BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of

Consolidated Edison Company of New York, Inc.

Case 07-E-0523

September 2007

Prepared Testimony of:
Accounting Panel

Kristee Adkins
Public Utilities Auditor 2

Claude Daniel
Public Utilities Auditor 2

Sean Malpezzi
Senior Auditor

Thomas J. Rienzo
Public Utilities Auditor 3

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Jane Wang
Public Utilities Auditor 2

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Q. Please state your names, employer, and business addresses.

A. We are Kristee Adkins, Claude Daniel, Sean Malpezzi, Thomas Rienzo, John Scherer, and Jane Wang. We are employed by the New York State Department of Public Service (Department). Our business addresses are Three Empire State Plaza, Albany, New York 12223 and 90 Church Street, New York, New York 10007.

Q. Ms. Adkins, what is your position at the Department?

A. I am employed as a Public Utilities Auditor 2 in the Office of Accounting, Finance and Economics.

Q. Please describe your educational background and professional experience.

A. I graduated from the State University of New York Institute of Technology in Marcy, New York in 2002 with a Bachelor of Science degree in Accounting and Finance. I have been employed by the Department since June 2005. In the course of my employment, I examine accounts, records, documentation, policies and procedures of regulated utilities. I have participated in the rate proceedings in Case 06-G-1332, Con Edison –

Gas Rates, Case 05-W-0802, Adrian's Acres West Water Company, Inc., and in Case 05-G-1494, Orange and Rockland Utilities, Inc. (Orange and Rockland). I have also worked on asset transfer filings for Consolidated Edison Company of New York, Inc. (Con Edison) in Cases 06-M-0407, 99-E-1146, and 07-E-0106 and for Adrian's Acres West Water Company, Inc in Case 06-W-1187.

Q. Ms. Adkins, have you previously testified before the New York State Public Service Commission (the Commission)?

A. Yes, I have submitted testimony on various other operating revenues such as late payment charges (LPC) and operation and maintenance (O&M) expense forecasts in Case 05-G-1494, Orange and Rockland – Gas Rates and in Case 06-G-1332, Con Edison – Gas Rates.

Q. Mr. Daniel, what is your position at the Department?

A. I am employed as a Public Utilities Auditor 2 in the Office of Accounting, Finance and Economics.

Q. Please describe your educational background and professional experience.

A. I graduated from Hunter College of the City

University of New York with a Bachelor degree in Accounting and joined the Department in 1986.

Q. Please describe your responsibilities with the Department.

A. I routinely examine accounts, records, documentation, policies, and procedures of regulated utilities. I have also reviewed numerous petitions filed by Con Edison seeking authority for asset transfers, deferrals and reconciliations.

Q. Mr. Daniel, have you previously testified before the Commission?

A. Yes, I have prepared cost of service exhibits and offered testimony on various O&M expense, other taxes and rate base adjustments in previous Con Edison Electric, Gas and Steam Rate Cases including Cases 04-E-0572, 06-G-1332, 05-S-1576. I also testified on rate base items in Case 90-C-0191, New York Telephone Company - Rates.

Q. Mr. Malpezzi, what is your position at the Department?

A. I am employed as a Senior Auditor in the Office of Accounting, Finance and Economics.

Q. Please describe your educational background and professional experience.

A. I graduated from Siena College, Loudonville, New York in 2001 and have a Bachelors of Business Administration (B.B.A.) degree with an Accounting Major. I have been employed by the Department since September of 2005. Previously, I was employed as an Auditor for the NYS Credit Union League.

Q. Please briefly describe your responsibilities with the Department and professional experience.

A. I have general responsibility for accounting and ratemaking matters related to New York's municipal electric utilities. My direct responsibilities include examination of accounts, records, documentation, policies and procedures of regulated utilities. I have been involved in several electric rate cases including: Case 05-E-1496, Plattsburgh; Case 05-E-1247, Castile; Case 06-E-0334, Churchville; Case 06-E-0911, Village of Freeport. I have prepared various analyses directly related to revenue requirement.

Q. Mr. Malpezzi, have you previously testified before the Commission?

A. Yes. I submitted testimony before the Commission on Labor Expense and various O&M expense adjustments in a Village of Freeport Electric Department rate filing, Case 06-E-0911.

Q. Mr. Rienzo, what is your position at the Department?

A. I am employed as a Public Utilities Auditor 3 in the Office of Accounting, Finance and Economics.

Q. Please describe your educational background and professional experience.

A. I graduated from Siena College, Loudonville, New York in 1986 with a B.B.A., majoring in Accounting. I have been employed by the Department since 1990. Prior to joining the Department, I was the Manager, State and Local Tax for Cluett, Peabody & Co., Inc., in Troy, New York.

Q. Please briefly describe your responsibilities with the Department.

A. My direct responsibilities as a Public Utilities Auditor include examination of accounts, records, documentation, policies and procedures of regulated utilities. For the last five years, I have served as the “Account Executive” for municipal issues within the Office of Accounting, Finance and Economics. The “Account Executive” is the initial point of contact for both Department Staff and the utilities relating to a specific issue or industry. I have been involved in numerous rate and accounting examinations, including most of the recent municipal rate proceedings, specifically: Case 06-E-0911, <u>Village of Freeport;</u> Case 06-E-1247<u>,</u> <u>Churchville;</u> Case 05-E-1247, <u>Castile;</u> Case 05-E-1496, <u>Plattsburgh Municipal Lighting Department;</u> and Case 04-E-1485, <u>City of Jamestown Board of Public Utilities</u>. In each of these proceedings, I have prepared various analyses directly related to revenue requirement.

Q. Mr. Rienzo, have you previously testified before the Commission?

A. Yes. I have testified before the Commission on revenue requirement and rate of return. I submitted revenue requirement and rate of return testimony on a Village of Freeport Electric Department rate filing in Cases 95-E-0676 and 06-E-0911, <u>Village of Freeport</u>.

Q. Mr. Scherer, what is your position at the Department?

A. I am employed as a Supervisor in the Office of Accounting, Finance and Economics.

Q. Please describe your educational background and professional experience.

A. I graduated from Siena College, Loudonville, New York in 1988 and have a B.B.A. degree with an Accounting major. I have been employed by the Department since 1988.

Q. Please briefly describe your responsibilities with the Department.

A. My responsibilities include examination of accounts, records, documentation, policies and procedures of regulated utilities. I have been involved in numerous rate and accounting examinations including Con Edison’s last three electric rate proceedings, the Company’s electric and gas rate unbundling proceeding and the Company’s last two gas and steam rate cases. I have general responsibility for accounting and ratemaking matters related to Con Edison and its affiliate Orange and Rockland Utilities.

Q. Mr. Scherer, have you previously testified before the Commission?

A. Yes, I have testified in numerous Commission proceedings on a variety of accounting and regulatory issues including property taxes, pensions and other post employment benefit (OPEBs), EBCAP adjustments, O&M expense forecasts, federal income taxes, various rate base components, and tax refunds. With specific reference to Con Edison, I submitted testimony in the Company’s prior electric, gas, and steam rate cases, the Unbundling Track of the Competitive Markets Proceeding (Case 00-M-0504) and in two income tax proceedings.

