STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service Commission held in the City of Albany on November 17, 2011

COMMISSIONERS PRESENT:

Patricia L. Acampora, Deputy Chairwoman
Maureen F. Harris
Robert E. Curry, Jr.
James L. Larocca

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

ORDER DENYING PETITIONS FOR REHEARING AND/OR CLARIFICATION

(Issued and Effective November 21, 2011)

BY THE COMMISSION:

Orange and Rockland Utilities, Inc. (O&R or Company) and the Utility Intervention Unit of the New York Department of State (UIU) have each petitioned for rehearing of our Order issued June 17, 2011, in which we authorized the Company to increase its rates for electric service.[1] O&R seeks rehearing of our decisions to disallow funding in rates for the Company's Annual Team Incentive Plan (ATIP) and to require an austerity adjustment to revenue requirement. UIU contends that our approval of O&R's price out of its sales forecast was arbitrary and capricious because we failed to recognize that non-competitive sales revenues were under counted.

Pursuant to the State Administrative Procedure Act, notice of the filing of the rehearing petitions was published in

[1] Case 10-E-0362, Order Establishing Rates for Electric Service (issued June 16, 2011) (June 2011 Order).

the New York State Register on August 10, 2011.[2] Responses to the petitions were received from the Department of Public Service Staff and the Municipal Consortium in Support of Reasonable Rates (MC).[3] By letter to the Secretary, the Company responded to the petition of UIU.[4]

Pursuant to PSL §22 and the Commission's Rules (16 NYCRR §3.7(b)), a party may seek rehearing of a Commission order only on the grounds that the Commission committed an error of law or fact or that new circumstances warrant a different determination. For the reasons discussed below, we find no error of law or fact and no new circumstances that would justify rehearing.

DISCUSSION

ATIP

In our June 2011 Order, we declined to provide an allowance in rates for the cost of O&R's ATIP program, which offers incentive compensation to non-officer management employees based on the achievement of defined goals. We found that O&R had failed to demonstrate that its overall compensation for these employees with incentive pay included was reasonable, and that, contrary to the standards we have stated and reaffirmed repeatedly in recent cases, its incentive plan was

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[2] SAPA No. 10-E-0362SP2.

[3] Staff Response to Petition of the Utility Intervention Unit for Clarification and/or Rehearing and Petition of Orange and Rockland Utilities, Inc. for Rehearing, filed August 12, 2012; Reply on Behalf of the Municipal Consortium in Support of Reasonable Electric Rates to the Motion for Clarification and/or Petition for Rehearing of the Utility Intervention Unit of the New York Department of State and the Petition for Rehearing of Orange & Rockland Utilities, Inc., filed August 12, 2011.

[4] Letter from John L. Carley, Assistant General Counsel, dated August 12, 2011.

not focused solely or in large part on goals related to customer service or to the safe and reliable provision of electric service.[5] The incentive compensation provided by ATIP was based on the achievement of both financial and non-financial goals, and there was insufficient information presented to demonstrate quantitatively that achievement of the goals related to safety, reliability and customer service would provide benefits to ratepayers sufficient to justify funding in rates for incentives aimed in part at achieving corporate financial objectives.

We went on to say that, notwithstanding the failure to meet our previously enunciated standards, we would have considered funding for ATIP if O&R had demonstrated that overall compensation for the Company's non-officer management employees, with ATIP included, was reasonable relative to similarly situated companies, and that the plan included no elements that could potentially be adverse to ratepayer interests or tend to promote results inconsistent with Commission policies. We found the evidence presented by O&R inadequate to support such a finding.

In requesting rehearing, O&R advances two principal arguments. First, it contends that we should have found that it met our standards for ratepayer funding of incentive compensation because its customers benefit substantially from ATIP. O&R points out that in 2009 it revised the program significantly to place greater emphasis on customer service goals and less on the corporate net income goal. Overall, it says, the plan has helped lower debt financing rates, promoted employee cost consciousness, and contributed to high levels of performance in customer service areas.

