed the method that the Commission adopted in the last electric rate case. It considers this to be proper because the Company presents the very same R&D projects here. DPS Staff believes that Consolidated Edison should not be allowed to depart from the terms and requirements of the Commission's 2008 Rate Order.

In its reply brief, Consolidated Edison claims that the correct capitalization adjustment was made in the last rate case for the projects presented here and there is no need to make another, second adjustment that would overstate the likely capitalization of projects. If, however, the Commission applies the capitalization adjustment that DPS Staff proposes, the Company believes that the amount of the adjustment should be no

[281] The Company's Initial Brief, pp. 224-226.

more than $465,000. According to the Company, the adjustment advanced by DPS Staff includes a slippage adjustment from the last electric rate case, and the aggregate capitalization of R&D projects does not rise to the level DPS Staff suggests. With respect to DPS Staff's assertion that the Company should have identified additional projects it would fund with the amounts requested in this case, Consolidated Edison states that there is little likelihood that there would be sufficient funding available for any more projects.

We have no recommendation on this issue. After going around and around on it for more than enough time, it is apparent that the arguments on this issue are among the most cryptic of all those we have considered in these cases.

The Company, for example, starts out its initial brief with arguments criticizing DPS Staff's proposed adjustment, without explaining, in even the broadest terms, its own proposal and why it is reasonable. Both parties go back and forth between discussing capitalized expenses and capitalized credits for successful R&D projects, but neither draws any connection between the two.

DPS Staff also discusses the Company's proposal as if it were a violation of the 2008 Rate Order,[282] but it does not explain why a decision on this issue in the prior case applies for all time, while other cost of delivery service issues in the prior case are eligible for consideration in a new rate case. DPS Staff, like the Company, also takes no time to explain the basic principles that it believes should apply to determine the appropriate ratemaking.

DPS Staff also finds support for its position in that 40% of R&D projects have been successful in past periods (Tr. 2729); while the Company claims it capitalized only

[282] DPS Staff's Reply Brief, p. 48.

approximately $465,000 per year of R&D expense, or a total of $2.3 million over the last five years. These two claims seem inconsistent, but neither disputes the other's claim. The Company also claims that DPS Staff's adjustment would duplicate that adopted by the Commission in the last case (the Company's Initial Brief, p. 224 and Company Reply Brief, p. 89) and DPS Staff does not reply on that point.

In the absence of any firm ground on which to make a recommendation, we decline to do so. As a place holder, we are reflecting an adjustment half way between the proposals of the Company and DPS Staff.

2. EEPS Transfer

DPS Staff proposes that $400,000 of R&D related to energy efficiency be considered in the EEPS case for reasons discussed in connection with the Company's planned administrative expenses (§(V)(R), below).

The Company opposes DPS Staff's proposal, as follows:[283]

1. DPS Staff's witness conceded she did not know any details about the other case.
2. An order issued in the EEPS case in June 2008 states that the Commission is undecided on certain policy issues, including the treatment of R&D costs. No EEPS working groups are focusing on that issue currently.
3. Inclusion of such costs in the EEPS case will unfairly prejudice the cost-effectiveness evaluation of the Company's energy efficiency programs.
4. Consideration in the EEPS case may take place after the start of the Rate Year, denying the Company necessary funds.

We take no position on whether inclusion of R&D costs would "prejudice" the cost-effectiveness evaluation of the Company's energy efficiency programs. That said, no information

[283] The Company's Initial Brief, pp. 227-228.

has been presented that persuades us this issue would be better addressed and resolved in the EEPS case.

3. 3G Reporting

DPS Staff proposes that the Company be required to file semi-annual reports on its Third Generation (3G) Program projects, identifying all projects, budget, total-to-date spending and progress, as well as activities, costs, and benefits for each project, beginning 30 days after a Commission order is issued. In response to the Company's criticism that such reports would be duplicative, useless, and burdensome, DPS Staff argues:[284]

1. There is little accountability for the 3G Program and the Company does not currently provide the reporting requested.
2. There are 3G projects outside of the R&D program that are not included in the Company's R&D status reports (Ex. 435; Tr. 3476-77).
3. Information provided on 3G projects on the record is not sufficient, because projects can change in scope or magnitude in six months (Tr. 3476). Considering the nature of these 3G projects (Ex. 435), including many studies, the future is uncertain.
4. The reports would give DPS Staff a better understanding of all aspects of the projects and their costs and benefits.
5. The information requested should be readily available if the Company monitors properly throughout the year. The reports should not be voluminous and preparation should not hinder progress of high priority items.

The Company opposes DPS Staff's reporting proposal for the following reasons.[285]

1. DPS Staff's concern about a lack of accountability is unfounded as the Company explained in this case the elements of its 3G Program (Tr. 3472-73) and this need not be repeated. Moreover, the Company already files 3G information in an annual R&D report to the Department.

[284] DPS Staff's Initial Brief, pp. 140-142.

[285] The Company's Initial Brief, pp. 228-231.

2. DPS Staff gives no explanation about why the further reports are needed or how they would be used to address DPS Staff’s concerns that there be more accountability for R&D spending.
3. The Company meets with DPS Staff semi-annually to discuss its 3G initiatives.
4. Thus, there is no good reason to impose an additional administrative burden on the Company and additional costs on ratepayers.

In its reply brief, Consolidated Edison states that it would be burdensome to provide the reports. It points to its rebuttal testimony and states that it has demonstrated accountability for the program and there is no need for additional monitoring and accounting. Instead of additional reports, the Company believes that the project should be discussed at the semi-annual meetings at which it can provide all the information DPS Staff needs.

As the reports DPS Staff seeks are unrelated to any rate case filing requirement proposal, we are not sure why DPS Staff is raising this as an issue. DPS Staff in its own right can seek whatever reports it needs and expect compliance without the need for Commission action.

Now that it has raised it as an issue, however, some things stand out. First, there is no specification of the total 3G dollars involved, making it difficult to assess the need for semi-annual reports. Second, it appears some 3G Program elements are not subject to R&D reporting and, thus, part of the requested reports would be duplicative and part would not. Third, DPS Staff does not explain whether it expects both semi-annual reports and the semi-annual meetings that have apparently been going on for some time. DPS Staff should decide its needs and allow the Company to meet them in the most efficient and cost-effective manner.

One final point here that is broader than this specific issue concerns whether the Department as a whole ought to review holistically from time to time all of the formal and informal reporting requirements placed on the Company or any other utility, to make sure all existing requirements are reasonable and should remain in place. It is possible this could result in savings to the Company that will benefit ratepayers in future rate cases.

L. <u>Financial Services (Letter of Credit Costs)</u>

The Company notes that its formal update/rebuttal filing includes $2.1 million more for letter of credit costs in the Rate Year. That filing anticipates that its letter of credit costs for $143 million in 2009 for the New York Workers' Compensation Board will cost 175 basis points rather than the 45 basis points paid in the past.

In a note on the same page, however, the Company also advises that it obtained surety bonds for the New York Workers' Compensation Board at rates comparable to those incurred in the past for a letter of credit. However, it says it is not further updating its revenue request on the grounds that other expenses are going up following the close of the record.

DPS Staff acknowledges that letters of credit might become more difficult to obtain and costlier. With respect to the Company's self-insured workers' compensation loss obligations, DPS Staff: [286]

1. Understands the Company is pursuing cost saving alternatives, such as surety bonds.
2. Understands these costs should be known by the time the Commission decides these cases.
3. Recommends the Company be allowed to provide, and the Commission reflect, the known costs associated with those obligations.

In its reply brief, DPS Staff states that Consolidated Edison should reduce its rate request by $2.1 million to reflect

[286] DPS Staff's Initial Brief, pp. 209-210.

the known cost of the surety bonds that have been obtained to satisfy its workers' compensation self-insured loss obligations.

In its reply brief, Consolidated Edison states that it is not proposing to make this reduction to the rate filing because it has likely experienced a myriad of other cost increases and decreases in the post-hearing period. It is opposed to the Commission reflecting the latest known, actual costs for workers' compensation obligations when it renders its decision in this case. The Company states that there are many expenses that could be higher or lower than the forecast amounts and it would be unfair to single out this expense item for a downward adjustment. Any such updates, according to the Consolidated Edison, should be made using an approach that is fair and equitable to customers and the Company.

We agree with the Company that the process for updates should be fair and equitable. Updates for known and measurable changes that can be readily verified are permitted through the Company's brief on exceptions in accordance with the terms of the Statement of Policy on Test Periods in Major Rate Cases. We have trouble reconciling the Company's position on this issue with its proposal to update its property tax expense request by $2 million as well as with its proposal, supported elsewhere in this recommended decision, for full reconciliation of debt costs. Updates in forecasts are not generally allowed past the hearings, but the Company's recent actual is not a forecast. Our cost of electric delivery service recommendation reflects a $2.1 million reduction in expense, as well as the property tax expense update.

M. Consultants

The Company advises that it removed from revenue requirement its fees related to the 2007 steam incident. Accordingly, it suggests there is no disputed issue.[287]

In its reply brief, Consolidated Edison corrects a misstatement included in its initial brief. Rather than indicate that it had removed consultant costs associated with the 2007 steam pipe rupture incident, the Company now states that it removed $1.5 million of legal consulting costs that were subject to insurance reimbursement.

In its initial brief (p. 142), DPS Staff indicates that its consultant adjustments (whatever they are, it does not say) are discussed elsewhere in its brief. It does not touch on consultants in its reply brief.

Based on all of the above, we conclude there are no issues that warrant analysis and a recommendation.

N. Uncollectible Expenses

The Company proposes an allowance for uncollectibles based on its recent two-year average experience. This results in a $2.1 million increase. It argues this is a reasonable approach, as such costs have gone up significantly in both of those years and more of the same is expected in light of the worsening economy. It observes as well that write offs necessarily lag actual billing.

DPS Staff argues for following what it understands to be the long-standing Commission practice of using a three-year average of write-offs (0.61%)(Tr. 2733) to project uncollectible accounts expense, notwithstanding the Company’s contention that

[287] The Company’s Initial Brief, p. 231.

a two-year average (0.62%)(Tr. 2137) would reflect the impact of current changed economic conditions, because:[288]

1. Consistent use of an unadjusted three-year average avoids the need to litigate the issue in every case and, over time, still makes the Company whole for economic variations (Tr. 2734).
2. When the Company updated its two-year average to reflect actual, known available information for the first six months of 2008, the uncollectibles percentage did not increase, but remained at 0.62%.

The Company objects, arguing:[289]

1. DPS Staff does not challenge the actual increase in such expenses.
2. Forecasts in other Commission cases have relied on bases other than a three-year average, including the use of a 12-month average in one case (Tr. 2324).

In its reply brief, DPS Staff states that it had asked the Company to provide the information Consolidated Edison gathered from other utility companies concerning the periods they use to estimate their uncollectibles expense. However, Consolidated Edison did not provide the requested information and, therefore, DPS Staff believes that little weight should be given to the Company’s statement that other companies use periods shorter than three years. DPS Staff also notes that either a two-year or a three-year estimate would provide the Company cost recovery. DPS Staff acknowledges that the use of a two-year average provides the Company its recovery earlier. These last two points appear to be based on the premise that the Company would be kept whole by the consistent use of a three-year historic average.

DPS Staff continues to support an update of its three-year average, which would increase from 0.59% to 0.61% taking into account the data for the first six months of 2008. The

[288] DPS Staff’s Initial Brief, pp. 142-144.

[289] The Company’s Initial Brief, p. 232.

difference between DPS Staff’s proposed factor (0.61%) and the Company’s two-year average (0.62%) is about $100,000.

In its reply brief, Consolidated Edison states, as a practical matter, there is no material difference between the Company and DPS Staff’s proposed level of uncollectible expense. Nevertheless, the Company remains concerned about the use of any selective update approach that uses data that is not on the record.

We recommend that uncollectibles expense be updated at the time of the Commission’s decision based on the latest available 12 months of actual data. To begin, we do not understand the Company’s concern about using actuals that are not on the record as this is the essence of updates for known and measurable amounts that are readily verifiable. Second, in light of the economic downturn, uncollectibles data for 2005 through 2007 or 2006 through 2007 could well be unreasonably stale. Pending such an update, our cost of service determination reflects the .62% factor experienced on average in 2006-2007.

O. Regulatory Commission Expense

The Company and DPS Staff agree that regulatory Commission expense should be forecast by using a three-year average of historic costs. However, DPS Staff would adjust the historic average and disallow $677,000 to remove costs associated with the Company’s 2004-2005 rate case and the Vantage emergency preparedness audit.

DPS Staff’s reasons in support of this adjustment are as follows:[290]

1. Contrary to the Company’s argument, a 3-year average does not normalize the effect of non-recurring items; rather, non-recurring items must be removed from the 3-year average

[290] DPS Staff’s Initial Brief, pp. 144-146.

total expense before a proper historic average can be established.

2. Although the Company might, or might not, face other unanticipated events in the Rate Year, the Company has not met its burden of forecasting changes from the historic base level and properly supporting them.
3. The Company's complaint, that DPS Staff's position is inconsistent with treatment of a large unusual and unexpected mid-year New York City property tax increase in 2003, is not valid. The growth rates used to project property tax expense in the Company's last electric rate case excluded the effect of that non-recurring expense.
4. The costs related to the Company's 2003 electric rate case and 2007 Electric Emergency Outage Response Program audit should be removed from the 3-year historic average because they are not expected to recur in the future and Consolidated Edison has not forecasted or supported other costs.

The Company disagrees with DPS Staff's proposal for the following reasons.[291]

1. The specific proceedings referenced by DPS Staff are non-recurring. However, similar work is occurring. Thus, the 2004-2005 rate case costs were replaced with 2007-2008 and 2008-2009 rate case costs. The cost of spent nuclear fuel litigation is also expected to increase over past levels.
2. The use of an average of three years is intended to minimize the impacts of non-recurring items, vitiating the need for a separate adjustment for non-recurring items.
3. DPS Staff is inconsistent in suggesting specific adjustments here and favoring strict reliance on historic averages to forecast most other expenses.

In its reply brief, DPS Staff insists that it is necessary to adjust for non-recurring items to arrive at a proper, three-year average. DPS Staff also denies that its calculation of a three-year average is inconsistent with any other adjustment it has proposed.

In its reply brief, Consolidated Edison addresses the 2004 electric rate case and the 2007 electric emergency outage response audit costs that DPS Staff would normalize out of the

[291] The Company's Initial Brief, pp. 233-235.

three-year average. The Company considers rate cases as recurring events and states that in any particular three-year period it may have one or more rate proceedings pending. Even if there were to be a multi-year stay-out agreement, the Company states that there would be follow-up collaboratives, studies, and meetings for which it would incur on-going regulatory expenses.

With respect to the emergency outage response audit expenses, Consolidated Edison states that they are apt to recur, albeit in a different guise, and it would distort the three-year average to exclude the outage and thereby not capture any other non-recurring costs that are difficult to predict. Consolidated Edison does not consider either the rate case or the audit costs to be unusual or unexpected. Since they are not “non-ordinary,” the Company believes they should be recognized.

Based on the arguments presented, we recommend against DPS Staff's adjustment. We see no value in normalizing out the expense of one rate case only to adjust the average back up to reflect one or more additional sets of rate case expenses in the Rate Year. The costs of the Vantage emergency preparedness audit are non-recurring, but we observe that the portion of plant in service subject to temporary rates, pursuant to the 2008 Rate Order, is now subject to a management audit and the chances seem at least even that there will be some replacement for it in the Rate Year.

Nevertheless, for reasons discussed below (§IX) related to general equipment, we recommend a $2 million disallowance of rate case/regulatory Commission expense to deter future failures to comply with the minimum standards set forth in the Statement of Policy on Test Periods in Major Rate Proceedings. This adjustment is a reasonable alternate to disallowing more than $70 million of capital expenditures in general plant or equipment that were not properly supported in the Company's initial tariff filing in May 2008.

P. Collection Agency Fees

DPS Staff supports the use of the Test Year expense level of collection agency fees, adjusted for inflation, to forecast Rate Year expense. The Company followed the same approach in its original filing. DPS Staff rejects the Company’s use of a different methodology in its update/rebuttal testimony, even though the new methodology would have increased the revenue requirement by only $12,000. DPS Staff states that the Company does not intend to pursue the forecast methodology issue or the updated, higher estimate, due to the immaterial difference in forecast expense.[292]

The Company confirms this on brief, stating that it accepts DPS Staff’s outcome in this case in light of significant energy cost reductions since the time of its informal update (July 2008). However, it states that it does not agree with DPS Staff’s methodology.

We have no substantive objection to the two parties’ agreement on a $12,000 issue.

Q. Other Accounts Payable Items

The Company agrees with DPS Staff that accounts payable should be based on the historic Test Year costs plus escalation. It, thus, abandons a different approach it had proposed on update. No further comment on our part is warranted.

[292] DPS Staff’s Initial Brief, pp. 146-147.

R. Energy Efficiency Related Programs[293]

It is undisputed that the Company's T&D capital construction program for the next five years is $1.2 billion smaller than it would otherwise be on account of anticipated energy efficiency improvements that will cost an unspecified amount. There is also agreement that many cost issues related to the Company's energy efficiency plans should be considered in the EEPS case rather than here.

Meanwhile, the Company seeks recovery in the Rate Year of approximately $2 million of O&M expenses related to program administration, training, market research, and website development costs and $500,000 for Smart Electric Technologies pilot programs. The Company contends that its proposal is reasonable for the following reasons:[294]

1. The Company expects to continue a certain level of energy efficiency and demand response programs regardless of what happens in the EEPS case and those activities should be funded in base rates. The activities proposed will be undertaken regardless of the scope of activities the Company is authorized to undertake in the EEPS case.
2. There is no funding in the EEPS case for demand response programs.
3. The proposed projects contribute to the general goal of energy efficiency.
4. Transferring these costs to the EEPS case will delay their consideration.

DPS Staff opposes any allowance for these items because:[295]

1. The Company's Energy Efficiency programs are not known at this time.

[293] Other energy efficiency proposals are considered above in §(IX)(A)(1)(B)(2) and (3).

[294] The Company's Initial Brief, pp. 234-238. An issue not briefed by CPB is also discussed.

[295] DPS Staff's Initial Brief, pp. 153-155.

2. The Company’s proposal is contrary to the express terms of ordering paragraphs 1 and 7 of the Commission’s June 23, 2008 order in the EEPS case.[296]

In its reply brief, Con Edison states that it has examined the referenced clauses of the Commission’s EEPS order and denies they support DPS Staff’s position. According to the Company, there is nothing in the referenced ordering clauses that precludes current recovery of certain energy efficiency costs in base rates, particularly those related to demand response and targeted DSM programs. The Company states that the funds for these programs are currently needed and this funding is independent of the outcome of the EEPS proceeding.

To maintain a basic infrastructure for administering energy efficiency and demand response programs (and research and development), Consolidated Edison believes it should be allowed to recover such costs currently in base rates. The Company notes that it is incurring the expenses and this activity is consistent with state policy.

It is uncontested on this record that the Company needs basic infrastructure to administer its existing demand response programs. It also seems very likely if not certain that the Company will need this basic infrastructure for expanded energy efficiency programs going forward. We have also reviewed ordering clauses 1 and 7 of the Commission’s June 23, 2008 order.[297] Like the Company, we see nothing in those paragraphs concerning the recovery of energy efficiency infrastructure costs in base rates. We recommend that the Company's O&M expenses be allowed. We take no position on how

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[296] Case 07-M-0548, Energy Efficiency Portfolio Standard, Order Establishing Energy Efficiency Portfolio Standard and Approving Programs (issued June 23, 2008), pp. 69-71.

[297] Case 07-M-0548, Energy Efficiency Portfolio Standard, Order Establishing Energy Efficiency Portfolio Standard and Approving Programs (issued June 23, 2008), pp. 69-71.

such costs should be treated for purposes of evaluating the cost-effectiveness of the Company's energy efficiency programs.

S. Emergency Management Program Non-Labor Expenses

The Company notes that the appropriateness of DPS Staff’s proposed $487,000 expense disallowance for this category depends on how the Commission resolves a dispute between the Company and DPS Staff about whether a number of new emergency management positions should be funded in rates (See Issue (IV)(A)(2)(j)).

Under the same topic heading in its initial brief, DPS Staff states that it supports a proportional $357,000 reduction of the Company’s request for associated equipment.[298] To the extent the Company had hired more than three of the additional emergency management positions by the December 8, 2008 deadline for filing the Company’s reply brief, DPS Staff states that it would support funding the associated equipment on a proportional basis.

As discussed above in Sections (IV)(A)(2)(k) (Emergency Management) and (V)(I) (Materials and Supplies), we recommend that the Commission allow all costs associated with the Company's 16 incremental emergency management positions. It is not apparent to us why the figures discussed by the Company ($487,000) and DPS Staff ($357,000) differ by $130,000.

Our cost of electric delivery service recommendation reflects the Company's number, subject to verification that it is the correct figure.

T. Contract Labor

DPS Staff recommended reducing the Company’s original request for contract labor from $6.689 million (raised to $7.568

[298] DPS Staff’s Initial Brief, pp. 155-156.

in the Company's preliminary update) down to $3.648 million, because:[299]

1. The Company's request (preliminary update) represented a 25% increase over the historic Test Year level, which itself was unusually high compared to expenses in calendar years 2004-2006 (Tr. 2867-68).
2. At the same time, Consolidated Edison is requesting a 26% increase in Company labor expense over the historic year level, and DPS Staff's own Company labor recommendation represents more than a 10% increase (Ex. 5, Sched. 1, p. 3; Ex. 265, Sched. 3: Ex. 147, Sched. 3).
3. In light of the significant increase in labor expense, the Company should be able to manage its work requirements through reprioritization and thus avoid a portion of the contract labor expense. (Tr. 2687).
4. Consolidated Edison did not rebut DPS Staff's adjustment.

DPS Staff also notes that the Company's formal update increased its contract labor forecast by $16.631 million,[300] which included a $1.048 million reclassification from "Other" O&M expense, an adjustment that does not affect revenue requirement and that DPS Staff accepts.[301] DPS Staff opposes the additional $14.486 million for contract labor for the five-year underground inspection program, for reasons set forth in discussion of that program above [Section V(C)(1)].[302] DPS Staff also says it addressed the requested increase for the trip circuit monitor program ($0.437 million) elsewhere in its brief, but a computer search of the brief did not yield any fruit.

The additional $14.486 million for contract labor for the five-year underground inspection program is part of the additional funding described in our discussion of that program above and resolved by our recommendations there. No further

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299 DPS Staff's Initial Brief, pp. 156-157.

300 The correct increase for contract labor in the Company's formal update is $16.850 million. Ex. 265, Sched. 11, p. 3; Ex. 403, Sched. 11, p. 14.

301 DPS Staff's Initial Brief, p. 157.

302 Ibid., pp. 157-158.

discussion is necessary here. Any proposed adjustment DPS Staff might have had with respect to the trip circuit monitor program is obviated by its failure to pursue the issue in brief. The Company has not addressed DPS Staff's proposed generic historic cost adjustment to contract labor in testimony or in brief. We therefore recommend adoption of DPS Staff's $3.920 million generic adjustment to contract labor and recommend an allowance, for items other than the five-year underground inspection program, of $5.133 million.

VI. TAXES OTHER THAN INCOME TAXES

Arguments on three related issues are summarized first, followed by one discussion.

A. Property Taxes Expense Level ($86.7 Million)

As of the close of the hearings, the Company sought a total allowance for property tax expense of $1,031,733,000[303] and DPS Staff proposed a total allowance of $945,091,000.[304] Other parties did not take a position on this issue.

The $86.7 million difference between these two totals is more than 10% of the Company's updated, ameliorated request of $819.024 million for the Rate Year. The Company and DPS Staff agree that the forecast of Rate Year property tax expense should be updated at the time of the Commission's final decision using the latest actual information available at that time. DPS Staff expects such an update process will significantly narrow the dollar difference between it and the Company.[305]

Some elements of Rate Year property tax expense, however, will not be known by March 2009 and will have to be

[303] Ex. 265, Sched. 4.

[304] Ex. 147, Sched. 4.

[305] The Company agrees. Accordingly, arguments about forecast differences that will be mooted by an update based on actual data are not discussed in this recommended decision.

forecast. These elements include the New York City tax rate that will be effective July 1, 2009, the tax rates for municipalities located in Westchester, Orange, Rockland, Dutchess, and Putnam counties, and estimated growth in plant. As to the future tax rate changes affecting the Rate Year, the Company proposes that they be forecast taking into account average tax rate changes over five years, but also reflecting reasonable judgment about whether historic average tax rate changes are a reasonable proxy for future tax rate changes. Based on such judgment, for example, the Company projects a zero tax rate change for one class of utility property in New York City (instead of the historic 0.46% average rate of decrease), because the 2008-2009 preliminary rate for such property was up 4.8%. As another example, it forecasts a tax rate decrease of 2.50% for another class of utility property (instead of a 2.91% average decrease), because current economic conditions will preclude further decreases at historic rates. Likewise, the Company projects that the Westchester and other municipal tax escalation rate would increase from 2.59% to 4.0%.[306]

In its direct testimony and its trial briefs, DPS Staff argues forecasts of tax rate changes should be based solely on historic five-year average tax rate changes, because the Commission adopted this approach in past rate cases, including the Company's last electric rate case,[307] and as the consistent use of the same forecasting approach will help ensure differences between forecast and actual tax rate changes will even out over time.[308] DPS Staff notes as well that it is difficult to forecast property taxes. DPS Staff opposes the Company's approach, arguing that if historic averages are "selectively discarded" only in years the Company forecasts tax

[306] The Company's Initial Brief, pp. 240, 243-44.

[307] Tr. 2742. No other citations are provided.

[308] DPS Staff's Initial Brief, p. 160.

rate increases greater than the historic average, the probability is high that the Company will over-collect property tax costs over time.

The Company counters that DPS Staff's proposal should be rejected in part on the grounds that Commission decisions on property tax issues in all recent Company rate cases, except the last one, were the product of negotiations (such as in 1997, 2000, and 2005) and provided for full reconciliation of property tax expense. It is inaccurate, it says, to suggest that the use of a five-year average is a firm precedent or a consistent Commission practice. Second, the effect of projecting a five-year average tax rate change in the Company's last case was a significant shortfall that the Company expects will total $75 million or more in the rate year ending March 31, 2009. Third, the Company argues that DPS Staff and the Commission would not hesitate to abandon a five-year average tax rate change and employ judgment if information was available suggesting property tax rates would likely decrease next year at a rate that differs from historic tax rate changes.

In its reply brief the Company adds several new arguments covering DPS Staff's suggestion that consistent use of five-year averaging will ensure that actual tax rate changes now will be included in the average in future rate cases.[309] It argues that DPS Staff itself is unreliable in maintaining any consistent approach to forecasting costs or applying reconciliation mechanisms from case to case and the Company cannot assume the Commission will continue to use an averaging mechanism in the future. What if, for example, the Commission in the future adopts the approach DPS Staff takes to municipal infrastructure support costs? In that case, use of a historical average with a downward-only reconciliation mechanism, applied

[309] The Company's Reply Brief, pp. 99-101, 103.

consistently over time, would cap the Company at the average for ratemaking purposes, but require it to make refunds when actual costs are below average and never allow it to recover shortages when costs are above average.

The Company also says[310] that in the 2008 Rate Order, the Commission stated only that "the best estimate" of property taxes should be used to set rates[311] and none of the parties knew of any particular circumstance to militate against a five-year average there; but events since quickly changed, resulting in a material deviation from that average. Maintaining that the five-year average is not the "best estimate" in this case, the Company further analogizes property taxes to municipal infrastructure support costs as those largely outside the Company's control for which the Commission said in the last case the estimate "is not limited to a review of the historic information."[312] The Company concludes by noting that the current economic circumstances clearly eliminate reasonable reliance on use of the five-year historical average for property taxes, since municipalities will be hard pressed to meet their financial needs without raising taxes.

On reply, DPS Staff discounts the Company's reference to the $75 million increase in property taxes over what was forecast for the current rate year.[313] DPS Staff says the primary driver for the increased expense was a large increase in assessed valuation, which should not be an issue here, since DPS Staff projected Rate Year assessed values using the latest known Handy Whitman Index. The July 2008 NYC tax rate changes increased only slightly over 1% for class 3 property and decreased by nearly 2% for class 4 property, it states.

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[310] The Company's Reply Brief, p. 101.

[311] The 2008 Rate Order, supra, p. 57.

[312] Ibid., p. 49.

[313] DPS Staff's Reply Brief, p. 63.

B. Reconciliation of Property Taxes

The Company proposes that the Commission adopt a bilateral property tax expense reconciliation mechanism that would permit the Company to defer for future recovery from or credit to customers any differences between actual and forecast property tax expense.[314] It suggests that there can be no reasonable dispute that actual tax expense can vary significantly from a forecast, noting that in 2002-2003 New York City imposed an 18.5% property tax increase. It reiterates that the Commission’s forecast in the last case was too low by approximately $75 million. Nor can there be any reasonable dispute, it says, that when actual and forecast taxes differ materially, it is for reasons outside of the Company’s control and despite the Company’s demonstrated aggressive efforts to keep property tax expense as low as possible.

The Company observes that full reconciliation of property taxes was also allowed in the past to minimize the risk its customers would pay too much for property taxes, assuming the underlying forecast is intended to create equal risk that it might be too high or too low. It suspects DPS Staff is not overly concerned about forgoing this ratepayer protection on the grounds that DPS Staff anticipates actual tax expense will more likely be higher, rather than lower, than its forecast.

The Company notes that its forecast of Rate Year tax expense assumes several tax benefits that may or may not materialize.[315] It would be unreasonable, it says, for the Company alone to be at risk, should the Commission decline to allow bilateral reconciliation and those benefits then fail to materialize. The Company does not state the dollar amounts involved.

[314] The Company’s Initial Brief, pp. 247-50.

[315] Ibid., p. 249 n. 117.

DPS Staff argues that the Commission does not traditionally provide for a bilateral reconciliation or true up of property taxes in a one-year litigated rate case, noting that this is exactly what the Commission held in the Company's last electric rate case.[316] DPS Staff goes on to say that utilities are to be afforded a reasonable opportunity to recover costs, but they need not be afforded guaranteed protection from all matters beyond the Company's control. If costs rise above the forecast level, DPS Staff says, the Company may seek relief, just as it did following the decision in its last electric rate case.[317]

Anticipating DPS Staff's argument against bilateral reconciliation, the Company observes that the Commission has provided for full reconciliation of property tax expense in all years of multi-year rate plans, including the first. If DPS Staff's summary of Commission precedent were accurate, it says, property tax expense would not be subject to bilateral reconciliation in the first rate year of multi-year rate plans. The Company also argues that the ability to file a deferral petition is not a reasonable substitute for full reconciliation, because costs would be subject to recovery only if material and the Company is not over-earning. Even if it prevails after filing such a petition, moreover, current costs are recovered in a future period, increasing the Company's current borrowing

[316] DPS Staff's Initial Brief, pp. 161-162. No other case citations are provided.

[317] This statement refers to the Company's August 4, 2008, petition to defer and amortize up to $75 million of property tax expense. The petition is docketed in Case 08-M-0901 and is not before us.

needs at a time when such needs are already high and capital markets are in turmoil.[318]

The Company also suggests DPS Staff's support for the deferral petition approach rings hollow.[319] It notes that DPS Staff opposes recover in these cases (subject to reconciliation) of even a portion of the amount by which actual tax expense exceeded the forecast in its last case. The deferral petition approach, it argues, becomes confiscatory when facts reasonably implying property tax increases will be higher than the historic average are ignored in setting rates.

C. 2008 Property Tax Deferral ($25.1 Million)

Another disputed property tax issue in this case concerns the Company's just-referenced deferral petition docketed in Case 08-M-0901. The Company seeks permission in that case to defer up to approximately $75.4 million in the rate year ending March 31, 2009 and asks in this case to amortize that amount over three rate years, or approximately $25 million per rate year, starting in Rate Year One.

Of the total, $61.8 million results from final tax rate increases adopted in July 2008 that were higher than the five-year average rate of increases relied on in the Company's last case. Another $13.6 million is related to the Company's expectation, well supported by numerous statements by New York City's mayor, that a 7% property tax reduction currently in effect will be suspended on January 1, 2009, six months earlier than the Company had previously been expecting.

The Company argues the amount to be amortized in rates in this case should be forecast along with all other changes in

[318] If actual taxes exceed the forecast, this criticism also applies to the bilateral reconciliation approach the Company favors.

[319] The Company's Reply Brief, p. 102.

revenues and expenses.[320] It notes as well that prompt Commission action on its deferral petition is warranted and that denial of its petition will require that it take a material current charge against income. Finally, the Company argues that reflecting an amortization amount in its revenue requirement is consistent with DPS Staff's position in the Company's last case—-repeated here—-that the Company can always seek relief should actual property tax expenses be higher than forecast.

DPS Staff states that it does not support amortization of any amount as the Commission has not authorized the requested deferral. It says a thorough evaluation will be made of the Company's petition in the other docket, utilizing criteria normally applied in such instances.[321] Alternatively, if the Commission decides to prejudge the outcome of the other case and permit recovery of property tax under-recoveries, such recovery should be limited to actual known under-recoveries only (i.e., the $61.8 million). DPS Staff, which is in full control of the timing of the submission of a recommendation to the Commission, gives no estimate of when it will be ready to submit the matter to the Commission. (DPS Staff, of course, cannot commit the Commission to an action date.)

In anticipation of DPS Staff's argument, the Company suggests it is suspicious about what criteria will be applied to its pending deferral petition and it reiterates that the deferral petition route is clearly not reasonable, equitable, or in any way comparable to including in rates a fair and reasonable estimate of property taxes for the Rate Year.[322] On reply,[323] the Company contends that delaying recovery of these taxes will further strain its financial position and place the

[320] The Company's Initial Brief, pp. 250-251.

[321] DPS Staff's Initial Brief, pp. 162-164 (citing Tr. 2425-26.)

[322] The Company's Initial Brief, p. 251.

[323] The Company's Reply Brief, p.103.

burden on future customers, and that it has mitigated the request by seeking three-year amortization.