Q. Ms. Wang, what is your position at the Department?

A. I am employed as a Public Utilities Auditor 2 in the Office of Accounting, Finance and Economics.

Q. Please describe your educational background and professional experience.

A. I graduated from Tsinghua University, Beijing, China in 1985 with a BS degree in Electric Power Engineering. I also received a Master’s degree in Electric Power Engineering from Tsinghua University in 1988. I received a Master’s in

Business Administration from Union College, Schenectady, New York in 1997. I have experience working as a cost engineer with General Electric and a Staff Accountant with Time Warner Cable. I have been employed by the Department since April 2005. I have worked on municipal rate proceedings and general accounting examinations.

Q. Please briefly describe your responsibilities with the Department.

A. My responsibilities include examination of accounts, records, documentation, policies and procedures of regulated utilities. I have worked on Case 05-E-0553, Village of Bath, Con Edison's petition for accounting change regarding its lease agreement with the City of New York for transformer vaults in Case 06-E-1101, and currently Con Edison's petition regarding the asset retirement obligation in Case 05-M-1624. In Case 05-S-1376, Consolidated Edison Company of New York, Inc. – Steam Rates, and Case 06-G-1332, Consolidated Edison Company of New York, Inc. – Gas Rates, I worked on revenue requirement models and accounting examinations.

Q. Ms. Wang, have you previously testified before the Commission?

A. Yes, I have submitted testimony in Con Edison last steam and gas rate proceedings in Case 05-S-1376, Consolidated Edison Company of New York, Inc. – Steam Rates and Case 06-G-1332, Consolidated Edison Company of New York, Inc. – Gas Rates.

Q. Panel, what is the purpose of your testimony?

A. Our testimony addresses accounting aspects of Con Edison’s electric rate filing. We will discuss and recommend adjustments in the following areas:

- Late Payment Charge Revenues
- Fuel management Program
- ADR Deferred Tax Benefits
- Direct Current Incentive Program
- World Trade Center Costs
- Company Labor
- Duplicate Miscellaneous Charges
- Pension and OPEB Expense
- Employee Welfare Expense
- ERRP Major Maintenance

- Informational Advertising Expense
- Insurance Expense
- Interference Expense
- Site Investigation and Remediation
- Postage
- Rents – ERRP Carrying Charge
- Shared Services
- Uncollectible Expense
- Water Expense
- Other Operation and Maintenance Expense
- Inflation
- Property Tax Expense
- Reconciliation and Deferred Accounting - Property Taxes
- Earnings Base Capitalization Adjustment
- Prepaid Pension - EBC
- Business Incentive Rate Discounts Expense
- Excess Deferred State Income Taxes
- Long Island City Outage Costs
- Deferred Income Taxes-Section 263A
- Federal Income Taxes
- First Avenue Proceeds
- Deferred Accounting Requests

We also summarize Staff’s overall revenue requirement position.

Q. What is the effect of Staff's adjustments on rate of return?

A. The adjustments, as shown on Exhibit___(AP-2), Schedule 1, increase the electric rate of return before any proposed rates from 3.30% to 4.42%.

Q. What is the rate of return recommended by the Financial Panel?

A. The Financial Panel recommends a 7.25% rate of return based on an 8.9% return on equity. As a result, the indicated rate change in electric rates is a $618 million increase for the rate year ending March 31, 2009.

Q. What are the major areas where Staff is proposing adjustments?

A. The adjustments fall into eight major categories: sales, other operating revenues, Operation and Maintenance (O&M) expenses, depreciation, property taxes, rate base, income taxes, and working capital.

Q. Please highlight the amount of the adjustments for each of categories.

A. Witness Liu has proposed $18.4 million of additional sales revenues which are offset by the Consumer Service Panel's recommendation to increase the low income program by $12.4 million.

This Panel proposes $65.2 million of adjustments to the Company's other operating revenues. Of this amount, $23.2 million reflects our proposal to reduce the Company's requested level of World Trade Center costs recoveries, $20.7 million is related to Staff's proposal to pass back excess deferred state income taxes to customers and $17.6 million is related to our proposed pass back to customer prior cost over-recoveries.

Staff is proposing $103.4 million of adjustments to O&M expenses. The major adjustments are to Site investigation and remediation costs, Company Labor, Interference, Informational Advertising, Stock Options and Employee welfare expenses.

Various Staff witnesses have proposed adjustments to rate year depreciation expense totaling $33 million. These adjustments related to the proposed elimination of certain capital projects, changes to the Company's proposed depreciation rates and the treatment of the reserve deficiency.

This Panel is proposing adjustments of $2.8 million to the Company's taxes other than income taxes.

Staff is proposing to decrease the Company's proposed rate year rate base by $574 million. This is primarily driven by adjustments to the Company's treatment of its prepaid pension expense, reductions to the Company's capital construction forecast, corrections of Company errors in the EBC calculation, and the elimination of deferred World Trade Center costs.

Staff's adjustments have impacts on the income taxes, primarily due to lower income resulting from our recommended return on equity. Staff's adjustments also affect the Company's working capital needs. Finally, as noted above the Finance Panel recommends a lower rate of return than the Company's request.

Q. Will the Panel refer to, or otherwise rely upon, any information produced during the discovery phase of this proceeding in its testimony?

A. Yes, the Panel will refer to, and has relied upon, several responses to Staff Information Requests (IR) and Company supplied workpapers. They are designated as Exhibit___(AP-1).

Q. Is the Panel sponsoring any other Exhibits?

A. Yes, as previously mentioned, the Panel is sponsoring Exhibit___(AP-2), which is Staff's cost of service presentation. In addition, we have Exhibit___(AP-3), which we will describe in detail later.

Q. Please describe Exhibit __ (AP-2).

A. Exhibit___(AP-2) contains eight schedules. Schedule 1 is Staff's projection of electric operating income, rate base and rate of return for the 12 months ending March 31, 2009, and includes Staff's proposed revenue requirement. Schedule 1 is supported by Schedules 2 through 8.

Q. Please describe the format of Schedule 1.

A. Column 1 of Schedule 1 contains the income statement, rate base and rate of return figures as filed by the Company for the rate year, before a revenue increase. Column 2 contains the Company's preliminary updates as of August

7, 2007. Column 3 reflects the income statement, rate base and rate of return figures as updated by the Company. Column 4 contains references to the supporting schedules that present Staff’s adjustments set forth in Column 5. Column 6 presents Staff’s projected rate year figures before a revenue increase. Column 7 contains Staff’s proposed changes in revenues, and Column 8 is Staff’s projected rate year income, rate base and rate of return after this revenue increase.

Q. What information is shown on Schedules 2 and 3?

A. Schedule 2 projects O&M expense cost elements for the rate year. Schedule 3 projects taxes other than income taxes.

Q. What information is shown on the remaining schedules?

A. Schedules 4 and 5 project New York State and federal income tax expenses, respectively. The adjustments in these schedules correspond primarily to adjustments set forth in other schedules. Schedule 6 projects the rate base for the rate year ending March 31, 2009. Schedule 7 projects an allowance for working capital, which is a component of rate base. Schedule 8 lists Staff's adjustments with their supporting witnesses.

Proposed Three-Year Rate Plan

Q. Con Edison sponsored a three-year rate proposal in its filing. Will the Panel address this proposal?

A. No. Witness Rasmussen states in his pre-filed testimony at page 11, lines 9 though 16 that, while Con Edison proposes a three-year rate plan, the Company does not waive its rights to file for new rates immediately after the conclusion of this case should it determine that the rates set by the Commission in its rate order for the first rate year are inadequate or if the Company determines that the terms set by the Commission for the other two rate years are unreasonable. Given the Company's position, our testimony will only address the issues necessary for the Commission to determine rates for a single rate year, or until the Company files its next rate case and the Commission makes a determination on that request.