We were well aware of these arguments when we rendered our decision. The fact remains that the plan retains

[5] June 2011 Order, p. 40

significant corporate financial goals and O&R's filing failed to provide the type of quantitative demonstration we have required to support a finding that the cost to ratepayers to fund incentive compensation is at least matched by the value of the benefits they receive. Our conclusion that the Company failed to meet the standards defined by our previous decisions concerning incentive compensation programs reflects no error of fact or law warranting rehearing.

Next, O&R argues that we should have found that it met the alternative showing we described in our order because the ATIP program is clearly aligned with customer interests and Commission policies, and no party to the case argued that the total compensation levels at the Company--fixed and variable pay and benefits--were excessive. That it did not submit a comparable compensation study should not be held against it, O&R says, because it could not have anticipated the need for evidence the Commission had not previously required.

Our suggestion that the reasonableness of a utility's total compensation levels is best demonstrated through a comparable compensation study was intended as guidance for utilities that may, in the future, desire to justify incentive compensation as an element of a reasonable total compensation package. Nevertheless, O&R might well have anticipated the utility of such evidence in this case. Other than the Company itself, all parties to this case opposed funding for ATIP, and they did so by addressing the standards we have set out in previous cases. By opposing ATIP, those parties implicitly asserted that total compensation for non-officer management employees, with ATIP included, was potentially excessive. That they did not address "total compensation" as a separate concept is understandable, and is no evidence that they would have agreed that O&R's total compensation levels were reasonable. It

was O&R's obligation to demonstrate the reasonableness of total compensation, including incentive compensation, and we found that it did not meet that burden.

Although we find no grounds for granting rehearing on this issue,[6] some clarification of our intent in discussing the total compensation approach to justifying ratepayer funding of incentive compensation is warranted.

Our fundamental objective, where utility labor expense is concerned, is to ensure that customers pay no more, and no less, in rates than what is necessary and sufficient to attract and retain employees with the qualifications and motivation to ensure the provision of safe and adequate service. Historically in rate cases, parties have generally treated "traditional" pay and benefits as one item, and incentive compensation programs as something separate and distinct. Inherently, this has meant that if base pay and benefits were deemed reasonable, then incentive compensation must be something above and beyond, an award or a bonus. The parties' analyses and our treatment of them in our orders have tended to reflect this perspective. If employees are receiving something extra, then the question necessarily becomes, what are the benefits ratepayers are receiving in return that would justify funding in rates?

The first point we intended to make in the June 2011 Order is that we are not abandoning the precedents reflected in our orders. If a utility deliberately or de facto requests funding in rates for an incentive program that would award payments above and beyond what would be considered reasonable

[6] We note that O&R also argues that we should have approved funding for ATIP in this case because we have done so in previous cases and because the Company has agreed to refund to customers any allowance for ATIP that is not awarded as incentive compensation. We addressed both these points in our June 2011 Order and O&R has presented nothing new to demonstrate any error of law or fact in our conclusions.

total compensation for a particular class of employees, it can and must demonstrate that the plan meets the standards for quantifiable ratepayer benefit that we have defined.

The second point we wanted to emphasize is that it is not necessary to maintain an artificial distinction between compensation in the form of traditional pay and benefits and compensation that is incentive based. As we have stated previously, we recognize that variable compensation and incentive plans are common management tools aimed at encouraging performance improvements that can lead to more competitive operations.[7] Consequently, if a utility can demonstrate that total compensation including incentive compensation for a class of employees is reasonable, with a comparable total compensation study of similarly situated companies being the preferred methodology, our concern about the relationship of incentive plan objectives to ratepayer interests is substantially diminished. As long as the plan does not promote employee behavior that would be contrary to ratepayer interests or Commission policies, the fact that it may contain financial, budgetary or other goals that benefit shareholders as well as ratepayers will not, by itself, be grounds for disallowing funding in rates, even if the relative benefits are unquantified.

Austerity

In May 2009, in response to the harsh economic conditions faced by many New York ratepayers as a result of the nationwide recession, we directed utilities to develop plans for temporary cutbacks in spending that would generate immediate

[7] Case Nos. 10-E-0050, et al., Niagara Mohawk Power Corporation – Electric Rates, Order Establishing Rates for Electric Service (issued January 24, 2011), p. 39.

rate relief for customers.[8] O&R submitted a report indicating that it expected to be able to produce $825,000 in savings for its ratepayers. Subsequently, we advised the utilities that we would expect all rate filings through 2010 to continue to identify potential discretionary spending cuts for austerity purposes until the economic downturn was reversed. O&R filed this case in 2010.