D. Discussion

We do not agree with DPS Staff's suggestion that the Commission requires the use of unadjusted five-year historic averages for projecting tax rates. As the Company maintains, even if based upon five-year historic averages, tax rate projections in its recent rate cases, except for the last, have largely been a product of negotiated agreements the terms of which the Commission adopted in whole or in part without indicating any preferred projection method. In that last, contested case the Commission indicated only that the "best estimate" should be used in rate setting. No party apparently raised before the Commission the issue of whether rate year property tax rates must be set on the basis of unadjusted five-year averages or may be subject to adjustment in light of changing circumstances, and the Commission did not, in fact, address that issue one way or the other.[324]

DPS Staff claims that consistent use of unadjusted five-year averages variations between forecasts and actual property tax rates will even out over time. This assertion is not intuitively obvious and amounts to a bare assertion. DPS Staff's flip side argument, that "selectively discarding" the average only in years when the Company forecasts tax rate increases higher than average will lead to over-collecting property tax expenses over time, also appears disingenuous. DPS Staff fails to explain why the use of judgment to adjust historic averages would be limited to those circumstances. Even assuming the Company would have no incentive to predict decreases from historic averages, there is little reason to believe DPS Staff or other parties would not recommend

[324] 2008 Rate Order, supra, pp. 56-57.

judgmental adjustments if they saw changed circumstances leading them to view the conclusion that tax rates would drop in the rate year as reasonable. Moreover, the flexibility to depart from historic averages when tax rates can reasonably be predicted to fall is hardly an approach the Commission should decline to follow if the interests of ratepayers are to be protected.

DPS Staff notes that the bulk of the Company-claimed $75 million increase of actual property taxes over what was predicted in the current rate year resulted from increases in assessed valuation, not tax rates. Notwithstanding that DPS Staff considers its use of the latest Handy Whitman Index figures in projecting assessed values will preclude such an occurrence in the Rate Year, its argument does not obviate considering potential tax rate increases--the remaining way municipalities can boost property tax revenues in the current economic circumstances--that are bringing greater fiscal pressures on them. DPS Staff has not offered any specific challenges to the particular judgmental adjustments the Company has proposed to the five-year averages here and we find their use reasonable.

DPS Staff opposes true-up of property tax expense for a one-year rate case, contending the Commission did not approve true-up in the Company's most recent, one-year rate case and the Company is not guaranteed protection against all increases in costs beyond its control. As the Company points out, however, there does not seem to be a substantial difference between providing true-up for a one-year rate case and providing for it in the first year of a multi-year rate case, as the Commission has accepted in several recent Company rate cases.[325] In the

[325] We recognize, however, that allowing true-up for property taxes in multi-year rate plan cases may be one of various means to create incentives to negotiate multi-year plans.

Company's last rate case, the Commission found only that the "typical" approach for a one-year rate case does not provide a property tax reconciliation mechanism.[326] We believe the current state of economic upheaval calls for reconciliation even if it is an atypical approach. Given the unusual level of uncertainty over how long the current volatile economic conditions will last and how municipalities will cope with the consequent fiscal stress and given our overall objective of reasonably minimizing some downside risk and earnings potential above its cost of capital, we recommend that the Commission adopt a two-way reconciliation mechanism for property tax expense.

We decline to recommend three-year amortization of the $75.4 million that is the subject of Case 08-M-0901. To do so would prejudge the outcome of that proceeding. However, we believe DPS Staff should make every effort to complete review of the issues in that separate proceeding, initiated in early August, 2008, and make a recommendation in time so that the Commission can decide that case on or before the date on which it reaches its decision in the pending rate proceeding.

In sum, the property tax allowance should be calculated using all the latest known information, the latest available Handy Whitman Index information, the Company's forecast of future property tax rate increases, and the forecast of Company property consistent with our rate base recommendations. These elements should be further updated to the extent feasible at the time of the Commission's final decision.

VII. DEPRECIATION

The Company's filing shows a deficiency in the depreciation reserve for electric plant as of December 31, 2007, which does not include any effects of the 2008 Rate Order

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[326] Ibid., p.57.

(Tr. 3495-3498). As a consequence of the 2008 Rate Order, it is likely that the depreciation reserve deficiency will not be reduced in magnitude during the upcoming Rate Year. Nevertheless, with one minor exception, no party proposes to change the Company's depreciation rates at this time. DPS Staff, for example, in endorsing the Company's depreciation proposal, asserts that it would be premature to make additional changes at this time, when the impacts of the changes in the prior case have yet to be reflected in the Company's depreciation reserve. The only issue in dispute in this case is whether the Commission should adopt the proposals of either the NYC Government Customers or Westchester County to change the means by which the Company recovers net salvage costs.

A. Net Salvage/PAYGO ($70.0 Million)

1. Summary of Arguments

Putting aside any issue about a depreciation reserve excess or deficiency, the Company's depreciation rates are currently set according to a method under which the Company is supposed to be compensated by current customers for the decrease in value of capitalized plant as it is being used up and for the anticipated cost of removing that plant from service once it is completely used up. The latter removal costs are generally described as negative salvage costs because the Company frequently incurs significant labor and other costs to remove plant that exceeds any positive salvage value of the plant removed. Both the NYC Government Customers and Westchester County propose that the current method be changed in part so that negative salvage costs would be recovered from customers after rather than before such costs are incurred. Such an approach is referred to as the Pay-As-You-Go or PAYGO method. The Company has submitted testimony and exhibits opposing the PAYGO proposals and has briefed the issue at length. DPS Staff has generally indicated that it supports the Company's position and the reasons behind it.

The NYC Government Customers' proposal would change the current accrual basis for recovery to a cash basis. The consequence of this change would be to eliminate the $670 million deficiency in the depreciation reserve and create in its place a $365 million surplus.[327] Instead of including an amount in depreciation rates representing the accrual of future net salvage, depreciation rates would instead include an amount to account for current net salvage expense. However, because a surplus in the depreciation reserve is created by the change in method, the NYC Government Customers' proposal would draw upon that surplus during the transition period to reduce depreciation expense below the level of current net salvage expense.[328] Consequently, these customers propose that only $70 million in depreciation expense be included in rates for negative net salvage in the Rate Year, with the difference between the $70 million and the actual current negative net salvage expense to be recovered from the depreciation reserve surplus. After the surplus is drawn down, a full recovery of current net salvage could be implemented.[329] The Company's rate filing includes $140 million as an accrual for negative net salvage; therefore, the impact of the NYC Government Customers' proposal

[327] The NYC Government Customers' Initial Brief, pp. 22-23.

[328] The NYC Government Customers' Initial Brief, p. 23; Tr. 4448.

[329] Id. In their initial brief, the NYC Government Customers argue that any Company criticisms of PAYGO based on Ex. 307 should be ignored because that Company exhibit does not accurately reflect the PAYGO proposal presented here. NYC Government Customers' Initial Brief, pp. 28-29. We understand that, while Ex. 307 assumed that the $70 million net salvage costs to be allowed in rates would continue through 2018, the proposal is that such a rate allowance would only continue until the depreciation reserve surplus was exhausted, a period of time estimated by the Company to be approximately three years.

is the difference, or $70 million, as a reduction to depreciation expense and to the cost of electric delivery service.

The County of Westchester (Westchester) similarly recommends a change from accrual to cash accounting for negative net salvage, although it limits its proposal to the Company's transmission and distribution (T&D) accounts. Under Westchester's approach, negative net salvage value for T&D accounts would be removed from both depreciation expense and depreciation reserve calculations. Instead, negative net salvage would be treated as an amortization and expensed currently. The amortization amount set in rates would be the average amount spent on negative net salvage over the last ten years. Differences between actual spending and the amortization amount would be totaled, with any differences added to the amortization amount the next time rates are set.

As is the case under the NYC Government Customers' proposal, the change proposed by Westchester eliminates the depreciation reserve deficiency and creates a surplus. Westchester proposes that the surplus be amortized over ten years and asserts that the result is a decrease in depreciation expense, with a corresponding decrease in the cost of electric delivery service of $70 million for the Rate Year.[330]

The most significant aspect of the PAYGO proposals made by the NYC Government Customers and Westchester is the change in timing as to when the Company recovers the costs of negative net salvage. According to the NYC Government Customers, the current approach is inequitable, as current customers are required to pay for a cost that is almost always incurred in order to install a new asset to serve future customers. They assert that the current methodology is

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[330] Tr. 4634; Westchester's Initial Brief, pp. 11-12.

analogous to requiring homeowners to cover, through mortgage payments, the future demolition costs of their home.[331]

The Company disagrees, however, and asserts that the PAYGO method is inequitable. Under PAYGO, the Company says, future customers who did not benefit from a piece of plant in service today would pay for the removal cost of that plant. Meanwhile, those customers who benefited from a piece of plant today would not pay for the costs of removal.[332] According to the Company, analogous concerns led the Commission to reject the use of the PAYGO method for the recovery of pension costs.[333]

Westchester appears to accept the Company's view as to some inequity in the PAYGO method. It notes, however, that the current situation, in which there is a large depreciation reserve deficiency, already guarantees that there will be inter-generational inequity, due to the Company's own proposal to defer recovery of depreciation reserve deficiency.[334] The NYC Government Customers note that the inter-generational concerns are not particularly applicable to "mass accounts," in which thousands and millions of assets, such as meters, each with its own vintage and service life, come and go like customers. In these accounts, there is a relatively consistent addition and subtraction of a large number of assets, so that customers in any year are not particularly advantaged or disadvantaged by the use of one method or another.[335]

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[331] The NYC Government Customers' Initial Brief, p. 18.

[332] The Company's Initial Brief, pp. 255-256.

[333] The Company's Initial Brief, p. 256.

[334] Westchester's Initial Brief, pp. 12-13 and Westchester's Reply Brief, pp. 6-7.

[335] Tr. 4455-4456. While the exact magnitude or proportion of these mass accounts was not quantified, the NYC Government Customers' witness testified that mass accounts include "most if not all" of the Company's Electric Department accounts. Tr. 4442.

Rather than the policy arguments regarding inter-generational equity, the main premise behind the PAYGO proposals is their ability to afford immediate, short-term rate relief. Both the NYC Government Customers and Westchester propose to reduce revenue requirements by $70 million annually through the change to PAYGO.[336] According to Westchester, ratepayers now are facing steep rate increases and need mitigating offsets. It asserts that, after the Company's construction program is reduced to more reasonable levels, customers should be better positioned to pay the deferred increases associated with negative net salvage.[337] It argues that the PAYGO method would continue to make the Company's stockholders whole for depreciation expenses, while giving ratepayers the benefit of immediate cost savings.[338]

The Company counters, however, that the adoption of the PAYGO approach would negatively impact its cash flow, requiring it to raise about $50 million of additional capital each year. The Company asserts that this is not the time to create such an additional cash flow requirement.[339]

Much of the disagreement between the PAYGO proponents, on the one hand, and the Company and DPS Staff, on the other hand, is the debate about which method is more likely to produce a "time bomb" in the future, in the form of a large amount of unrecovered net salvage costs to be paid by future customers. According to the NYC Government Customers, continuation of the current approach will result in the need for large rate increases in the near term that are not tenable. The NYC

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[336] The NYC Government Customers' Initial Brief, p. 23; Westchester's Initial Brief, pp. 11-12.

[337] Westchester's Reply Brief, pp. 6-7.

[338] Westchester's Initial Brief, pp. 11-12.

[339] The Company's Initial Brief, p. 262; the Company's Reply Brief, p. 110.

Government Customers assert that the Company has excluded large negative salvage costs from its revenue requests and its calculation of the depreciation reserve deficiency.[340] They assert that, if recent negative net salvages are recognized, depreciation rates would need to increase by over $300 million annually and the depreciation reserve deficiency would be over $3.7 billion.[341] Assuming a ten-year amortization of the $3.7 billion deficiency, ratepayers would pay off the deficiency through a charge of $370 million annually which, added to the increased depreciation expense of $300 million annually, would create an annual rate impact of $670 million.[342] This expense is described as the "time bomb" that would be avoided with PAYGO.[343]

DPS Staff fully supports the Company's position that the current accounting for negative net salvage should continue. It advocates that each depreciation account should be reexamined in a future rate proceeding to ensure that depreciation rates properly reflect the net salvage costs that the Company is expected to incur in the future.[344] In reply, the NYC Government Customers assert that DPS Staff's recommendation to increase depreciation rates gradually will mean that the difference between the theoretical reserve and the actual reserve will continue to grow.[345] They note that, while the actual depreciation reserve reflects historic accruals, based on conservative negative net salvages, current levels of negative net salvage are much higher, creating a need to increase the magnitude of the actual deficiency to support the higher cost of

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[340] Tr. 4457.

[341] Tr. 4458.

[342] Tr. 4458.

[343] The NYC Government Customers' Initial Brief, pp. 21-22.

[344] DPS Staff's Initial Brief, pp. 167; Tr. 3497-3498.

[345] The NYC Government Customers' Reply Brief, p. 11.

removal of all plant now in service. The growing reserve deficiency will have to be recovered at some point in the future, they note.[346]

The Company asserts that PAYGO does not eliminate any "time bomb" revenue increase due to higher net salvage costs. Instead, the Company argues, PAYGO merely postpones it[347] Under PAYGO, the Company asserts, once the depreciation reserve surplus created by the change in method is exhausted, depreciation expense would increase by $130 million and rates would have to follow suit in order to provide the Company full recovery.[348] Moreover, the Company asserts that current net salvage costs are considered in the development of net salvage factors in use under its method (Tr. 1619).[349]

On reply, the NYC Government Customers acknowledge the rate increases inherent in their proposal once the depreciation reserve surplus is drawn down. However, they assert that the increase implicated by their proposal is still preferable to the rate impact that will result from the current accrual methodology.[350]

Another argument advanced by the NYC Government Customers on behalf of the PAYGO method is that the current approach is fraught with uncertainty. They suggest it is not possible to estimate accurately today the cost to remove plant from service far into the future. For example, underground distribution conduits going into service today are expected to be removed from service in 2090.[351] The Company responds that the

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[346] Id.

[347] The Company's Initial Brief, pp. 259-260.

[348] The Company's Reply Brief, p. 104.

[349] The Company's Initial Brief, pp. 259-60.

[350] NYC Government Customers' Reply Brief, p. 12.

[351] NYC Government Customers' Initial Brief, pp. 19-20.

long time until salvage costs are incurred is not cause for concern. Rather, estimates are made and updated over time to reflect changes in circumstances. Indeed, the Company points out, such an update was performed in these proceedings.[352]

The Company criticizes the PAYGO approach on the grounds that it could expose customers to wild fluctuations in net salvage costs. The Company points out that such costs are not spread over time, but instead are incurred all at once at the time an asset is retired. According to the Company, future Commissions might well balk at the bill impacts and either delay or deny full recovery, increasing the Company's business risk.[353] According to the NYC Government Customers, such fluctuations apply to many of the Company's expenses. To recognize this, abrupt changes in negative salvage can be amortized over more than one year.[354] Therefore, they assert, PAYGO will not increase the risk that the Company will not fully recover. Instead, any difference between allowed and actual costs would be trued-up using the depreciation reserve.[355]

The parties also debate the legitimacy of their respective preferred methods. The Company points out that the Commission rejected a PAYGO proposal in the Company's last electric rate case.[356] It acknowledges that some jurisdictions use PAYGO, but notes that the vast majority currently follow the method used in New York and by the Company.[357] For their part, the PAYGO proponents note that New Jersey and Pennsylvania have

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352 The Company’s Initial Brief, p. 256.

353 The Company’s Initial Brief, pp. 257, 262-263.

354 NYC Government Customers’ Initial Brief, p. 27.

355 Id.

356 The Company’s Initial Brief, p. 255.

357 The Company’s Initial Brief, p. 262; the Company’s Reply Brief, p. 105.

adopted PAYGO and that the Company uses a form of the PAYGO approach for its gas operations.[358]

An important issue regarding the negative net salvage accounting in this case concerns the income tax consequences of the different methodologies. The NYC Government Customers raised this tax issue in this case for the first time, noting that a tax rationale in favor of the PAYGO approach was not raised or considered when the Commission rejected the proposal in the Company's last electric rate case. According to the NYC Government Customers, the current approach is inferior, because the expense and income tax deduction for the removal occur in the future, while the revenue is received and taxable before that time.[359] According to the NYC Government Customers, these tax consequences are significant enough to eliminate their prior assumption that the PAYGO method would produce higher revenue requirements over the long term.[360]

The Company's Accounting Panel responded that the NYC Government Customers' calculation of the income tax effects was correct as far as it went, but failed to take account of the benefit to customers of the tax deduction received when the Company pays removal costs. The tax benefit associated with this deduction, included in the current filing, is approximately $80.7 million. Therefore, current customers are paying a carrying charge of $15.5 million, but they are also receiving a tax credit of $80.7 million, for a net tax benefit of $65.2 million (Tr. 2348-2352). The Company's Accounting Panel went on to explain that the tax benefit available under the current

358 NYC Government Customers' Initial Brief, pp. 24-25; Westchester's Initial Brief, pp. 11-12; Westchester's Reply Brief, pp. 6-7.

359 NYC Government Customers' Initial Brief, p. 20.

360 NYC Government Customers' Initial Brief, p. 21, citing Tr. 4454-55.

accrual method would not flow through to customers under the PAYGO method (Tr. 2352). The Company's comparison of the tax benefits of the two proposals is summarized in Ex. 404, which was initially prepared by the NYC Government Customers but, as modified slightly, was adopted by the Company's Accounting Panel witnesses as a fair summary of their testimony.

In their initial brief, the NYC Government Customers assert that the Company's Accounting Panel's calculation is flawed. They argue that the estimate of the tax benefits of the current approach assumes a double benefit to customers. That is, in Accounting Panel's calculation, when the Company pays salvage costs, it flows through the tax benefit and reduces the rate base by the same amount.[361] Counsel for the NYC Government Customers questioned the Company's Accounting Panel regarding an alleged double count during the hearing, but the Company's Accounting Panel stood by its calculations (Tr. 2372-2379). In the Company's reply brief, the Company clarifies further and justifies its accounting for the tax benefits and affirms its analysis.[362] It also notes that the tax consequences of switching to a PAYGO method would create an additional intergenerational subsidy, in that current customers would receive a tax benefit and pay no removal cost for plant currently in service, while future customers would pay historical negative salvage costs plus an additional amount for associated income taxes.[363] According to the Company, this tax accounting is not only appropriate but required under generally accepted accounting principles.[364]

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[361] NYC Government Customers' Initial Brief, pp. 31-32.

[362] The Company's Reply Brief, pp. 107-108.

[363] The Company's Reply Brief, p. 108.

[364] Id.

2. Discussion

The NYC Government Customers and Westchester have raised a thought-provoking proposal regarding the PAYGO method. The issue warrants and has received a full hearing and serious consideration. We recommend that the proposal not be adopted.

On this record, it seems clear that the principal effect of switching from the accrual to a cash-basis PAYGO method is to shift cost recovery for negative net salvage farther into the future. The short-term effect is to moderate any need for a present rate increase. In the longer term, customers would be required to fully fund negative net salvage without the benefit of any accrual over time by customers currently benefiting from the assets to help fund their eventual salvage.

We believe it is reasonable that customers using equipment and plant today contribute toward negative net salvage and the associated costs.[365] Today's customers benefit from the payment of negative net salvage accruals by past customers, whereas the abrupt shift in methods proposed by the NYC Government Customers and Westchester would result in current customers paying less than their fair share under either method. Therefore, the concerns raised about inter-generational inequity weigh in favor of retaining the current method.

[365] While initially intriguing, we are not persuaded that the current approach for rate recovery of negative net salvage costs is like a homeowner paying for the ultimate demolition costs of a home in mortgage payments. If a home is purchased and deteriorates over time this will be reflected in the property's market value. If it deteriorates to a point that it must be demolished, the homeowner will incur such costs directly, abandon the property and create a public nuisance, or sell the home, in which case the demolition costs will be reflected in the sale price. How the initial home purchase was financed seems irrelevant.

We also find a switch to PAYGO to be an inappropriate means of rate moderation at this time. The parties have made much of the so-called “time bomb” that may be looming if the Company continues to fail to recover the full amount of negative net salvage costs. The problem is real and must be addressed. PAYGO is not the answer, in that its elimination of the depreciation reserve deficiency is more illusory then real. While the deficiency may be wiped out as a matter of accounting, the Company's need to pay future negative net salvage remains. Reducing current contributions to cover those future costs should not be considered a solution to the “time bomb” problem. The already large depreciation deficiency reserve suggests that there is already a problem of intergenerational inequity, in which future customers will bear some costs that should arguably be covered now by existing customers. A switch to PAYGO at this time would merely exacerbate this problem.

The proposed change would have a negative impact on the Company. The Company's claim that the change would reduce its cash flow, perhaps forcing it to seek additional cash in the credit markets, is unrebutted. We agree that the ongoing large construction program and increased capital costs argue against reducing further the Company's cash flow and increasing its need to seek incremental outside financing.

The current method offers the advantage of spreading negative net salvage costs over time. While there is uncertainty in predicting such costs in the future, the method allows for a constant update in the costs as rates are reset in each rate case.

Finally, we are persuaded that the Company's Accounting Panel has accurately reflected the tax consequences of these two methods. The Panel’s testimony and the Company's explanations on brief demonstrate that, at least under current circumstances, where a large depreciation reserve deficiency exists and where negative net salvage costs exceed the amount allowed in rates, the income tax accounting of the current method benefits customers.[366]

VIII. COST OF CAPITAL

This section considers all of the arguments about the cost of equity and debt, capital structure, and related updates and true-ups. To increase the probability that this recommended decision will be completed on or close to schedule, this section includes a comparatively less comprehensive summary of all the arguments and fewer citations to the trial briefs. However, all of the arguments have been considered carefully.

A. Cost of Common Equity

1. Context

The Company's cost of common equity is a major variable in determining the Company's cost of providing electric delivery service in the Rate Year. The broad context for evaluating the arguments and evidence include seminal U.S. Supreme Court precedent to the effect that, assuming an efficient and economical management, the allowed return on equity should be adequate for the Company to maintain and support its credit, to allow it to raise capital, and equal to that being made on other investments in other business undertakings which are attended by corresponding risks and uncertainties.

The narrower context is that the Company is planning to continue with substantial construction, that its internally generated cash flow will be weaker than is typical as a result, and that the Company's bonds were downgraded by two of three major rating agencies, and placed on negative watch by a third, following the 2008 Rate Order. An express issue raised is

[366] The Company's Initial Brief, pp. 260-261.

whether the New York regulatory environment is deteriorating, and, thus, whether the risks of investing in the Company and the corresponding return requirements are both going up.

A key overlay on the cost of equity issue is that the Company submitted testimony and briefs in support of an 11.00% equity return for the Rate Year or 11.30% for Rate Years One through Three (the difference being a so-called “stay-out” premium of 30 basis points or .3%). Meanwhile, the Company’s May 2008 tariff filing and its October 2008 updated $819.024 million revenue request are both based on a return on equity of 10.00%. The annual effect of the difference between 10.00% and 11.30% is approximately $155 million.

A second key overlay is that there were dramatic changes in financial markets after these cases started. Known ramifications to date include that tax-exempt auction rate notes as of the October 2008 hearings had an annualized rate of 9.0% (Tr. 1886) and the Company issued 10-year unsecured debt on December 2, 2008 at what we have been advised is an all-in cost of approximately 7.18%. The latter figure exceeds DPS Staff’s September and October 2008 forecast of a 5.87% cost for 10-year debt for the Rate Year (Tr. 3323). There is great uncertainty about whether financial conditions will be better or worse in the Rate Year. In light of these changes, the Company states on brief that it may request, at the time of its brief on exceptions, that rates be set based on a cost of equity that is greater than 10%.

2. General Issues

The first issue is whether we should determine the cost of equity outright or limit our inquiry to where the cost of equity falls within a range up to and including 10.00%, the amount reflected in the Company’s filed and updated revenue requests.

We have mixed reactions. On the one hand, looking at anything above 10% ignores the legal significance of the tariff filing that is suspended. Moreover, looking at anything above 10% facilitates the Company's ability to seek to update a forecast rather than an actual, verifiable cost as of the time of its brief on exceptions. This would be contrary to the express terms of the 1977 Statement of Policy on Test Periods in Major Rate Proceedings.

On the other hand, a failure to determine the cost of equity outright would effectively deny parties the ability to except to parts of our analysis that the Commission might elect to consider given the financial circumstances presented. For this reason, we conclude that we should make the broader of the two alternative analyses.

The second general issue is the weight to be accorded to arguments that any particular equity cost estimation method or input is or is not reasonable based solely on how that issue was decided in one or more other cases. We conclude that such arguments should be given very little weight and that the issues presented should be resolved based on the evidence and arguments in this case. This is not to suggest that Commission precedent should be ignored. It simply means that the evidence, arguments, and circumstances can differ from case to case and, thus, that consideration of the issues should be based on the factual information and arguments presented here. Arguments that explain the reasons why a particular approach should or should not be taken are all accorded relatively greater weight.

The third general issue concerns the extent to which we should give weight to Westchester's proposal that the 9.1% equity return allowance adopted in the 2008 Rate Order be readopted here. Given that its proposal is supported by no analysis, that it is supported by two persons who are admittedly not experts on the issue (Tr. 4626), and that it ignores that circumstances have obviously changed since the Company's last electric rate case, that proposal is entitled to little if any weight.[367]

The final general issue concerns the selection of an appropriate "proxy group" to estimate the Company's cost of equity. The Company, DPS Staff, and CPB each use groups of roughly comparable companies in order to estimate the Company's cost of equity. These are referred to as "proxy groups." The single material difference between DPS Staff's and CPB's group, on the one hand, and the Company's group, on the other, is that the Company's group excludes many other comparable companies and CPB questions whether they were excluded in order to affect the results of the Company's analyses. On brief, the Company focuses solely on another difference between the proxy groups, that it correctly suggests is moot, having to do with the percentage of each proxy company's earnings from regulated operations.

In the absence of any Company argument responsive to CPB and given that Dr. Morin agreed generally with the approach DPS Staff used to develop its proxy group (Tr. 3210), we conclude that it is more reasonable to use the DPS Staff/CPB proxy group.

3. Discounted Cash Flow (DCF) Model Issues

In very simple terms, the Discounted Cash Flow Model posits that the cost of equity is the sum of the yield (dividend divided by share price) plus expected growth. The Company uses a simple model with one growth estimate and DPS Staff and CPB use a two-stage model that reflect both short-term and infinite growth expectations. Issues presented concern the share price

[367] One Company witness had also suggested that the Company's cost of common equity exceeds 25% (Tr. 1853). The Company offers no such argument on brief. Accordingly, we do not discuss that contention either.

to use, whether expected dividends should be reflected quarterly or at the end of the year, and growth expectations.

(a) Share Price

In testimony submitted in September 2008, DPS Staff and CPB both calculated a dividend yield using share prices over the six-months ending in June 2008, on the grounds that this would smooth out noise associated with daily fluctuations and that their growth rates were developed in the timeframe covered by this price data. The Company argues for use of a recent spot price on the grounds that current information is more indicative of expectations in the Rate Year or, put differently, that data from early 2008 is stale. DPS Staff is unconcerned, noting that its yield calculations should be updated as of the time of the Commission's final decision.

In the years when rate cases were typically litigated, the Commission's routine practice was to update the DCF yield calculation using 20 recent days' data. There is no information in the record about why that long-standing practice was abandoned. It appears this may be the result of a concern that short-term data might be aberrational. In light of markedly changed circumstances in financial markets and uncertainty about the future, however, reliance on six months of data ending at any time in the past year does not seem reasonable. Our cost of equity reflects yield data for the three months ending November 2008. The Commission should update this again using data for the three months ending in February 2009.

(b) Quarterly or Annual Dividends

The Company's model reflects that dividends are paid quarterly while DPS Staff's and CPB's models assume dividends are paid once a year, at the end of the year. DPS Staff supports its approach on brief, stating that the Commission has repeatedly decided this issue in DPS Staff's favor. Given that the Company states that this issue alone is worth 20 basis points (Tr. 3211 and 3221), that dividends are actually paid quarterly rather than at the end of the year, and in the absence of any substantive explanation of why the Company's proposed approach is wrong, we recommend adoption of the Company's approach. The Commission should do likewise at the time of the final update. Given that we do not have access to a model that reflects dividends quarterly, however, our cost of delivery service calculations are based on an annual dividend. Using the DCF inputs described above and next, and making no other changes, the Company is invited to provide in its brief on exceptions the impact on our calculations of reflecting quarterly dividends.

(c) Growth

The disputes about anticipated growth rates are among the most hotly contested cost of capital issues. DPS Staff proposes reliance on Value Line's forecast of dividend growth for the next five years and a long-term or sustainable growth rate averaging 5.3% based on retention growth or growth in retained earnings. The Company is critical of both approaches, arguing that dividend growth is dependent on earnings growth, that dividend growth cannot be expected to keep pace with earnings growth in a period of increased capital spending, and that one has to assume a cost of equity to estimate retention growth in order to estimate the cost of equity. It argues that this circularity is not reasonable. The Company, on the other hand, uses one growth estimate each in two different runs using Value Line and Zacks forecasts of earnings growth over five years of 6.0% and 7.6%. DPS Staff argues there is no proof that such growth rates are sustainable based on indicators that the economy in general will grow at a rate of 4.8% to 5.0% and, in any event, that five year forecasts are not consistent with the desired projection of infinite growth.

DPS Staff is persuasive that there is no proof that the Company's earnings growth estimates for the next five years are sustainable in the infinite future. The Company does not respond to this argument on brief. However, DPS Staff offers no good response to the criticisms that it is circular to calculate the cost of equity based on a retention growth rate that assumes a cost of equity. Our DCF calculation, accordingly, reflects a short-term growth rate in dividends based on the updated Value Line forecast and a long-term growth rate of 5.6%, based on a Gross Domestic Product growth rate of 3.4% from 1929 through 2007 and an approximate inflation rate of 2.2% (Tr. 3232).

(d) DCF Finding

Based on the above discussion, we find that the DCF indicated cost of equity for the DPS Staff/CPB proxy group in the Rate Year is 10.29%.

4. Capital Asset Pricing Model (CAPM) Issues

The Company, DPS Staff and CPB all prepared equity cost estimates using the CAPM and zero-beta CAPM. The basic formula (Ex. 440, p. 14) is that the cost of equity is equal to a risk-free rate plus the product of beta and a market risk premium. Beta is a measure of market risk or systematic risk that cannot be minimized by diversification (Tr. 3149-3150 and 3343-3344). More stable stocks like the Company's have a beta of less than one and more volatile stocks or stocks that tend to move more than the market in response to a circumstance have betas greater than one. An empirical or zero – beta CAPM is generally employed as a check for firms, like the Company, with a beta of less than one.

(a) Beta

The parties generally agree on a beta: DPS Staff uses the .80 median beta of its proxy group. CPB uses .81, and the Company uses the .82 average for its proxy group. Given that we do not recommend the Company's proxy group, we adopt the simple average of the DPS Staff and CPB figures or .81 rounded.

(b) The Risk-Free Rate

The Company proposes a 4.5% risk free rate based on the market prices and coupons (or yields) of 30-year treasury bonds. Others criticize this proposal as it is based solely on yields in April 2008 and does not reflect the yield on 10-year treasury bonds.[368] DPS Staff and CPB support risk-free rates of 4.16% and 4.18%, respectively, based on average 6-month yields of 10-year and 30-year Treasury bonds. The Company criticizes these proposals, arguing that 30-year bonds are long-term investments more akin to common stocks and because 30-year Treasury bonds were yielding 4.69% as of June 2008. DPS Staff replies that any concern about use of stale Treasury yields will be addressed by an update at the time of the Commission’s decision. It also chastises the Company for failing to mention that yields on 30-year Treasury bonds stood at 3.17% as of December 3, 2008.

In the absence of any substantive response to the Company’s argument in support of the use of yields on 30-year treasuries only, we recommend its position be adopted using average 30-year treasury rates for the three months ending in February 2009. A similar average for the three-months ending in November 2008 is reflected in our CAPM calculation.

(c) The Market Risk Premium

The Company supports a market risk premium of 7.6% based on the average of an historic risk premium of 7.1% and a forward-looking risk premium forecast of 8.1%. DPS Staff criticizes the former figure on the grounds that it reflects periods unlike now. The latter figure is opposed because it assumes a dividend growth rate of 10.35% in the short- and long-

[368] DPS Staff’s Initial Brief, pp. 179-183.

term. The Company replies that there is no significant serial correlation in successive historic risk premiums from year to year and points the reader to its DCF growth arguments summarized above.

DPS Staff argues in favor of a 7.36% market risk premium based on the difference between a market return estimate for the S&P 500 and the risk free rate while CPB employed a 7.22% premium using the same approach and slightly different data.

The Company criticizes reliance on a single Merrill Lynch analyst's estimate of market returns and says that the effect of adopting DPS Staff's proposal is to rely solely on the DCF methodology (because that is the method used by the Merrill Lynch analyst to estimate a market return.)

The Company does not respond convincingly to DPS Staff's criticism of the 8.1% forward-looking risk premium. On that basis, we recommend adoption of the approach employed by DPS Staff and CPB, subject to the caveat that 30-year Treasury yields be used to calculate the risk free rate.

(d) CAPM Finding

In light of the above findings, we hold that the CAPM and zero-beta CAPM indicated cost of equity for the proxy group are 10.67% and 11.05%, respectively, or an average of 10.86%. These figures should be updated at the time of the Commission's decision.

5. Risk Premium Method

The Company is the only party to present a Risk Premium estimate of the cost of common equity. It argues that the cost of equity is the sum of its previously discussed 4.5% risk-free rate and the 5.7% average risk premium between earned equity returns and long-term bond yields over a period of years. Alternatively, it argues the cost of equity is the sum of the 4.5% risk-free rate and the 5.6% risk premium implied by allowed equity returns over a period of years. It argues that the historic risk premium should be expected to continue and that the result of the latter proposal is conservative because some of the allowed returns were minimums adopted in rate plans that offered significant positive incentive opportunities.

DPS Staff pans the historic analysis, saying there is no proof that the Company's prospective risk premium is exactly equal to the average experience by utilities in a Moody's index over the 74 years ending in 2006. It adds, moreover, that two Company witnesses (Hoglund and Morin) provided contradictory testimony on that topic. DPS Staff likewise objects to the alternative analysis, saying there has been no showing that the risks faced by the Company are the same as those reflected in the Company's calculation.

We recommend that the Risk Premium Method not be relied upon in this instance. Based on a careful reading of DPS Staff's criticisms of this method (Tr. 3371-3373) and the Company's update/rebuttal (Tr. 3242-3244), we are persuaded by DPS Staff's argument that the Company's Risk Premium approach has not been shown to provide information about the riskiness of investing in Consolidated Edison during the Rate Year.

6. Weighting the Results

A basic question presented is whether the results of the various methods should be weighted equally (averaged) or whether greater weight should be accorded to the DCF results.

The Company's basic position is that no one estimation is superior to the others, that no one method is perfect (including the DCF) for reasons discussed above, and that investors, in fact, do not rely on any one method. Accordingly, it argues all methods should be given equal weight.