Other Operating Revenues

Late Payment Charge (LPC) Revenues

Q. Please explain the Company’s methodology used to forecast late payment charge (LPC) revenues.

A. The Company’s Accounting Panel forecasted LPC revenues at $21.329 million for the rate year using a historic three-year average of LPC revenues. In the response to Staff IR DPS-178, the Company stated that a three-year average ratio of LPC revenues to sales applied to the rate year sales revenues produced a similar amount of LPC revenues for the rate year as the historic three-year average of LPC revenues.

Q. Does the Panel agree with this statement?

A. No, the Panel does not. LPC revenues will be understated using a historic three-average of LPC revenues alone.

Q. Please explain.

A. LPC revenues have a relationship to sales revenues. We agree with the forecast methodology described by the Company’s Accounting Panel in the response to Staff IR DPS-178. The Company’s Accounting Panel stated that the LPC revenue forecast was based on the relationship between LPC revenues to sales revenues. The calculation starts with the LPC revenues expressed as a percentage of actual sales revenues to develop a ratio for each of the three previous years. These three ratios are then averaged, and the average ratio is applied to the forecast of customer sales revenues to determine the LPC revenues forecast.

Using data provided in the response to Staff IR DPS-179, we developed a three-year average of LPC ratios of .2704% for non-residential and .4417% for residential. We applied the ratios to Staff’s forecast of sales revenues which results in our LPC revenue forecasts of $9.635 million for non-residential and $12.402 million for residential. Therefore, our forecasted total rate year LPC revenues are $22.037 million; this results in an adjustment to LPC revenues of $708,000.

Fuel Management Program

Q. Please explain the Company’s forecast of Fuel Management Program revenues.

A. The Company’s Accounting Panel forecasted Fuel Management Program revenues using only the historic year (12 months ending December 31, 2006) level of $98,721.

Q. Does the Panel agree with this forecast method?

A. No, the Panel does not. Fuel Management Program revenues will be understated by using just the historic year ending December 31, 2006.

Q. Please explain.

A. The Company's records show that the Fuel Management Program revenues for the 12 months ending December 31, 2004, 2005 and 2006 were $69,346, $245,017 and $98,721, respectively. Using a historic three-year average to forecast the rate year level will mitigate anomalies and fluctuations evident in any single year. In the response to Staff IR DPS-300, the Company acknowledged that the 2004 and 2005 results could conceivably recur in the rate year. The Company also indicated that it would not object to using a historic three-year average to forecast Fuel Management Program revenues. The historic three-year average is $138,000, which results in an adjustment of $39,000 to the Company's forecast.

ADR Deferred Tax Benefits

Q. Please explain the Company's proposal regarding its Asset Depreciation Range (ADR) Deferred Tax Benefits.

A. During the Company's 2005 year-end closing process, the Company discovered that the deferred income taxes for several categories of plant created under the ADR tax law were not being properly amortized as a result of the installation of a new tax accounting system in 2000. This accounting error occurred during the period of 2000 through 2004. On August 11, 2006, the Company filed a petition for the disposition of the 2000 and later ADR deferred tax benefits not properly accounted for (Case 06-E-0990). The Petition is pending before the Commission. The Company's proposal would defer for customers' benefit the rate impact of correcting the deferred ADR tax balance not properly accounted for during the period of 2000-2004, as well as the recalculation of the overearnings adjustment for the period of 2000-2006. In this case, the Company proposes to pass back to customers over a three-year period the deferred principal and interest totaling $48,176,000.

Q. Does the Panel agree with the Company’s proposal?

A. Yes. The Panel agrees with the three-year amortization of the ADR Deferred Tax Benefit of $48,176,000 to pass this amount back to the customers. However, the accounting treatment proposed in Case 06-E-0990 is pending before the Commission. Therefore, this treatment should be subject to update or reconciliation based upon the final determination by the Commission.

Direct Current Incentive Program

Q. Please describe Con Edison’s Direct Current (DC) conversion program.

A. In the 1990’s, Con Edison had a population of over 4,000 customers taking DC service. The Commission authorized the funding of a conversion incentive program designed to encourage these customers to convert from DC service to alternating current (AC). The program proved to be successful, and by petition dated June 12, 2007 the Company reported that as of that date only six customers remained on DC service. The Company’s petition seeks Commission authorization to terminate the provision of DC service effective September 30, 2007.

Q. What is the relevance of the DC incentive program to the Company’s rate filing?

A. The program has relevance to the rate case because the Company has unexpended program funds that rightfully belong to customers and can be passed back to customers in this case.

Q. What is the level of unexpended funds?

A. As of June 30, 2007, the Company’s financial report indicates that the there are $11.2 million of unexpended funds related to the DC conversion incentive program. In response to Staff IR DPS-480, the Company projects that it will have unexpended funds of $9 million after considering all remaining conversion costs and interest on the deferred balance.

Q. What is your recommendation regarding the disposition of the unexpended funds and interest?

A. Given the magnitude of the requested rate increase and the impact on customers, we recommend that the entire balance be refunded to customers as an offset to the revenue requirement. We reflect our proposed disposition as a $9 million adjustment to rate year other operating revenues. In addition we reflect the average unamortized net of tax balance of $2.8 million as an offset to the Company's rate base. Since the $9 million is an estimate and the basis for the estimate was not provided by the Company, we recommend true-up once the actual balance remaining is known.

World Trade Center Costs

Q. What does the Company propose with respect to its World Trade Center (WTC) related costs?

A. Con Edison seeks to recover $103.2 million of deferred O&M expenditures and accrued interest that relate to the WTC incident over a three-year period, or $34.4 million per year. In addition, the Company seeks to recover $86.1 million of deferred capital expenditures over a thirty-year period, or $2.9 million per year. The unamortized deferred balances have been included in the Company's rate base request. The Company believes it is unlikely that it will be reimbursed for these costs from government sponsored programs.

Q. Does the Panel agree with the Company's belief that it will not recover these funds from other sources?

A. No. In fact, the Company has already recovered a significant level of funds from various sources. Moreover, we expect that the Company will be reimbursed for other costs from insurance and under the federally-sponsored program.

Q. Please explain.

A. On June 11, 2007, Con Edison was reimbursed $54,294,317 for electric related WTC costs from a federal government sponsored program – United State Department of Housing and Urban Development's appropriation for Utility Restoration and Infrastructure Rebuilding, which is administered by the Lower Manhattan Development Corporation. In addition, based on recommendations contained in an audit report under this program, the Company recovered $2.1 million from its insurers and is seeking an additional $12.4 million of WTC electric plant expenditures from the Port Authority (see response to Staff IR DPS-503). If the Company is unsuccessful in recovering the $12.4 million from the Port Authority, the federal program will reimburse the Company for 75% of the costs. The Company's request to include in its rate base nearly $70 million of costs it has already recovered or can reasonably expect to recover prior to the start of the rate year is inappropriate.