In our June 2011 Order, we found that economic conditions had not sufficiently ameliorated to justify reversing our austerity policy. We reduced O&R's revenue requirement to reflect an imputation of $478,000 in austerity savings, representing the $825,000 O&R said it could achieve, less savings expected to inure to the benefit of ratepayers as a result of measures already reflected in revenue requirement.

O&R's request for rehearing centers on two contentions. First, the Company argues that we did not recognize the savings to ratepayers during the rate year that will result from its efforts to contain health care, pension and management compensation expense. This is simply not the case. We described O&R's cost saving measures in our June 2011 Order and acknowledged that Staff had found them to be commendable.[9] Those cost savings, however, were not the result of austerity measures.

Once again, we emphasize that our austerity policy was not a call for a general effort to improve the efficiency of operations and achieve long-term cost reductions. That is always the obligation of every utility and needs no separate statement from us. The purpose of our austerity initiative was

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[8] Case 09-M-0435 - Proceeding on Motion of the Commission Regarding the Development of Utility Austerity Programs, Notice Requiring the Filing of Utility Austerity Plans (issued May 15, 2009).

[9] June 2011 Order, p. 56.

to have utilities identify short term means of avoiding or postponing expenditures to give immediate cash relief to ratepayers without impairing the safety or reliability of service or utility earnings. We gave full credit to O&R for the austerity savings it did achieve, and merely required it to complete the effort it originally said it could accomplish. The resulting adjustment was fair, and in fact quite modest in relation both to the adjustments we have made to other utility revenue requirements and to the adjustments recommended by other parties in this case.

O&R also suggests that basing the austerity adjustment on the amount of savings the Company reported it could achieve in 2009 was inconsistent with our treatment of the austerity adjustment in recent cases involving Consolidated Edison Company of New York, Inc. (Con Edison).[10] In those cases, it says, we approved joint proposals establishing three-year rate plans with austerity adjustments that were phased down over the rate plan term. To be consistent, O&R argues, the austerity savings the Company projected in 2009 should be reduced for a rate year starting in 2011.

The analogy is inapt. The essence of a negotiated resolution to a rate case is compromise. The basis for any one provision of an agreement is often indeterminable outside the context of the overall proposal. That is a major reason why the resolution of a particular issue that results from the approval

[10] Case 09-E-0428, Consolidated Edison Company of New York, Inc. - Electric Rates, Order Establishing Three-Year Electric Rate Plan (issued March 26, 2010); Case 09-S-0794, Consolidated Edison Company of New York, Inc. - Steam Rates and Case 09-G-0795, Consolidated Edison Company of New York, Inc. - Gas Rates, Order Establishing Three-Year Steam and Gas Rate Plans and Determining East River Repowering Project Cost Allocation Methodology (issued September 22, 2010).

of a negotiated rate plan does not establish a precedent for the decision of similar issues in future litigated proceedings.

The phase down of the austerity adjustment in the Con Edison rate plans essentially recognized that savings achieved in one year would, to some extent, reduce the available savings opportunities in future years.[11] We have effectively done just that in this case. We did not require the Company to achieve the same $825,000 in austerity savings in 2011 that it said it could realize in 2009. We reduced the requirement to reflect savings achieved in prior years. O&R has identified no error of fact or law and has described no new circumstances that would persuade us to grant rehearing on this issue.[12]

Sales Forecast Price Out

In exceptions to the recommended decision in this case, UIU and the MC contended that the increase in revenues projected by O&R to result from the higher level of sales the Company forecast was impossibly small. This, it said, must mean that the price out model used by O&R to translate sales into revenues was flawed, causing forecast revenues to be understated, and revenue requirement to be inflated. Neither MC nor UIU produced an alternative price out forecast, nor did

[11] It should also be noted that Con Edison's electric business had already achieved substantial austerity savings for customers prior to the case establishing the three-year rate plan.