DPS Staff criticizes the Company's approach, on the grounds that too much weight is given the more subjective CAPM method. DPS Staff proposes that 2/3, 1/3, and zero weight be given to the DCF, CAPM, and Risk Premium results. DPS Staff says the DCF result should be given more weight as it has been the principle equity costing approach of regulators throughout the country and in New York for many years and as that method relies on readily available, objective data. As to the CAPM, it suggests use of an historic beta may not be a good indicator of future volatility if the systematic risk of a firm or industry changes. Likewise, it suggests that historic market risk premiums may not represent the future and that a forward-looking market risk premium involves significant subjective judgment.

Anticipating these arguments, the Company asserts that DPS Staff is evaluating CAPM using a tougher standard than it applies to the DCF method. Consolidated Edison states, for example, that DCF growth forecasts are also based on subjective judgment and that DPS Staff's concerns about use of an historic beta pale in comparison to the circularity defect in using a forecast cost of equity, to estimate retention growth, to estimate the cost of equity.

We conclude that the Company is correct to contend that all three methods presented in this case involve the use of some subjective judgment. On that basis, and given our recommendation that the Risk Premium Method not be employed, we recommend the DCF result and simple average of the two CAPM results be given equal weight. The result is 10.58%.

7. Credit Quality Adjustment

After completing their estimates of the equity cost of their proxy groups, DPS Staff and CPB both made a credit quality adjustment to reflect that the Company has a credit rating ("A1" by Moody's and "A-" by Standard and Poor's) higher than the median credit rating (BBB) for the proxy group and, thus, must be considered a relatively less risky investment opportunity. Their respective downward adjustments, based on the yield differences between "A" (the average of an S&P "A-" and the higher Moody’s “A1”) and “BBB” rated bonds over a six-month period, are 49 basis points (DPS Staff), and 15 basis points (CPB).

DPS Staff argues a credit quality adjustment is warranted because the proxy group companies, on average, receive a greater percentage of revenues from non-utility operations, and as credit ratings are comprehensive, reflecting combined business and financial risks facing each company (Tr. 3356). DPS Staff also argues that its specific adjustment is reasonable to the extent a comparison of proxy group and Consolidated Edison bond yields differed by 33 basis points over six months and that a further 16 basis point adjustment is warranted as equity investors’ returns are subordinate to those of debt holders. However, in light of increased differentiation between levels of credit risk in the past several months, and the increase in incremental capital costs associated with a downgrade below the S&P “A-“ rating, DPS Staff suggests the Commission might want to exercise additional judgment in determining the appropriate credit quality adjustment. One alternate approach, it says, would reduce its proposed credit quality adjustment from 49 to 33 basis points.

The Company opposes any credit quality adjustment and argues in the alternative that DPS Staff’s 49 basis point adjustment is excessive. Key reasons offered in opposition to an adjustment include that the proponents introduced no proof of a correlation between credit quality and observed equity returns while Ex. 296 shows that no such correlation exists. It also points to DPS Staff’s willingness on brief to support a credit quality adjustment of 33 basis points without any record basis and states that this is proof of the frailty of the adjustment. It maintains, moreover, that such an adjustment is unwarranted and potentially very harmful because of instability in the markets at a time when the Company has substantial capital needs.

Reasons as to why DPS Staff’s adjustment is too high include that CPB’s proposed adjustment is smaller, that the Company is really more like an “A-“ and the proxy group companies are more like a “BBB+,” that the adjustment ignores that the Company’s debt is unsecured, and that the results are not plausible. On this last point, the Company points out that its single A, subject-to-downgrade bonds were yielding 6.27% at the time of the hearings. Application of a 49 basis points adjustment would result in a 5.78% yield that is lower than the 6.03% yield on “AA” rated utility bonds in the same period.

It makes sense intuitively that market segment and business risks of the Company are the same whether one is interested in purchasing its bonds or stock. However, neither DPS Staff nor CPB replies to the Company's argument about Ex. 296 and we cannot tell looking at that exhibit whether or not the Company's argument is correct. DPS Staff’s willingness to suggest an alternative adjustment goes more to the question of the extent of any adjustment rather than whether one is warranted.

We disagree with the arguments that a credit quality adjustment should not be adopted in a period of market volatility and of increased demand for capital. Our view is that each element of cost should be determined on a stand-alone basis and arguments like these are properly considered at one time, after all of the cost of service determinations are made, in balance with other competing reasons why the Commission should or should not base rates solely on costs.

Turning to the Company’s argument that the Company is more like an A- and that the proxy group is one like a “BBB+,” it is unfortunate that DPS Staff and CPB do not reply, other than to the extent that DPS Staff seems to acknowledge that the

Company is more like S&P's "A-" rating than Moody's "A1.". We find the Company's discussion on this point very hard to follow and, accordingly, give it no weight.

As to the Company's argument that DPS Staff's proposal does not reflect that some proxy group debt is secured and that the Company's is not, we are at a disadvantage to the extent other parties have not responded. However, we tend to doubt any adjustment is warranted on account of this fact, given that bond ratings of the proxy groups and the Company presumably reflect already the relatively lower risk associated with First Mortgage or other secured debt issued by the proxy group companies or their subsidiaries.

Turning to the Company's argument that a 49 basis point adjustment is implausible, we note that this contention is based on a spot yield comparison while DPS Staff's adjustment is based on observed differences in bond yields over a six-month period. This Company argument is not a reasonable basis for rejecting or changing the proposed adjustment.

Taking all the above into account, it continues to make sense that equity costs for a firm will generally go up and down with debt costs. However, we have no evidentiary basis to support this. Meanwhile, the Company claims to have proven there is no correlation between debt costs and earned equity returns. We cannot tell whether this Company argument is or is not correct. In light of this uncertainty, and DPS Staff's alternative suggestion on brief, we recommend DPS Staff's updated credit quality adjustment of 53 basis points be halved, or 26.5 basis points.

8. Flotation or Issuance Costs

The Company, DPS Staff and CPB each support a flotation or issuance cost adjustment to the indicated cost of common equity. Their proposals are 30, 4 and 15 basis points, respectively.[369] The key reason the Company seeks a higher adjustment is that it is seeking to recover some issuance costs that it claims were incurred in the past but not yet recovered in rates. The Company's brief does not disclose the dollar amounts of such costs or specify when they were incurred. Nor does it offer any explanation about why issuance costs that were incurred in the past should be reflected in future rates any more than any other historic expense item for which no deferral is allowed. We recommend the Company's issuance cost proposal be rejected.

DPS Staff's 4 basis point adjustment assumes a $250 million equity infusion, an issuance cost of 1.5% or $3.75 million, based on the Consolidated Edison Inc.'s (CEI, the Company's parent) prior three equity issuances. That dollar amount comprises .04% of the Company's $9.3 billion of average common equity. No party contends or proves that the calculation is incorrect so far as it goes.[370] Moreover, CPB's proposal is based on a projection of equity infusions greater than now appears likely.[371] In this light, we recommend DPS Staff's issuance cost adjustment and it is reflected as well in our overall cost of delivery service calculation.

9. Reasonableness of Results

The Company presents a number of arguments to the effect that either a greater number of cost of equity methodological issues should be resolved in its favor, or that the overall determination of its cost of equity should be adjusted up for the long-run benefit of customers. Specific arguments along these lines include the following:

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[369] Tr. 3174, Tr. 3359, and Ex. 440, pp. 16-17.

[370] Anticipated equity infusions are discussed further under capital structure, below.

[371] Ex. 440, pp. 16-17.

1. Authorized equity returns in New York are close to if not the lowest in the nation. For example, DPS Staff's proposed 9.5% is lower than the 10.94% equity return for DPS Staff's proxy group (Tr. 3217).
2. Equity cost estimation techniques supported here by other parties led to the Company's downgrading following the 2008 Rate Order and a significant increase in analyst concerns that New York is becoming a less supportive regulatory environment. A further downgrade is possible if the same approaches are adopted again.
3. Decreased regulatory support regarding the cost of capital in the short run could lead to a further downgrade, increased capital costs for the Company and, in a volatile market, a lack of access to capital at reasonable terms. This could reduce reliability and service quality, contrary to DPS Staff's position that maintenance of an "A" bond rating is in the best interest of customers (Tr. 3339-3400).
4. Decreased regulatory support in other forms, such as disallowances of reasonable O&M and capitalized costs, capital expenditure caps, downward only reconciliations, and revenue adjustment mechanisms with no upside potential, all increase the risk that the Company will not have a real opportunity to earn whatever equity return is nominally allowed.
5. Tightening the regulatory screws (or taking the Company to the regulatory woodshed) makes no sense in light of the Company's large capital needs, its weak internally generated cash flows, volatile financial markets, and the negative investor perceptions of New York regulation already mentioned.

DPS Staff, CPB, and Westchester respond separately on these points and those arguments are collectively as follows:

1. (a) The Company's comparison of allowed equity returns throughout the nation is inapt as it does not account for differences in credit risk. Moreover, the Company's comparison accounts for equity return differences, but not all of the other ratemaking parameters that affect the risk that an allowed return might or might not be achieved. New York is distinguishable to the extent it uses a forward-looking rate year, allows full recovery of commodity-related costs, and permits full reconciliation for sales revenues and some expenses. The effect is that the Company frequently earns more than its allowed rate of return, including in the three years ending March 31, 2008. The Company's comparison also ignores that the Company has

outperformed the S&P, NASDAQ, and Dow Indices and has been recommended by some analysts as one of the highest-yielding utility stocks (Exhs. 391-394 and 433).

(b) The Company's comparison of the 9.5% ROE supported by DPS Staff to the 10.94% average allowed return for the DPS Staff proxy group ignores the difference in risks between holding companies with no allowed rate of return (Tr. 3285) and with non-utility revenues greater than 10%, and the Company's parent, which has very little non-utility revenues.

2. DPS Staff's cost of capital recommendations are adequate to support the Company's "A-" S&P rating and a rating of at least "A3" by Moody's. (The latter would be a drop from the current "A1", but would be comparable to an S&P "A-" rating).
3. The Company's witness acknowledged that a modest incremental cost of debt change resulted from the downgrade earlier in 2008. There is no good reason to believe the Company will be denied access to capital markets. This is contrary to the expectations of Moody's and S&P (Ex. 395, pp. 5 and 6, Ex. 459, p. 4). This is also contrary to the fact that the Company just issued $600 million of debt in a period in which it has an allowed equity return of 9.1%. DPS Staff also states that its proposals would support ratings in the "A" category (Tr. 3303).
4. The proposed disallowances of O&M and capital expenditures are based on the expectation that under-expenditures or significantly lower expenditures in these categories in the past will be repeated in the future. These proposed disallowances are intended to ensure the Company does not collect revenues to match costs it will not incur.[372]
5. The Company's large capital needs, weak internally-generated cash flow, and volatile financial markets have already been factored in and warrant no additional adjustment.

As noted in Section I above, we believe that many of these arguments pertain less to the question of the Company's Rate Year cost of equity and more to do with whether or not the Commission, as a matter of discretion, should exercise its legal authority to set rates based on factors beyond costs (e.g.,

[372] This argument is not offered expressly in connection with the equity return arguments, but it is clearly a key underpinning of DPS Staff's direct case and needs to be considered here.

customer bill and investor earnings impacts), or to rely more on short- or long-term costs. With that said, we offer the following observations:

1. The Company introduced some evidence in this case to the effect that many of New York’s regulatory approaches are not unique. We have not had time to reach any firm conclusions on that information. The Company argument, that DPS Staff’s 9.5% is too low compared to the allowed returns for DPS Staff’s proxy group, is unpersuasive for the reasons given by DPS Staff in response.
2. The Company, certainly, and rating agencies, probably, pay more attention to the Commission’s equity cost determinations than to any other cost of service element. During the hearings, this was referred to as the “headline” return. While the cost of equity is a large cost, it clearly is not the only cost and attention to one cost over all others seems illogical, or may be based on reasons not discussed on the record. We believe that it is the overall Commission determination that should be evaluated for reasonableness.
3. The record here does not provide any clear basis for the Commission to determine that maintenance of the Company's “A-“ and “A1” ratings would or would not be reasonable. Long-standing Commission policy was to maintain a single “A” rating. It appears that policy might no longer be in force, but inquiries during the hearings about when and why that took place shed no light on these questions. Any current practice contrary to that earlier policy probably warrants careful scrutiny in an open process in light of current economic conditions, so that the Commission will have an objective basis to guide its future equity return determinations.
4. While it is true that the Company earned more than its cost of equity in past rate years (albeit in the context of a rate plan with equity earnings sharing terms), the adoption of an RDM in the 2008 Rate Order removes sales above the forecast amount as a major opportunity for the Company to earn more than its allowed rate of return. With an RDM in place, the Company will be protected from the financial impacts of sales lower than forecast. However, it should not be assumed that over earnings in the past will continue in the future. Thus, the Company's upside earnings potential is less than what it used to be and the Commission’s deliberations should carefully account for this.

5. Individual elements of the Company’s cost of delivery service should be evaluated on a stand-alone basis. This minimizes the probability that multiple, duplicative adjustments might be made on account of concerns that ratepayers can’t afford it or investors won’t be satisfied.
6. In the Company’s last electric case, DPS Staff testified that its recommendations would be adequate to avoid a downgrading. We have not reached any firm conclusions about whether the downgrades resulted from DPS Staff’s proposals, from Commission action independent of those proposals, for other reasons, or on account of some combination of the above.
7. Providing revenues to the Company to ensure reliability and service quality and insisting that the funds be used directly for such purposes, does not amount to unfair tightening of the regulatory screws. However, such measures will reduce the Company’s upside earnings’ potential and this must be considered when setting rates.

10. <u>Equity Earnings Sharing Trigger and Cap</u>

No party proposes an equity earnings sharing trigger or cap. However, we believe the Commission should give serious consideration to both. In light of the RDM and the one way reconciliation of capital expenditures discussed in Section IX, and the labor and related disallowances discussed in Section IV, we believe the probability the Company will over earn is already minimized somewhat. However, it is possible our productivity recommendations are too generous. In light of the Company’s past hiring practices, it is also not beyond the pale that it would fill even fewer positions in the Rate Year than we recommend be funded. In that context, with the current economic downturn, and with the Company’s downside earnings risk reasonable minimized, we do not think it would be unfair to impose a relatively tight sharing trigger for 50%/50% equity earnings sharing between 50 and 100 basis points above the allowed equity return with the latter figure serving also as an equity earnings cap. Any earnings from positive earnings incentive mechanisms adopted in these or other cases should be ignored for purposes of this mechanism. The earnings calculations should be per the Commission, ignoring disallowed costs. Using the 10% equity cost requested by the Company, the 50%/50% earnings sharing trigger would be 10.5% and the equity earnings cap would be 11.0%. Fifty percent of equity earnings above 10.5% and all equity earnings above 11.0% would be deferred with interest of the future benefit of customers.

B. Capital Structure

The basic question presented is whether the Company's overall weighted cost of capital should be calculated based on the Company's actual, stand-alone capital structure or based on the consolidated capital structure of its parent, CEI, as adjusted to remove what reasonably ought to be the capitalization of CEI's relatively small unregulated subsidiary businesses. On a percentage point basis, there is a very small difference between the Company's proposed equity ratio (48.47%)[373] and DPS Staff's proposals of 47.96% in testimony and 48% on brief. However, the cost difference between 48.47% and 47.96% is estimated to be worth approximately $7.4 million per year.

DPS Staff supports its 48% proposal on the grounds that it is adequate to maintain the ratings of the Company's senior unsecured debt obligations within their respective S&P and Moody's categories (Tr. 3316), to reflect that the Company's parent is using the Company's financial strength to fund unregulated operations with less equity than would be required to achieve an "A" category rating on a stand-alone basis, and in light of the substantive reasons the Commission set forth when it rejected the Company's position in the 2008 Rate Order.

[373] CPA supports the Company's position in light of current uncertainty.

The Company supports its own proposal and opposes DPS Staff’s on the grounds that:[374]

1. DPS Staff’s capital structure assumes a $200 million decrease in new equity offerings and a $200 million increase in new debt offerings.
2. DPS Staff failed to establish any factual or other reasonable basis to impute an equity ratio that is lower than the Company's actual.
3. The Company's unregulated affiliates now comprise primarily an ESCO, there are no plans for an increase in unregulated operations, and the rating agencies are indifferent to its existing unregulated operation.

We recommend that the Commission adopt DPS Staff’s proposal. Whether the Company's affiliated-unregulated operations are small or large, it is not reasonable that rates be based on equity costs that are properly allocated to the unregulated operations and their customers. There is also record evidence that investments in ESCOs are riskier than investments in the Company (Tr. 3294-3295) and the Company does not provide any substantive rebuttal to DPS Staff’s testimony questioning the amount of new equity and debt to be issued (compare Tr. 3294 and Tr. 1836.)

C. Cost of Debt

The Company expects to issue at least $1.1 billion of debt before the end of the Rate Year, in addition to the $600 million of 10-year debt recently issued. As of the time of the hearings, DPS Staff and the Company were projecting incremental debt costs of 5.85% and 6.14% respectively. The annual cost difference between the two is estimated to be $20 million.

On brief, the parties do not argue about whose estimate of debt costs is better and why. They focus instead on the best way to update the estimated cost of debt at the time of the Commission’s decision. They also agree as a matter of

[374] Alternatively, the Company argues that DPS Staff imputes too much of CEI’s equity to unregulated operations.

principle that actual and forecast debt costs should be trued up in light of market uncertainty.

DPS Staff favors a true-up of all debt costs because the Commission authorized a true-up of the interest expense associated with about $635 million of Company auction rate tax-exempt debt in the 2008 Rate Order and volatility in credit markets is up significantly since then. A continuation of that true-up and a true-up of all other debt costs, it says, will insulate the Company and ratepayers, depending on whether credit conditions get better or worse.

As to the specifics of the update to be made at the time of the Commission’s decision, DPS Staff favors reliance on Moody’s then current determination of current yield requirements of similarly-rated utility debt and yield spreads on the Company's outstanding debt obligations.

The Company similarly favors an update, but proposes that it be based on then-current projections of Treasury rates and then-current actual secondary market spreads on the Company's outstanding debt, plus any new issuance premiums. The secondary market spreads, it says, should come from Citigroup’s “Utility Debt in the Secondary Market” and the new issue premiums would come from transactions near the date of the order or a knowledgeable underwriter.

DPS Staff objects, in part, expressing concerns that the Citigroup yield spreads might be overstated and that it would not be able to verify such figures and that forecast Treasury rates should not be relied upon (Tr. 3322). It also advises that the new issuance premium associated with the Company's recent debt offering is on the order of 40 basis points.

We favor an update method that is simple, transparent, and reasonable. The Company does not respond to DPS concern about using forecast Treasury rates. Accordingly, we recommend and have employed in our cost of service recommendations the update approach proposed by DPS Staff, including the 40 basis point new issuance premium.

As to whether or not debt costs should be subject to a true-up, we believe rates should be set in this case in a way that reasonably minimizes the Company’s downside risk on matters that are largely beyond its control, that the Company should not be able to profit by holding on to funds that are intended to ensure reliability and service quality, and that the Company should have some minimal upside earnings potential in connection with costs it can control. Our sense is that a debt cost true-up would be a reasonable component of such a regulatory approach.

D. Overall Rate of Return

In light of the discussion above, suggesting the cost of common equity is 10.35%, and the Company's request for a return on common equity of 10% to ameliorate impacts on customers, the Company's overall allowed rate of return should be 7.86% as follows:

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.
RATE OF RETURN REQUIRED FOR THE RATE YEAR
TWELVE MONTHS ENDING MARCH 31, 2010
PER ALJs

	Average Capitalization %	Cost Rate %	Weighted Cost Rate %
Long Term Debt	49.60%	5.96%	2.96%
Preferred Stock	1.10%	5.34%	0.06%
Customer Deposits	1.30%	3.75%	0.05%
Common Equity	48.00%	10.00%	4.80%
Total	100.00%		7.86%

This should be updated at the time of the Commission's decision and subject to the equity earnings sharing trigger and cap discussed above.

IX. RATE BASE

A. Lower Allowances for Infrastructure ($24.5 Million)

1. Transmission & Distribution

(a) Introduction

The Company forecasts a transmission and distribution (T&D) capital construction program of $1.723 billion in 2009, $1.596 billion in 2010, and $1.360 billion in 2011. Before turning to numerous disputed issues about its projections, the Company provides on brief a high-level overview of its initial rate case presentation in support of its projections.[375] Key points in this overview include the following:

1. The Company's T&D system is critical to providing electric service to over 9 million people in New York City and Westchester. Two key approaches to operating the system reliably include responding to problems as they occur and programmatically upgrading and replacing parts of its system before they become degraded, obsolete, or are no longer supported by manufacturers.
2. Its capital construction program is driven in large part by annual demand growth of approximately 1.2%, including the effects of demand side management (DSM) initiatives (or 1.6% without DSM). Accordingly, many of the Company's substations will exceed their load ratings by 2017 unless steps are taken gradually to avoid that situation. While some small commercial property development is on hold, and this is reflected in its demand forecast, large commercial projects are going forward. It must be ready to serve those projects at full capacity even if the new buildings are not filled initially.
3. The Company has an extensive capital project development, approval, and implementation process to help ensure as few dollars as necessary are spent on projects that are needed.
4. Employee performance and training are key to a successful Company construction program.

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[375] The Company's Initial Brief, pp. 302-313.

5. The Company has taken numerous steps to minimize its capital budget. Examples include the following:

    - As a result of planned energy efficiency measures, costing an unspecified amount, the Company expects to be able to defer $1.2 million of substation capital projects beyond the next 5 years and to defer to 2016 a major ($65 million) transmission feeder project.
    - The Company's construction plan excludes $155 million for work that ought to be done but that is being delayed to ameliorate bill impacts. Thus, for example, 10 of 150 large transformers with average lives in excess of 40 years need to be replaced each year, but the costs for only 2 to 3 each year are reflected in its pending request.
    - The Company's Bid Check section helps ensure contractor bids are reasonable, saving the Company $115 million since 2003.
    - Cost controls, including the use of a project manager, are employed for large capital projects.
    - The Company generally procures outside services and equipment using a competitive bidding process.
    - The Company is now using "Third Generation (3G) System of the Future" technology. For example, the Company was able to meet the applicable second contingency criterion (two feeders can go out without affecting service on a network) by linking two substations in a way that deferred some transformer and associated cable costs and avoided altogether other such costs.
    - The Company employs numerous load relief measures (e.g., shifting load) before building new substations.

6. The costs of transmission and distribution equipment and components are up sharply, reflecting significant increases in the costs of copper (up 80%), steel (up 40%), and synthetic rubber (up 15%) in the period December 31, 2005 through January 1, 2008. Further such increases in early 2008 are not reflected in the Company's revenue request nor are expected increases in the costs of new transformers starting in 2010, when new energy efficiency requirements begin to apply.

With that as back drop, the Company goes on to summarize the three basic organizations involved in planning and conducting T&D construction, namely, Substation Operations, System and Transmission Operations, and Electric (Distribution

System) Operations, and the seven categories of T&D capital construction to be undertaken. The latter categories are:

1. Meet Economic Growth
2. System and Component Performance
3. Public Safety and Environmental Protection
4. Storm Hardening and Response
5. Employ Advanced Technology
6. Process Improvements
7. Security

At a high level, the Company summarizes on brief the capital work that is planned for 2009 and 2010 by the three organizations in the pertinent categories.[376] As set forth in Appendix II, this summary covers approximately $1.659 billion of the $1.723 billion T&D capital construction total set forth in the Company's original filing for 2009 and approximately $1.521 billion of the $1.596 billion total set forth in the Company's original filing for 2010.

In the Company's update/rebuttal presentation, very modest updates were made, reducing the Company's T&D capital construction forecast for 2009 by about $9 million on its own accord and accepting about $3 million of DPS Staff's proposed adjustments.[377]

Finally, as noted in Section I above, the Company's initial brief reports a $100 million reduction in the Company's 2009 capital budget. The Company states that it plans to provide the impacts, but no date for this is specified. Unfortunately, this recommended decision was prepared with no from information about the basis or impacts of the $100 million reduction.

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[376] The Company's Initial Brief, pp. 314-329.

[377] The Company's Initial Brief, pp. 329 and 344, n. 146. The two lists of accepted changes are not the same, but the amounts involved are relatively small.

(b) DPS Staff's Historic Spending Adjustment

General and program- or project-specific arguments concerning DPS Staff's proposed T&D capital expense adjustments are extensive. The key arguments are summarized in the next 20 plus pages, followed by one discussion.

(1) General Arguments

DPS Staff begins its discussions of rate base allowances for infrastructure by describing and defending its general approach, which is not to propose changes to the Company's capital budgets or the amounts to be invested in capital projects and programs (Tr. 2988). Instead, DPS Staff proposes to adjust the amount forecast to be added to plant in service balances for the Rate Year, based on DPS Staff's forecasts of expected investment levels. This affects the amount of carrying charges (e.g., return, depreciation, and property taxes) that would be recoverable in rates. For all T&D capital dollars, DPS Staff's proposed adjustment to Rate Year plant in service is $125.769 million (Tr. 2990). The related adjustment to O&M is $40 million for T&D alone (Tr. 2991).

DPS Staff justifies its approach on these grounds:[378]

1. The Company's budgets are forecasts of construction/ program schedules and their costs. Historically, the Company does not always spend its budget and an analysis of many programs and projects demonstrate that fact.[379] The Company's adoption of capital and O&M budgets does not assure budgeted amounts will be expended (Tr. 284).
2. DPS Staff examined each line item in the Company's capital budget (Tr. 2998). Review of the data in responses in Exhibit 169 indicates that differences between actual and forecast investment vary from year to year for any line item.
3. The historic relationship between budgeted and actual expenditures provides a reasonable guide to what the

[378] DPS Staff's Initial Brief, pp. 215-222.

[379] DPS Staff's Initial Brief, pp. 220-221.

Company will spend on its capital projects and programs going forward (Tr. 3008).

4. For each line item, DPS Staff compared historical budgets and historic expenditures, then made adjustments to plant in service to reflect its forecast expenditure levels for each (Tr. 3007).
5. The Company has not challenged DPS Staff's analysis of the historic data or its historic cost adjustments summarized in Exhibit 171.
6. Based on historic performance, use of the Company's unadjusted budget to set rates could result in ratepayers supplying revenues to match carrying costs that will not exist, which the Company admits (Tr. 256) would be grossly unfair to ratepayers.
7. Contrary to the Company's argument, DPS Staff's adjustment is not restrictive by project. The purpose of the adjustment is to determine a reasonable level of plant in service and reflect a realistic overall funding level, not to discourage the Company from undertaking any particular project. The Company is entitled to spend whatever level it deems appropriate to provide safe and adequate service (Tr. 2988).

As discussed below, the Company accepts a handful of small adjustments that flow from DPS Staff's approach, beyond those it accepted at the time of its update/rebuttal filing (late September 2008). However, it also provides T&D program-by-program reasons why it believes DPS Staff's historic spending adjustment is not well supported or will deny it revenues to support new investment that needs to be made.

At a more general level, however, the Company has several basic criticisms of DPS Staff's historic spending adjustment, as follows:[380]

1. DPS Staff frequently offers no program specific explanation of why the adjustment is reasonable.
2. DPS Staff's focus on historic costs is contrary to the Commission's 1977 Statement of Policy on Test Periods in Major Proceedings which discusses the need to consider historic data, emerging actual results, and projected

[380] The Company's Initial Brief, pp. 329-330.

changes in operations and costs. DPS Staff's analysis generally focuses only on the first of these.

3. The Company's presentation includes substantial information on planned changes in operations and increased costs of equipment and materials, justifying increased capital and related O&M expenditures.
4. As recently as the 2008 Rate Order, the Commission rejected proposals to disallow a return on T&D dollars without accounting for prospective planning and the assessment of need for new investment based on aging infrastructure and demand growth.

The Company's specific responses to DPS Staff's historic spending and any other project-specific adjustments are organized following the seven categories of T&D capital work, with each category divided into the affected organizational units.

(2) Specific Programmatic Arguments[381]

Substation Operations (Ops.) – Economic (Eco.) Growth

1. Astor Substation – DPS Staff proposes reducing the allowance for the Astor area substation project from $6 million to $3 million (Ex. 172, p. 1), because:[382]

a. The scope of the project has been reduced as a result of DSM, so that the need for a fifth transformer's installation has been pushed back from 2009 to 2013 (Ex. 169, responses to DPS-76 and DPS-228).
b. The fifth transformer has been relocated as a spare unit under the Spare Transformer program and is charged to that program.

The Company accepted DPS Staff's proposal in its update/rebuttal filing.

[381] The Company's Initial Brief, pp. 331-373.

[382] DPS Staff's Initial Brief, pp. 230-31. As used in this section references to "allowances" and "disallowances" should be understood to refer to the proposed allowance or disallowance of carrying charges on proposed capital investment dollars.

2. Emergent Load Relief – DPS Staff objects to $1.7 million (Ex. 172, p. 1). The Company accepts DPS Staff’s proposal on brief.

System and Transmission Ops. – Eco. Growth

Vernon – West 49th Street – DPS Staff objects to $6.3 million, because updated project costs are lower by that amount. (Ex. 172, p. 4). The Company accepted DPS Staff’s proposal in its update/rebuttal filing.

Electric Ops. – Eco. Growth

There are no adjustments proposed by DPS Staff.

Substation Ops. – System and Component Performance

DPS staff objects to 15 projects costing a total of $32.6 million in 2009 and $32.5 million in 2010 of which 12 are system and component performance projects. DPS Staff’s adjustments are based on historic spending levels. The Company responds generally that an estimate based on historic spending is not appropriate for forecasting the scope and extent of future work. DPS Staff is also said to be inconsistent by opposing the funding of work that is needed while simultaneously urging the Company to proactively and aggressively replace and upgrade aged infrastructure (Tr. 2996-97). The 12 specific projects and any specific arguments concerning each are as follows:

1. Relay Modification Program – DPS Staff proposes that $1.8 million of $5.5 million be disallowed in both 2009 and 2010 (Ex. 172, p. 2).

> Company Response: The System is key to monitoring reliability and security of the system. DPS Staff’s proposed adjustment ignores enhancements needed following the LIC outage in 2006 and a lightening strike at a substation in 2007, the latter of which was subject to DPS Staff’s 2007 electric reliability performance report to the Commission and resulted in a $5 million revenue

> disallowance for Consolidated Edison. Upgrading and replacing aging and problematic relays is also said to be critical for meeting North American Electric Reliability Corporation (NERC)/Northeast Power Coordinating Council (NPCC) standards.

2. Obsolete 138 kV Circuit Breaker Program – DPS Staff proposes that $1.7 million of $11.7 million be disallowed in both 2009 and 2010 (Ex. 172, p. 3).

> Company Response: It is cost effective to replace rather than repair obsolete breakers as spare parts are difficult to obtain. There are 5 such breakers at the Astoria West Substation that need to be replaced in 2009 and 5 more to be replaced at the Vernon Substation in 2010. These are 10 of 50 such breakers on the system.

3. Various Facility Upgrade Program – DPS Staff proposes that $5 million of $8 million be disallowed.

> Company Response: This involves structural improvements such as facades, foundations, retaining walls, HVAC, lighting, plumbing, drainage modifications, and fire protection system upgrades. The work planned is to respond to identified deterioration out of possible candidate projects totaling $24 million. Historic spending does not recognize this. A number of projects in this area involve installation of critical fire protection equipment.

4. Battery and Rectifier Replacement Program – DPS Staff proposes that $1 million of $3.5 million be disallowed in both 2009 and 2010 (Ex. 172, p. 3).

> Company Response: It needs to replace substation batteries at the end of the applicable 15-year life, and to replace DC System components necessary for rectifiers. The $3.5 million projection is based on identified projects needed to complete scheduled work. The Company has been exceeding its budgets by 8% for three years (2005-2007). Five substations require DC system upgrades to operate the breakers and disconnect switches that control power flow and protect the transmission system in fault conditions.

5. Capacitor Cable Upgrade Program – DPS Staff proposes to disallow $1.5 million of $3 million in both 2009 and 2010 (Ex. 172, p. 3).

> Company Response: 47 capacitor banks at 23 different substations operate with cables rated for less than continuous operation. Work in this area in 2008 is on budget and the Company spent 24% above budget in 2007. Adoption of DPS Staff's historic spending adjustment would delay implementation of important upgrades.

6. Substation Loss Contingency Program – DPS Staff proposes to disallow $1.5 million of $2.0 million in both 2009 and 2010 (Ex. 172, p. 3).

> Company Response: This program involves the purchase of spare substation and transmission equipment to facilitate prompt Company responses and to avoid delays associated with lead times to procure such equipment. The Company's gradual build up of such equipment will be delayed under DPS Staff's proposal.

7. Control Cable Upgrade Program – DPS Staff proposes to disallow $250,000 of $1.0 million in both 2009 and 2010 (Ex. 172, p. 2).

> Company Response: The $1 million per year request is consistent with 2008 expenditures and needed for work at the Dunwoodie Substation.

8. Substation Automation Target Information System Program – DPS Staff proposes to disallow $.65 million of $2.0 million in both 2009 and 2010 (Ex. 172, p. 3).

> Company Response: The adjustment would delay deployment of leading edge technology that enables remote, real-time access to critical equipment operating data. An installation at the Jamaica Substation is planned for 2009.

9. Area Substation Reliability and Auto Ground Switches Program – DPS Staff proposes to disallow $2.5 million of $10.5 million in both 2009 and 2010 (Ex. 172, p. 3).

> Company Response: This program provides a second line of fault protection and substantially improves reliability. The Company's proposed funding supports work on 5 to 7 of the Company's 400 transformers per year. DPS Staff's proposal would slow that to a rate of 3 to 5 per year.

10. East 63rd Street Substation Continuance Program – DPS Staff proposes that the entire $5 million be disallowed in both 2009 and 2010 (Ex. 172, p. 3).

> Company Response: Substations 1 and 2 at this location were built in the 1950s and are two of the few that still have outdoor switchgear in Manhattan. Prior upgrade options did not work out. Replacement of switchgear in 12 staged steps is feasible at this location and $5 million is needed to procure equipment in 2009.

11. Additional Ground and Test Program – The Company accepts DPS Staff's proposed $.4 million disallowance on brief.

12. Elmsford Substation Refurbishment – DPS Staff expressed concern about a delay in the project for which $37 million and $36 million are budgeted, respectively, in 2009 and 2010. On brief, DPS Staff concedes that the Elmsford Substation Refurbishment project seems badly needed due to significant deterioration of this 49-year old facility. Given that none of the physical site work has been started, DPS Staff says it will monitor the progress of the project and determine whether an adjustment might be warranted in a future rate case.[383]

> Company Response: The Company explains that earlier refurbishment plans were not feasible. The revised project scope is $87 million instead of $143 million if the Village of Elmsford (in Westchester County) approves the project.

System and Transmission Ops. – System and Component Performance

DPS Staff objects to the amounts sought for two of the Company's programs.