Q. Were these known changes reflected in the Company's August 7, 2007 update?

A. No they were not. The costs are still included in the Company's rate base request.

Q. Are there other WTC costs that the Company is seeking recovery of from ratepayers that the Company has an opportunity to recover from the federally-sponsored program?

A. Yes. The Company seeks recovery of $117.7 million of interference costs incurred through March 2007. Approximately $68 million relates to expense activity and the remainder is capital in nature. The Company is seeking three-year recovery of expense interference costs and thirty-year recovery of capital interference costs. These costs qualify as reimbursable costs under the federal program. However, the Company has yet to file a claim under the program.

Q. Does the Panel have any other concerns with the Company's request?

A. Yes. Since September 11, 2001, the Company has deferred all WTC-related costs and accrued interest costs thereon. We discovered that since March 2007, the Company transferred $60.3 million of capital and retirement costs from the deferral accounts to plant in service and the depreciation reserve.

Q. Why is this change relevant to this proceeding?

A. Consistent with the terms of its current rate plan, the Company reconciles Transmission and Distribution (T&D) net plant balances to the level provided in rates. As a result of the transfer of costs to plant in service and the reserve, carrying charges will be deferred on WTC related costs in the reconciliation process. The Company's rate filing includes an estimate of interest costs through the start of the rate year based on the assumption the cost remained in the deferred accounts. If the transfer to plant in service is not properly addressed, a double recovery of carrying costs will occur, once via the true-up of T&D costs allowed under the rate plan and then again via the allowed WTC cost deferral mechanism.

Q. Do you have any other observations that should be noted?

A. Yes. Our review of the Company’s supporting workpapers revealed that the Company did not fully reflect rate recoveries of WTC costs when determining the level of costs it seeks recovery of in this case. The current electric rate plan provides for recovery of $14 million per year, or $42 million over its term. The Company’s workpapers reflect recovery of $36.1 million, leaving $5.9 million unaccounted for. Failure to correct this error will also result in a double recovery of costs by the Company.

Q. Please summarize your concerns with Con Edison's proposed recovery of WTC costs?

A. There is uncertainty about the Company’s ultimate costs and reimbursement levels. The

Company is seeking recovery of WTC-related costs from customers when neither the Company nor Staff can definitively state what the net cost will be. Estimates of various costs and expected reimbursement levels are all that can be offered. Costs are still being incurred and the federal review process is still underway. Even at this late date, much remains unknown regarding the federal reimbursement levels. The Company is seeking recovery of interference costs from customers in advance of seeking federal reimbursements and its filing does not reflect any anticipated reimbursements for interference costs. The Company's proposal to include deferred costs and related deferred interest in rate base is very problematic given the known and expected changes that have not been addressed by the Company. Failure to address each of our concerns would result in double recovery of costs and/or would result in providing the Company with a return on investments that it has been reimbursed by taxpayers or insurance providers.

Q. How is this issue being addressed by the

Commission?

A. In 2001, Con Edison filed a petition with the Commission in which it sought authority to defer and recover its WTC-related costs, Case 01-M-1958. The Commission found that it was premature to consider the petition because other avenues of recovery of these costs have not yet been exhausted. We expect that once those reimbursement options are settled, the Commission will address the appropriate treatment of these costs in that proceeding.

Q. Does the Panel have any interim recommendations on this issue?

A. Yes. We recognize the extraordinary nature of these expenditures and that in the end insurance and other sources of reimbursement may not cover all the underlying costs. While we have not audited the WTC-related expenditures in any significant detail, Staff has monitored the Company’s restoration and rebuilding activities as well as Empire State Development Corporation's review of the Company's reimbursement claims. We recognize that the ultimate determination as to the prudence of the underlying costs will be the Commission’s. We believe that costs in excess of our recommended recovery level here will be considered prudent expenditures. Therefore, as an interim measure, until all of the costs are known and all of the reimbursement issues are settled, we recommend that the Commission allow the Company to continue the current rate treatment. Currently, the Company is recovering and amortizing $14 million of WTC related costs per year. In addition, the Company is deferring carrying charges on net of tax deferred balances at its pre-tax rate allowance for funds used during construction. Continuation of this treatment will eliminate our concerns regarding errors and the implications of known and expected changes that have not been reflected by the Company. The accrual of carrying charges on actual book balances is, in essence, self correcting. This approach by default addresses our concerns over potential double recoveries and forecasting errors by limiting the Company’s return to actual net investments. The recommended amortization level is reasonable after consideration of all our concerns. This treatment should be subject to full reconciliation based on actual expenditures net of federal and insurance recoveries, the establishment of appropriate amortization periods for the various categories of both capital and O&M expenditures, or other treatment as the Commission may prescribe in Case 01-M-1958. To reflect this recommendation, we adjusted other operating revenues and eliminated the deferred costs from the Company's rate base.

Operation and Maintenance Expenses

Company Labor

Q. Does the Panel propose an adjustment to Con Edison's rate year Labor Expense forecast?

A. Yes. We are proposing several reductions to Con Edison's rate year Labor Expense forecast.

Q. Do you agree with the Company's proposal to hire a meteorologist for $150,000?

A. No. The Company states that the meteorologist would supplement its subscription weather services by providing an independent review of weather forecasting models to more accurately determine expected local weather conditions.

The Company currently utilizes subscription weather services that provide around the clock information. The weather subscription services employ teams of meteorologists with support staff and highly sophisticated weather equipment. The New York metropolitan area receives significant coverage from the weather services. The Panel does not agree that a single Company meteorologist will more accurately determine expected local weather conditions simply by independently reviewing other’s weather forecasting models. Therefore, we recommend that the Commission deny the Company’s request to fund a meteorologist.

Q. Do you agree with the Company’s proposed program changes for Finance and Accounting staffing?

A. No. In the Accounting Panel’s testimony at page 56 the Company states, “Seven of the twelve incremental employees are a result of an assessment performed by KPMG LLP (“KPMG”) of the tax function in the Company.” We requested a copy of the assessment in Staff IR DPS-462, however, to date, the Company has refused to provide the assessment. The Company’s

Accounting Panel then stated that, “Resource levels were determined by KPMG to be not comparable with that of peer companies. KPMG recommended that the Company consolidate the tax functions into one department, led by a Tax Director or similar executive devoted solely to tax matters.” In Staff IR DPS-462, we requested a cost benefit analysis for the additions to Finance and Accounting, but one has not been provided to date. Staff does not see the benefit to the Company of adding six Senior Tax Accountant/Attorney ($750,000) and the VP-Tax ($230,000) based solely on a peer group Analysis by KPMG, which the Company refuses to provide to Staff and without a cost benefit analysis.

Q. Does the Panel agree with the Company’s proposal to add a Corporate Accounting-Financial Reporting Accountant?

A. No. The Company’s workpapers, entitled Line 64 Finance and Auditing, state, “Reflects an incremental Accountant (2L) position ($80K annually) required to coordinate a complete ‘plain English’ review of our 10-K. In 2007, we are planning to review the entire 10-K document and re-write the document in a more user friendly format." The Company has provided no rationale as to why it cannot perform this function with current employees.

Q. Does the Panel agree with the Company's proposal to add a Corporate Accounting-Regulatory Filings Accountant at $80,000 annually?