[12] O&R's petition includes an argument that our decision effectively reduces the Company's authorized return because it will continue to pay for ATIP and will not be able to achieve the savings required by the austerity adjustment. That argument applies to every decision the Commission makes concerning revenue requirement. If a utility spends more for a particular line item expense than was allowed in rates, all things being equal (which they never are), earnings available to shareholders will be reduced. The mere statement of that possibility is not an assertion of any error of law or fact in our decision.

either identify any specific defects in the forecast performed by O&R. Their contentions were derived from calculations they made based on their assumptions concerning the average level of tail block rates for each service class.

In response, O&R pointed out that UIU and MC failed to take into account that most of the increase in sales was projected to come from the primary commercial classes, which have very low tail block rates, and that the overall number of O&R customers was forecast to decline, which would reduce revenues from customer, billing and payment processing and metering charges. These factors, the Company contended, helped explain why the forecast average rate per kWh declined while forecast sales increased.

Staff supported the Company's price out of its sales forecast. It argued that UIU and MC based their contentions on an overly simplistic view of the changes to the sales forecast and price out that emphasized the increase in sales projected while failing to take into account other changes to the price out model that reduced forecast revenues by over $2 million. Furthermore, Staff said, if any residual error remained in the model, which it doubted, ratepayers would be fully protected by the Revenue Decoupling Mechanism (RDM) adopted in this case.

In our June 2011 Order we concluded that the factors cited by Staff and the Company provided a plausible explanation for the relatively small increase in revenues produced by the price out model. We also agreed with Staff that if there were any hidden discrepancy in the model, ratepayers would be protected against any overpayment by the operation of the RDM.

In its request for clarification or rehearing, UIU presents a new set of calculations, similar to those relied on previously by it and MC, but this time based only on the forecast revenues for the residential rate class. It says these

calculations show that the projected increase for the residential class is also very small in relation to the forecast increase in sales. This, UIU contends, casts doubt on the reasons given by Staff and the Company as possible explanations for the price out model results. The residential class, by definition, includes no primary commercial customers and, UIU asserts, the reduction in the forecast of total customer numbers is not sufficient to reduce customer charge and other revenues enough to account for the relatively small increase in total revenue.

UIU continues to object to the output of the price out model without pointing to any flaws in the process that produced it. As Staff points out, UIU uses an overly simplistic surrogate for a highly sophisticated price out model, and then, on the basis of its alternative results, demands that we prove the negative--that our adoption of the Company's model did not involve any error of law or fact. We decline to assume such an obligation. The failure to identify an error of law or fact is grounds to deny rehearing.

Moreover, as a practical matter, the issue raised by UIU is moot because there is no relief that we could grant on rehearing that would be of any benefit to ratepayers. Neither UIU nor any other party has identified any specific flaws in the O&R price out model that we could require to be corrected. Consequently, the only way we could ensure that the model operated correctly in this case would be to require the Company to reconcile every detail of its forecast to demonstrate the nexus between changes in sales and changes in revenues. Given that O&R has made a new rate filing for the rate year beginning July 1, 2012, with new sales and revenue forecasts, such a major reconciliation effort would be a massive misuse of time and resources that could better be devoted to ensuring that the

relationship between changes in sales and changes in revenue in the current case is transparently clear. In this regard, we share UIU's concerns, and we fully expect that such clarity will be evident when the case is presented to us for decision.

In the meantime, ratepayer interests are fully protected. Because we adopted an RDM using the revenue per class model, any increase in revenues beyond forecast levels inures to the benefit of ratepayers. If forecast revenue levels in this case were too low, as UIU suggests, so are the RDM revenue targets. The effect of higher revenue will be to generate credits for ratepayers that will be automatically returned through a rate adjustment at the end of the rate year or earlier through interim adjustments if accumulated credits exceed 1.5% of revenues. Under the circumstances, we see no benefit to litigating this matter further.

CONCLUSION

No grounds for finding that our June 2011 Order was flawed by any error of law or fact have been presented. Accordingly, the petitions for rehearing of O&R and UIU will be denied.

The Commission orders:

1. The petitions for rehearing and/or clarification of Orange and Rockland Utilities, Inc. and the Utility Intervention Unit of the New York Department of State are denied.

2. This case is continued.

By the Commission,

Jaclyn A. Brilling

Digitally Signed by Secretary
New York Public Service Commission

JACLYN A. BRILLING
Secretary