1. Emergent Transmission Reliability Program – Going beyond its historic spending adjustment, DPS Staff opposes all

[383] DPS Staff's Initial Brief, pp. 231-232. Ex. 172, p. 2 confirms that DPS Staff proposes no adjustment at this time.

of the Company’s $10 million request for the Emergent Transmission Reliability Program, because:[384]

a. The program essentially funds capital projects that have not explicitly been identified when the annual budget is developed (Tr. 3021).

b. Consolidated Edison expended no capital in this category since at least 2004 and budgeted funds for this purpose only in 2005 and 2008 (Ex. 169, p. 18).

c. The Company’s plant-in-service model shows allocation of the $10 million ratably to plant-in-service during the Rate Year, meaning the Company plans to invest capital in this project over the course of the year in specific monthly amounts reflecting historic seasonal construction patterns.

d. If unforeseen situations requiring capital expenditures that affect transmission reliability arise between budget cycles, the Company should invest the capital needed to ensure safe and adequate service and assign it to proper plant accounts, subject to review in a subsequent rate case (Tr. 3021-3022).

DPS Staff disagrees with the Company’s claim, for this program and the Transmission Feeder Failure Program discussed next, that the requested funding should be provided to address proactively issues that arise in the transmission system, as they arise, without the need to wait for a rate cycle to include them in the capital budget. DPS Staff opposes as well Consolidated Edison’s alternative proposal to combine the two categories and provide a total allowance of $7.0 million per year for the combined program (Tr. 3995), because:[385]

a. The Transmission Feeder Failures Program is an on-going program with a good history of expenditures upon which a reasonable forecast of future expenditures may be made.

b. The Emergent Transmission Reliability Program has no consistent history of expenditure levels and should not be funded at all, for the reasons listed above.

[384] DPS Staff’s Initial Brief, pp. 223-226 and Ex. 172, p. 5.

[385] DPS Staff’s Initial Brief, pp. 225-226.

Company Response: The Emergent Transmission Reliability Program is intended to address transmission feeder reliability concerns. The Company budgeted $10 million in 2005 but used 88% of it to reconductor feeder 99032. The Company had no significant expenditures in 2006 and 2007. This work has a priority rating of 10 of 21. The amount is for unforeseen events that typically arise. A denial makes it more difficult to address emergent reliability problems. At a minimum, allow the $2.9 million historic average, consistent with the approach DPS Staff uses to support its adjustments for many other programs.

2. Transmission Feeder Failure Program –DPS Staff proposes that $1 million of $5 million be disallowed in 2009 and 2010 because:[386]

a. The Company's actual expenditures have varied from lower to higher than budgeted over the last several years (Ex. 169, p. 18).

b. The average actual expenditure level for 2005 through 2007 was $4 million (Tr. 3019).

Company Response: The $1 million above historic levels reflects the increased number and cost of repairs (Ex. 59, p. 15). The expected costs are in Ex. 169, p. 816 (redacted version).[387]

DPS Staff Counterpoint:[388] Ex. 59 states that the number and cost of transmission repairs has increased. Ex. 169, p. 18 reveals that the Company budgeted $4 million and only spent $1.818 million in 2007. This suggests a greater disallowance is warranted. Ex. 169, p. 816 simply presents tabulated forecasts for 2009 through 2012 and does not demonstrate any linkage between facilities and increased costs.

Electric Operations – System and Component Performance

DPS Staff proposes adjustments to 16 programs in this category and the Company accepts five. Of the remaining 11, ten are based on DPS Staff's historic spending adjustment method

[386] DPS Staff's Initial Brief, p. 223 and Ex. 172, p. 5.

[387] For some exhibits, there is a public or redacted version as well as a confidential version.

[388] DPS Staff's Reply Brief, pp. 78-79.

(use of a three-year average) for a total adjustment of $40.984 million in 2009.[389] One of these adjustments ($3 million) corrects a mathematical computation; the Company accepts this in part.

As above, the Company's basic position is that past expenditures on these programs are not indicative of future expenditures needed to maintain and improve the performance of its infrastructure. The Company likewise continues to maintain that DPS Staff wants the Company to avoid problems programmatically, but opposes the necessary funding. The specific programmatic issues raised are discussed. The first three are discussed in greater detail as they are the subject of DPS Staff testimony.

1. <u>Underground Secondary Reliability</u> – DPS Staff proposes reductions for the Underground Secondary Reliability Program of $16 million of $55.268 million in 2009 and $8 million of $50.612 million in 2010 because:[390]

a. Although the program is critical in addressing Consolidated Edison's aging infrastructure, reliability enhancement to the secondary grid, and pedestrian safety, the Company has historically under-spent its budget, including in 2008. DPS Staff's proposal accurately reflects the Company's average historic spending (Tr. 3031).

b. The Company claims it is on track to spend the full budget amount for 2008, but as of August 2008 it had spent only $22.3 million. DPS Staff calculates that the Company is on pace to spend only $33.5 million of $42.5 million budgeted for this calendar year, yet the Company is now requesting $12.832 million more for 2009 than it will spend in 2008.

c. Consolidated Edison claims that it failed to spend up to the budgeted amounts in prior years for various reasons, but does not explain those reasons.

[389] The Company's Initial Brief, p. 345, notes 147 and 149.

[390] DPS Staff's Initial Brief, pp. 232-234 and Ex. 171, p. 6.

d. Ramping up spending to $70.727 million in 2012, as DPS Staff proposes, would encourage the Company to establish a reasonable level of spending that should be manageable.

Company Response: In its initial brief, the Company explains that this work involves replacing secondary cable and conduit, upgrading secondary structures containing equipment, and installing vented service boxes on the street and vented composite service boxes on sidewalks in order to mitigate stray voltage. The Company needs full funding; a backlog will continue to grow even at full funding. The number of inspections requiring replacement is way up in the fourth of a five-year cycle. 10,300 secondary mains and services and 24,996 structures were identified for upgrades in the first six months of 2008. Another related cost is for vented manhole covers (discussed separately below) that DPS Staff expressly supports on a program basis. The funding supported by DPS Staff is also lower than 2006 and 2007 actuals, when the Company spent $59.4 million and $44.9 million for mains and service replacements and lower than the $42.5 million that the Company budgeted and is on track to spend in 2008. Nor does DPS Staff's adjustment recognize the incremental spending on a vented cover program. DPS Staff ignores that the backlog for this work is growing and that the unit costs are up. For example, material and labor for a secondary cable section went from $10,000 in 2006 to $13,900 in 2007 and the same costs for an obstructed secondary cable went from $13,600 in 2006 to $16,700 in 2007.

Company Further Response:[391] DPS Staff's $33.5 million projection for the current rate year is a straight line projection based on $22.3 million expended through August 2008 (Tr. 4009). The Commission should take notice that its actual expenditures through November are $34 million and it projects $37.8 will be invested by December 31, 2008.

2. Network Reliability Program – DPS Staff originally proposed to disallow $24 million of $25.2 million in 2009 and $12 million of $25.7 million in 2010 because the Company under-spent its budget in 2005-2007 and is underspending its

[391] The Company's Reply Brief, p. 123.

$42.4 million 2008 budget by $18.2 million.[392] On cross-examination, DPS Staff acknowledged that the Company had no budget for this program in 2005-2007. On redirect, DPS Staff testified that its proposed adjustment is reasonable based on the Company's past level of effort on the Underground Secondary Reliability Program just discussed. On brief, DPS Staff questions the Company's commitment to the Network Reliability program because:[393]

a. Although the Commission supported this program during the Washington Heights implementation plan in Case 99-E-0930, to date there has been minimal progress by Consolidated Edison.[394]

b. As of July 2008, the Company had spent only $244,730, bifurcating only eight feeders (Ex. 169, response to DPS-197), of the $18.441 million budgeted for this rate year (Ex. 51, p. 3).

c. Historic spending for the program was zero in 2004-2006 and only $47,000 in 2007 (Ex. 169, response to DPS-40), but the Company has provided no explanation of why expenditures were so low despite its claimed commitment to the program.

Company's Response: DPS Staff's historic adjustment rationale is inadequate for such a large amount. In any event, the Company spent $28.9 million in 2005, $59.4 million in 2006 and $44.9 million in 2007 on underground secondary reliability, not $1.2 million. Indeed, the actual-to-budget ratio was 66.6% in this period. This suggests a minimum allowance of $16.7 million and $17.1 million for 2009 and 2010 vs. DPS Staff's proposed $1.2 million and $13.7 million allowances. On re-cross examination, moreover, DPS Staff acknowledged that the year-to-date information it provided is for underground secondary reliability. This is not accurate as the record shows the Company spent $22.3 million as of August 2008 and that it is on track to hit the budget of $42.5 million. The Company concludes, arguing that the network reliability projects are all needed in 2009, in part, to do further feeder bifurcation work (to prevent network shutdown).

[392] Ex. 172, p. 6.

[393] DPS Staff's Initial Brief, pp. 234-35.

[394] The captioned case concerned a major system outage in July 1999 and recommendations to avoid a recurrence.

Company Further Response:[395] The Company re-emphasizes that this is a new program and that $1.2 million is 2009 is inadequate for specific projects discussed in its rebuttal testimony (Tr. 4008).

3. Transformer Purchase Program – The Company states that DPS Staff proposes to disallow $3 million each in 2009 and 2010 for an error in the cost of shunt reactors. The Company advises that it accepts DPS Staff's adjustment for 2009 but that it does not accept it for 2010 based on recent information suggesting a 40% increase in the cost of shunt reactors. DPS Staff confirms that it and the Company now agree the $3 million adjustment for shunt reactors should be made for 2009 alone.[396]

4. Cable Crossing Primary - DPS Staff proposes that $5 million of $8 million be disallowed in both 2009 and 2010 (Ex. 172, p. 6).

Company Response: The program was initiated in 2008. There is no historic spending. DPS Staff's historic adjustment should not apply. Three specific river crossings to be done in 2009 involve the Roosevelt Ave. Bridge, the Riverdale Network Feeder, and the Croton River Crossing.

5. Sectionalizing Switch Program – DPS Staff proposes to disallow $2.2 million of $4.2 million in 2009 and $2.4 million of $4.4 million in 2010 (Ex. 172, p. 6).

Company Response: It spent $2 million in 2006 and 2007 to install these switches on backbone feeders. It needs to invest $3.2 million in 2008 and $4.2 million in 2009 to increase to 25 the number of switches installed per year at $.175 million per switch. DPS Staff's historic adjustment fails to account for this planned program expansion.

6. Shunt Reactors Program – DPS Staff proposes to disallow $.4 million of $1.4 million in 2009 and $1.6 million of $2.8 million in 2010 (Ex. 172, p. 6).

[395] The Company's Reply Brief, pp. 123-124.

[396] DPS Staff's Initial Brief, p. 235.

Company Response: Shunt reactors prevent over-voltage conditions on the low voltage secondary network when an out-of-service feeder remains energized. The Company installed them on its 27 kV feeders in the Long Island City Network in 2007 and 2008. The Company plans to install 123 shunt reactors over the next five years (15 in 2009) and 27 per year thereafter (2010-2013). Prior to 2007, there was no budget for this type of work.

7. 4 kV Unit Substation (USS) Switchgear Replacement Program - DPS Staff proposes to disallow approximately $.842 million of $2.2 million in both 2009 and 2010.

Company Response: Approximately 170 units are more than 40 years old. Serious problems are being experienced. The Company plans to change them out over 20 years. DPS Staff's adjustment would reduce the number to be changed out to only one per year. The Company changed out two units in 2007 and plans two more for 2008.

8. USS Life Extension – DPS Staff proposes to disallow $.7 million of $1.8 million in 2009 and $.45 million of $1.2 million in 2010 (Ex. 172, p. 6).

Company Response: This involves replacement of air with vacuum circuit breakers, extending the life of unit substations. Original equipment is frequently older than 40 years and requires substantial maintenance. DPS Staff's adjustment ignores recent work to replace 10 of these and denies the Company the carrying costs of replacing proactively critical unit substation equipment.

9. USS Automation Program – DPS proposes to disallow $57,000 of $150,000 in both 2009 and 2010 (Ex. 172, p. 6).

Company Response: Remote operation hastens customer service restoration. 25 substations lack this equipment. DPS Staff's proposal extends this work from four to six years and the $93,000 DPS Staff would allow annually is less than the $122,000 spent by the Company in the first eight months of the current rate year.

10. Facility Improvement Program – DPS Staff proposes to disallow $163,000 of $425,000 in 2009.

Company Response – This money is needed to upgrade unit fencing, landscaping, paving and security over two years. There were no such expenses prior to 2008.

11. Temperature Gauges Program – DPS Staff proposes to disallow $38,000 of $100,000 in both 2009 and 2010 for replacement of pressure-operated gauges with electronic gauges. The Company plans 10 installations per year and DPS Staff’s proposed allowance would cover only 6-7 per year.

Substation Ops. – Public Safety and Environmental

DPS Staff proposes two program disallowances based solely on the Company’s historic rate of investment.

1. Pumping Plant Improvement Program – DPS Staff proposes to disallow $3.3 million of $8.5 million in both 2009 and 2010 (Ex. 172, p. 4).

> Company Response: These costs relate to the extensive dielectric oil system that cools its feeders. The Company’s $5.6 million spent to date in 2008 (compared to the $8.5 million budget) reflects a City moratorium on the use of helical screw piles (delaying Corona substation work) and delays in obtaining DEC permits to refurbish Pier 98. Annual funding of $8.5 million is needed to address identified and emergent work.

2. Public Utility Recirculation Station Supervisory Control and Data Acquisition – DPS Staff proposes to disallow all of the $3 million requested in each of 2009 and 2010.

> Company Response: This project is intended to replace an obsolete communications system that has mistakenly shut down the plants that cool its feeders. The $3 million is consistent with the scope and priority of this work.

System and Transmission Ops. – Public Safety and Environmental

1. DEC Program Line – The Company accepts DPS Staff’s proposed disallowance of $150,000.

2. Environmental Enhancement – The Company accepts DPS Staff’s proposed disallowance of $150,000.

Electric Ops. – Public Safety and Environmental

1. Vented Manhole Covers – DPS Staff proposes a disallowance of $1.3 million of $10.0 million in 2009 (Ex. 172, p. 7), arguing this work can and should be completed but that it doubts the Company will do so based on past performance. On brief, DPS Staff argues that its adjustment to the Vented Manhole Cover program is based on the Company's historic "maximum capability" in any one year to date. It argues that whether Consolidated Edison's estimates for new work are accurate cannot be determined with certainty, because the Company has not commenced the new work and thus has no experience, which justifies an adjustment based on historic costs.[397]

> Company Response: The cost to complete this program will exceed the $8.66 million spent in 2005. The 24,500 vented covers installed in 2005 cost $355 each. Of the 9,000 yet to do, 4,050 will require a manhole rim regrade and cost $2,000 each while the other 4,950 will still cost only $355 each. DPS Staff's adjustment would prevent completion of the program in 2009.
>
> Company Further Response:[398] DPS Staff is inconsistent to propose a disallowance of the needed funds and to insist that the remaining work should be completed in 2009. If DPS Staff's adjustment is adopted, the Company should have two years to complete the work.

2. Streetlight Isolation Transformer Program – DPS Staff proposes to disallow $1.9 million of $7.8 million in 2009 and $4.5 million of $10.5 million in 2010 (Ex. 172, p. 7). On brief, DPS Staff argues that its proposal is reasonable because:[399]

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[397] DPS Staff's Initial Brief, pp. 241-242.

[398] The Company's Reply Brief, p. 125.

[399] DPS Staff's Initial Brief, p. 242.

a. Given that the program is in its infancy, no baseline for a typical level of expenditures has been established.

b. It is not clear the Company can meet the goals it has set, and until more is known, a more measured increased is warranted.

c. DPS Staff's adjusted amount still results in an increase of about 45% over the amount budgeted for the current rate year ($4.1 million) (Tr. 3039-40).

Company Response: This is a 10-year program to install 163,000 isolation transformers to minimize stray voltage on street lamps and traffic lights. The Commission stated in the 2008 Rate Order that this is an urgent public safety matter and DPS Staff wants the Company to make a concerted effort to complete the work. The Company began this program in 2008 and its $4.1 million budget covers just six months of installations. DPS Staff's proposed adjustment would result in 3,000 fewer installations in 2009 and a continuation of that approach over time would extend the program from 9 to 18 years.

Electric Ops. – Storm Hardening

DPS Staff proposes to disallow $6.4 million of $32.4 million in 2009 and $6.2 million of $31.6 million in 2010 for eight different programs in this category. The Company's update/rebuttal presentation accepts $.586 million in an unspecified year and the Company contests DPS Staff's other proposals as follows:

1. C-Truss (Pole Reinforcement) Program – DPS Staff proposes a $.4 million disallowance of the $1.7 million sought by the Company for both 2009 and 2010, because:[400]

a. The Company forecasts a rejection rate for poles that is above the historic average (Ex. 169, response to DPS-118).

b. The Company's estimate is based only on replacements in the Brooklyn/Queens operating area in 2005, whereas DPS Staff based its adjustment on historic costs over a three-year period in the Company's entire service territory.

[400] DPS Staff's Initial Brief, pp. 238-240.

c. The Company provided no support for its allegation that a reallocation of funds caused it to have a backlog of C-trussings and replacements.

d. Over the three-year period 2005-2007, total actual Company expenditures on this program were only 44% of total budgeted expenses (Ex. 169, response to DPS-40).

e. DPS Staff's proposed adjustment takes the highest actual expense and prorates it for the Company's proposed change from a 12-year to a 10-year inspection cycle, then adds 50% of the difference between that amount and the Company's proposal, providing for uncertainties related to cost and the changed inspection cycle.

f. If, as the Company claims, DPS Staff had not adjusted for the change from a 12-year to a 10-year cycle, DPS Staff would have recommended only $.77 million per year for this program.

Company Response: C-Trusses are pole reinforcements. In some past years, budgeted amounts had to be diverted to higher priority work. This led to a backlog. Moreover, the Company used to inspect poles using a 12-year cycle but 10 years is an industry standard it plans to follow in the future. The funding requested is needed for a 10-year schedule and will not address the backlog.

2. Auto Loop Reliability – DPS Staff proposes to disallow $2.4 million of $7.4 million in both 2009 and 2010 (Ex. 172, p. 7).

Company Response: Auto loops isolate fault areas to minimize the number of customers affected. This new, seven-year program started in 2008. There is no historic spending base for DPS Staff's proposal. The Company expects to spend its $4.97 million budget in 2008. The Company presented a detailed plan (Ex. 65, pp. 5-8) for 2009 and 2010; the projected cost is $7.3 million per year. DPS Staff is inconsistent to insist on a Reliability Performance Mechanism and to propose a disallowance of auto-loop costs without providing any program-specific reason.

3. Aerial (Okonite) Cable Replacement Program – DPS Staff proposes to disallow $1.6 million of $2.5 million in both 2009 and 2010 (Ex. 172, p. 7).

Company Response: Okonite is defective, obsolete, poorly performing cable that supplies single-contingency unit substations and sensitive, non-network high load customers such as hospitals, nursing homes, and businesses. This cable should be replaced before it fails, consistent with DPS Staff's support for programmatic prevention of problems. DPS Staff supported $2.5 million for 2008 and its position here is an abrupt reversal with no programmatic basis. The Company does not affirmatively discuss past actual and budget amounts and faults DPS Staff for failing to do so for 2008.

4. #4 and #6 Self-Supporting Wire Program – DPS Staff proposes to disallow $.9 million of $3.2 million in both 2009 and 2010. (Ex. 172, p. 7.)

Company Response: This program involves the replacement of 4.78 million feet (905 miles) of 40 year old cable that is subject to sagging in high load conditions and breaking in the winter. The Company plans to replace that amount over 23 years, or .208 million feet (38.4 miles) per year, at an annual cost of about $3.2 million. DPS Staff's adjustment would slow this to 31 years.

5. Replace ESCO® with Kyle® Switches – DPS Staff proposes to disallow $.5 million of $2.5 million in 2009 and $.3 million of $2.3 million in 2010 (Ex. 172, p. 7.)

Company Response: This involves replacement of obsolete switches with the most current technology and the installation of Supervisory Control and Data Acquisition (SCADA) equipment to monitor and control these devices. This work is key to reducing customer interruptions and to speed up service restorations. Thus, a disallowance would be inconsistent with improving the Company's Customer Average Interruption Duration performance. DPS Staff supported $2.5 million for this work in the Company's last electric rate case, compared to the $2.0 million DPS Staff now supports.

Company Further Response:[401] DPS Staff properly concedes that all the storm hardening programs are warranted (DPS Staff's Initial Brief, p. 237). Given that DPS Staff also proposes that expenditures in this category be subject to a downward only reconciliation, there is no need to adopt DPS Staff's adjustments based on historic costs.

[401] The Company's Reply Brief, pp. 124-125.

System and Transmission Ops. – Advanced Technology

1. Steam System Energy Management System – DPS Staff originally proposed to disallow in its entirety the $2.0 million and $1.5 million sought by the Company for 2009 and 2010. On brief, DPS Staff argues:[402]

a. The project involves replacing the Company's steam system Energy Management System (EMS) co-located within its transmission and distribution EMS in its Energy Control Center (Ex. 67, p. 1).

b. Approximately half of the steam system's needs are met with dual service (electric and steam) plants, with EMS controlling those dual service plants as well as steam-only plants (Tr. 4037).

c. Although the Company suggests only a 5% allocation of costs of this project to its steam customers, the same percentage for charging System Operations O&M programs to steam, it provides no justification for such an allocation.

d. Given that 50% of steam system needs are met with the dual service plants, a 25% allocation of these capital costs to the electric system is reasonable.

Company Response: In its initial brief, the Company argues that this system has to be replaced because the electric Energy Management System is being replaced. If an allocation to steam customers is made, the Company continues, it should be based on the system operations O&M allocation.

Company Further Response: In its reply brief,[403] the Company acknowledges DPS Staff's recent support for a 25% electric allocation to the electric system but argues that DPS Staff's new proposal does not go far enough. Specifically, DPS Staff's allocation does not reflect that the Company's dual service units 6 and 7 at East River are allocated fully to electric plant and that 66.4% of East River Units 1 and 2 is assigned to electric plant. The correct electric allocation would thus be 41.5% rather than 25%. The Company also requests that it be permitted to defer carrying charges on the costs to be allocated to steam customers pending the September 30, 2010 expiration

[402] DPS Staff's Initial Brief, pp. 227-228.

[403] The Company's Reply Brief, pp. 120-121.

of the current steam rate plan (Case 07-S-1315). The Company does not state whether such a proposal is consistent with the terms of the current steam rate plan.

2. <u>EMS Visualization Display (Bulk Power Improvement Project)</u> – DPS Staff proposes to disallow in both 2009 and 2010 the full $.5 million sought for a new Energy Management System visual display. It argues:[404]

a. As of the time of a meeting between Company and DPS Staff personnel as part of the discovery process, there were no firm Company plans, requests for proposals, or design instructions developed for the project, which is still early in its conceptual planning stage, and it has the lowest priority ranking of any project in the System and Transmission Operations category (Ex. 169, p. 128).

b. The planned improvements the Company lists in its update/rebuttal testimony (Tr. 4035) were not presented in its original prefiled testimony, its "white papers,"[405] or discussed with DPS Staff when the topic was raised at a meeting held at the Company's Energy Control Center as part of discovery (Tr. 4035). The update/rebuttal information is late filed.

Company Response: In its initial brief, the Company states that there is no issue about whether this is needed to operate the bulk power supply system. Given progress to date, there is no reasonable basis for DPS Staff's concern about the project not going forward.

In its reply brief,[406] the Company faults DPS Staff for: (1) failing to specify what transpired at the referenced meeting that led it to conclude that there are no firm plans; (2) failing to cross-examine the Company's update/rebuttal testimony on this topic; (3) proposing an adjustment on which DPS Staff asked no written discovery questions: and

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[404] DPS Staff's Initial Brief, pp. 228-229.

[405] White papers are project or program-specific explanations that were prefiled and that are in evidence. They support or supplement the narrative explanations set forth in the Company's prefiled testimony.

[406] The Company's Reply Brief, pp. 121-123.

(4) objecting untimely to information that is already in evidence.

Electric Ops. – Advanced Technology

DPS Staff proposes no disallowances in this category but recommends two issues be transferred for consideration in the EEPS case.

1. Area Profile System – According to the Company, it developed a new mapping system known as the Area Profile System, in response to DPS Staff's February 2007 report on the Long Island City network outage. The new system helps the Company collect and assess critical population and household impacts during an emergency. The Company proposes to spend $.1 million in both 2009 and 2010 to expand functionality to cover more databases. DPS Staff considers this part of administration and implementation of an energy efficiency program that should be considered in the EEPS case. The Company argues that regardless of any energy efficiency goals, the system is primarily needed to continue its demand response program, which is not under consideration in the EEPS proceeding.

2. Energy Efficiency IT Systems Development – The Company plans to invest $5.3 million through 2012, including $2.1 million in 2009 and $1.1 million in 2010, to develop the information technology needed for the Company to plan, implement, and evaluate its energy efficiency programs. Like the prior issue, DPS Staff suggests these costs should be considered in the EEPS case.

> Company Response: This expenditure is appropriate regardless of what happens in the EEPS case in light of the Company's commitment to reduced carbon emissions and as the system will also support the Company's demand response programs not covered in the EEPS case. Deferring this issue to another case creates uncertainty about cost recovery. Alternatively, the Commission should provide for deferral of all costs and carrying charges, subject to recovery of the deferred costs through the MAC.

Electric Ops. – Process Improvements

Work Management System – DPS Staff proposes to disallow $1.5 million of $1.5 million in 2009 and $6.5 million of $13.5 million in 2010. On brief, DPS Staff supports its proposal on the grounds that:[407]

a. Although the adjustment will double the length of time for project completion, it can be extended without jeopardizing the electric system or significantly hindering daily work tasks (Tr. 3037-38, Ex. 172, p. 7).

b. The adjustment allows for continuation of work on the program, while helping to reduce the impact of rate increases on ratepayers.

Company Response: This project is to start in 2009 to consolidate all work management systems. The in-service date falls in 2012. DPS Staff understands its adjustment would delay the project to 2016 but the Company argues that this is too long to wait. The Company asserts that the work is responsive to the 2008 Rate Order (p. 92) and makes sense in light of DPS Staff's rigorous review of the Company's work management processes and procedures in the ongoing audit.

DPS Staff Counterpoint:[408] Commission interest in work management does not warrant full funding, especially in the absence of any Commission determination that the Company's current work management system is inadequate.

Substation Ops. – Security

DPS Staff proposes to disallow $3.1 million of $4.1 million in 2009 and $3 million of $4 million in 2010 for substation operations security enhancements (Ex. 172, p. 4). The Company assumes DPS Staff's adjustment is based on historic spending as no other explanation is given.

Company Response: The Company is committed to security. Expenditures have gone up every year. Work must be done to comply with Security Specification CE-ES-2002 by the end of

[407] DPS Staff's Initial Brief, pp. 240-241.

[408] DPS Staff's Reply Brief, pp. 79-80.

2012 (see Ex. 58, pp. 68-69). Use of historic spending is not appropriate as the bulk of security work was in the corporate capital budget until 2008. The Company expects to invest $3 million at seven facilities by the end of 2008. DPS Staff failed to confer with the Department's Utility Security Section. DPS Staff, including three DPS Staff witnesses in the current case, also supported $2 million annually for such expenditures in the Company's last electric rate case.

(3) Discussion

We reviewed in great detail all of the T&D general and project- or program-specific issues that remain between the Company and DPS Staff. Putting aside a few issues discussed separately below, we find as follows:

1. The Company generally presents a very strong case in support of the specific programs and projects it plans for 2009 and 2010. In general, it describes the work that is planned, how the work will benefit the system, the bases of its forecast, and why its planned investments are sometimes greater than in past years. One general exception is that the Company advises that it now projects a capital budget that is $100 million less than presented on the record. Given that the 1977 Statement of Policy on Test Periods in Major Rate Proceedings generally bars updates of forecasts this late in a case, the Commission should consider this updated forecast only if it will be equally willing to consider update forecasts that would tend to support a higher rate increase.
2. Part of the reason why the Company's overall T&D capital investment presentation is so persuasive is that no party critiques or disagrees with much of it on a substantive basis. Scanning the project- or program-specific arguments summarized above, for example, it is apparent that DPS Staff offers no substantive arguments on 10 of 10 outstanding issues related to substation operations – system and component performance, on 9 of 11 issues related to electric operations- system and component performance, on 2 of 2 issues related to substation operations – public safety and environmental, on 4 of 5 issues related to

3. electric operations – storm hardening, and on the only issue related to substation operations – security.[409]

4. Another part of the reason why the Company's overall T&D capital plans seem reasonable is that DPS Staff expressly agrees much of the work needs to be done (e.g., underground secondary reliability, vented manhole covers, and the streetlight isolation transformer program) and as there are instances where the work is intended to ensure adequate fire protection, avoid oil leaks harmful to the environment, minimize the risk of stray voltage incidents to members of the public, and increase electric system reliability.

5. We conclude that disallowing projected capital expenditures, based solely on an analysis of historic expenditures, would amount to a departure from the 1977 Statement of Policy on Test Periods in Major Rate Proceedings. Among other things, that policy states that the principal goal of the ratemaking function is to set rates that will produce the required revenue in the period during which those rates will be in effect.[410] It is not clear to us why DPS Staff proposes to depart from that Policy Statement. An examination of its arguments with respect to the vented manhole covers suggests it cannot comfortably agree with a forecast (related to installations of rims) unless it knows in advance that the forecast will be accurate. Its proposal to disallow significant portions of the costs of the important street light isolation transformer program – even in the context of a proposed one-way reconciliation of carrying changes, discussed separately below – given the absence of a base line of expenditures on this program, is further proof of a reluctance to be wrong. However, the referenced Policy Statement requires that forecasts be made for the future, using the best information available. A guarantee that such forecasts will be accurate is not required.

Turning to specific issues on which substantive arguments are offered by both the Company and DPS Staff, we reach the following conclusions:

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[409] That DPS Staff did not consult the Department's security office and nevertheless proposes that certain security investments be disallowed further undermines DPS Staff's position on that topic.

[410] 17 NYPSC 25-R, 26-R (1977).

1. Emergent Transmission Reliability – No one can be certain whether or not such costs will actually be incurred in the Rate Year. The Company has incurred $2.9 million annually on average and there is no evidence that it ever needed $10 million per year for this purpose. The allowance should be set at $2.9 million each for both 2009 and 2010.

2. Transmission Feeder Failure Program – The Company has not explained reasonably the basis of a $1 million increase over the $4 million annual average. DPS Staff's adjustment should be adopted.

3. Underground Secondary Reliability – It remains to be seen whether the Company is on track for 2008. However, the results of inspections by the Company in the first part of 2008 are uncontested and much of the needed work is related to safety. There is also an open question about whether costs for materials will be much higher in the Rate Year. In these circumstances, it is better to err on the high side for this category, subject to a one-way reconciliation term we recommend and discuss below.

4. Network Reliability Program – The correct Rate Year allowance seems to turn primarily on whether the Company is on budget in the current rate year and whether it is reasonable to assume the historic relationship of actual to budget investment in the underground secondary reliability program will apply as well to the relatively new network reliability program. Based on all the information presented, DPS Staff's proposed disallowances seem excessive, especially for 2009. We recommend use of a $17 million allowance each for both 2009 and 2010.

5. Vented Manhole Covers and Streetlight Isolation Transformers – As noted above, DPS Staff's reluctance to support any specific allowance for rim regrade work and streetlight isolation transformers does not seem a reasonable basis for adjustments to either of these items, especially with the

reconciliation term we propose below. DPS Staff's adjustments should not be adopted.

6. C-Truss (Pole Reinforcement) Program – DPS Staff's proposed adjustment seems well supported to the extent it examined a broader base of information about pole reinforcement rates on the Company's system. DPS Staff's adjustment should be adopted.

7. Steam System Energy Management System – We are persuaded by the arguments in the Company's reply brief to the effect that a 41.5% allocation of costs to the electric department would be reasonable. As to the proposed deferral of costs to be allocated to the steam system, we have not been provided any information to assess whether the requested relief should be granted. There is no discussion, for example, about whether the requested deferral is consistent with the terms of the current steam rate plan. Our overall opinion is that this is an electric rate case and that steam rate issues are not properly raised here.

8. EMS Visualization Display – The Company has not established why this investment would be reasonable. DPS Staff's proposed disallowances are recommended.

9. Area Profile System and Energy Efficiency IT Development – It is recommended that the Commission allow the amounts sought by the Company. The Company offers good reasons to believe the investments should be made regardless of what happens in the EEPS case and no substantive arguments are offered in response. No response is offered either to the Company's procedural argument to the effect that neither of these issues lends itself to prompt consideration in the EEPS case.

10. Work Management System – We recommend that DPS Staff's proposed disallowance be rejected. Its conclusion that the work

can be delayed without significantly hindering daily work tasks amounts to improper micromanagement of the Company.

(c) Adjustments proposed by the NYC Government Customers and Westchester

In its initial brief, the NYC Government Customers support the application of an overall 8% downward adjustment to Consolidated Edison's T&D capital and O&M expenditures, following the approach that the Commission employed in the 2008 Rate Order.

They offer the following arguments:[411]

1. The Commission adopted a generalized 8% adjustment to capital expenditures in the last case to mitigate the rate increase associated with a proposed $1.819 billion T&D capital budget for 2008.
2. A similar proposal is warranted here in light of the proposed $1.767 billion capital budget for 2009, reducing the revenue requirement by $14 million.
3. The 8% cap should also apply to associated O&M, reducing revenue requirement by $11 million.
4. The 8% cap would give the Company ample flexibility in light of evidence that 20% to 25% of its capital budget is discretionary.

For the following reasons, the Company opposes the NYC Government Customers' proposed disallowance:[412]

1. The Company's filing explains in detail the Company's extensive efforts to mitigate cost increases.
2. Many of the programs for which incremental dollars are sought are mandated and expensive, including underground inspections, annual stray voltage testing, and danger tree removal. Very few of the programs are discretionary.
3. The Company is exposed to over $100 million in revenue disallowances if its performance falls below specified levels.
4. Criticisms of its budgeting process are vague. Meanwhile, the Company is undergoing a management audit and it will

[411] NYC Government Customer's Initial Brief, pp. 33-37.

[412] The Company's Initial Brief, pp. 125-127.

address in that context any recommendations for budget process changes.