A. No. The Company has provided no rationale as to why the Company's current employees cannot perform this task.

Q. Do you agree with the proposed incremental hiring of two Senior Analysts for the Company's Treasury Department?

A. No. In the Company's workpapers under Treasury Department it states that, "The goal is to rotate these employees into all sections of Treasury with the objective of having them replace annual turnover that can occur in an organization." The result of this would be to have two individuals perpetually rotating into all sections of Treasury and funded in rates. The indication that they would, "replace annual turnover that can occur in an organization" does not signify that there will be two or any positions opening annually. The positions, which total $180,000 annually, should not be perpetually pre-funded in rates.

Q. Do you agree with the proposed incremental hiring of an analyst to be the Lease Administrator for the Company's Real Estate section at $85,000 annually?

A. No. While the Company does cite what the responsibilities for the analyst would be, it does not explain what has changed in the department to create the need for the position or why staff currently handling these responsibilities is insufficient.

Q. What is the total adjustment to Finance and Accounting Labor based on the aforementioned individual adjustments.

A. The aforementioned adjustments to Accounting and Finance Staff total $1,405,000, which agrees with the total provided in the Company's Exhibit_(AP-5), Schedule 6, Page 5 of 6, under Finance & Auditing Human Resources – Hires. In the Company's exhibit it shows electric operations' allocation of this as $1,024,000. We recommend removing the entire amount of

$1,024,000 from Finance and Accounting Labor expense.

Q. Does the Panel propose any other labor adjustments?

A. Yes. The Company’s 2006 Annual Report reflects redundant officers, Kevin M. Burke as Chairman and CEO and Eugene R. McGrath as Chairman and Trustee. The report indicates that Mr. McGrath’s term expired on March 1, 2006. In the rate year we adjusted Labor expense for salaries, life insurance costs, matching contributions to the savings plan and deferred income plan, for the removal of Eugene McGrath. The 2006 Annual Report also indicates that the Vice Chairman Joan Freilich term expires on December 1, 2006. Additionally, in the rate year, we adjusted for the expired term of Ms. Freilich.

Q. What are the total for the adjustments to Executive Compensation?

A. Based on the removal of the two aforementioned Executives electric Labor expense should be reduced by $4,731,142. This amount is based on electric operations allocation of 78.7 percent of labor and other benefits which combined total $6,184,499 for Mr. McGrath and Ms. Freilich.

Q. Do you agree with the Company's proposed program changes related to the Shared Services Administration?

A. No. The Company's Accounting Panel indicates that the goal of the Shared Services Administrative group is to improve the efficiency and effectiveness of its organizations and affiliates. On page 43, the Panel states, "It is estimated that as a result of the restructuring and the formation of the Shared Services Administration that savings will be achieved over time. In this filing, the Company assumes that the cost of the group will be funded by achieved savings within five years. The Company is in the early stage of this initiative and there is no anticipated savings in the first year. Thus, the Company is reflecting 25 percent of the group's labor cost as productivity savings, or $222,000." The Company's testimony did not provide a basis for the productivity savings of approximately $222,000 in the rate year.

Q. Please continue.

A. In its reply to Staff IR DPS-496, Shared Services Administration question d, the Company indicated that the total labor costs incurred for the Shared Services Administration for the period of July 2006 through August 2007 were $1,390,000 and forecasted costs for the period of September 2007 through March 2008 are $905,000 (for a total of $2,295,000 incurred prior to the rate year). Additionally, the Company stated that, "The rate year level of labor costs will be approximately $1,552K excluding wage award." The Company is projecting that it will incur approximately $3,847,000 of labor costs in connection with the Shared Services for the 32-month period of July 2006 through March 2009, of which $2,805,000 is allocated to electric operations, without any identified program related savings. The Company did impute $222,000 productivity savings to offset the labor costs in the rate year.

Q. Do you agree with the level of proposed savings?

A. No, we do not. In its testimony, the Company's Accounting Panel identified increased efficiency and improved effectiveness through standardization, inter alia, as justification for creating the Shared Services Administration. However, in the rate year, the Company will allocate $1,131,576 of Shared Services Administration labor to electric operations, while proposing $222,295 of productivity savings. In effect, the Company's Shared Services Administration will increase rate year electric labor costs by $909,281. As previously noted, the Company expects the program to be self-funding through achieved savings within five years. By the end of the rate year, the "five-year" period referenced by the Company will be over half complete. Staff expects that as of the rate year, the Company should be able to achieve significant program savings in an amount equal to at least the costs of operating the Shared Services Administration. As a result, we recommend the elimination of the entire Shared Services Administration Labor Expense net of imputed productivity, or an adjustment of $909,281.

Q. Do you have any other adjustments to Shared

Services Administration?

A. Yes. In the Company's Worksheet labeled Line 58 Shared Services Administration, other operating expenses were allocated to electric operations. The electric portion of these expenses are forecast to be $276,648 for the Rate Year. Based on the aforementioned removal of labor associated with the Shared Services Administration, a tracking adjustment of $276,648 to Other O&M must also be made.

Q. Do you have any other adjustments to Labor Expense that track adjustments made by Staff?

A. Yes. Based on the adjustments to Labor Expense we made an adjustment to reduce the Labor escalation by $711,000.

Q. Do you have any adjustments to Payroll Taxes?

A. Yes. The Company's Exhibit___(AP-5), Schedule 1, Page 3 of 6, reflects Company Labor for the 12 months ending March 31, 2009 as $562.8 million. Company Exhibit_(AP-5), Schedule 1, Page 3 of 6, reflects Payroll Taxes for the 12 months ending March 31, 2009 as $55.1 million. The $55.1 million in payroll taxes divided by the Company Labor of $562.8 million reflects an effective Payroll Tax rate of 9.79%. This matches the Tax Rate the Company provided indicated for January 2009 in the Company workpaper entitled Line 5 Payroll Taxes. We recommend a Payroll Tax rate tracking adjustment of 9.79% to reductions in Labor Expense of $11.1 million, resulting in a reduction in Payroll Taxes of $1.09 million.

Duplicate Miscellaneous Charges

Q. Explain the proposed adjustment to Duplicate Miscellaneous Charges.

A. The Company's rate year forecast of Duplicate Miscellaneous Charges reflects no change from the historic year level. This treatment is inconsistent with the Company's forecast of the underlying costs, which are O&M expenses. Our rate year forecast of Duplicate Miscellaneous Charges reflects general escalation from the historic year level, consistent with the Company's treatment of other O&M expense items. Our adjustment increases the rate year Duplicate Miscellaneous Charges by $896,000, which has the effect of reducing rate year total O&M expenses.

Pension and OPEB Expense

Q. Is there any adjustment to the Company’s pension and OPEB net expenses?

A. No. The Company’s preliminary update reflects the latest pension and OPEB actuarial information available. We accept the Company’s updated pension and OPEB expense levels.

Pension and OPEB Reconciliation

Q. How does the Panel address the Company’s request to true up the pension and OPEB costs?

A. We recommend that the Company continue to reconcile its actual pension and OPEB expenses and tax benefits related to the Medicare prescription drug subsidies to the level allowed in rates, pursuant to the Pension Policy Statement.

Employee Welfare Expenses

Q. Please explain the Company’s forecast methodology for employee welfare expenses.

A. The Company’s health insurance costs forecast for the rate year was developed based on contract rates and the number of participants as of February 7, 2007. Company witness Hector Reyes states that he used three different methods for escalating employee welfare expenses. First, a labor factor of 6.39% was used to escalate costs that are a function of salaries and wages. Second, a non-labor factor of 4.7% was used to escalate costs that are unrelated to salaries and wages. Third, the projected health care cost trend rates were used to escalate hospital and medical costs at 8% and prescription drug costs at 9.5%. The Company's forecast of employee welfare expense is $97.482 million for the rate year.