Westchester supports reducing Consolidated Edison's proposed $1.756 billion T&D capital construction programs by an overall 15.5%, or $273 million, which would reduce projected rate base for the Rate Year by $222 million and decrease the Rate Year cost of electric delivery service by about $45 million.[413] The County's proposed adjustment would eliminate carrying charges for lower priority projects, with reductions within individual construction program elements of $84.2 million or 15.7% for substations; $18.6 million or 8.9% for transmission; $161.7 million or 16.22% for distribution; and $8.4 million or 50% for system operations.[414] Westchester contends these adjustments are warranted because:[415]

1. The Company's proposal, to increase net T&D plant by $1.37 billion per year over three rate years, is nearly twice the spending level of recent years and represents an enormous construction program. That program, coupled with other costs in its filing, would result in a burdensome rate increase for customers.
2. The Commission has the obligation to adopt measures that would bring any rate increase to more reasonable levels. In Consolidated Edison's last electric rate case, the Commission adjusted the Company's capital program to reflect the Company's historic inability to achieve its proposed spending levels.
3. The Company has little incentive to give serious consideration to the impact of its expansion program, keep its capital spending under control, or balance the need for reliable service with just and reasonable rates.
4. Reducing the construction budget by 15% will result in reliability that is still adequate, while reducing impacts

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[413] Westchester's Initial Brief, pp. 17-18. Like DPS Staff, Westchester discusses Rate Year net plant dollars while the Company's presentation is based on a calendar year total-capital-outlays basis.

[414] Ibid., p. 17.

[415] Ibid., pp. 16-18.

on ratepayers to a more modest level and affording the Company the flexibility to reorder all of its projects to fit within this budgetary constraint.

It appears the Company does not address this proposal directly on brief.

We acknowledge that the Commission adopted an 8% T&D capital program in the 2008 Rate Order and that it might be inclined to consider in these cases a repeat of that adjustment, extension of the adjustment to T&D-related O&M as the NYC Government Customers propose, or an increase in the magnitude of such a general T&D disallowance, as the County of Westchester proposes.

There are some aspects of this case that might not be the same as last year’s, however, and these should be taken into account. These include that the Company’s rate request is already ameliorated by more than $427 million annually, that the Company’s capital construction budget already reflects deferment of needed work worth $155 million, and that the Company’s Infrastructure Investment Panel acknowledges that more than 8% of the work it plans is discretionary.

Consistent with discussions elsewhere in this RD, we propose that the Commission make all necessary determinations in this case about the Company’s reasonable cost of delivery service and that it thereafter consider collectively the pros and cons of all alternatives proposed for setting rates based on considerations beyond cost.

2. General Equipment

The Company projects capital expenditures of $76.916 million in 2009 and $74.048 million in 2010 for general equipment. Among other things, such equipment, which is a sub-category of common plant, includes all furniture, vehicles, tools, communications equipment, computers, and lab equipment.

Budget information about these expenditures was included in the Company’s initial prefiled exhibits, but absolutely no testimony was provided in support at that time. DPS Staff sought to confirm that there was no such testimony during the discovery process. The Company did not respond directly to the question posed but it provided some further information at that time. There was no follow-up discovery by DPS Staff.

In its direct testimony, DPS Staff proposed that the Commission provide no Rate Year allowance for general equipment, due to the Company's failure to provide adequate support.

The Company filed update/rebuttal testimony, which sought in part to provide the programmatic explanation that was not included in the Company's original filing. When cross-examined about that aspect of its update/rebuttal, the Company acknowledged that the information being provided was available to the Company at the time of its original May 2008 filing. DPS Staff promptly moved to strike and the motion was granted in a ruling issued November 4, 2008. The ruling removed some of the Company's update/rebuttal from evidence, retained that information in the transcripts as an offer of proof,[416] and offered the Company an opportunity to have the late filed information considered if it would agree to a several day extension of the suspension date without a make-whole. The condition was intended to reflect the Company's tardiness in presenting its direct case on this single issue in terms of the extent to which this made its entire direct case tardy. The overall goal was to deter a recurrence by imposing some consequences for failure to abide by the minimum requirements of the 1977 Statement of Policy on Test Periods in Major Rate Cases. The ruling did not discuss the proper rate allowance for general equipment.

[416] An offer of proof shows what a party would have attempted to prove in information not taken into evidence.

The Company has not appealed the ruling, but notes that it reserves its right to do so in its brief on exceptions as provided under 16 NYCRR 4.7.

At issue now, accordingly, is whether or not to adopt DPS Staff's proposed disallowance. On brief, however, DPS Staff objects in part to the November 4, 2008 ruling because:[417]

1. The conditional, multiple day suspension date extension discussed in the ruling was shortened slightly to reflect that DPS Staff did not timely file its motion to strike.
2. In an e-mailed informal ruling of September 19, 2008, the ALJs indicated only that they were "inclined" to require "that any motions to strike prefiled testimony or exhibits be served on or before October 10, 2008," and that the deadline would ensure required rulings could be issued timely.
3. In view of the language in the September 19th e-mail, DPS Staff did not believe there was an absolute directive that motions to strike be made on or before October 10th.
4. The delay in the hearings caused by DPS Staff's oral motion after October 10, 2008 did not affect the original time period for the hearings, which ended three business days ahead of schedule.

DPS Staff also objects, apparently, to the Company being afforded an opportunity to have the excluded testimony considered on the condition that the Company extend the suspension date by several days without a make-whole. It argues that remedy fails to reflect that it was the parties, not the Commission, who were adversely affected by the shortcomings in the Company's original filing.[418]

These arguments appear to be out of time as a procedural matter (16 NYCRR 4.7) as trial briefs are submitted to the judges who issued the ruling rather than to the Commission that typically reviews appeals from rulings. With so

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[417] DPS Staff's Initial Brief, pp. 243-244.

[418] DPS Staff's Initial Brief, p. 244. However, the ruling is intended to reflect the impact on ratepayers.

many issues pending, we also hesitate to take time now to reconsider the November 4, 2008 ruling as a matter of discretion. In any case, it is apparent that DPS Staff may not be considering the e-mail the judges sent to all active parties on October 7, 2008 (1:39 p.m.), adopting what had been proposed on September 19. The latter e-mail was distributed after we had solicited and received no comments on the proposed due date for motions to strike.

Turning to the substantive issue, DPS Staff recommends in its initial brief exclusion from plant-in-service of all of the Company's planned investment in general equipment for 2009 through 2012, as well as $93.0 million in 2011 and $7.0 million in 2012 for a Corporate Accounting Ledger System, because:[419]

1. The Company did not address and justify either General Equipment or the Corporate Accounting Ledger System in its original prefiled testimony or exhibits.
2. The Company's response to DPS-318 (Exhibit 190) asking for justification for these projects, was unresponsive.
3. The Company admitted during cross-examination that it did not address General Equipment in its prefiled testimony or exhibits (Tr. 489).
4. Even in its proffered but stricken update/rebuttal testimony, the Company failed to provide information justifying the Corporate Accounting General Ledger System project.
5. The Company has the burden of proof to demonstrate a basis for its request for rate relief for these significant proposed projects, but has provided no justification for the need, timing, or costs of the projects.

The Company argues that there are numerous good reasons why DPS Staff's proposed General Equipment disallowance should be rejected in its entirety, regardless of whether an appeal is taken to the ruling. These include the following:[420]

[419] DPS Staff's Initial Brief, pp. 244-246.

[420] The Company's Initial Brief, pp. 374-387.

1. DPS Staff nowhere asserts that general equipment is not needed for the Company to provide safe and adequate service or that the Company is paying too much for any of its general equipment.
2. The support provided by the Company’s initial filing is the same as it has always provided, without any objection, in prior electric, gas, and steam cases. DPS Staff’s proposed adjustment rests on an abrupt change in practice and is unfair.
3. DPS Staff did not communicate its concerns about the Company’s filing until DPS Staff’s direct case was filed in early September 2008. Its concerns could and should have been communicated earlier, such as in follow-up discovery. The judges rejected a similar approach in the Recommended Decision in the Company’s last electric rate case, when CPB employed it, and the Commission implicitly adopted the judges’ reasoning in that case.
4. The Company’s direct case includes budget figures for general equipment on a monthly basis for the Linking Period and the Rate Year. Workpapers (not in evidence) were also provided as was the Company’s detailed common plant model.
5. It is implausible that DPS Staff “stumbled upon” the general equipment expenditures too late in the case for it to conduct discovery because the common plant model was provided to DPS Staff in mid-June 2008, the response to DPS Staff’s discovery request was provided on July 11, 2008, and in light of DPS Staff’s general claim that it made a diligent effort to investigate the capital and O&M programs supported by the Company’s Shared Services Panel.
6. Simple reliance on the Company’s three-year historic average spending would result in an allowance of $75.2 million. That is directly in line with the Company’s $76.916 million forecast for 2009 and slightly higher than the $74.048 million the Company forecasts for 2010.
7. DPS Staff’s proposal to disallow costs, incurred or to be incurred in the Linking Period, is particularly egregious as:
    - DPS Staff did not explain in its testimony that this was part of its proposal.
    - The effect is to disallow what the Commission already allowed in the Company’s last electric rate case, something the Company describes as a form of retroactive ratemaking.

- As of August 2008, the Company had already spent over $40 million of the $99.3 million allowed in its last case and was on schedule to spend the balance.
- This aspect of DPS Staff's proposed adjustment is inconsistent with another DPS Staff proposal, to require the Company to justify, in its next rate case, any deviations of 10% or more between actual and forecast capital spending. Here, in contrast, DPS Staff is proposing a disallowance without the Company being able to make a showing about whether or not the costs it incurred in the Linking Period were reasonable.

In the event the Company successfully appeals the November 4, 2008 ruling and the portion of its testimony that was stricken reverts to record evidence, the Company argues this information provides even further reasons why DPS Staff's adjustment should be rejected in its entirety.[421] For example, that information explains in detail the Company's need for all the computer equipment reflected in its projection.

In its reply brief, DPS Staff argues:[422]

1. The 2008 Rate Order does not relieve the Company of its obligation to provide evidence about its actual Test Year investment, as well as data for the Linking Period and Rate Year.
2. The Company's unsupported claim of past rate case practice is not a basis for relieving the Company of its obligations.
3. The judges should ignore the portions of the Company's initial brief that rely on the stricken testimony.
4. The Company has the burden of proof and parties should not have to conduct discovery to help the Company meet that burden.

The Company further addresses this issue as follows:[423]

1. There is much evidence about the Company's projected investment in general equipment outside of the stricken testimony.

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[421] The Company's Initial Brief, pp. 385-387.

[422] DPS Staff's Reply Brief, pp. 80-82.

[423] The Company's Reply Brief, pp. 125-129.

2. In light of the draconian nature of DPS Staff's proposed adjustment, DPS Staff should have explained why it is changing its position on the level of proof required on these routine expenditures.
3. DPS Staff's refusal to engage in follow-up discovery and to raise an issue about the Company's direct case for the first time in prefiled testimony is inconsistent with DPS Staff's practice on other issues in these and prior proceedings.
4. The Company did not rebut DPS Staff's arguments concerning the general ledger as the proposed work will take place after the Rate Year.
5. DPS Staff's challenge to the November 4, 2008 ruling is untimely. The Company also disagrees with that ruling but for reasons properly included in any appeal.
6. DPS Staff's concerns about inadequate information being provided for the Linking Period ignores that much of it (May 2008 through March 2009) will occur well after the Company submitted its original filing.

Several basic issues are presented. The first is whether the overriding goal of ratemaking is to project as reasonably as possible the Company's Rate Year cost of electric delivery service or to project as reasonably as possible the Company's' Rate Year cost of electric delivery service based solely on information presented timely and in a procedurally correct manner. In general, we conclude that the latter standard should apply if the current rate case process is to have any discipline and be fair to all parties. It is obviously difficult, for example, for DPS Staff and intervenors to submit testimony in response to information presented for the first time in a utility's update/rebuttal testimony.[424]

The second issue is whether DPS Staff and other intervenors are or should be under an obligation to use the discovery process to help a utility flesh out those aspects of its direct case that do not meet even the general standards set forth in the 1977 Statement of Policy on Test Periods in Major

[424] If stricter filing requirements were adopted, the focus could shift more to the merits and less to procedural concerns.

Rate Cases. There is precedent that suggests that such an obligation exists. For several reasons, however, we recommend the Commission relieve DPS Staff and intervenors of any such obligation on a prospective basis.

To begin, deficient tariff filings increase the time and effort to be devoted to discovery. This necessarily reduces the time available for other rate case milestones. Second, such an obligation on DPS Staff and other intervenors provides encouragement to utilities to provide discovery responses that are not direct, complete, or clear, or that are otherwise problematic, on the grounds that no cost of service adjustment will ultimately be sustained unless and until all discovery efforts have been exhausted. The result is that it takes way too much time to get needed information and less time is available for analysis of that information. This is an unfair drain of non-Company resources devoted to any case and should not be countenanced.

A third issue presented is whether the referenced Policy Statement standards for rate case filings do not apply to “routine” expenditures like general equipment and, if so, whether those standards have been waived if those standards were not met over a period of years without any objection. As to the first part, it is apparent that the Company's initial filing supports numerous O&M and capital expense items involving far fewer dollars. The notion that expenditures of more than $70 million per year are routine and need not be explained in the Company's direct case is very weak in this context.

Turning to whether the Company's approach has been accepted in past rate cases with no objection, there is no direct evidence on either side. Accordingly, we do not know if the Company's allegation is true. As noted in the November 4, 2008 ruling, however, we do not think parties can waive a standard adopted by the Commission.

The final major question presented is whether much or all of the Company's request for general equipment purchases should be disallowed in whole or in large part given the procedural problems noted. We have mixed feelings on this question. On the one hand, it is apparent that something needs to be done that will cause the Company specifically, and other utilities generally, to take responsibility for presenting all of the necessary supporting information at the time of their tariff filings.[425] On the other hand, a disallowance of all the costs of general equipment seems unreasonable, particularly in the absence of any information suggesting the Company does not need vehicles, computers, and the like to provide reasonable delivery service in the rate year. We conclude that the Company's proposal should be adopted but subject to a $2 million disallowance of rate case expenses discussed in Section V (O).

A few other observations are also in order as follows:

1. Given that DPS Staff is expressly supporting a one-year rate plan, we do not understand why it is expressing concern about planned expenditures for the general ledger system to be made beyond the Rate Year.
2. The Company's response on that point also makes clear that its support for a three-year rate plan is only nominal at this point.
3. A Commission decision providing a general equipment allowance for the current rate year does not, in the absence of adequate proof in this case, foreclose the Commission from disallowing prospectively the carrying costs on general equipment projected to be purchased during the Linking Period or Rate Year in this case. It would be a prospective denial of costs the Company did not prove to be reasonable in this case.

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[425] Indeed, a very good argument could be made that hard rules should be adopted, specifying in some detail the minimum standards for all rate case filings and that consideration should be given to amending the PSL suspension provisions so that the 11-month period would commence only after the filing is deemed compliant with all applicable requirements.

4. Evidence about purchases of general equipment in the Linking Period does not have to be known to be persuasive. Such evidence would typically include known and projected information accompanied by an adequate explanation.

5. We have not considered the stricken update/rebuttal testimony in our analysis of this topic.

3. Electric Production

The Company projects annual expenditures of approximately $39 million, which would be lower than the three-year average historic expenditures of approximately $41 million per year. (The Company offers a correction to the latter figure on brief, suggesting the correct three-year average is $43.3 million.) The approximately $39 million would be spent to maintain infrastructure and systems at East River Units 6 and 7 (installed in the mid-1950s) and six gas turbines installed at its steam generating stations.

On brief, the Company summarizes work to be done in the categories of environmental, health and safety (including environmental protection and regulatory requirements in each of these areas); boilers and steam turbines; mechanical, electrical, and control systems replacement at East River; roofs, structural, and waterfront work; and security.[426]

DPS Staff testified that it had no reason to believe that the Company could or should not invest the proposed amounts and that it thought the proposed projects are reasonable. However, it proposes that $5.428 million be disallowed for the following reasons:[427]

1. When DPS Staff questioned the timing and cost of the proposed program, the Company responded with little evidence supporting its projections (Tr. 2813-14).

2. Many of the electric production capital projects are currently in the process of conceptual design and work scope development, with the timing and cost information uncertain and subject to change (Tr. 2821-22).

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[426] The Company’s Initial Brief, pp. 387-392.

[427] DPS Staff’s Initial Brief, pp. 246-249.

3. DPS Staff's five-year historic average covered an appropriate span that reflects periods of various spending levels; it could have used a seven-year period that incorporated capital spending levels that were substantially lower (Tr. 2830-31).

4. Because of the uncertainty in the Company's projections, it would be unfair to customers to allow the Company to recover carrying charges based on mere claims that it will move forward with these projects (Tr. 2822).

The Company argues that DPS Staff unreasonably proposes a disallowance of $5.60 million based on the Company's five-year historic average annual expenditures of $33.4 million:

1. DPS Staff's proposal is inconsistent with its own substantive conclusion that the work the Company proposes needs to be done. DPS Staff's proposal is also unreasonable to the extent it is not accompanied by any suggestions about which Company projects should not go forward. Indeed, a DPS Staff witness testified that the specified work should be done.

2. DPS Staff's proposal ignores that the 2003 and 2004 expenditure levels included in its historic average are not representative as they immediately followed the East River Repowering Project.

3. The unreasonableness of DPS Staff's proposal is obvious when one accounts for DPS Staff's proposal that the cuts be made on a <u>pro</u> <u>rata</u> basis. The Company argues that such an approach is not possible.

Adding to these points, the Company argues:[428]

1. Low expenditures in part of DPS Staff's historic period were attributable to the East River Repowering and the Waterside retirement going on at the time. DPS Staff fails to address either, even though the facts are conceded (Tr. 2831-2832).

2. Recent actuals are in line with the $40 million projection.

3. DPS Staff unreasonably supports funding lower than that allowed in the 2008 Rate Order.

Turning to concerns expressed by NYECC's witness at the hearings, about an increase in Environmental, Health and

[428] The Company's Reply Brief, pp. 129-131.

Safety costs of more than 100% over historic levels, the Company argues that no adjustment is warranted because the historic levels included some, but not all, of such costs (the rest were in some other category) and all costs in this category are now presented together.

A review of the arguments just summarized and the relevant testimony[429] suggests to us that the basic issue presented is the extent to which a forecast of Rate Year Capital investment in electric production or any other capitalized facilities must be refined before the Commission should rely on it to set rates. This appears to be the key issue in part because DPS Staff agrees the Company has justified a need for the work planned.[430] DPS Staff also states that the Company has spent more than $40 million per year for the last several years and that it has no reason to believe that the Company should not continue to spend at the Company's proposed levels.[431]

As to the process of costing out the necessary work, DPS Staff suggests the Company has nothing more than a "wish list,"[432] while Company witnesses explain how the capital budget was developed and describe the results as good faith estimates necessary to operate its generating facilities safely, efficiently, and reliably.[433]

We note that the 1977 Statement of Policy on Test Periods in Major Rate Proceedings states that "major plant additions from the end of the historic period should be separately identified, indicating actual or estimated in-service dates." There is nothing in that standard specifying the extent to which the cost forecast should be refined or finalized. Our

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[429] E.g., Tr. 2809-2824, Tr. 2831-32, and Tr. 973-981.

[430] Tr. 2819-20.

[431] Tr. 2813.

[432] Id.

[433] Tr. 973-75.

sense is that DPS Staff is reading such a requirement into the referenced Policy where it does not exist.

Moreover, DPS Staff does not respond directly to the Company's argument that it would be reasonable to forecast capital investments in this category using three years of data, but not using data for five years of which two are aberrational.[434]

In light of all of the above, and given our separate recommendation concerning the one-way reconciliation of electric production capital expenditures (discussed below), we recommend against DPS Staff’s proposed adjustment.

4. Municipal Infrastructure Support

The Company incurs costs to protect or move parts of its system in connection with municipal infrastructure work. The Company forecasts municipal infrastructure capital expenditures based on an estimate of costs for all projects expected to be undertaken in connection with New York City’s construction plans.[435] The Company projects it will incur approximately $33.7 million of such expenditures in 2009 and $34.35 million in 2010.

DPS Staff proposes that the annual allowance for interference capital additions to plant-in-service be calculated by using the five-year average of actual expenditures for 2003 through 2007, or $22.125 million (Tr. 2523), resulting in disallowance of more than $11 million, because:[436]

[434] We are surprised by DPS Staff’s suggestion that its proposal using five years of historic data is reasonable because it declined to use a seven-year historic period and recommend an even larger adjustment. Such an argument seems beneath DPS Staff.

[435] This is a different method from the one used to estimate municipal infrastructure O&M expenses.

[436] DPS Staff’s Initial Brief, pp. 249-251.

1. The Company's forecast is 30% higher than its 2007 actual level and comparing the 2003-2007 budget levels to actuals reveals significant variations, ranging from under spending by 15% to over-spending by 30% (Tr. 2522).
2. Thus, the Company's budgets have not been reasonable indicators of actual expenditures and basing the forecast on recent actual expenditure levels is more reasonable (Tr. 2522).
3. The Company's update/rebuttal testimony provided no support for the disagreement with DPS Staff's approach, but merely discussed the process it uses to protect its system and admitted it is a "guess" how successful the Company will be in altering New York City's proposed routes of its infrastructure systems (Tr. 623-28).
4. DPS Staff's use of recent historic expenditure levels is a better guide than the Company's guess about what might occur.

The Company opposes DPS Staff's proposal for the following reasons:[437]

1. DPS Staff's proposal ignores the latest information provided by the City regarding its future infrastructure projects. The Company's forecast reflects such information.
2. DPS Staff does not question the need for or cost of any specific project.
3. Past variations between budget and actual amounts reflect that the Company has little control over most of the variables affecting these costs.
4. The Company closely coordinates with the City in an effort to minimize the costs incurred to protect its equipment.

On the record presented, it is undisputed that it is very difficult to develop accurate forecasts of municipal infrastructure capital investment that the Company will have to make during the Rate Year. The forecasts presented by DPS Staff and the Company could both be too low or could both be too high. The current economic downturn only compounds this uncertainty because it is anyone's guess about whether and how this will affect the City's construction plans. It is also clear that the

[437] The Company's Initial Brief, pp. 396-398.

Company has very little control over the exact work that will need to be done, though it is in a position to influence to some degree the efficiency with which the necessary work is performed.

In these circumstances, we recommend an annual allowance of $34 million each in both 2009 and 2010 subject to the terms of the downward-only reconciliation terms recommended below. This option simultaneously ensures that if the forecast expenditures exceed the actual, ratepayers will receive full credit, including interest. Meanwhile, the chances are reasonably minimized that the Company will need to invest more than its forecasts.

A good argument could be made that full reconciliation of capital investment and O&M expenditures associated with municipal infrastructure would be reasonable in the context of a rate plan that reasonably minimizes the Company's downside risk and offers it only minimal upside earnings potential. The program costs are subject to large swings and are to a very great extent beyond the Company's control. A big negative associated with such an option, however, is that it reduces or eliminates the Company's incentive to minimize the costs associated with essential municipal infrastructure work. For that reason, and because it is recommended that property taxes and debt costs be added to those costs to be subject to full reconciliation, we are not recommending full reconciliation of municipal infrastructure costs.

5. Facilities (including 125th Street)

(a) West 125th Street

The Company’s filing sought support for $4.6 million of capital expenditures and $.755 million in O&M costs in the event it sold its West 125th Street property and had to move one of its customer service centers to another location. If the building were not sold, the Company sought support for $3 million of capital investment in its West 125th Street property, so it could continue to be used for the same purposes.

The Commission approved the sale of the referenced property on October 28, 2008 (Case 08-M-0930). Based on this change in circumstances, and given uncertainty about when the closing will take place and the costs to replace the facility, the Company withdraws its two prior alternative requests and now proposes that it be permitted to set off the actual costs of the new facility against the costs avoided as a result of the sale and to add to or subtract from that difference the after-tax net gain on the sale. Any after-tax net gain, it says, would be deferred for the benefit of ratepayers.

In its initial brief, DPS Staff opposes the Company's request to true-up the additional costs of moving its 125th Street property Customer Service Center and Field Operations Reporting Center to a replacement facility and leasing and renovating that replacement facility, because:[438]

1. The only incremental cost not reflected in the Company's proposed revenue requirement is lease expense allocable to electric operations of $22,825 per month (Tr. 2423-24).
2. The Company must first purchase or lease a replacement facility, then complete a build-out estimated to take 13 months, suggesting an in-service date no earlier than February 2010, very near the end of the Rate Year (Ex. 359; Tr. 2423). The build-out plans are not yet known and the Company has not even transferred the 125th Street property.
3. The true-up proposal gives Consolidated Edison no incentive to control capital spending associated with a replacement facility. Denial of a true-up would provide that incentive.
4. Since the in-service date would be no earlier than nearly the end of the Rate Year, the amount subject to deferral and true-up would be de minimis.

[438] DPS Staff’s Initial Brief, pp. 325-327.

The Company replies as follows:[439]

1. The Company is proposing a true-up of all incremental costs incurred and avoided.
2. DPS Staff fails to describe how the Company will recover its reasonable incremental costs if there is not true-up.

We offer no recommendation on this issue. The record focuses on costs associated with either keeping on selling the West 125th Street Property. In light of Commission action in another case in October 2008, the trial brief arguments primarily comprise new proposals with no clear explanation by either side about why the competing proposals are or are not reasonable on a substantive basis. The parties should provide the needed clarity in their post-RD briefs.

(b) Hurricane Hardening

The Company initially included $10 million in its construction forecast for "hurricane hardening." According to the Company, DPS Staff balked and supported no allowance, citing the absence of any specific Company plans or schedule for this work.

On brief, DPS Staff says it supports disallowance of the entire $36.125 million of the Company's request for the Hurricane Building Hardening project over the 2009-2013 period, because:[440]

1. The Company's response to DPS-156 (Ex. 190), concerning the timing and cost of this project, showed it had not selected a scope of work or developed a working estimate or a schedule for the project. Consolidated Edison characterized the $36.125 million as a placeholder.
2. In its update/rebuttal testimony, the Company said it plans to spend $1.5 million in 2009 and $9.5 million thereafter,

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[439] The Company's Reply Brief, pp. 131-132.

[440] DPS Staff's Initial Brief, pp. 251-253. Given its support for a one-year rate plan, we are not sure why DPS Staff discusses a total for five calendar years. The Company's Initial Brief, p. 401, also describes the $36.125 million figure as one for four years (Tr. 335).

but it has failed to respond to DPS-617, seeking review of the basis for the update estimates.

3. Therefore, there is no evidence to support the Company’s claims.

In its initial brief, the Company confirms that its update/rebuttal proposal is for a $1.5 million capital investment in the Rate Year for work that would take place during that time for two projects. Specifically, the Company proposes to construct storm-hardened shelters for 350 persons at Irving Place and for 15 persons at its Energy Control Center, as well as other work. Not all of the work would be done in the Rate Year.

The Company argues that these shelters are critical to rapid restoration, are not questioned on the merits, and that all questions about timing and scope of the project have been resolved. The $1.5 million proposed investment, it says, should be reflected in its revenue requirement.

The Company further responds as follows:[441]

1. DPS Staff’s discovery request 617 was tendered a week before the evidentiary hearings and was answered on November 20, 2008, even though DPS Staff did not ask that an exhibit number be reserved for that response.
2. Contrary to DPS Staff’s claim, the Company’s update/rebuttal testimony supports the $1.5 million for the Rate Year and that testimony is in evidence (Tr. 396-400).

As a procedural matter, the Company's initial filing did not include the Company's plans for the Rate Year. By inserting a place holder, it essentially reserved for itself the option of providing a firm plan at a later date, after its direct case was filed and after the direct cases of DPS Staff and intervenors were prefiled. The 1977 Statement of Policy on Test Periods in Major Rate Cases provides for changes in

[441] The Company’s Reply Brief, pp. 132-137.

estimates, but does not expressly provide for updates of “place holders.”

The result, as in the case of general equipment, is that less time is available for analysis of the Company's plans. The Company also acknowledges that it responded to a non-objectionable discovery request by DPS Staff 43 days after the request was tendered and suggests this is reasonable because hearings were ongoing and because DPS Staff did not seek to reserve an exhibit number for the discovery response. However, the Company is required to respond to every discovery request within 10 days or to state by that deadline a date by which an answer would be forthcoming. Our impression is that the Company is way too cavalier about its failures in this regard.

Turning to the reasonableness of the Company's plans, the Company is correct that there is no substantive criticism. However, there were only approximately two weeks between the September 29, 2008 due date for update/rebuttal and October 15, 2008 commencement of hearings. Moreover, there was no general opportunity within the confines of a case with an 11-month suspension period for DPS Staff or intervenors to submit testimony and exhibits in response to the Company’s update/rebuttal. As far as we can tell, there was no cross-examination of this information presented in the Company's update/rebuttal on this topic (Tr. 396-400).

The Company's proposal might well be reasonable. Given the procedural problems, however, it is very possible that no counterpoint is offered because there was inadequate time to do so. We decline to recommend the Company's proposal in this context, especially as relatively fewer dollars are at stake.

(c) Flush Facilities

The Company originally proposed to invest $23.5 million in four flush facilities that currently receive accumulated debris that the Company forces out of its underground distribution structures. These facilities operate 24/7 and, in 2007, managed approximately 11 million gallons of water and 13,000 tons of debris.

DPS Staff opposed the Company's proposal because the Company's plans were vague. In its update/rebuttal filing, the Company sought support for only $1.2 million for design work because the Company has decided that the needed work should be completed over a longer period of time. The Company argues on brief that in the absence of any substantive objection, and as the Company is working now on a Request for Proposals for the work to be done, it seeks support of a $1.2 million capital expenditure.

On brief, DPS Staff opposes rate recovery for the $23.45 million or the $1.2 million, because:[442]

1. The Company did not meet its burden to show the project would be completed and used and useful during the Rate Year (Tr. 2457).
2. Although the Company presented updates of $1.2 million in design work in 2009 and $12 million in 2010 (Tr. 432), responses to DPS-158 and DPS-425 (Ex. 190) regarding project cost estimates, cost breakdowns, and forecast dates of completion for each of the four facilities, failed to provide sufficient detail to demonstrate the project will be completed and used and useful in the Rate Year.
3. Thus, there is no record evidence to support the Company's update.

The Company replies[443] that DPS Staff unreasonably refers to two discovery requests that were asked and answered before the Company's plans changed and before the Company submitted its update/rebuttal request for $1.2 million. It also faults DPS Staff for failing to acknowledge receipt of a discovery response (#618; not in the record) in further support of the $1.2 million. DPS Staff, it says, should not be able to

[442] DPS Staff's Initial Brief, pp. 253-54.

[443] The Company's Reply Brief, pp. 133-34.

argue in support of an adjustment citing the lack of a discovery response and to support another adjustment by ignoring a discovery response it did receive.

The Company's response to DPS Staff discovery request #618 is not in the record. Accordingly, we are not in a position to evaluate the procedural issue of whether DPS should have referred to that response in its arguments.

Based on the information before us, we recommend DPS Staff's proposed adjustment be adopted. The Company argues the $1.2 million will be spent on design work. However, it never responds directly to DPS Staff's arguments that such costs will not enter plant in-service in the Rate Year. The closest the Company comes to this is to say that it does not expect construction on the first facility to start until 2010.[444] But only one quarter of that year is in the Rate Year.

(d) Human Resources Enterprise Shared Services

DPS Staff proposes a reduction from $4.35 million to $2.35 million to correct an error in the Company's plant-in-service model for the Human Resources Enterprise Shared Service project, based upon the 2008 budget shown in Exhibit 141.[445] DPS Staff states that the Company's update/rebuttal testimony is silent on the issue. The Company's trial briefs are silent on this issue as well.

In the absence of any objection from the Company, DPS Staff's $2 million adjustment is recommended.

B. Capital Expenditure Cap/Reconciliation and Capital Expenditure Reporting/Rate Case Demonstration

1. Overview

Of all the issues presented, several that are of the greatest concern to the Company involve DPS Staff's various

[444] The Company's Reply Brief, p. 403.

[445] DPS Staff's Initial Brief, p. 254.

proposals to: (1) continue a one–way reconciliation for T&D plant that was adopted in the 2008 Rate Order [i.e., carrying charges on capital expenditures that are reflected in rates but not incurred would be calculated (but using a different method) and deferred for the future benefit of ratepayers]: (2) apply such a reconciliation to several additional categories of plant [production, shared services (including general equipment), and municipal infrastructure]; and (3) create new reporting and rate case filing requirements. The arguments on each of these issues are summarized first, followed by one discussion.

2. The Reconciliation Proposal

The Company objects to continuation of the existing one-way reconciliation mechanism for T&D plant as follows:

1. Lower capital expenditures resulting from lower costs for materials and equipment result in a deferral for the benefit of ratepayers but higher capital expenditures resulting from higher costs for materials and equipment would unfairly have to be absorbed by the Company's shareholders, at least until and perhaps beyond the time rates are next set.
2. Such a mechanism unduly limits the Company's flexibility to respond properly to changing circumstances, even though it is undisputed that it will face changed circumstances and that it has an obligation to respond to such changes. The limitation on its flexibility is that the carrying costs on capital expenditures beyond those forecast in this case would have to be absorbed by the Company, at least until and perhaps beyond the time rates are next set.

In reply, DPS Staff:[446]

1. Denies there would be a reduction in the Company's flexibility to respond to changing circumstances, arguing the mechanism merely protects ratepayers from paying for costs not incurred and that the Company can seek relief in the future for any costs it incurs that were not forecast.
2. Argues it is ridiculous for the Company to suggest the proposed mechanism would provide it an incentive to avoid

[446] DPS Staff's Reply Brief, pp. 82-84.

expenditures above forecast amounts, on the grounds that any such action would be contrary to the Company's public service obligations.

3. Asserts the one-way mechanism would not be onerous as the Company's cost projections typically reflect contingencies. (No record citations are provided.)
4. Explains that the general downward-only reconciliation proposal is intended to apply to all projects and programs with the exception of Electric Operations Advanced Technology and Storm Hardening and Response Programs. DPS Staff proposes that the latter be subject to separate program– or project-specific downward reconciliation mechanisms. DPS Staff's goal is that there would be no double count.

Further points offered by Consolidated Edison concerning the proposed one-way reconciliation include that there is no reason for DPS Staff's adjustments based on historic costs if ratepayers will be fully protected by a one-way capital cost reconciliation mechanism.[447]

3. <u>The Proposed Expansion of One-Way Capital Reconciliation</u>

As noted above, DPS Staff proposes that the capital expenditure reconciliation mechanism, currently in effect for T&D investment, apply prospectively to T&D, electric production, municipal infrastructure, and shared services capital expenditures. On brief, DPS Staff counters contentions set forth in update/rebuttal testimony by the Company's Accounting, Infrastructure Investment, Municipal Infrastructure, and Shared Services panels. DPS Staff states:[448]

1. The reasons offered in opposition do not rise above the interests of customers.
2. Consolidated Edison is asking ratepayers to fund significant capital investments during difficult economic conditions, and it is only fair to protect ratepayers with a mechanism that would credit them for carrying charges on plant that is funded in rates, but that does not actually enter service.

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[447] The Company's Reply Brief, pp. 134-135.

[448] DPS Staff's Initial Brief, pp. 257-58.

3. The recent economic downturn has resulted in decreases in the costs of copper, steel, and other commodities that could lower the actual costs of the Company's capital projects (Tr. 1924).

The Company disagrees with the proposed expansion for the following reasons:

1. The Commission adopted the one-way reconciliation for T&D plant in the 2008 Rate Order for the express reason that the increase in such expenditures over what had been planned in a prior case was considered extraordinary. With respect to the new capital expenditure categories advanced by DPS Staff, there is not even an allegation much less any proof that the Company's proposed capital expenditures would be extraordinary.
2. DPS Staff's proposal is advanced by one key witness and several subject–area specific panels. The manner in which each suggests the one-way reconciliation would be performed differs to an extent that one cannot tell what is being proposed. A specific example of such a difference concerns whether or not the Company would have to exceed the total capital dollars reflected in rates before DPS Staff's reconciliation and other proposals would apply.

A further point offered by the Company concerning the proposed expansion of the one-way reconciliation includes that DPS Staff's refusal to support bilateral reconciliation is most egregious in the case of municipal infrastructure capital costs that are driven primarily by New York City and over which, through no fault of its own, it can exercise very little control.[449]

4. Other Proposed Requirements

DPS Staff proposes that the Company be required to file quarterly reports on capital expenditures with detailed explanations for actual investments in projects and programs that vary by 10% or more from the amounts reflected in rates or that involve programs or projects beyond those considered in this case. DPS Staff also proposes that the Company be required to file the same information in the Company's next electric rate

[449] The Company's Reply Brief, pp. 134-135.

case,[450] together with a complete justification of the then-current book cost of plant that forms the basis of that rate request. DPS Staff justifies these proposals on the following grounds:[451]

1. With or without DPS Staff's proposed one-way reconciliation mechanism, situations might occur where the Company invests in plant at a level equal to that on which rates were set, but completes only a portion of the work that was expected.
2. Such situations will not be readily transparent to the Commission because no existing reporting requirements demonstrate the relationship of actual and forecast capital expenditures and project activities.
3. The Company's rate requests are based on a historic Test Year and associated net book plant as a starting point, with no detailed analysis of how that net book plant compares to the level of net plant or specific projects upon which rates were set in the past (Tr. 2556).
4. DPS Staff and the Commission would be able to use the capital expenditure and project/program activity information in the next rate case to determine the reasonableness of the Company's actual book cost of plant and determine whether any adjustment is warranted (Tr. 2557-2558).

Anticipating Consolidated Edison's opposing arguments, DPS Staff contends:[452]

1. The Company's claims of administrative burdens and costs are contradicted by the fact that Consolidated Edison already compiles and distributes the subject information internally in its monthly Capital Budget Status Report (Ex. 169, Response to DPS-50, Corporate Instruction CI-610-1).

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[450] The quarterly report would have to include: information on all actual capital expenditures and specific project and program activities detailing how they differ from forecasts; identification and explanation for cost variations of +/-10% by project and program; and justification for new capital projects not presented in this (or, in the future, the Company's last completed) rate case, as well as projects abandoned or materially altered in scope. DPS Staff's Initial Brief, p. 314.

[451] DPS Staff's Initial Brief, pp. 313-315.

[452] DPS Staff's Initial Brief, pp. 316.

2. Quarterly meetings and other interactions between DPS Staff and Consolidated Edison concern some capital budget issues, but often focus on T&D and, thus, are not a reasonable substitute for the proposed quarterly reports.
3. The Company's concern over the 10% variation threshold's application to Electric Production and Shared Services budgets can be alleviated by making the variation apply to: each project defined in the T&D budgets; each Functional Program in the Electric Production budget; and each category defined under Facilities Capital, Information Resources Capital, and Human Resources Capital in the Shared Services budgets.
4. The proposed reporting requirements would in no way limit Consolidated Edison's flexibility to respond to the needs of its system and customers, but simply require reporting on what it is doing to satisfy those needs for the benefit of ratepayers.
5. The Company has the burden of proof to justify the plant in service upon which it requests rates and cannot reasonably expect rate recovery for new plant added beyond what was previously approved by the Commission, without any discussion in a future rate filing. For example, in the last Consolidated Edison rate case, the Commission found inadequate the Company's justification of capital expenditures in excess of prior forecasts. On that basis, it made $240 million of the Company's annual revenue requirement temporary and subject to recovery through an adjustment clause for the benefit of ratepayers until the Commission, after audit and review, determines whether the Company had fully satisfied its burden of proof or that expenditures should be disallowed and refunds made.[453]

As to the proposed quarterly reporting requirement, the Company argues as follows:

1. The Commission previously required annual reporting in the context of a three–year rate plan in which capital costs in excess of those forecast were subject to full reconciliation. This reporting requirement was properly dropped in the Company's last electric rate case.
2. No need for quarterly reports has been established by DPS Staff and this is a flaw given that the proposed one-way reconciliation mechanism would be implemented on an annual rather than a quarterly basis.

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[453] 2008 Rate Order, pp. 105 and 107.

3. The Company does not budget quarterly and it would be required to do so in the future if quarterly variations between actuals and forecasts are to be the subject of incremental reporting requirements.
4. Quarterly reporting makes no sense and would be unduly burdensome as variations between forecasts and actuals should be expected on a quarterly basis.
5. DPS Staff makes no provision for the incremental costs of the Company meeting this new reporting requirement.
6. Since 2005, the Company has been meeting with DPS concerning capital expenditures and the new quarterly reporting requirement is unnecessary in light of these ongoing and productive discussions.

Turning to the proposal that the Company be required in its next case to prove the reasonableness of deviations between actual and forecast capital expenditures, the Company argues:[454]

1. Adoption of DPS Staff's proposal amounts to the imposition of requirements beyond those set forth in the Commission's Statement of Policy on Test Years in Major Rate Proceedings and it would not be reasonable to make such a change in the absence of notice and an opportunity to comment by all parties who might become subject to similar requirements in other cases.
2. There is substantial precedent to the effect that past utility expenditures are presumed to be reasonable, until such time as some other party takes issue, at which time the utility has the burden of proving such costs are reasonable. DPS Staff's proposal ignores and is contrary to such precedent and creates a presumption of imprudence.
3. The Company expects that any retrospective review that would be made under DPS Staff's proposal will necessarily be conducted unfairly with the benefit of 20/20 hindsight rather than be based on whether what the Company did was reasonable at the time and under the circumstances.

In further support of its proposals for future rate case presentations, DPS Staff argues:[455]

1. The proposal is not a dramatic change because 16 NYCRR Part 61 requires utilities to establish by competent evidence

[454] The Company's Reply Brief, pp. 416-420.

[455] DPS Staff's Reply Brief, pp. 85-87.

the original cost of property used and useful and accrued depreciation on that property.

2. Inclusion of information in support of all net plant additions and concerning all major deviations from prior plans and projections will put DPS Staff in a better position to evaluate the Company's rate base in future rate cases.

As to DPS Staff's proposed new reporting and rate case demonstration requirements, the Company further states:[456]

1. DPS Staff fails to justify the need for the proposed new reporting requirements, the level of detail that would be required, or the need for quarterly rather than annual reports.
2. The 2008 Rate Order does not support DPS Staff's proposal because that order focused on $1.6 billion of actual T&D investment in excess of a three-year forecast and DPS Staff would require the Company to prove the reasonableness of all new plant in service in each rate case.
3. DPS Staff's rate case filing requirements are not practical. If certain programs or projects are funded in this case in late March 2009, and the Company files a new rate case in May 2009, the Company will not be able to report on or present evidence about the investments it has not yet had a chance to make.

As noted above, DPS Staff also proposes that the current one-way reconciliation approach be modified as to how carrying charge credits will be calculated. It states that this is necessary to isolate the net changes in the book cost of plant and to exclude the effects of the cost of removal (Tr. 2554-2555).[457] The Company states that DPS Staff's proposal should be rejected or adopted subject to changes to reflect that the Company's filing includes removal costs in the forecast of net plant. If this is not addressed, the Company says, DPS Staff's proposal would result in an under-run of net plant equal to $201.862 million.

[456] The Company's Reply Brief, pp. 135-136.

[457] DPS Staff's Initial Brief, p. 255.

On brief, DPS Staff concurs on this last point, but it continues to advocate adoption of its refund reconciliation proposal, because:[458]

1. It wants to eliminate the effect of possible increases in the cost of removal, above the forecast level, on the carrying charge credit.
2. The Company's refinement, while appropriate, does not fully address DPS Staff's concern.

In further response to DPS Staff's arguments on this point, the Company says that what DPS Staff is basically proposing is that in any instance in which actual capital dollars for a project or program (net of removal costs) are less than forecast capital dollars, that difference alone would be credited to ratepayers even if the actual associated removal costs incurred for that project or program are greater than the forecast. The Company suggests this aspect of DPS Staff's proposal is even more unfair than the rest and states that it is not possible to reconcile plant targets with removal cost included (the only type of targets that exist in this case) with actual plant figures net of removal costs.[459]

5. Discussion

Based on a careful examination of the arguments and evidence, we recommend, first, that the Rate Year capitalized dollars allowed for T&D, Electric Production, Shared Services, and Municipal Infrastructure should all be subject to a one-way reconciliation mechanism like the one in effect for T&D today. The Company is correct that, outside the T&D category, it is not proposing any dramatic increase in capital expenditures similar to that proposed for T&D in its last electric rate case. However, there are other reasons why the mechanism should be expanded.

[458] DPS Staff's Initial Brief, p. 256–257.

[459] The Company's Reply Brief, pp. 137 and 138.

As we see it, there are several basic options presented. The Company's proposal is that all of its specific capital expenditure proposals should be allowed subject to no reconciliation provision. This provides some risk that activities will exceed the forecast and the Company will have inadequate revenues. In light of the Company's unreasonably high comfort level with allowances for expenditures for payroll far in excess of what the Company actually spends, however, we have grave concerns that the Company might invest less in plant than what the Commission allows and retain some or all of the difference for shareholders, whether or not the Company is earning in excess of its allowed return on equity. Accordingly, we recommend against this approach.

The second basic option presented is DPS Staff’s proposal to disallow numerous portions of the Company's planned expenditures based primarily on historic expenditure levels and to overlay on that a downward-only reconciliation mechanism. We believe that this approach unnecessarily increases the risk that the Company will not have a reasonable opportunity to cover its actual costs of providing reliable service and to earn its allowed return on common equity. This approach would also increase the chances that the Company would not have adequate resources to fund work that may arise beyond what it currently plans. We agree that circumstances can and do arise under which utilities have to invest more than provided for in rates. However, the probability of this occurring should be minimized reasonably to ensure good reliability and service quality while avoiding confiscation. In this light, we do not recommend DPS Staff's approach.

Another basic option presented is to require bilateral or two-way reconciliation of capital expenditures. As previously noted, such an approach removes the Company's incentive to minimize those costs that it can control. In the context of what will very likely be a one-year rate plan, moreover, we believe the chances are quite low that the Company will expend more on capital programs than the total we recommend be reflected in rates.

The final option presented, and the one we recommend, is to minimize the chances the Company will be short, by allowing most of what it seeks, keeping in place the incentives the Company has to minimize the costs it can control, and holding ratepayers completely harmless for anything allowed in rates but not spent by the Company on its proposed projects and programs or any projects or programs not considered here that become necessary and are important enough to warrant a reallocation of funds allowed for programs or projects considered in these cases.

Turning to DPS Staff's proposed new reporting requirements, we recommend that they be rejected outright or pared back considerably. The Company makes a good case that detailed quarterly reports do not make sense, as the Company does not prepare quarterly forecasts that would be needed to do quarterly reconciliations and as it must be expected that circumstances will arise that will warrant adjustments from quarter to quarter that may well be of no consequence by the end of a one-year period. A requirement that the Company explain quarterly all deviations of 10% or more from all of its program budget amounts seems unwarranted for this reason. Moreover, if the Company will be required to make a complete presentation in its next rate case, describing the overall reasonableness of its rate base and explaining any significant deviations from prior plans, something we do not recommend, the quarterly reports would be largely redundant. Based on all of the above, it seems more reasonable to require the Company to provide to DPS Staff the Monthly Capital Budget Status Report that DPS Staff refers to on brief.[460]

We have mixed feelings about DPS Staff's proposals regarding new rate case filing requirements. At a general level, it stands to reason that the Commission, the Department, other parties, and the public would all want to know that an extremely large capital construction program that will be affecting rates in the long run is limited to that which cannot be avoided, being managed efficiently, and that the actual costs being incurred are reasonable for the work being done. On the other hand, investors could become wary if they conclude that the risk is going up that large portions of the Company's rate base expansion will necessarily be subject to review and a possible future disallowance.[461]

As a practical matter, the filing requirements proposed by DPS Staff would have the effect of overlaying on each rate case a general investigation into plant additions in a recent past period unlike anything commonly employed in Commission practice.[462] This necessarily means that the Company would need to devote relatively more resources to preparing its presentation, increasing costs to be recovered from ratepayers, and that the Department (which presumably will have the same or fewer resources) will either need to allocate incremental DPS Staff resources in each rate case or forego other aspects of its rate case review to ensure a thorough review and analysis of the information that would be presented by the Company. This would

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[460] DPS Staff's Initial Brief, p. 316.

[461] Indeed, investors may see no difference between DPS Staff's proposal and temporary rates.

[462] We agree with the Company that nothing in the 1977 Statement of Policy on Test Periods in Major Rate Cases could reasonably be understood to require such a filing. Nor does 16 NYCRR Part 61.

all have to be completed within the confines of a case subject to an 11-month suspension period.

A selective audit of a statistically-significant sample of capital investment work orders and invoices, with the assistance of qualified DPS Staff members or outside consultants, appears to be a much more cost-effective approach, either for ensuring that actual, past utility investments are prudent or for determining whether or not a full-blown prudence investigation is warranted, in or outside the context of a major rate case.

The final issue presented is whether the current one-way reconciliation approach should be modified to exclude the effects of the cost of removal. We recommend against such a change as the actual costs of removal can reasonably be expected to differ from forecasts, just as the actual costs of equipment and materials can differ from forecasts. DPS Staff says it wants to eliminate the effects of an increase in the cost of removal, but it does not say why.

Some other arguments also warrant further comment in the event the Commission decides to adopt DPS Staff's proposed new rate case filing requirements:

1. The Company expresses concern that a retrospective review of its past investments in plant would be based on 20/20 hindsight rather than based on whether the Company's actions were reasonable at the time and under all of the circumstances. The Company, however, does not state the bases of its concern and we are thus in no position to evaluate whether its concerns are warranted.
2. There is a practical problem associated with requiring the Company to prove in its next rate case the reasonableness of plant additions during the Rate Year. This is because very little actual information would be available should it make another rate case tariff filing in April or May 2009. Accordingly, there would have to be a greater lag between when rates are set and the commencement of any review of plant changes for the period during which such rates will be in effect.

C. EB Cap Adjustment ($22.3 Million)

The Earnings Base Capitalization (EB Cap) adjustment was first adopted in a 1975 Niagara Mohawk Power Corporation rate case because the Commission found it would be improper for a utility to earn a return on a rate base that exceeded the utility’s total capitalization. Such an adjustment has been adopted in many Commission cases since 1975 and doing so here would have the effect of increasing the Company’s rate base.

For the following reasons, NYPA opposes use of an EB Cap adjustment here:[463]

1. The Company claims that such an adjustment is required but it could provide nothing to substantiate this claim. Accordingly, the Company is not entitled to such an adjustment.
2. Unlike other rate base components, the EB Cap figure is a fall-out number rather than a forecast. While it is uncontested that a major driver of this adjustment is volatility of pension and OPEB assets, the Company, at a minimum, should be required to project EB Cap and provide appropriate support for such estimate. The impacts of such an adjustment are simply too great to be based solely on testimony to the effect that such adjustments are traditional.
3. It is not reasonable to conclude that an EB Cap adjustment is needed because of the Company’s use of FERC’s 1/8 cash working capital formula (discussed below).

Noting that the EB Cap adjustment in these cases increases its average rate base by $388 million, the Company disagrees with NYPA’s proposal to eliminate the adjustment, as well as the reasoning underlying NYPA's proposal. The Company offers the following arguments in its initial brief:[464]

1. The primary driver of the Company’s EB Cap adjustment is use of a cash working capital formula that does not reflect the working capital requirements associated with non-cash credits that are flowed back to customers, including, for example, pension credits.

[463] NYPA’s Initial Brief, pp. 3-5.

[464] The Company’s Initial Brief, pp. 423-424.

2. The Company’s EB Cap adjustment in this case excludes certain pension credits from the EB Cap calculation, consistent with DPS Staff’s proposal in the Company’s last electric rate case and the terms of the 2008 Rate Order (pp. 83-86). This lowered the EB Cap adjustment and mitigated the Company’s proposed revenue increase.
3. The Commission rejected a similar NYPA proposal in the 2008 Rate Order and NYPA has provided nothing new that warrants a second review.

Further Company arguments offered in its reply brief are as follows:[465]

1. NYPA is incorrect to suggest this adjustment is not required because there is ample Commission precedent to ensure a utility has a reasonable opportunity to earn a rate of return on all capital invested in its utility business.
2. That precedent, including the 2008 Rate Order, makes clear that the adjustment is warranted whether it results in a downward or upward adjustment to rate base.
3. It is uncontested that the FERC formula is a short-cut approach to estimating cash working capital needs in the Rate Year. In this light, it is reasonable to conclude that an effect of the EB Cap adjustment is to correct for any under- or over-statement of cash working capital by using the FERC formula.

We acknowledge that an EB Cap adjustment is reflected routinely in Commission rate determinations. The explanations provided by the Company in these cases are not adequate for us to conclude even on a gross basis that the resulting $388 million increase in rate base is reasonable. It refers, for example, to some pension credits in only the broadest of terms and suggests the adjustment is reasonable because of the use of the FERC formula for cash working capital. We agree with NYPA insofar as it suggests that a better explanation of the $388 million rate base adjustment is warranted in these cases. In the absence of any DPS Staff support for NYPA’s adjustment, however, we do not support NYPA’s proposals.

[465] The Company's Reply Brief, pp. 138-140.

D. Working Capital – Lead-Lag Study

The Company's updated, corrected revenue request is based in part on the Company earning a rate of return on $195.6 million of cash working capital.[466] This amount was calculated using FERC's formula based on 1/8 of the total of certain O&M expenses.

NYPA objects to the approach used and the result and argues that the Commission should require the Company to perform a lead-lag study that would accurately quantify the Company's cash working capital needs. Pending that study, NYPA argues the Commission should allow a return on a Company rate base that is $19.4 million lower, to reflect the results of a simple lead-lag study prepared by NYPA. Whatever the Commission decides to allow for cash working capital, NYPA argues that the Company should be required to perform a study that would show whether use of the FERC formula in the past has resulted in reasonable cash working capital allowances. It suggests such a study would be useful and not unduly burdensome.

NYPA supports its study proposal for future rate cases as follows:[467]

1. It is superior to use a lead-lag study to estimate cash working capital because such a study quantifies the net difference in time between the Company's receipt of revenues from customers and its payments for materials and services. Such a study alone is a sound basis for determining cash working capital requirements.
2. Use of FERC's 1/8 formula ignores real-world time lags and no evidence or precedent has been provided to the effect that the Commission requires or prefers use of the FERC formula.

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[466] Cash working capital is a cost of service as the Company needs to borrow capital to reflect that there are time differences between (1) the provision of service by the Company and its receipt of payment, and (2) the Company's receipt of materials and services and its payment for them.

[467] NYPA's Initial Brief, pp. 5-7.

3. Ease of use is not a valid basis for determining cash working capital requirements; the same level of rigor required to substantiate all other cost elements (with the exception of the previously discussed EB Cap adjustment) should be required for this cost element.

Turning to its proposed cash working capital rate base adjustment, NYPA states:

1. It submitted an approximation of a lead-lag study (Ex. 351) that demonstrates the Company's need to prepare a full lead-lag study and that the FERC 1/8 formula likely overstates working capital requirements by $79.4 million. The approximation is based on the lead-lag study submitted by the Company's affiliate--Rockland Electric Company--in New Jersey (Ex. 405) and assumes similar business practices in the two companies.
2. The Company criticized NYPA's effort, explained how a lead-lag study should be performed, and sought to distinguish itself from its affiliate. However, NYPA made clear that it performed an approximation (not a full study), the Company knows how to perform a lead-lag study but failed to do so, and the efforts to distinguish the Company and its affiliate confirms that the FERC formula one-size-fits-all approach is inherently inaccurate and highly inappropriate.

As noted above, finally, NYPA observes that the Company has not in more than 30 years studied the accuracy of the FERC formula as applied to it. NYPA argues the Company should be required to examine projected and actual cash working capital requirements in the last five years. Even if the Commission prefers the ease of a simple formula approach, such a study might show that 1/9 of certain O&M expenses might be all that is reasonably required for the Company. The fact that the EB Cap adjustment is a plug-in number should not deter the Commission from requiring such a study, according to NYPA, because the Commission's overriding concern should be whether the Company follows sound cost-of-service principles when estimating its Rate Year rate base.

The Company argues that NYPA's proposal should be rejected for the following reasons:[468]

1. The Commission first decided to discourage the use of a lead-lag study in a 1970 case involving the Company, because the time and expense of such studies is disproportionate to any increase in accuracy. There has been no indication of any change in the Commission's preference in many cases over the years.
2. The Commission requires an EB Cap adjustment to ensure the FERC 1/8 cash working capital formula does not result in an excessive or inadequate rate base.
3. The approximation of a lead-lag study proffered by NYPA is fraught with problems and should be ignored. The NYPA study is based on a Rockland Electric Company filing in New Jersey:
    - That ignores that the Company's affiliate serves affluent residential customers who use nearly three times the amount of energy used by the Company's residential customers.
    - Is an incomplete and altered version of an exhibit filed by the Company's affiliate in a 2006 New Jersey rate case, but is unaccompanied by any supporting documentation explaining the reasons for deletions and changes.
    - Includes approximately $5 billion of revenues, but only $2.3 billion of expenses. It is incomprehensible that $2.7 billion of expenses are ignored in the study.
    - Inadequate support is provided for some of NYPA's lead-lag revenue-day figures.

NYPA replies, arguing:[469]

1. Any claimed "preference" the Commission might have for the simplistic FERC 1/8 formula over a lead-lag study dates back 40 years, when slide rules were commonly used, calculators were in their infancy, and computer spreadsheet software unheard of. Sophisticated calculations that were time consuming and expensive then can be performed readily now.

[468] The Company's Initial Brief, pp. 424-428.

[469] NYPA's Reply Brief, pp. 4-6.

2. With the Company's proposed working capital requirements being so large, it is time to go beyond a simple, short-cut formula and adopt the far more accurate lead-lag methodology either encouraged or required in other jurisdictions, including New Jersey.
3. NYPA's summary of a Rockland Electric lead-lag study (Ex. 351) is not misleading, but exactly what it purports to be, a summary for the purpose of showing why it is likely that the FERC 1/8 formula overstates the Company's cash working capital requirements.

Further arguments offered by the Company are:[470]

1. Given that the EB Cap adjustment corrects for any shortcomings in the FERC formula for cash working capital, the Company should not be required to undertake what would no doubt be contentious prospective or retrospective lead-lag studies unless the Commission is inclined to abandon the EB Cap adjustment.
2. In the absence of any indication that the Company's cash working capital situation is unique in New York, any shift to a new approach is best considered in a generic proceeding open to all interested parties.

We agree with the Company that the Commission has made clear its preference for the FERC approach because of its relative ease of use. Meanwhile, we also agree with NYPA that it is possible use of the FERC cash working capital formula may systematically over-estimate the Company's cash working capital needs. In the end, however, no purpose would be served in requiring submission of a lead-lag study in the absence of any Commission-expressed willingness to abandon the EB Cap adjustment. We believe such an outcome is very unlikely. Accordingly, NYPA's proposals are not recommended.

E. Rate Base Treatment for Deferred Overhaul and Local Law 11 Expenditures

DPS Staff contends that the O&M costs incurred to bring the East River Facility into compliance with Local Law 11 should be deferred and recovered over two years, with interest

[470] The Company's Reply Brief, pp. 140-141.

accrued on the deferred, net of tax balance, at the other customer contributed capital rate, not to exceed $250,000. DPS Staff's related proposal is that the $2.5 million cost for a scheduled overhaul of the Unit 6 rotor at East River Station should be spread over three years. It argues these proposals are consistent with those adopted in other cases, including in a recent Consolidated Edison steam case.

On brief, the Company states that it can accept these proposals, contingent on the Commission explicitly approving deferral of these costs at the appropriate carrying charge, which, it says, is the overall rate of return of 10% rather than the other customer contributed capital rate of only 5%.[471] The overall rate of return, it notes, is the carrying cost rate used to calculate amounts the Company owes customers. Anything less than full recovery, it concludes, would be improper.

Anticipating the last argument, DPS Staff defends use of the customer contributed capital rate on these grounds:[472]

1. The Company is wrong to claim that use of the customer capital rate would not allow it to recover its costs associated with postponing recovery of costs incurred in a prior period and to contend that it should be allowed to include the deferred balance in rate base to recover "full carrying charges" (at the overall allowed rate of return) on the deferred balances.
2. The accounting and ratemaking treatment DPS Staff proposes for Local Law 11 expenses is consistent with that reflected in the recent steam case. Specifically, the Commission authorized recovery of Local Law 11 expenditures of $4.9 million over three years and use of the customer capital rate for the accrual of carrying charges. That order also authorized identical accounting and ratemaking for certain water treatment expenditures.
3. The Company's proposal to include the deferred balance in rate base unrealistically assumes it will have spent the

[471] The Company's Initial Brief, pp. 429-431. Page 295 of the same brief, however, suggests the overall rate of return should be 7.97%, including a 10.00% return on equity.

[472] DPS Staff's Initial Brief, pp. 258–261.

entire amounts for each project by the beginning of the Rate Year. In neither case will the work occur immediately, nor will it be finished instantly; it will be conducted over time. It is not proper to include the un-recovered and likely un-incurred costs in rate base.

4. DPS Staff’s proposed accounting and ratemaking treatment for these projects is consistent with that for the East River Repowering Project (ERRP) major maintenance expenditures. To date, there has been no actual rate recovery or outflow of cash for either the East River Unit 6 generator rewind or Local Law 11 work; there has been actual rate recovery and cash outflow for ERRP major project maintenance work. Thus, rate base treatment is not proper for either the East River Unit 6 generator rewind or Local Law 11 work, but is for ERRP major maintenance.

5. Staff’s proposal matches recovery of carrying charges to the expected outlay of funds and is totally consistent with its proposed treatment for other regulatory deferrals.

In its reply brief, DPS Staff adds the following:[473]

1. Allowing full carrying charges in this instance would eliminate the Company’s incentive to minimize the necessary costs.

2. Rate base treatment is not appropriate as there has been no revenue recovery or outflow of cash related to these items.

Further arguments by the Company include that:[474]

1. The Company proposes to include only the average amount in rate base and, thus, there is no basis for DPS Staff’s concern that not all the dollars will have been spent as of the beginning of the Rate Year.

2. The Commission’s decision in the recent steam case adopts terms that were the product of negotiations and does not establish that such an approach is reasonable in the context of a litigated case.

3. Given that no citations are provided, no weight should be given to DPS Staff’s arguments to the effect that its proposal is consistent with that in place for other deferrals.

Based on our review of the arguments presented, it appears that the key issue presented is whether the Company

[473] DPS Staff’s Reply Brief, pp. 87-88.

[474] The Company’s Reply Brief, pp. 141-142.

should be required to amortize certain large expenses over time and accrue interest at less than its full cost of capital in order to provide it an incentive to minimize the costs.[475] We believe the answer ought to be no. In the absence of some proof that the Company can finance the costs in question at less than its overall cost of capital, the effect of DPS Staff's proposal is to confiscate utility property. Admittedly, the amount of confiscation is lessened to the extent the total costs to be amortized are minimized. However, DPS Staff's proposal is contrary to the fundamental tenet that rates should be set to allow the Company to recover its reasonable costs of doing business and a reasonable opportunity to earn its allowed rate of return.

F. Deferred Fuel

The Company states that its initial filing showed an actual historic average deferred fuel balance, net of tax, of $81.8 million and projected that this would decrease to $26.5 million in the Rate Year.

The Company updated this figure on a preliminary basis in July and DPS Staff reflected that update in its calculations. However, the Company subsequently determined that the original and update figures both reflected an error.

The Company's update/rebuttal forecast is $38.6 million, net of tax, an amount close to the $37.0 million reflected currently in rates. The Company argues its latest update should be adopted.[476]

[475] As in the discussion of the cost of equity issues, arguments based solely on what the Commission did in other cases are given little weight. The substantive reasons offered for and against a proposal should determine whether or not it ought to be adopted.

[476] The Company's Initial Brief, p. 431.

DPS Staff opposes the Company’s update, because:[477]

1. Consolidated Edison attributes the increase to its forecast cost of fuel. This is completely inconsistent with the Company’s update/rebuttal, which actually decreased its forecast cost of fuel by $103.324 million.
2. DPS Staff submitted an interrogatory request on October 8, 2008, asking the Company to explain and illustrate how it derived the revised Rate Year forecast, but the Company has not responded.

The Company replies, stating:[478]

1. The Company’s deferred fuel projection is about half of that in the historic Test Year, suggesting that the correction adequately reflects a reduction in forecast purchased power costs since the May 2008 tariff filing.
2. The Company informally responded to DPS Staff’s referenced discovery request within a short period and a formal response was tendered on November 20, 2008, providing DPS Staff more than enough time to understand the Company’s adjustment.

We are not certain how this issue should be resolved. The Company had no right to take until November 20, 2008 to respond finally to a discovery request tendered on October 8, 2008. DPS Staff, on the other hand, takes the position that the discovery response was never answered and the Company contends that it was. We cannot tell which party is correct. DPS Staff and the Company also do not join issue on whether this is a correction of an error (the Company’s claim) or an update inconsistent with the Company’s updated cost of fuel. In the absence of a better basis, we recommend rates be set based on an allowance of $32.5 million, the midpoint between the position of the two parties.

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[477] DPS Staff’s Initial Brief, p. 262.

[478] The Company’s Reply Brief, pp. 142-143.

X. REVENUE ALLOCATION/RATE DESIGN

A. 2005 ECOS, Revenue Allocation and Tolerance Bands

Pending consideration of all the evidence and arguments, we recommend the Commission-determined electric delivery service revenue requirement should be allocated on an across-the-board equal percentage basis, net of fuel and purchased power. Adoption of this approach continues existing cost-rate relationships to the extent practicable at this time. Any alternative revenue allocation or rate design based on a review of the arguments that remain pending, once adopted, should apply solely on a prospective basis.

B. TCC Treatment *vis-à-vis* NYPA

A major contested issue not dealt with yet is whether the Commission-determined NYPA revenue requirement should be offset in part by Transmission Congestion Contract (TCC) revenues the Company receives in excess of its congestion costs. On a related topic, it is uncontested that the $150 million of net TCC revenues imputed in the Company's last electric rate case should be reduced to $120 million now. This change, all other things being equal, increases the Company's cost of electric delivery service by $30 million. All parties recognize that no portion of that $30 million should be allocated to NYPA unless and until NYPA is allowed to share in the Company's surplus TCC revenues. For the time being, accordingly, no portion of that $30 million increase should be allocated to NYPA.

XI. OTHER ISSUES

C. Three-Year Rate Plan

As noted in the Procedural History (Appendix I), the Company originally filed tariffs for the Rate Year (or Rate Year One). However, it also proposed electric revenue increases of

$474.7 million and $420.5 million for Rate Years Two and Three or, alternatively, levelized revenue increases for all three years.

The Company argues that a multi-year plan would afford it greater flexibility to schedule and execute programs in the most cost-effective way, put more pressure on it to manage its resources, and permit it to focus on operations rather than on rate cases.[479]

Out of all the other parties, only two said anything at all about the Company's multi-year proposal. DPS Staff proposes a one-year rate plan and generally declines to address Consolidated Edison's three-year rate plan proposal, because:[480]

1. Although Consolidated Edison proposed a three-year rate plan, it purports to reserve the right to file for new rates immediately after an order is issued if it considers the Commission's decision inadequate or unreasonable (Tr. 2737).
2. DPS Staff believes multi-year plans are better developed in negotiations among parties. Normally, with a multi-year plan, ratepayers receive the benefit of rate certainty and shareholders the opportunity to earn a reasonable profit over the extended term. Here, the Company leaves open the option of challenging or ignoring a Commission-adopted multi-year rate plan.
3. The Company shows a lack of commitment to a three-year plan, because it failed to update beyond a single year in its preliminary update or its formal update/rebuttal filing.
4. The great risk of uncertainty about the current economic slowdown militates against the Company's now stale three-year rate plan proposal (Tr. 1877-1880).

The Company argues these are not reasonable bases for rejecting or declining to evaluate its multi-year proposals as the reservation of Company rights that is objectionable to DPS Staff matches a standard or boiler plate term in most if not all joint proposals filed with the Commission.

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[479] The Company's Initial Brief, pp. 503-505.

[480] DPS Staff's Initial Brief, pp. 319-321.

Westchester, on the other hand, argues ratepayers are better off with a one-year rate plan. The Company disagrees with the County, noting that no rationale was offered in support and pointing out that the Commission for many years now has adopted more multi- than single-year rate plans.

Given that only two reasons were given for not considering the Company's multi-year proposals, and that it believes such reasons do not hold water, the Company asks the Commission to consider or adopt its multi-year rate proposals.

While the Company nominally supports a multi-year rate plan, it is clear that it has no such expectation in a litigation context. No updates have been filed for Rate Years Two and Three, for example, and most of the arguments on brief focus on Rate Year One O&M expenses and capital investments planned for calendar 2009 and 2010. Moreover, in the absence of a Company commitment to "stay-out" for a period of years, something we do not believe the Commission can legally require, it seems a waste of time to project the Company's cost of electric delivery service for 24 months beyond the Rate Year. This recommendation makes it unnecessary to consider a Company proposed multi-year surcharge mechanism for capital additions that it believes should be part of any multi-year rate plan.