Q. Does the Panel agree with the Company's forecast method?

A. No. The gross domestic product inflation indexes reflect a basket of goods and services, including health care services. On advice of counsel, the application of a separate escalation factor in projecting health care costs, other than the general inflation factor, is inconsistent with the Commission's practice, as stated in Commission Opinion No. 84-27 issued October 12, 1985. Our adjustment reflects the latest known health costs plus general inflation. In the response to Staff IR DPS-477, the Company states that the latest known 2007 contract rates were used in the original exhibit.

Q. Please explain the Panel’s adjustment to employee welfare expenses.

A. We start with the latest available information on the Company’s contract rates and number of participants to determine the Company’s costs for the calendar year 2007. We then escalate the 2007 health insurance costs by the general inflation factor of 2.42% to calculate the costs for the calendar year 2008. Then, we escalate the 2008 forecast of health insurance costs by the general inflation factor of 1.98% to calculate the costs for the calendar year 2009. Finally, we use a combination of nine months of 2008 costs and three months of 2009 costs to forecast health insurance costs for the rate year (12 months ending March 31, 2009). Our approach results in a reduction of $5.846 million to the Company’s rate year level of employee welfare expenses.

Q. Does the Panel have any other adjustment to employee welfare expense?

A. Yes, our last adjustment tracks the reductions in the rate year labor expense resulting from various Staff adjustments to the Company's proposed employee levels. Our adjustment reduces rate year employee welfare expense by $1.019 million.

Q. Please explain.

A. We expressed our adjusted forecast of employee welfare expense of $91.636 million as a percentage of the Company's total rate year labor expense. The result was that employee benefit expense represented 16.27% of rate year labor expense. We apply the 16.27% benefit factor to the total Staff proposed reductions to labor expense of $6.264 million. The result is a reduction of $1.019 million to rate year employee welfare expense.

East River Repowering Project Major Maintenance

Q. What are the Panel's concerns related to the East River Repowering Project (ERRP) major maintenance costs?

A. We address three issues related to ERRP major maintenance costs: 1) The Company's forecast of ERRP major maintenance costs for the rate year;

2) The Company’s proposal to establish and fund a permanent reserve for ERRP major maintenance costs; and 3) Disposition of the unexpended maintenance funds at the end of the current electric rate plan.

Q. Does Staff adjust the Company’s forecast of ERRP major maintenance costs in the rate year?

A. No. The Staff Production Panel reviewed the Company’s rate year forecast of ERRP major maintenance schedule and costs. The Panel supports the Company’s $7.5 million rate year forecast.

Q. How does the Staff Accounting Panel view the Company’s request to fund a permanent reserve for ERRP major maintenance?

A. The Company has failed to explain how reserve accounting would benefit customers, especially in a one year rate case when Staff supports the Company’s requested recovery of maintenance costs from customers. The Panel sees no basis for establishing a permanent reserve for ERRP major maintenance costs when the Company can reasonably estimate the amount and has relative control over the timing of the occurrence of such costs.

Q. How do you propose to address the unexpended funds for ERRP major maintenance at the end of the current electric rate plan?

A. The Company anticipates that it will have $8.7 million accrued for major maintenance, but not expended at the end of the current rate plan. In consideration of the magnitude of the requested rate increase, we propose that the entire $8.7 million be returned to customers as a rate moderator. We also propose to include the net-of-tax impact of $2.622 million in rate base, a reduction to the rate base.

Informational Advertisement

Q. Please explain the Informational Advertising expense element and Staff’s proposed adjustments?

A. Informational Advertising includes the Company’s projected costs for general outreach and education and public affairs. This Panel proposes an adjustment to the public affairs component. The Consumer Services Panel will address an adjustment to the general outreach and education components.

Q. Do you have any adjustments to Public Affairs expense?

A. Yes. In the Company's workpaper entitled "Line 63 Public Affairs" under the Justification for Energy Education and Customer Awareness it states, "Con Edison uses advertising and marketing to inform our customers and the public about topics such as the need to maintain and enhance the electric infrastructure, energy conservation, and how to contact us in the event of an emergency." In the same worksheet, the Company forecasts the funding for the programs to increase from $10,501,000 for "Actual 2006" to $19,001,000 for "Forecast RYE 2009", an increase of 81%. Electric operation's allocation of this increase would be $6,897,000. In the Company's reply to Staff IR DPS-392, question c, it indicates that, in 2006, $3.2 million was spent on the Energy Education Program and $2.8 million was spent on the Working For You program. In the response to question b of the same IR, the Company states, "The benefit to the customer is that they will have access to more information on how they can take control of their energy usage.” We believe that this is insufficient to support an increase in Public Affairs expense of 81% and recommend that the request for the $6,897,000 be denied.

Insurance Expense

Q. Do you agree with the Company’s rate year forecast of Insurance Expense?

A. No. Con Edison’s Insurance Expense for the years 2004-2006 were $27,220,800, $24,931,200 and $24,071,400, respectively, indicating a declining trend. The Company’s Insurance Expense program change of $5,353,300 is an increase of 22% over the historic year. In the Company’s response to Staff IR DPS–436, it states that, “The program change of $5.354 million for Insurance premiums on line 41 assumes a 10%/annum increase in premiums after escalation.” In the Company’s workpapers, the Company forecasted an increase of 17% in liability insurance from the April 2007 premium of $876,200 to the June 2007 estimated premium of $1,016,500. The Company’s general ledger reflects that the premium for June 2007 was $901,761, an actual increase of 2.9% over the

$876,200 in April 2007. In addition, in the Company’s response to Staff IR DPS-481, Question 13, it provided insurance premium expenses comparing “As Filed July 2007” to “Actual 2007”. This response shows that several of the premiums are actually decreasing. Based on the latest known premium change and the aforementioned declining trend for Insurance, the Panel used the 2.9% annual growth rate to arrive at a reduction of $3,752,129 to Insurance Expense.

Interference Expense

Q. Does the Panel propose any adjustments to the Company’s interference expense forecast?

A. Yes, we are proposing several adjustments which reduce the Company’s interference expense forecast by $11.586 million from the allowance proposed in the Company’s August 2007 update.

Q. Please explain the process used by the Company to develop its rate year interference expense forecast.

A. In his testimony, Company witness Gencarelli states that the Company’s rate year interference expenses are based on the level of capital work to be performed by New York City (NYC) in the rate year. Three times annually, in its Capital Commitment Plans, NYC identifies the capital projects it anticipates for the up coming year. Of the projects identified in the Commitment Plan, NYC estimates the percentage of projects it expects to complete in the year; this estimate is referred to as the commitment target. In the January 2007 Capital Commitment Plan, NYC expected to complete approximately 66% of the plan projects. The Company projected its rate year interference expense by multiplying NYC’s capital commitment target by 100.7%, to arrive at the expected NYC capital expenditures. The Company then multiplied the expected NYC capital expenditures by 11.7%, in order to determine the total Company’s interference expense for the rate year. This number was further refined by multiplying the total Company interference expense by 76% in order to arrive at the electric department’s interference expense. Mr. Gencarelli indicated that the ratios used to calculate the Company’s forecast were developed by comparing the historic levels of capital work projected in NYC’s Capital

Commitment Plan to the Company's historic interference expense experienced in corresponding calendar year. Workpapers provided by the Company show the calculation of each percentage used.