D. Deferral Accounting/Reconciliations (including 125th Street)

The Company has numerous deferral accounting proposals in this case, including the following:

1. Continue deferral accounting for costs the Commission previously authorized such as for pensions and OPEBs, environmental remediation, storm costs, East River Repowering Project maintenance costs, and World Trade Center costs.
2. Allow deferral accounting for all items for which it proposes reconciliations, including property taxes, O&M interference costs, inflationary increases above a threshold average over three years, changes resulting from new laws or new taxes, and changes related to the sale of its 125th Street property. It says the targets for all

items to be reconciled should be updated based on its filing (which we assume refers to its update/rebuttal filing unless modified in the Company's trial briefs.) These reconciliation mechanisms are needed because the magnitudes of the costs are beyond the company's control and the timing of the costs is uncertain. As evidenced by a reduction in NY State's statutory income tax rate from 7.5% to 7.1% last year, these reconciliations can be beneficial to ratepayers.

3. Allow the company to offset deferred debits against deferred credits to simplify Company reporting, to make its financial reports more meaningful to investors.

Anticipating DPS Staff's opposition to point 3 on this list, the Company contends that DPS Staff offers no reason why such an offset is perfectly reasonable in the context of multi-year rate cases but not reasonable in the context of a single-year rate case.[481] Moreover, it emphasizes that it is seeking a multi-year rate plan and, in that context, it would be its plan to make an annual submission to the Office of Accounting and Finance. The Company notes, finally, that a setoff of deferred debits and credits would help to minimize a build up of large net deferrals to be passed back or recovered from customers in the future.

In the category of reconciliations, DPS Staff discusses two in connection with the Company's electric operations capital programs. As to the first, DPS Staff states that it has not recommended any specific project or program adjustment under Advanced Technology, but recommends that at the conclusion of each Rate Year, Consolidated Edison should be required to refund to customers the incremental carrying charges on any shortfall from the category totals proposed by the Company, as adjusted by the Staff Accounting Panel (Tr. 3034-36), because one-way reconciliation will:[482]

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[481] The Company's Initial Brief, pp. 506-509.

[482] DPS Staff's Initial Brief, pp. 235-237.

1. Allow Consolidated Edison to take full advantage of improvements in the industry regarding monitoring, modeling, and data processing to benefit electric system operation.
2. Encourage the Company to allocate funding properly to the Advanced Technology program.

DPS Staff maintains that the Company misinterprets DPS Staff's reconciliation proposal, which DPS Staff intends should apply only to the Advanced Technology program as a category, not to individual projects within it.

As in the case of Advanced Technology, DPS Staff recommends that the Company be required to refund to customers the incremental carrying charges on any shortfall of spending on the Storm Hardening and Response program from the cumulative level DPS Staff proposes. DPS Staff again says the Company misinterprets its reconciliation proposal, which is intended to apply to projects in the Storm Hardening and Response program cumulatively, not on an individual project basis.[483]

There is no dispute among the parties and we have no objection to the Company's proposal to continue existing reconciliations such as, for example, for pensions and OPEBs, SIR costs, and storm costs.

As discussed elsewhere, we recommend incremental or new full reconciliation of non-income taxes and debt costs and one-way (downward only) reconciliation of capital costs in several categories and for electric interference O&M.

As to the separate Advanced Technology and Storm Hardening and Response programs, DPS does not explain why separate reconciliations are needed for these two programs. We envision one capital investment downward reconciliation for all the investment categories specified in this RD, with accrued carrying charges being deferred for the benefit of customers to the extent the Company invests less than that grand total. No

[483] DPS Staff's Initial Brief, pp. 237-38.

other deferrals or reconciliations are recommended by the undersigned. No arguments have been offered concerning why deferred debits and credits should not be offset automatically against one another. On that basis, we recommend the offset approach proposed by the Company.

F. Retail Access Issues

1. Outreach and Education

The Company does not comment on this issue in its initial brief. However, DPS Staff supports the Company's proposal to discontinue its "Power Your Way" outreach and education program on retail access, to "normalize out" $1.622 million of historic Test Year expenditures, and to subsume informational activity expenses under its general O&E budget (Tr. 3578-79).[484]

DPS Staff urges the Commission to affirm the sufficiency of the Company's remaining educational activities related to retail access (Tr. 1302-03), continuation of on-line tools for customers to choose an energy supplier (Tr. 1225), and provision of information on retail choice in its Customer News, at community events and presentations, and through its Call Center (Ex. 382).

RESA and SCMC separately oppose the Company's proposal to discontinue annual outreach and education expenditures related to *"Power Your Way"* and retail access in general. They argue that a reasonable level of retail access outreach and education costs should be recovered in rates. However, they offer no specific amount. RESA and SCMC argue:[485]

1. The Company is confusing reasonable and necessary educational expenses with the Company's promotion of retail access.

[484] DPS Staff's Initial Brief, pp. 328-29.

[485] RESA's Initial Brief, pp. 11-14; SCMC's Initial Brief, pp. 5-9.

2. Significant portions of the $1.622 million Test Year budget amount was for education rather than promotion, including expenditures related to bill redesign, business and residential events, *“Power Your Way”* educational reminders, and the distribution of ESCO lists.
3. The Company’s witness acknowledged the need to engage in outreach and education related to retail access and Company and DPS Staff witnesses agree that there is a need to continue to educate consumers about supply choice.[486]
4. Outreach and education on supply choice make sense as the Company expects to add 300,000 customers per year[487] and, important in light of difficult economic times, because such information affords customers the option of reducing their energy costs.
5. Only recently, the Commission directed utilities to continue to provide objective outreach and education on the availability of retail access.[488]

Based on our review of the arguments and evidence, we recommend that $730,000 of the $1.622 million be restored in order to cover the costs of a Green Power Campaign ($650,000), a Green Power bill insert ($72,000), and the Company’s maintenance of an up-to-date list of retail electric energy suppliers ($8,000).

G. Estimated Billing/Use of AMR

2. Strategic Installation of AMR

The Company proposes to install strategically some meters with automated meter reading (AMR) capability. Among other things, it proposes to replace at a rate of 3,500 per year approximately 93,000 obsolete automated meter reading devices where customers are infirm or otherwise have difficulty

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[486] RESA’s Initial Brief, p. 12, citing Tr. 1302-03, Ex. 382, and Tr. 4720.

[487] Tr. 4723-24.

[488] RESA’s Initial Brief, p. 12 and SCMC’s Initial Brief, p. 7, citing Case 07-M-0458, Policies and Practices Intended to Foster the Development of Competitive Retail Energy Markets, Order Determining Future of Retail Access Programs (issued October 27, 2008), p. 13.

providing meter access. Second, the Company has approximately 100,000 additional meters to which the Company has not had access for over 120 days. It proposes to replace these at a rate of 10,000 per year. Finally, the Company proposes to install meters with AMR in all new and refurbished buildings, noting that this will help it avoid future metering costs at an incremental cost of $20 per meter. Incremental O&M expenses associated with this proposal are $210,000 annually. The Company does not identify the associated capital costs on brief.

Staff opposes the Company’s proposal for AMR projects outside Westchester County, because:[489]

1. The proposed strategic AMR investments do not provide labor savings comparable to those from the saturated AMR installations in Westchester (i.e., meter reading routes cannot be abandoned altogether).
2. Strategic AMR investments could become stranded if the Commission approves the Company’s advanced metering infrastructure proposal (Tr. 4692-93). (No information is provided as to when or whether that might happen.)
3. To the extent the Company plans to replace existing and obsolete remote meters with AMR meters that cost only half as much (Tr. 1409-10), the Company has failed to offset the revenue requirement by reducing the rate allowance for the existing devices or to decrease the revenue requirement for use of less expensive devices.
4. To the extent the Company claims strategic AMR installations would provide efficiencies (Tr. 1411-12), it has failed to identify those efficiencies and use them to offset the AMR costs.

The Company responds as follows:[490]

1. AMR helps ensure bills will be based on actual rather than estimated bills and DPS staff acknowledges that customers prefer bills based on actuals over estimates.
2. It is feasible that any stranded costs that might result from a future Commission decision authorizing Advanced Metering Initiative (AMI) could be minimized by retrofitting AMI meters with AMR modules.

[489] DPS Staff’s Initial Brief, pp. 330-332.

[490] The Company’s Initial Brief, pp. 514-516.

3. AMI is projected to occur over a period of at least seven years once it starts and this will help to minimize any stranded costs for AMR equipment.

For the reasons that follow, the NYC Government Customers support the Company's proposal to invest a modest $1.3 million to deploy AMR technology at meter locations that are hard to read, i.e., small accounts with three or more estimated bills over three years and large accounts with even one estimated bill.[491]

1. The Company currently has about 100,000 meters to which it has been unable to gain access for 120 days or more on average. These are typically on meter reading routes where it is expensive (more time consuming), dangerous, or otherwise inefficient to read meters in a conventional manner.
2. An increase in the number of actual rather than estimated meter readings will help eliminate a barrier to expanding energy efficiency measures. For the City's meters alone, in the period July 2004 through June 2007, approximately 32% of all bills were estimated, a rate that is three times the Company's system average and two times that for other NYPA customers.
3. An increase in the number of actual rather than estimated meter readings will help ensure customers pay only for the service they receive.
4. Other benefits of the Company's proposal include a reduction in labor required to read meters (a labor intensive task), reduced meter reader injuries, and increased customer convenience.

A DPS Staff witness testified in opposition to the Company's proposal and the NYC Government Customers disagree with DPS Staff for the following reasons:[492]

1. DPS Staff is unduly concerned about the possibility of the $1.3 million becoming stranded if an AMI initiative is adopted for the Company. To begin, the Commission has not selected an appropriate AMI technology, much less adopted a plan for its deployment and funding. Second, AMI will very likely be deployed gradually over seven years, decreasing

[491] NYC Government Customers' Initial Brief, pp. 76-79.

[492] NYC Government Customers' Initial Brief, pp. 79-83.

the amount of AMR costs that might be stranded. Third, the Commission has stated that it has concerns about the Company's $713 million AMI proposal in another case, in part because the potential benefits "are far from clear or certain."[493] This suggests it may be years before the Commission ever approves an AMI plan for the Company. Fourth, such a concern ignores that AMR technology installed now may be subject to upgrade to accomplish AMI goals, a possibility the Commission previously credited.[494]

2. The fact that strategic deployment of AMR in hard-to-read locations would not provide the same degree of benefits as the saturation deployment of AMR in Westchester is not a good reason to bar a strategic deployment that produces the previously summarized benefits.

3. Among other things, DPS Staff's witness acknowledged the energy efficiency and bill accuracy benefits of the strategic AMR deployment proposed by the Company.

The Company argues:[495]

1. The criteria for installing AMR proposed by the NYC Government Customers are too broad and should be based on a consistent rather than intermittent lack of access to a meter.

2. The proposed criteria ignore that AMR technology is not effective in certain locations.

The record shows the following:

1. The Company plans to invest $19.716 million in 2009 and $3.923 million in 2010 to complete its AMR saturation program in Westchester. This is a program that has been ongoing for years. DPS Staff has no objection to this investment.

2. In both 2009 and 2010, the Company plans to invest $1.3 million per year for hard to read meters at new locations, $.5 million per year to replace obsolete technology at existing locations and $1.28 million per year for new accounts. DPS Staff opposes all of this primarily because O&M cost savings will be less than those achieved in the Westchester saturation program and because of the potential

[493] Cases 94-E-0952, 00-E-0165 and 02-M-0514, Competitive Opportunities, Competitive Metering, and Competitive Metering for Gas Service, Order Requiring Filing of Supplemental Plan (issued December 19, 2007), p. 19.

[494] Ibid., p. 8.

[495] The Company's Initial Brief, p. 516.

to increase stranded costs. DPS Staff's concern regarding lower O&M savings is not contested.

3. The City disagrees with DPS Staff as to the $1.3 million per year for hard-to-read meters, citing the customer and public policy benefits of actual meter readings over estimates. The latter benefits are not contested.
4. DPS Staff expresses concern about the Company not reflecting in its request that new AMR devices cost less than the old ones. We do not understand this argument on the assumption that the earlier installations would have been capitalized and, to the extent not fully depreciated, would be retired.
5. DPS Staff also suggests the Company's estimate is based on the higher cost of old AMR equipment but no evidence is offered to support this.
6. Whether or not the Company's strategic AMR proposal will increase stranded costs is an open question because it depends on Commission action in another case (concerning AMI) and no indication has been provided concerning the timing or likely outcome.
7. Aside from its support for the $1.3 million the Company seeks for new hard-to–read meter locations, the only issue raised by the NYC Government Customers concerns the criteria to be used for determining whether a meter is hard to read. The Company argues persuasively that the criteria proposed by the NYC Government Customers are too broad.

Taking all of the above into account, we recommend the Commission allow the $3.08 million per calendar year of investment and incremental O&M of $34,000 in the Rate Year, subject to the caveat that such funds be used exclusively to accelerate replacement of the 93,000 obsolete AMR devices at a rate of $.5 million per 3,500 devices, or slightly more than 21,000 devices per year. We view this outcome as maintenance of the *status quo*, the same reason that DPS Staff appears to support an incremental investment of more than $20 million in the Company's Westchester AMR saturation program.

L. Section 185 Clean Air Act Fees And RGGI Costs

1. Clean Air Act Fees

The Company expects that its generation facilities will start incurring in the future, but retroactive to 2008, the cost of Clean Air Act Section 185 fees for emissions of each ton of nitrous oxide and volatile organic chemicals in a severe non-attainment area. The Company's estimate of such fees for 2008 is $5.064 million.[496] We recommend this amount be allowed on the understanding it will be recovered other than via base rates.

2. Regional Greenhouse Gas Initiative (RGGI)

The Company seeks to recover approximately $10.8 million per year to match the cost of Regional Greenhouse Gas Initiative (RGGI) $C0_2$ allowances. This estimate is based on a need for 2.1 million allowances per year in the initial compliance period at $5.00 each.[497] The $5.00 is in the futures market range of $4.50 to $6.50 per allowance. It proposes the costs be recovered through the Market Supply Charge (MSC) and subject to reconciliation through the Market Adjustment Charge (MAC).

DPS Staff opposes Consolidated Edison's proposal because:[498]

1. The potential amount of financial exposure of the Company, and thus ratepayers, is currently unknown. For example, the Company has not completed its review of contracts for outside generation. Thus, consideration of Company determinations of responsibility for these RGGI costs would be premature.

[496] The Company's Initial Brief, p. 523. We do not know if this figure is for the Company or for the portion of the total allocated to the electric department.

[497] This estimate does not account for the Company's potential responsibility for allowances of NJ generators from which the Company purchases energy.

[498] DPS Staff's Initial Brief, pp. 338-340.

2. If Consolidated Edison becomes responsible for RGGI costs associated with its retained generation and purchased supply, the magnitude of ratepayer impact might be sufficient that the Commission would wish to consider a cost recovery other than MSC/MAC.

We agree with DPS Staff that the Commission may decide in the future that RGGI costs should not be reflected in the Market Supply Charge and the Market Adjustment Charge. However, DPS Staff offers no reason why the Company should be at risk for recovering these costs pending such a decision. The Department is very supportive of RGGI to help reduce CO_2 emissions and the use of auction proceeds to foster energy efficiency and clean energy technologies. Anything less than full and timely recovery of related costs seems inconsistent with that strong support.

M. Business Incentive Rate Lost Revenue (without the Company waiving its rights to address in future)

The Company originally proposed to include in rate base $3.339 million of net-of-tax Business Incentive Rate (BIR) revenue short falls plus interest. This is consistent with how such amounts were treated, starting in 1997 and continuing from 2000 to early 2005. DPS Staff countered that the $3.339 million should be removed from rate base until the Commission determines the amount of the revenue shortfall. It suggested as well that the Commission has not authorized a deferral of BIR lost revenue between November 2003 and May 2004.[499]

The Company states on brief that its updated rate request reflects DPS Staff's proposal, even though it believes it was previously authorized to defer the revenue losses in question. The Company asks the Commission to establish a process for further review of the matter and disposition of the shortfalls. It stands ready, as it did during these

[499] There appears to be agreement that revenues lost associated with new loads and new jobs are not recoverable.

proceedings, to provide the data necessary to verify the $3.339 million.[500]

In a footnote, the Company also states that starting in 2005, short falls for prior periods were included in its revenue requirement but no longer reflected in its rate base.

In its own trial brief, DPS Staff proposes elimination from rate base of the entire $3.339 million, because the Commission has not reviewed the classification and the amount of lost revenues or authorized the Company to defer the lost revenue for future recovery (Tr. 2757).[501] According to DPS Staff, Consolidated Edison accepts the adjustment, without waiving its right to future recovery of the amount (Tr. 2250).

It appears that the review DPS Staff proposes will have to take place outside of these cases. However, we are provided no information about when such review might take place. We recommend that, if feasible, the review be completed in time so that the final outcome, whatever it is, can be reflected in the Commission's rate decision.

N. Miscellaneous NYECC Proposals

NYECC wants the Commission to require the Company to "demonstrate any cost efficiency or reductions in existing costs to customers for any new programs proposed," because:[502]

1. A number of new programs proposed in the Company's filing do not demonstrate any cost efficiency or reductions in existing costs to customers (Tr. 4591).
2. Cost containment is not a priority for the Company (Tr. 4591).
3. Many Company responses to interrogatories ignore or give short shrift to demonstrating either cost efficiency or reductions in existing cost areas when new programs are proposed (Tr. 4591-92 and Exhs. 249-259).

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[500] The Company's Initial Brief, pp. 524-526.

[501] DPS Staff's Initial Brief, pp. 340-41.

[502] NYECC's Initial Brief, pp. 34-35.

In addition, NYECC proposes that, to the extent the Company has not implemented feasible productivity gains and efficiencies in the same way that other businesses have in these difficult economic times, it should not be allowed to pass on the entirety of new program costs to customers (Tr. 4595).

NYECC also asks the Commission to require that the Company's guidance materials to its managers explicitly state that they must consider the rate impact on customers when developing operating and capital budgets, because:[503]

1. There is a lack of sufficient direction from the Company to its managers to consider rate impacts on customers when developing operating and capital budgets (Tr. 4587).
2. NYECC could not locate any such consideration in written guidance materials the Company provided in response to interrogatories (Tr. 4587; Exhs. 244-247).

NYECC also proposes generally that the Commission should make adjustments of unspecified amounts to the Company's revenue requirement based upon declining prices of gasoline, copper, and steel from record highs cited in the original filing and preliminary update, based upon recent declines in prices for those commodities.

In connection with the issue about the Company's initial rate case presentation on General Equipment, we discussed some disadvantages of proceeding solely under the Policy Statement on Test Periods in Major Rate Cases and discussed how adoption of formal rules or even an amendment to existing statutory suspension language might be in order. If the Commission adopts a process to consider such changes, NYECC's comments should be raised there anew.

NYECC is incorrect to suggest that cost is not a consideration within the Company. As summarized in the Section IX (A)(1)(a), concerning proposed disallowances of T&D and other capital expenditures, the Company clearly takes

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[503] Ibid., pp. 35-36.

numerous steps to minimize costs. If NYECC has any legitimate issue it is whether the Company adequately considers the rate impacts of its plans. As we see it, that is an open issue.

We do not endorse NYECC's suggestion that every new expenditure must result in efficiencies or cost reductions. Plant additions to serve new load, for example, should be made at the lowest reasonable cost, but will not necessarily and should not be expected by anyone to result in cost reductions. The goal in such instances is to generate new revenues to match the new costs. As the Company points out, its obligation to serve does not always result in the desired match.

Turning, finally, to NYECC's concerns about cost updates, we recommend throughout this document that updates going both ways be reflected on a consistent basis. Some updates for actual changes that are known and measurable and that are easily verifiable are reflected in our cost of electric delivery service recommendations. We have flagged a number of forecasts that some parties propose to update. We note that such updates are not usually considered after the evidentiary hearings and that the need for such updates may be greater now because of the economic downturn. However, no updated forecasts are reflected in our cost of electric delivery service recommendations at this time.

O. Thrift Savings Adjustment

In its initial brief, the Company discussed an issue that is not briefed by CPB.[504] No recommendation is warranted.

[504] The Company's Initial Brief, pp. 526-527.

P. Compliance with Public Service Law Section 66(19)

To facilitate the Commission's review under Public Service Law §66(19) of the Company's compliance with the recently completed Vantage Consulting, Inc. management audit,[505] DPS Staff reports that Consolidated Edison is in compliance with the Commission's directions and recommendations concerning the Company response to outage emergencies (Tr. 550).[506] The Company filed a Master Implementation Plan in March 2008 and quarterly updates in June and September. Twenty-six of 62 recommendations were satisfied as of June 2008. Target dates for most remaining recommendations fall within 2009, but several are not scheduled to be completed until 2010-2011. DPS Staff advises that it will continue to monitor the Company's progress.

Public Service Law §66(19), among other things, requires the Commission to incorporate into its decisions in major rate cases findings based on its review of the pertinent utility's compliance with the directions and recommendations resulting from the most recent management or operations audit. DPS Staff has provided all the information necessary for the Commission to make the requisite findings.

Q. Other Matters

During the evidentiary hearings, we noted that there may be legal limits on the Commission's power to allow an electric revenue increase greater than the $654 million initially sought by the Company or that amount plus 2.5% of revenues. No party submitted any arguments on this topic. If any party wants to be heard on that issue, it should do so in its brief on exceptions.

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[505] Independent Audit of Consolidated Edison Company Electric Emergency Outage Response Program (dated October 24, 2007).

[506] DPS Staff's Initial Brief, pp. 341-42.

A portion of the Company’s current revenues is allowed on a temporary basis subject to refund. If any party wants to propose draft ordering language that would continue the current level of temporary rate revenues, it should do so on its brief on exceptions.

XII. CONCLUSIONS

At a high level, we recommend the Commission set new electric delivery service rates employing a multi-part strategy as follows:

1. Determine the minimal but reasonable costs of the Company’s provision of electric delivery service based on the evidence and arguments and any updates it fairly decides to consider. Our estimate of the level of incremental electric revenues needed based on such costs is $632.447 million, as calculated in Appendix IV. Preliminary indications are that much of this is needed in light of increases in property taxes ($278.3 million), rate base ($194 million), return on equity ($118.8 million), and pensions and OPEBs ($66 million).
2. Minimize the Company’s downside earnings risk in light of the poor economy, by providing for reasonable allowances on all disputed issues and incremental full reconciliation of non-income taxes and all debt costs.
3. Minimize the risk to ratepayers that dollars intended to ensure reliability and service quality are used for those or more important projects or programs but not to support corporate excesses. Specific mechanisms to achieve that goal include a major disallowance of labor and related O&M expense and a downward only reconciliation of carrying charges on investment that ought to be but may not be made by the Company. Both of these are based primarily on DPS Staff proposals.
4. Balance the more limited possibility of upside earnings potential going forward, the Company's’ capital needs, and the significantly higher debt costs that would result from a downgrading below S&P’s “A-”, and employ a productivity adjustment of only 1% as well as an allowed return on equity of 10%, a 50%/50% equity earnings sharing above a trigger of 10.5%, and an equity earnings cap of 11.0%.
5. Consider separately the question of whether new rates should be based on the minimal reasonable costs of electric delivery or whether some macro adjustment is warranted

after balancing the long- and short-run impacts on customers and investors.

January 7, 2009

GLL:HAJ:yrs

PROCEDURAL HISTORY

On May 9, 2008, Consolidated Edison Company of New York, Inc. (Consolidated Edison or the Company) filed amendments to its electric tariff schedules by which it proposed to change its rates, charges, rules and regulations. The Company estimated that the tariff revisions, if approved, would produce an annual increase in electric revenues of $654.1 million over what they otherwise would be in the 12 months ending March 31, 2010 (the Rate Year or Rate Year One). The $654.1 million figure is $427.7 million lower than it would otherwise be because of Company proposals to extend the recovery periods for certain expenses, defer the recovery of a depreciation reserve deficiency, and seek a return on common equity of 10.0% as opposed to the 11.0% figure supported in the direct testimony of the Company's witnesses (collectively, the Amelioration Proposals).

The May 9, 2008 filing also provided information in support of further electric revenue increases of $475 million and $421 million, respectively, for the 12 months ending March 31, 2011 (Rate Year Two) and March 31, 2012 (Rate Year Three). These two amounts are lower than they otherwise would be because of the Amelioration Proposals. As an alternative, the Company proposed three levelized annual electric revenue increases of $556.7 million each.

The proposed Rate Year One tariff revisions are suspended through April 5, 2009.[507]

In a letter dated May 23, 2008, the Company reported on and proposed the disposition of a property tax refund from the Town of Mount Pleasant in the amount of $434,000. That matter was docketed in Case 08-M-0618 and assigned for

[507] Case 08-E-0539, Order Suspending Major Rate Filing (issued May 29, 2008) and Untitled Order (issued September 17, 2008).

consideration under Public Service Law §113(2) in connection with the pending electric rate filing.

Discovery ensued and active parties were identified. The Company advises that it responded to approximately 1,600 discovery requests, most of which had multiple parts. A formal litigation schedule was adopted without objection.[508] Among other things, it called for the Company to offer an informal update on July 25, 2008, for DPS Staff and intervenors to file their direct cases on September 8, 2008, and for the submittal of update/rebuttal presentations on September 29, 2008.

On June 18, 2008, the Company hosted a technical conference to provide interested parties with an overview of its May 9, 2008 filing.[509]

Notices of the pending electric tariff filing and tax refund petition, inviting public comments on both, were published in the State Register on September 24 and October 1, 2008, respectively. A Commission notice inviting public comments through January 25, 2009 was also published prominently in newspapers in circulation in the Company's electric service territory in November 2008. Affidavits of publication were received on November 26, 2008. A summary of public comments received is Appendix III.

Evidentiary hearings commenced on October 15, 2008 and concluded in October 24, 2008. Commissioner Robert E. Curry, Jr. participated in the October 23, 2008 hearing. As of the time of the hearings, the Company's updated and corrected electric revenue increase request for Rate Year One was

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[508] Case 08-E-0539, Ruling on Schedule (issued June 24, 2008).

[509] The handout for the conference is Ex. 209.

$819.024 million.[510] That figure remained $427.7 million lower than it otherwise would be because of the Amelioration Proposals. The Company's revenue requests for the second and third rate years were not updated or corrected as of that date, nor was the alternative proposal for three levelized revenue increases. Meanwhile, DPS Staff's corrected and partly updated direct case around that time supported a Rate Year One annual electric revenue increase of $346.117 million. Neither DPS Staff nor any intervenor took a substantive position with respect to the Company's proposed electric revenue increases for Rate Years Two and Three.

The evidentiary record includes approximately 5000 pages of transcript, a small number of which are protected from public disclosure on an interim basis.[511] There are also 460 exhibits that fill 15 binders.[512] Some of the exhibits are protected from public disclosure in whole or in part on an interim basis.

Initial trial briefs were timely filed and served by the Company; Department of Public Service (DPS Staff); The Consumer Protection Board (CPB); the New York Power Authority (NYPA); the City of New York (the City), the Metropolitan Transportation Authority (MTA) and the Port Authority of New York and New Jersey (Port Authority) (collectively, the NYC Government Customers); Consumer Power Advocates (CPA); the New York Energy Consumers Council (NYECC); the Pace Energy and

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[510] Ex. 403.

[511] 5023 transcript pages less Tr. 406, line 22 through Tr. 428, line 7. The latter are not in evidence, but remain in the transcript as an offer of proof. See Cases 08-E-0539 and 08-M-0618, Ruling on Motion to Strike (issued November 4, 2008).

[512] Numbers 1-462 with the exceptions of 72, 309, 334, all of which are blank, and counting exhibits 448-A and 448-B separately.

Climate Center (Pace); the Retail Energy Supply Association (RESA); the Small Customer Marketer Coalition (SCMC); and Joint Supporters. Citing computer problems, the County of Westchester's (Westchester's or the County's) initial trial brief was disseminated approximately two hours after the deadline.

On December 3, 2008, a notice of impending negotiations was filed and served by the Company. A memorandum reporting on that filing was distributed to Commissioners on December 4, 2008. Negotiations, which were to begin on December 10, 2008, have not yet borne any fruit.

On December 8, 2008, reply trial briefs were timely filed and served by the Company, CPB, NYPA, the NYC Government Customers, CPA, NYECC, Pace, RESA and Joint Supporters. Reply briefs by DPS Staff and Westchester were each filed minutes after the deadline. The initial and reply trial briefs comprise approximately 1,580 pages.

Twenty-six calendar days after the initial trial briefs were filed, it was readily apparent that we would not be able to analyze and prepare recommendations on all disputed issues by the targeted RD issuance date of January 5, 2009. (The latter date is three months prior to the suspension date.) Accordingly, in an electronic message dated December 17, 2008, we advised all parties of our plans to complete an RD on all revenue requirement issues on or shortly after January 5, 2009 and to prepare a separate RD on all other issues. All work on other issues stopped at that time. We expect to reinitiate those efforts soon on a schedule independent of the suspension date. Stated plainly, we anticipate a second Commission decision on all other issues <u>after</u> the suspension date. Whether our expectations will be borne out is not something we control.

In an electronic message dated December 18, 2008, the Company, DPS Staff, and CPB were invited to provide factual updates to inputs to their respective cost of common equity analyses. We relied on some of the factual information provided in our cost of common equity recommendations. We have not relied on any information provided in response that went beyond the information we requested.

Finally, the Company recently filed some further updates, including one for a 7.5% NYC property tax rate increase effective January 1, 2009. This is greater than the 7% tax rate increase the Company had been forecasting.

SUMMARY OF COMPANY CAPITAL CONSTRUCTION PROGRAMI

	2009 (BILLION $)	2010 (BILLION $)	2011 (BILLION $)	NOTES
TOTAL CAPITAL PROGRAM (AS FILED)	**$1.723**	**$1.596**	**$1.360**	
SUPPORT ECONOMIC GROWTH				
1. Substation Operations	.289	.228		Add New Substations and Expand Substation Capacity
	.025	.035		Key Components for Substation Interconnections
2. System & Trans. Ops.	.001	.001		Install Dynamic Feeder Rating Equipment to Increase Reliability and Increase Economic Imports
	.014	.022		Install New Phase Angle Regulator re: Poletti Retiring
3. Electric Ops. (Distribution)	.175	.161		New Business Projects
	.025	.026		Area Substation Load Relief Projects (Transfer Load)
	.112	.103		Base Growth Distribution System Relief
	.006	.006		Area Substation-Expand Capacity or Transfer
	.012	.010		Meter Purchases
	.659	**.592**		**Subtotal - Support Economic Growth**
SYSTEM & COMPONENT PERFORMANCE				
1. Substation Operations	.125	.122		Major Substation Equipment (Breakers, Obsolete Transformers, Spare Transformers)
	.009	.008		Replace Obsolete/Problematic Relay Equipment
	.066	.064		Miscellaneous Substation Components (See IB, p. 319)
2. System & Trans. Ops.	.130	.075		Construct 345 kV M29 Feeder and Academy Switching Substation
3. Electric Ops. (Distribution)	.056	.056		Emergency Repairs-Primary Network Cable Replacement
	.144	.139		Emergency Repairs-Secondary Network Open Mains
	.020	.020		Emergency Repairs-Service Replacements
	.015	.015		Emergency Repairs-Street Lights
	.014	.014		Emergency Repairs-Overhead System
	.023	.021		Emergency Repairs-Network and Overhead Transformers
	.066	.067		Distribution System-Primary Network System (See IB, pp. 321-322)
	.022	.027		Distribution System-Primary Network System-Other (See IB, p. 322)
	.055	.051		Safety-Vented Metal Service Boxes
	.005	.004		Modernization-Distribution Substations
	.147	.147		Transformer Purchases, Exclusive of the Cost Increase Expected from New Efficiency Requirements
	.897	**.830**		**Subtotal - System and Component Performance**

	2009 (BILLION $)	**2010** (BILLION $)	**2011** (BILLION $)	**NOTES**
PUBLIC SAFETY & ENVIRONMENTAL				
1. Substation Ops.-Env.	.015	.015		Dielectric Fluid Pumping (Cooling Improvements, Leak Detection and Control, New Monitoring System)
2. System & Trans. Ops.-Env.	.002	.004		Comply w/DEC Consent Order; Leak Detect. on Trans. Feeders
3. Elec. Ops-Env. (Distribution)	-	-		Oil Minders Program (<$1 million/yr.)
4. Elec. Ops.-Safety	.018	.011		Vented Manhole Covers and Street Light Isolation Transformer Program
	.035	**.030**		**Subtotal - Public Safety and Environmental**
STORM HARDENING AND RESPONSE				
	.007	. 007		Sectionalize Overhead Distribution Feeders to Minimize Outage Impact
	.003	.002		Install Automated Switches and Remote Monitoring and Control Equipment
	.003	.003		Replace Obsolete Cable
	.013	**.012**		**Subtotal - Storm Hardening and Response**
ADVANCED TECHNOLOGY				
1. System & Trans. Ops.	.010	.009		Hardware Updates of Energy Mgmt. System; Enhance Work Mgmt. System; Enhance Energy Mgmt. System w/NYISO, Cyber Security Enhancement; New Energy Mgmt. System Display
2. Elec. Ops. (Distribution)	.039	.030		20 Projects (See IB. pp. 327-328)
	.049	**.039**		**Subtotal - Advanced technology**
PROCESS IMPROVEMENT				
Elec. Ops. (Distribution)	.002	.014		3 Process Improvement Capital Projects
SECURITY ENHANCEMENTS				
Substation Ops.	.004	.004		Security Cameras, Digital Video Recorders, ID Card Access, Intercoms, Improve Physical Security
	1.659	**1.521**		**GRAND TOTAL DISCUSSED IN COMPANY'S IB**
COMPANY UPDATE	<.009>	-		Reduced Cost for One Substation and M29 Feeder
		<.003>		Accept Some Staff Adjustments

PUBLIC COMMENT CATEGORIES

A. Opposes any rate increase generally.

B. Opposes any rate increase in light of the weak economy.

C. Opposes any rate increase because of the impacts on customers generally, and especially on the elderly, those on fixed incomes and the poor.

D. The Commission should decide the rate case taking into account the customers' ability to pay.

E. Any rate increase should be conditioned on the elimination of all Company "fat" (example: legal department) and all costs resulting from inefficiency.

F. The Commission should decide the case balancing the need to restrain rate increases with the need for reliable service.

G. The Company has been encouraging customers to use less electricity and now it is citing reduced customer usage as a reason for needing a rate increase. This is unfair.

H. The PSC has not been doing a good job.

I. The Company's profits are already adequate.

J. I pay more for delivery than for commodity.

K. Any rate increase should be conditioned on the elimination of 400 double and damaged poles in the neighborhood of the White Plains North Broadway Citizens Association.

L. Any rate increase should be conditioned on an improvement in service quality in New Rochelle or generally.

M. Given that oil prices have come down, the Company's rates should decrease rather than increase.

N. EPA supports the proposed shore tariff to help clean the air and improve the health of New Yorkers, especially for low-income and minority persons. A rate setting work group should be quickly convened so that shore power can become a reality by the time the Commission decides the rate case.

O. The proposed rate increase should be granted so that the Company will have money to invest in infrastructure and earn a decent rate of return.

P. Any rate increase should be conditioned on stopping Company advertising that is unnecessary for a monopoly.

Q. Miscellaneous: (1) Any rate increase should be conditioned on requiring the Company to install metal instead of wooden poles, as this is what is done in other states. (2) Concerned about frequent adjustments in budget billing amounts. (3) Other reasons.

SUMMARY AND CATEGORIES OF PUBLIC COMMENTS
(As of 1/2/09 10:00 a.m.)

Customer Comment Number	Category A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Category Q
1	x	x	x														
2	x			x													
3	x		x		x												
4						x											
5					x	x											
6	x																
7	x	x															
8	x																
9	x						x										
10	x						x										
11	x							x									
12	x	x															
13	x		x					x									
14	x								x	x							
15											x						
16	x	x										x					
17		x											x				
18	x	x						x									
19														x			
20															x		
21	x	x						x	x								
22	x															x	
23	x	x	x				x										
24					x												
25	x	x							x								
26	x				x		x										
27	x																
28	x	x							x				x				
29	x	x					x										x
30	x	x					x										x
31*																	
32	x	x					x										x
33	x	x		x													
34	x	x		x	x												
35	x				x												

* Customer Bill Complaint Forwarded to OCS

SUMMARY AND CATEGORIES OF PUBLIC COMMENTS
(As of 1/2/09 10:00 a.m.)

Customer Comment Number	Category A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Category Q
36				x								x					
37								x									
38	x			x													
39	x				x							x					
40																	x
41	x	x			x												
42	x	x															
43	x																
44	x																
45	x	x															
46	x		x														
47	x	x			x			x									
48	x	x					x										
49	x	x			x												
50	x																
51								x									
52	x		x		x				x			x					
53	x		x						x			x					
54	x	x															
55			x														
56			x					x									
57					x												
58	x			x				x									
59			x														x
60		x															
61					x								x				
62		x								x			x				
63	x				x		x										
64		x		x													
65	x	x		x	x												
66	x											x					
67	x			x													
68																	x
69		x											x				
70	x				x												
71		x		x	x		x										
72	x				x												
73	x							x									

Consolidated Edison Company of New York, Inc.
Electric Operating Income, Rate Base & Rate of Return
For the Rate Year Ending March 31, 2010
($000's)

	Per Company as Updated	Adj. No.	Recommended Decision Adjustments	As Adjusted by Recommended Decision	Cost of Electric Delivery Service Adjustment	Recommended Decision Cost of Electric Delivery Service
Operating Revenues						
Sales Revenues	$7,270,758	1	$14,686	$7,285,444	$632,447	$7,917,891
Unbilled Revenues	14,000		0	14,000	0	14,000
Other Operating Revenues	241,175	2	24,045	265,220	2,214	267,434
Total Operating Revenues	7,525,933		38,731	7,564,664	634,661	8,199,325
Operating Expense						
Fuel	3,147,757		0	3,147,757	0	3,147,757
Operation & Maintenance Expenses	1,767,737	3	(96,918)	1,670,819	3,921	1,674,740
Depreciation Expense	593,068	4	(1,722)	591,346	0	591,346
Taxes Other Than Income Taxes	1,304,652	5	(14,790)	1,289,862	16,507	1,306,369
Gains from Disposition of Utility Plant	0			0		0
Total Operating Expenses	6,813,214		(113,430)	6,699,784	20,428	6,720,212
Operating Income Before Income Taxes	712,719		152,161	864,880	614,233	1,479,113
New York State Income Tax	15,227		11,624	26,851	43,611	70,462
Federal Income Tax	23,221		52,978	76,198	199,718	275,916
Electric Utility Operating Income	$674,271		$87,560	$761,831	$370,904	$1,132,735
Rate Base	$14,483,004	6	($81,262)	$14,404,702		$14,404,702
Rate of Return	4.66%			5.29%		7.86%

Consolidated Edison Company of New York, Inc.
Electric Other Operating Revenues
For the Rate Year Ending March 31, 2010
($000's)

	Per Company As Updated	Adj. No. 2	Recommended Decision Adjustments	As Adjusted by Recommended Decision	Cost of Electric Delivery Service Adjustment	Recommended Decision Cost of Electric Delivery Service
Miscellaneous Service Revenues	$13,174			$13,174		$13,174
Rent from Electric Property	15,601			15,601		15,601
Interdepartmental Rents	11,063			11,063		11,063
Other Electric Revenues:						
Transmission of Energy	11,456			11,456		11,456
Transmission Service Charges	18,600			18,600		18,600
Maint. of Interconnection Facilities	2,183			2,183		2,183
Excess Distribution Facilities	2,559			2,559		2,559
Late Payment Charges	25,529	a	$32	25,561	$2,214	27,775
Meter Reading Services	2,421	b	400	2,821		2,821
The Learning Center Services	769			769		769
Fuel Management	134			134		134
TCC Credits	120,000			120,000		120,000
Sithe Agreement	2,263			2,263		2,263
POR Discount	6,880	c	830	7,710		7,710
ESCOs / Marketer Charges	4,608			4,608		4,608
SO2 Allowance	1,315	d	1,985	3,300		3,300
Intercompany Rents 74/59th Street	(6,500)			(6,500)		(6,500)
Regulatory Deferrals:						
NYS Tax Law Changes	8,465			8,465		8,465
DC Service Incentive	3,000			3,000		3,000
S02 Credits	7,293	e	(3,993)	3,300		3,300
Verizon Pole Maint. Contract	14,500			14,500		14,500
ADR Tax Amortization (Principle & Interest)	16,357			16,357		16,357
Interest on FIT Audit Adjustments - Net	7,404			7,404		7,404
Gain on Sale of First Avenue Properties	43,890			43,890		43,890
Interest on Sale of First Avenue Properties	2,752			2,752		2,752
WTC Expenses	(14,000)			(14,000)		(14,000)
Carrying Charges on T&D Expenditures	(19,498)			(19,498)		(19,498)
Low Income Discount Program	(17,400)	f	(1,824)	(19,224)		(19,224)
Excess Deferred SIT	5,105			5,105		5,105
Transmission Service Charges	2,591			2,591		2,591
Deferred Property Tax Refund	258			258		258
Return of Stony Point Tax Refund	1,400			1,400		1,400
Misc. Property Tax Refunds	3,629			3,629		3,629
Management Audit	0			0		0
Deferrals from Case 04-E-0572 RY3	(5,592)			(5,592)		(5,592)
Interest on Deferrals from C. 04-E-0572 RY3	(186)			(186)		(186)
Pension Deferral	(6,428)			(6,428)		(6,428)
SIR Deferral	(18,698)	g	1,480	(17,218)		(17,218)
Property Tax Increase Deferral	(20,610)	h	20,610	0		0
Property tax deferral for earlier tax rebate	(4,525)	i	4,525	0		0
DSM	(587)			(587)		(587)
Total Electric Other Operating Revenues	$241,175		$24,045	$265,220	$2,214	$267,434

Consolidated Edison Company of New York, Inc.
Electric Operation & Maintenance Expenses
For the Rate Year Ending March 31, 2010
($000's)

	Per Company As Updated	Adj. No. 3	Recommended Decision Adjustments	As Adjusted by Recommended Decision	Cost of Electric Delivery Service Adjustment	Recommended Decision Cost of Electric Delivery Service
Admin & General Expenses Capitalized	($37,780)	a	$1,159	($36,621)		($36,621)
Inter-Utility Agreement - Ramapo-O&R	516			516		516
Asbestos Removal	239			239		239
Bank Collection Fees	266			266		266
Betterment Program	1,930			1,930		1,930
Boiler Cleaning	499			499		499
Building Services / Facilities	21,988			21,988		21,988
Central Engineering - Administrative	25			25		25
Central Engineering - Distribution	1,219	b	(382)	837		837
Collection Agency Fees	2,057			2,057		2,057
Communications - Telephone	12,620			12,620		12,620
Company Labor	608,528	c	(57,582)	550,946		550,946
AMR / AMI Saturation Savings	(778)			(778)		(778)
Consultants	11,620			11,620		11,620
Contract Labor	23,539	d	(4,427)	19,112		19,112
Corrective Maintenance	4,029			4,029		4,029
Contract Change	(3,080)			(3,080)		(3,080)
Disposal of Obsolete M&S	6,072			6,072		6,072
DSM	26,331			26,331		26,331
Duplicate Misc. Charges	(23,455)			(23,455)		(23,455)
EDP Equipment Rentals & Maintenance	4,184			4,184		4,184
Electric and Gas Used	731			731		731
Employee Pension / OPEBs	145,228			145,228		145,228
Employee Welfare Expense - Net	106,035	e	(4,260)	101,775		101,775
Environmental Expenses	19,079	f	(1,796)	17,283		17,283
ERRP - Major Maintenance	7,292			7,292		7,292
Facilities Maintenance	4,048			4,048		4,048
Financial Services	9,097	g	(2,073)	7,024		7,024
Gas Turbines	3,039			3,039		3,039
Information Resources	23,802			23,802		23,802
Informational Advertising	17,573	h	(4,642)	12,931		12,931
Injuries and Damages Reserve	41,073			41,073		41,073
Institutional Dues & Subscriptions	1,718			1,718		1,718
Insurance Premiums	22,756	i	(1,603)	21,153		21,153
Interference	93,466	j	(4,612)	88,854		88,854
Corporate and Fiscal Expenses	4,328	k	(690)	3,638		3,638
Mobile Diesel Generators	6,523			6,523		6,523
Manhour Expense	48,629			48,629		48,629
Marshall's Fees	1,099			1,099		1,099
Materials and Supplies	31,115	l	(3,674)	27,441		27,441
MGP - RCA / Superfund	0			0		0
Other Compensation	6,021	m	(6,021)	0		0
Outreach & Education	4,608	n	730	5,338		5,338
Other (Fossil)	1,797			1,797		1,797
Outside Legal Services	1,696			1,696		1,696
Paving	1,928			1,928		1,928
Plant Component Upgrade	428			428		428
Postage	14,079			14,079		14,079
Preventive Maintenance	1,665			1,665		1,665
RCA - Amortization of Hudson-Farragut	477			477		477
SBC / RPS	126,421			126,421		126,421
Real Estate Expenses	1,037			1,037		1,037
Regulatory Commission Expenses	30,051	o	(2,000)	28,051		28,051
Rents	63,571			63,571		63,571
Rents (ERRP)	68,547			68,547		68,547
Rents (Interdepartmental)	5,450			5,450		5,450
Research and Development	20,025	p	(1,365)	18,660		18,660
Stray Voltage	23,414			23,414		23,414
Scheduled Overhauls	2,690			2,690		2,690
Security	2,664			2,664		2,664
Shared Services	(8,924)			(8,924)		(8,924)
Storm Costs	5,600			5,600		5,600
Transformer Installations	96			96		96
Tree Trimming	16,551			16,551		16,551
Trenching	9,846	q	(371)	9,475		9,475
Uncollectible	50,989	r	91	51,080	3,921	55,001
Water	714			714		714
Water Chemicals	154			154		154
Other O&M	68,942	s	(3,400)	65,542		65,542
Total O & M Expenses	$1,767,737		($96,918)	$1,670,819	$3,921	$1,674,740

Consolidated Edison Company of New York, Inc.
Other Electric O & M
For the Rate Year Ending March 31, 2010
($000's)

	Per Company As Updated	Adj No.3s	Recommended Decision Adjustments	As Adjusted by Recommended Decision	Cost of Electric Delivery Service Adjustment	Recommended Decision Cost of Electric Delivery Service
Electric Parts, Repairs & Service	$11,642	1	($485)	$11,157		$11,157
Other Equipment, Parts, Repair & Service	3,147			3,147		3,147
Misc. Materials, Hardware, Parts & Supplies	5,952			5,952		5,952
Vehicle Maint., Service & Other Transportation	2,385			2,385		2,385
Substation Equipment, Parts, & Services	5,285			5,285		5,285
Training & Development	1,933			1,933		1,933
Audio & Visual	379			379		379
Printing Services	680			680		680
Programming Services	2,612			2,612		2,612
Rental Equipment - Other	2,082			2,082		2,082
Testing & Inspection	16,535			16,535		16,535
Other	16,310	2 & 3	(2,915)	13,395		13,395
Total Other O & M	$68,942		($3,400)	$65,542	$0	$65,542

Consolidated Edison Company of New York, Inc.
Taxes Other Than Income Taxes
For the Rate Year Ending March 31, 2010
($000's)

	Per Company As Updated	Adj. No. 5	Recommended Decision Adjustments	As Adjusted by Recommended Decision	Cost of Electric Delivery Service Adjustment	Recommended Decision Cost of Electric Delivery Service
Property Taxes						
New York City	$941,548	a	($10,412)	$931,136		$931,136
Upstate & Westchester	90,225			90,225		90,225
Total Property Taxes	1,031,773		(10,412)	1,021,361	0	1,021,361
Revenue Taxes	197,037	b	1,007	198,044	$16,507	214,551
Payroll Taxes	53,365	c	(5,385)	47,980		47,980
Subsidiary Capital Tax	5,229			5,229		5,229
Receipts Tax	14,622			14,622		14,622
All Other Taxes	2,626			2,626		2,626
Total Taxes Other Than Income Taxes	$1,304,652		($14,790)	$1,289,862	$16,507	$1,306,369

Consolidated Edison Company of New York, Inc.
New York State Income Tax
For the Rate Year Ending March 31, 2010
($000's)

	Per Company As Updated	Sch No.	Recommended Decision Adjustments	As Adjusted by Recommended Decision	Cost of Electric Delivery Service Adjustment	Recommended Decision Cost of Electric Delivery Service
Operating Income Before Income Taxes	$712,719	Sch. 1	$152,161	$864,880	$614,233	$1,479,113
Flow Through Items:						
Non-Taxable Income and Additional Deductions:						
Interest Expense	462,029		(11,550)	450,479		450,479
Medicare Part D Subsidy	15,347			15,347		15,347
Total Deductions	477,376		(11,550)	465,826	0	465,826
Normalized Items:						
Additional Income and Unallowable Deductions						
Book Depreciation	593,068	Sch. 1	(1,722)	591,346		591,346
Contributions in Aid of Construction	672			672		672
Capitalized Interest	17,662			17,662		17,662
Pension and OPEB Expenses Per Books	182,212			182,212		182,212
Total Additions	793,614		(1,722)	791,892	0	791,892
Non-Taxable Income and Additional Deductions						
NYS Depreciation	537,916		(1,562)	536,354		536,354
263A Capitalized Overheads	62,023			62,023		62,023
Removal Costs	201,879			201,879		201,879
Repair Allowance	47,326			47,326		47,326
Amortization of Capitalized Interest	3,929			3,929		3,929
Loss on MACRS Retirement	44,986			44,986		44,986
Pension / OPEB Expense - Funding	189,037			189,037		189,037
Westchester Property Tax Adjustment	1,416			1,416		1,416
Credits from Case 07-E-0523	87,231			87,231		87,231
Stony Point Property Tax Refund	5,029			5,029		5,029
SO2 Credits	7,293		(3,993)	3,300		3,300
Management Audit	0			0		0
WTC Expenses	(14,000)		0	(14,000)		(14,000)
Deferrals from Case 04-E-0572 RY3	(5,592)			(5,592)		(5,592)
Interest on Deferrals from Case 04-E-0572 RY3	(186)			(186)		(186)
T&D Deferral from Case 07-E-0523	(19,498)			(19,498)		(19,498)
SIR Deferral - April 2008-March 2010	(18,698)		1,480	(17,218)		(17,218)
Property Tax Increase Deferral - April 08-March 09	(20,610)		20,610	0		0
Property Tax Deferral for earlier end to tax rebate	(4,525)		4,525	0		0
DSM	(587)			(587)		(587)
TSC Revenues	2,591			2,591		2,591
Total Deductions	1,106,960		21,060	1,128,020	0	1,128,020
Total Adjustments to Income	(790,722)		(11,232)	(801,954)	0	(801,954)
NYS Taxable Income	(78,003)		140,929	62,926	614,233	677,159
Tax Computation						
Current NYS Income Tax Payable @ 7.1%	(5,538)		10,006	4,468	43,611	48,078
Deferred NYS Income Tax @ 7.1%	22,248		1,618	23,865	0	23,865
Brownfield Credit	(1,482)			(1,482)		(1,482)
Total New York State Income Tax	$15,227	Sch. 1	$11,624	$26,851	$43,611	$70,461

Consolidated Edison Company of New York, Inc.
Federal Income Tax
For the Rate Year Ending March 31, 2010
($000's)

	Per Company As Updated	Sch No.	Recommended Decision Adjustments	As Adjusted by Recommended Decision	Cost of Electric Delivery Service Adjustment	Recommended Decision Cost of Electric Delivery Service
Operating Income Before Income Taxes	$712,719	Sch. 1	$152,161	$864,880	$614,233	$1,479,113
New York State Income Tax	15,227	Sch. 5	11,624	26,851	43,611	70,461
Operating Income Before Federal Income Tax	697,492		140,538	838,029	570,622	1,408,651
Flow Through Items:						
Add: Additional Income and Unallowable Deductions						
Book Depreciation	593,068	Sch. 1	(1,722)	591,346		591,346
Hudson-Farragut Amortization - Per Books	477			477		477
Capitalized Interest	17,662			17,662		17,662
Total Additions	611,207		(1,722)	609,485	0	609,485
Deduct: Non-Taxable Income and Additional Deductions						
Interest Expense	462,029		(11,550)	450,479		450,479
Statutory Depreciation - at Current Book Rates	344,048		(999)	343,049		343,049
Statutory Depreciation - Change at Proposed Book Rates	0			0		0
Statutory Depreciation - Change with Reserve Deficiency	0			0		0
Removal Costs	201,879			201,879		201,879
Medicare Part D Subsidy - Post-Employment Benefits	15,347			15,347		15,347
Amortization of Capitalized Interest	2,073			2,073		2,073
Westchester Property Tax Adjustment	1,416			1,416		1,416
Dividends Paid on $5 Cumulative Preferred Stock	3,327			3,327		3,327
Total Deductions	1,030,119		(12,549)	1,017,570	0	1,017,570
Normalized Items:						
Add: Additional Income and Unallowable Deductions						
Contributions in Aid of Construction	672			672		672
Pension / OPEB Expenses - Rate Year	182,212			182,212		182,212
Deferred NYS Income Tax	22,248	Sch. 5	1,618	23,865		23,865
Total Additions	205,132		1,618	206,749	0	206,749
Deduct: Non-Taxable Income and Additional Deductions						
Statutory Depreciation - at Current Book Rates	249,519		(724)	248,795		248,795
Statutory Depreciation - Change at Proposed Book Rates	0			0		0
Statutory Depreciation - Change with Reserve Deficiency	0			0		0
263A Capitalized Overheads	62,023			62,023		62,023
Repair Allowance	47,326			47,326		47,326
Amortization of Capitalized Interest	1,856			1,856		1,856
Loss on MACRS Retirement	40,173			40,173		40,173
Pension / OPEB Expense - Funding	189,037			189,037		189,037
Correction of ADR Tax Amortization	0			0		0
Interest on Federal Income Tax Audit Adjustments - Net	0			0		0
Credits from Case 07-E-0523	87,231			87,231		87,231
Stony Point Property Tax Refund	5,029			5,029		5,029
SO2 Credits	7,293		(3,993)	3,300		3,300
Management Audit				0		0
WTC Expenses	(14,000)			(14,000)		(14,000)
Deferrals from Case 04-E-0572 RY3	(5,592)			(5,592)		(5,592)
Interest on Deferrals from Case 04-E-0572 RY3	(186)			(186)		(186)
T&D Deferral from Case 07-E-0523	(19,498)			(19,498)		(19,498)
SIR Deferral - April 2008-March 2010	(18,698)		1,480	(17,218)		(17,218)
Property Tax Increase Deferral - April 2008-March 2010	(20,610)		20,610	0		0
Property Tax Deferral for earlier end to tax rebate	(4,525)		4,525	0		0
DSM	(587)			(587)		(587)
TSC Revenues	2,591			2,591		2,591
Total Deductions	608,382		21,898	630,280	0	630,280
						0
Total Adjustments to Income	(822,163)		(9,453)	(831,615)	0	(831,615)
Federal Taxable Income	(124,671)		131,085	6,414	570,622	577,036
Tax Computation						
Current Federal Income Tax @ 35%	(43,635)		45,880	2,245	199,718	201,963
Deferred Federal Income Tax @ 35%	141,138		7,098	148,236	0	148,236
Amortization of Previously Deferred Federal Income Tax						
Depreciation - ADR/ACRS/MACRS - at Current Book Rates	(45,055)			(45,055)		(45,055)
Depreciation - ADR/ACRS/MACRS - at Proposed Book Rates	0			0		0
Depreciation - ADR/ACRS/MACRS - Reserve Deficiency	0			0		0
Loss on MACRS Retirements	(5,558)			(5,558)		(5,558)
Repair Allowance	(9,844)			(9,844)		(9,844)
Capitalized Overheads	(10,296)			(10,296)		(10,296)
Depreciation on Capitalized Maintenance/Computer Software	1,223			1,223		1,223
Investment Tax Credit	(4,752)			(4,752)		(4,752)
Total Federal Income Tax	$23,221	Sch. 1	$52,978	$76,198	$199,718	$275,916

Consolidated Edison Company of New York, Inc.
Rate Base
For the Rate Year Ending March 31, 2010
($000's)

	Per Company As Updated	Adj. No. 6	Recommended Decision Adjustments	As Adjusted by Recommended Decision	Cost of Electric Delivery Service Adjustment	Recommended Decision Cost of Electric Delivery Service
Utility Plant:						
Book Cost of Plant	$18,763,876	a	($16,110)	$18,747,766		$ 18,747,766
Accumulated Reserve for Depreciation	(3,808,281)	b	2,627	(3,805,654)		(3,805,654)
Net Plant	14,955,595		(13,483)	14,942,112		14,942,112
Non-Interest Bearing CWIP	558,093			558,093		558,093
Preferred Stock Expense	2,414			2,414		2,414
Unamortized Debt Discount Premium and Expense	137,066			137,066		137,066
Deferred Fuel - Net of Tax	38,565	c	(6,065)	32,500		32,500
Unamortized Balance - Hudson Farragut	1,323			1,323		1,323
Customer Advances for Construction	(269)			(269)		(269)
MTA Surtax - Net of Tax	3,063			3,063		3,063
Working Capital	607,571	d	(14,995)	595,536		595,536
Excess Rate Base Over Capitalization Adjustment	191,387			191,387		191,387
Early Retirement Termination Benefit (1999) - Net of Tax	7,795			7,795		7,795
DC Service Incentive - Net of Tax	(2,907)			(2,907)		(2,907)
System Benefits Charge/Retail Portfolio Standard - Net of Tax	4,011			4,011		4,011
Amounts Billed in Advance of Construction - Net of Tax	(5,709)			(5,709)		(5,709)
BIR Discounts - Recovery - Net of Tax	0			0		0
ERRP Major Maintenance	(1,325)			(1,325)		(1,325)
Rate Case Reconciliations - Net of Federal Income Taxes						
Recovery of Deferrals from C 04-E-0572 RY3	8,721			8,721		8,721
Recovery of Management Audit	0			0		0
Recovery of Various Deferrals from C. 07-E-0523	100,079			100,079		100,079
Recovery of Pension Deferrals from C. 07-E-0523	0			0		0
Recovery of SIR Deferrals from C. 07-E-0523	107,262	e 1	(8,490)	98,772		98,772
Recovery of 2008/2009 Property Tax Increase	31,114	e 2	(31,114)	0		0
Refund of Credit from C. 07-E-0523	(79,012)			(79,012)		(79,012)
Refund of Stony Point Property Tax Refund	(1,518)			(1,518)		(1,518)
Refund of SO2 Credits	(2,202)	e 3	1,206	(996)		(996)
Unbilled Revenues	54,950			54,950		54,950
Verizon Pole Maintenance - Reimbursement	(4,378)			(4,378)		(4,378)
Deferred TSC Revenues	(3,911)			(3,911)		(3,911)
Deferred DSM Costs	886			886		886
Deferred Scheduled Overhaul Costs	1,258			1,258		1,258
Deferred Facilities Maintenance Costs	743			743		743
Recovery of Property Tax Deferral for Earlier End to Tax Rebate	6,831	e 4	(6,831)	0		0
Accumulated Deferred Income Taxes						
ADR / ACRS / MACRS Deductions	(1,743,527)	f	127	(1,743,400)		(1,743,400)
Change of Accounting Section 263A	(316,186)			(316,186)		(316,186)
Vested Vacation	11,529			11,529		11,529
Prepaid Insurance Expenses	(3,817)			(3,817)		(3,817)
Unbilled Revenues	110,440			110,440		110,440
Contributions in Aid of Construction	12,295			12,295		12,295
Capitalized Interest	4,592			4,592		4,592
Repair & Maintenance Allowance - 2002-2006 IRS Audit	4,507			4,507		4,507
Fin 48 - Disallowed SSCM	(57,475)			(57,475)		(57,475)
MTA	(12,359)			(12,359)		(12,359)
Amortization of Computer Software	(43,047)			(43,047)		(43,047)
Customer Deposits	20,278			20,278		20,278
Call Premium	(19,552)			(19,552)		(19,552)
Deferred SIT	(202,170)	g	(1,617)	(203,787)		(203,787)
Total Rate Base	$14,483,004		($81,262)	$14,404,702	$0	$ 14,404,702

Consolidated Edison Company of New York, Inc.
Working Capital Allowance
For the Rate Year Ending March 31, 2010
($000's)

	Per Company As Updated	Sch.8 Ref	Recommended Decision Adjustments	As Adjusted by Recommended Decision
Materials & Supplies				
Liquid Fuel Inventory	$ 7,259			$ 7,259
Materials & Supplies, Excluding Fuel	88,670			88,670
Total Materials & Supplies	95,929		-	95,929
Prepayments				
Insurance	10,240		-	10,240
Rents	15,519			15,519
Property Taxes	220,940		$ 91	221,031
PSC Assessment	7,792			7,792
Interference	3,756			3,756
EPRI	264			264
Other	11,222			11,222
Total Prepayments	269,733		91	269,824
Cash Working Capital				
Total Operations & Maintenance Expenses	4,915,494		(96,918)	4,818,576
Less:				
Purchased Power Expenses	2,838,515			2,838,515
Gas Portion of Fuel	304,853		-	304,853
Recoverable Fuel Costs	22,799			22,799
Interdepartmental Rents	5,450			5,450
Uncollectibles	50,989		91	51,080
Pensions / OPEBs	145,228		-	145,228
Subtotal	3,367,834		91	3,367,925
Cash Working Capital Subject to 1/8th Allowance	1,547,660		(97,009)	1,450,651
Cash Working Capital @ 1/8th	193,458		(12,126)	181,331
Add: Cash Working Capital @ 1/12th on Recoverable Fuel Costs	1,900		-	1,900
Total Cash Working Capital	195,358		(12,126)	183,231
Total	561,020		(12,035)	548,984
Add: Working Capital Related to Purchased Power @ 1.64%	46,552		-	46,552
Total Working Capital	$ 607,572		$ (12,035)	$ 595,536

Consolidated Edison Company of New York, Inc.
Explanation of Recommended Decision Adjustments
For the Rate Year Ending March 31, 2010
($000's)

Adj. No.	Explanation		Amount
1	Sales Revenues		
	a. To reflect the RD's forecast of sales revenues.		$14,600
	b. To reflect the RD's forecast of rate year BPP/MFC/Metering revenues.		86
	Total Adjustments to Sales Revenues		$14,686
2	Other Operating Revenues		
	a. Late Payment Charges		
	Tracking the RD's adjustments to sales revenues.		$32
	b. Meter Reading Services		
	To reflect the RD's forecast of rate year meter reading revenues.		400
	c. POR Discounts		
	To reflect the RD's rate year forecast of POR Discounts.		830
	d. SO2 Allowances Credits		
	To reflect the RD's rate year forecast of SO2 allowances.		1,985
	e. SO2 Allowance Credit Deferral		
	To reflect the RD's adjustment of deferred S02 allowance proceeds to refund in the rate year.		(3,993)
	f. Low Income Discount Program		
	To reflect the RD's placeholder funding level for the low income discount program.		(1,824)
	g. SIR Deferral		
	To reflect the RD's forecast of rate year SIR program costs and recovery of prior years deferral.		1,480
	h. Property Tax Deferral		
	To eliminate recovery per the RD.		20,610
	i. Property Tax Deferral for earlier tax rebate		
	To eliminate recovery per the RD.		4,525
	Total Adjustments to Other Operating Revenues		$24,045
3	Operation & Maintenance Expenses (O&M):		
	a. Administrative & General Expenses - Capitalized		
	To update the A&G transfer credit for the RD's forecast of capital expenditures.		$1,159
	`		
	b. Central Engineering Distribution		
	To reflect the adjustment associated with the RD's historic hiring practices adjustment.		(382)
	c. Company Labor		
	1. To reflect the RD's labor normalization adjustment.	($6,015)	
	2. To reflect the RD's recommendations related to program change requests.	(19,408)	
	3. To remove variable pay from the rate year forecast.	(15,943)	
	4. To reflect the RD's rate year labor escalation rate.	(16,216)	
	Total Adjustments to Company Labor		(57,582)
	d. Contract Labor		
	1. To reflect the RD's rate year forecast of contract labor.	(3,920)	
	2. To reflect the adjustment associated with the RD's historic hiring practices adjustment.	(507)	
	Total Adjustments to Contract Labor		(4,427)

Consolidated Edison Company of New York, Inc.
Explanation of Recommended Decision Adjustments
For the Rate Year Ending March 31, 2010
($000's)

Adj. No.	Explanation		Amount
3	e. Employee Welfare		
	1. To reflect the RD's rate year forecast of health insurance costs based on the GDP deflator.	($1,506)	
	2. To reflect the RD's rate year forecast of other employee welfare expense.	(988)	
	3. Tracking the RD's adjustments to new employee headcount.	(1,766)	
	Total Adjustments to Employee Welfare Expense		(4,260)
	f. Environmental Expenses		
	To reflect the adjustment associated with the RD's historic hiring practices adjustment.		(1,796)
	g. Financial Services		
	To remove the increase in financing costs (Letters of Credit).		(2,073)
	h. Informational Advertising		
	To reflect the RD's rate year forecast of informational advertising.		(4,642)
	i. Insurance Premiums		
	To reflect the RD's forecast of rate year D&O insurance.		(1,603)
	j. Interference		
	To reflect the RD's rate year forecast of municipal infrastructure support expense.		(4,612)
	k. Corporate & Fiscal Expenses		
	To reflect the RD's elimination of Board of Directors stock options.		(690)
	l. Materials & Supplies		
	1. To reflect the RD's adjustment to the 5-year underground inspection program.	(3,213)	
	2. To reflect the adjustment associated with the RD's historic hiring practices adjustment.	(461)	
	Total Adjustments to Materials & Supplies		(3,674)
	m. Other Compensation		
	To reflect the RD's elimination of other compensation expense.		(6,021)
	n. Outreach & Education		
	To reflect the RD's allowance for Power Your Way program costs.		730
	o. Regulatory Commission Expenses		
	To reflect the disallowance associated with general equipment.		(2,000)
	p. Research & Development		
	To reflect the RD's capitalization of R&D costs.		(1,365)
	q. Trenching		
	To reflect the adjustment associated with the RD's historic hiring practices adjustment.		(371)
	r. Uncollectibles		
	Tracking the RD's rate year forecast of sales revenues.		91
	s. Other O&M		
	1. To reflect the adjustment associated with the RD's historic hiring practices adjustment.	(485)	
	2. To reflect the RD's rate year forecast of vehicle fuel expense.	(2,878)	
	3. To reflect the RD's adjustment related to Public Affairs.	(37)	
	Total Adjustments to Other O&M		(3,400)
	Total Adjustments to Operating and Maintenance Expenses		($96,918)

Consolidated Edison Company of New York, Inc.
Explanation of Recommended Decision Adjustments
For the Rate Year Ending March 31, 2010
($000's)

Adj. No.	Explanation		Amount
4	Depreciation Expense		
	To reflect the RD's rate year forecast of depreciation expense.		($1,722)
5	Taxes Other Than Income Taxes		
	Property Taxes (AP)		
	a. NYC		
	1. To reflect the RD's removal of the linear-trend escalation of assessed values for REUC property.	($14,298)	
	2. To bring the NYC tax rate increase from 7% to the actual 7.5% increase.	3,886	
	Total Adjustments to NYC Property Taxes		(10,412)
	b. Revenue Taxes		
	Tracking the RD's rate year revenue adjustments.		1,007
	c. Payroll Taxes		
	Tracking the RD's rate year adjustments to rate year labor expense.		(5,385)
	Total Adjustments to Taxes Other Than Income Taxes		($14,790)
6	Rate Base		
	a. Book Cost of Plant		
	To reflect the RD's forecast of rate year plant in service.		(16,110)
	b. Accumulated Reserve for Depreciation		
	To reflect the RD's forecast of rate year accumulated reserve for depreciation.		2,627
	c. Deferred Fuel		
	To reflect the RD's rate year forecast of deferred fuel.		(6,065)
	d. Working Capital		
	1. Prepaid Insurance		
	To reflect the RD's adjustments to insurance expense.	(721)	
	2. Prepaid Property Tax		
	To reflect the RD's adjustments to property tax expense.	(2,239)	
	3. Cash Working Capital		
	Tracking the RD's O&M expense adjustments.	(12,565)	
	Total Adjustments to Working Capital		(15,525)
	e. Regulatory Deferrals (AP):		
	1. Recovery of SIR Deferrals from C. 07-E-0523		
	Tracking the RD's rate year forecast of program costs and recovery of deferred costs.	(8,490)	
	2. Recovery of 2008/2009 Property Tax Increase		
	Tracking the RD's elimination of recovery of property tax increase deferral.	(31,114)	
	3. Refund of SO2 Credits		
	Tracking the RD's forecast of deferred SO2 allowance credits.	1,206	
	4. Recovery of Property Tax Deferral for Earlier End to Tax Rebate		
	Tracking the RD's elimination of recovery for property tax increase deferral.	(6,831)	
	Total Adjustments to Regulatory Deferrals		(45,229)
	h. Accumulated Deferred Income Taxes		
	1. ADR / ACRS / MACRS Deductions		
	Tracking the RD's FIT calculation.	127	
	2. Deferred SIT		
	Tracking the RD's SIT calculation.	(1,617)	
	Total Adjustments to Accumulated Deferred Income Taxes		(1,490)
	Total Adjustments to Rate Base		($81,792)