Q. Did the Panel review the workpapers provided? If so, what did the Panel find?

A. Yes, we reviewed the workpapers provided. Our review revealed that there were two errors in the workpapers that impacted the percentages used by the Company.

Q. Please explain the first error?

A. On page 10, line 12 through 14, of his testimony, Mr. Gencarelli states that the four-year average of the ratio of NYC capital commitment targets to the actual NYC expenditures was 100.7%; that is, NYC completed, on average, 100.7% of the capital commitment targets it projected over the four-year period of 2003 through 2006, inclusive. A review of the calculation reveals that the four-year average for 2003 through 2006 should be 98.3%. In its response to Staff IR DPS-186, the Company agreed that the 100.7% factor used in its interference expense forecast was incorrect and that the 98.3% was the correct percentage for the four-year average.

Q. Please explain the second error found in the Company’s interference expenditure workpapers.

A. On worksheet 1 for Exhibit_(TMG-2), the Company calculates the 11.7% used to quantify the Company’s interference expense. The Company used the four-year average of the ratio of NYC capital expenditures to the Company’s interference expenditures to develop the 11.7% used in its calculation. Worksheet 1 for Exhibit_(TMG-2) reports the 2003 total Company O&M for interference expense as $71.102 million, while work sheet 2 for Exhibit_(TMG-2) reports the 2003 total Company O&M for interference expense as $68.575 million. In response to Staff IR DPS-434, the Company indicated that the worksheet 2 amount of $68.575 million is correct. Substituting the worksheet 2 amount into the calculation reduces the ratio of NYC interference expenditure to Company interference expenditure to 11.6%.

Q. Did the Panel make any other adjustments to the

Company's interference expense forecast?

A. Yes. Mr. Gencarelli based his forecast of interference expense on NYC's forecast of its capital expenditures to be completed during the rate year. Since Mr. Gencarelli's forecast was based on projections of futures expenditures presented in rate year dollars, it is not necessary for the Company to increase its forecast of this expense element for inflation. However, in their Exhibit___(AP-5), Schedule 1, page 3 of 6, the Company's Accounting and Finance Panel did apply the general escalation factor of 4.7%, increasing expenses by $4.776 million. As indicated in response to Staff IR DPS-435, the Company agrees that the general escalation factor should not be used and states that the Company's August update incorporates the Panel's adjustments.

Q. Has the Panel reviewed the August update? If so, does the Panel agree that the Company has incorporated its proposed adjustment?

A. We have reviewed the August update. The Company's update did include schedules that incorporate the adjustments discussed. However, the Company's update did not include the actual calculation of the updated rate year interference expenditures ($103.656 million). In discussions with the Company while investigating the rate filing update, we were made aware of Exhibit TMG-2 Revised, which shows the calculation of the updated rate year interference expenditures. We expect that Exhibit TMG-2 Revised will be formally submitted in a September update.

Q. Does the Panel agree with the updated rate allowance for interference expenses?

A. No, we do not. Again, based on our understanding of Exhibit TMG-2 Revised, in its update, in addition to the corrections previously discussed, the Company updated its projections to incorporate NYC's April 2007 updated Capital Commitment Plan. In addition to an update of the projects anticipated in the January 2007 Capital Commitment Plan, the April Report increased the commitment target ratio from 66% to 89% for the capital projects to be completed in 2009.

Q. Does the Panel support the 89% commitment target?

A. No. We reviewed each Capital Commitment Plan report issued during the Company’s averaging period, as well as the two most recent reports (i.e., January 2003 through April 2007) and observed that the commitment target ratio predictably moved in a cycle. In each year, the January Capital Commitment Plan commitment target ranges from 62% to 66%, the commitment target increased in the mid-year report (issued in either April or May) to a range of 81% to 96%, and then drops back in the September report, to a range of 64% to 67%. We recalculated the interference expense using the Company’s methodology, updating for the corrections discussed earlier, incorporating the project changes contained in the April 2007 Capital Commitment Plan, but using the average September 2003 to 2006 report commitment target ratio (65%).

Q. Does the Panel propose any additional changes?

A. Yes. In its update, the Company removed the full $4.776 million escalation from its interference expense forecast. However, when initially forecasting the rate year interference expense, the Company used the historic level of interference expense as its starting point, then, increased that historic level for the forecasted program changes. The Company's historic interference expense included $2.326 million of labor not included in the Company's labor expense element. As a result, the Panel recommends the Commission allow an escalation on the labor component of the interference expense. This labor increase, at the labor escalation rate of 6.39%, is $.148 million.

Q. What level of interference expense is the Panel proposing for the rate year?

A. Incorporating the adjustments discussed, we are recommending an allowance of $92 million for interference expenses.

Q. In his testimony, Company witness Gencarelli proposes changing the method of reconciliation relating to interference expense from a 2.5% dead-band around the rate year estimate to a full true-up of actual expense to rate year forecast. Does the Panel support the Company's proposal?

A. No. Due to the magnitude of the Company's rate request, coupled with the fact that the rate year forecast for interference expense is 27% greater then the average interference expense over the last four years, we recommend that the Company be required to reconcile its actual interference expense up to the rate allowance, deferring any over-recovery for future refund to customers. Interference expense in excess of the rate allowance should be borne by the shareholder. This should encourage the Company to coordinate its interference expenditure work closely with NYC in order to ensure efficient use of resources.

Site Investigation and Remediation

Q. Does the Panel propose any adjustments to the Company's site investigation and remediation expense forecast?

A. Yes. The Panel has made adjustments to the site investigation and remediation (SIR) expense in both the linking period (12 months ending March 31, 2008) and the rate year. Additionally, we recommend a five-year amortization period, instead of the three-years proposed by the

Company.

Q. Please explain the adjustments the Panel is proposing to the SIR expense.

A. In response to Staff IR DPS-430, the Company revised its projections for the level of SIR expense that will be completed during the linking period. The Company now projects it will incur $55.6 million of SIR costs in the linking period, of which $43.8 million is allocated to electric operations. The revision is approximately $16.8 million less than the projected electric SIR expense included in the Company's August 7, 2007 update. Since the Company's rate filing included recovery of excess SIR expense incurred during the linking period, in excess of the $8.9 million currently allowed in rates, these program changes reduce the projected rate year allowance.

Q. Does the Panel have any additional adjustments?

A. Yes. We are also proposing adjustments to the rate year SIR expense.

Q. Please explain these adjustments.

A. We are proposing three adjustments to the rate year SIR expense. Two adjustments relate to specific SIR activities projected to be completed during the rate year. The first activity relates to the proposed remediation at the Purdy Street Station Manufactures Gas Plant (MGP) site. A portion of this activity includes remediation of parts of the grounds of St Raymond’s High School, which is operated under the auspices of the Archdiocese of New York. The remediation for the site that includes the St. Raymond’s property must be completed to the New York State Department of Environmental Conservation’s (DEC) “unrestricted use” standard. In response to Staff IR DPS-376, the Company states,” the remediation program being considered for the Purdy Street Station Site includes a “restricted use” cleanup coupled with engineering and institutional controls. Under the DEC’s Voluntary Cleanup Program, remedies that include such controls can be approved by DEC only if the owner of the property executes and records a Declaration of Restrictions and Covenants or an environmental easement that makes those controls binding on future property owners and enforceable against them by the DEC.”

In the same response, the Company acknowledged that "…the Archdiocese's input on the scope of the remediation program for the Purdy Street Station and consent to any institutional controls called for by the program is essential." In September 2005, the Company provided the Archdiocese with several remediation options for its review. As of August 7, 2007, the Archdiocese has not provided the Company with its opinions on the proposed remediation plans. We do not expect that this project will be completed on the schedule projected by the Company. Removing this project reduces the rate year electric SIR expense by $2.2 million. The second adjustment the Panel proposes relates to the West 45th Street Gas Works site. This activity relates to the redevelopment of a parking lot located near the Intrepid Air, Sea and Space Museum. In response to Staff IR DPS-377, the Company indicated it received some preliminary information on the redevelopment plan, but it has not received detailed designs or a firm schedule. The Company states that, "[b]ecause combining the remediation of the Intrepid parking lot with its redevelopment will likely result in significant cost savings to Con Edison and its customers, the Company does not plan to proceed with remediation of the parking lot until the property is ready to be redeveloped." Removing this project reduces the rate year electric SIR expenses by $7.4 million. The final adjustment the Panel proposes to the SIR captures the tax credits the Company expects to recover related to completed remediation activities. In response to Staff IR DPS-374, the Company indicated that it expects to receive approximately $0.4 million of tax credits under the DEC's Brownfield Cleanup Program. We propose to use the portion of these tax credits attributed to the electric department, or $0.3 million, as an offset to the rate year expenses.

Q. Please explain the Panel's recommendation for a five-year amortization period for SIR expense.

A. The Company's rate filing proposes a three-year amortization period to recover the rate year SIR expense. The current electric Rate Order provides the Company with an $8.9 million rate allowance for SIR. In response to Staff IR DPS-176, the Company indicated that the use of a three-year amortization period was “consistent with the time period included in Case 04-E-0572”. However, as indicated in a response to Administrative Law Judge Lynch’s question regarding the SIR allowance provided in the Joint Proposal in Case 04-E-0572, the current rate allowance was developed using a five-year amortization period. The response to ALJ Lynch’s question is provided in Exhibit___(AP-3). In light of the substantial increase in the requested level SIR expense, and in an effort to mitigate current customer bill impacts, the panel supports the continuation of a five-year amortization instead of the Company’s proposed three-year amortization.

Q. How do the adjustments proposed and the change in amortization period impact the rate request?

A. The adjustments proposed by the Panel decrease the electric portion of the SIR expense for the rate year by approximately $25.7 million. However, the longer amortization period will result in a larger portion of the rate year SIR costs going unrecovered, which are subject to carrying charges.

Q. Does the Panel support the Company’s proposal for full reconciliation of SIR costs?

A. Yes, we support a full reconciliation of the SIR costs.

Postage

Q. Does the Panel propose any adjustments to postage expense?

A. Yes.

Q. Please explain your adjustment.

A. In its rate filing, the Company increased the historic test year postage expense by 7.6%, to reflect the average increase in US Postal Service rates that went into effect on May 14, 2007 (approximately a $1 million increase to postal expense). The Company then applied the general escalation factor to arrive at the projected rate year postage expense, an increase of an additional $0.6 million. We are reducing postage expense by $0.6 million to eliminate the general escalation from the rate year allowance.

Q. Please explain why the Panel is making this adjustment.

A. In response to Staff IR DPS-80, the Company states that the May 2007 postal rate increase was “designed to carry the Postal Service through the fiscal years through September 2008. The Company further escalated postage cost for the September 2008 through March 31, 2009 time period.” The Company used the general escalation rate, which is designed to increase costs over the 27-month period from the end of the test year through the rate year, to increase costs for the six-month period October 1, 2008 through March 31, 2009. In its response, the Company acknowledged that the general escalation factor was not the appropriate rate to use to escalate costs for this period. According to the Company, the correct escalation rate for this period is 1.04%. The Company stated that it would reduce postage expense by $0.5 million when it submitted its updates. However, a review of the August 2007 update shows no such reduction.

Q. Is the Panel proposing an additional reduction?

A. Yes. We propose to remove the escalation. The Company’s proposed escalation increase is predicated on the proposition that the Postal Service will have new rates in effect on October 1, 2008. We disagree. The Postal Service has not announced any intention to increase rates as of that date. A review of the last ten Postal Service rate increases, dating back to February 17, 1985, reveals that the average period between increases is 32 months. As a result, we project that there will be no increase in the rate year. In addition, the increasing use of the internet should help ameliorate the effect of future postal rate increases. In response to Staff IR DPS-80, the Company provided data relating to the number of customers that receive their monthly Con Edison bills via e-mail (e-bill). The data indicate that the average number of customers receiving monthly e-bills has increased by 470% from 2004 through June 2007. In 2004, only 0.7% of total customers received bills via e-mail; in 2006 that number increased to 3.1%. The Panel expects that that number could exceed 5% in the rate year. At that level of e-bill participation, the Company could expect a net decrease or $0.1 million in postage expense (net of customer growth).

Rents – ERRP Carrying Charge

Q. Does the Panel have any issues with Con Edison's forecast of ERRP carrying charges?

A. Yes. The Company's original filing contained a few errors, including the tax amortization period for certain capitalized overheads and the forecast of the deferred state income tax balances. The Company's preliminary update filing corrected these errors as well as updated for actual ERRP plant additions through June 2007. Staff accepts the Company's updated forecast of ERRP carrying charge rents paid to steam which increase rate year expense by $3.949 million.

Q. Does the change in ERRP carrying charges affect the Company's delivery revenue requirement?

A. It does not affect the delivery revenue requirement, because the Company recovers the expense through the Monthly Adjustment Clause (MAC). The Company's update filing included an increase in forecasted rate year MAC revenues that fully offsets the expense increase.

Shared Services

Q. Does the Panel propose any adjustment to the Company's shared services costs?

A. Yes. Shared services reflect net billings between Con Edison and its affiliates for allocation of certain corporate costs and direct services performed between the Company and its affiliates, including Orange and Rockland Utilities (O&R) and Con Edison's holding company, Consolidate Edison, Inc. (CEI). The Company's documents supporting the development of the rate year shared services costs indicate a very complicated process. The Company's original filing contained a few errors. In response to Staff IR DPS-182, the Company provided corrections to its original filing. The Company further revised the shared service forecast in its preliminary update. The update still included errors. Staff proposes to keep the rate year shared services costs as provided by the Company in its response to DPS-182 until the Company provides all required information. If adjustments are appropriate, we will propose them at a later date. We reserve our right to update our testimony at the hearing.

Q. How does the shared service cost provided in the Company’s response to Staff IR DPS-182 change the Company’s forecast?

A. The rate year shared service costs provided in that response is a negative $7.989 million, which reduced the shared service costs by $1.381 million from the Company’s update.

Q. Does the Panel have any concerns with the Company’s development of the shared service expense?

A. Yes. The Company’s forecast methodology appears to be overly complex and prone to produce errors. We are working with the Company to streamline the process for future filing. Our goal is to produce a “roadmap” that ties directly back to the net affiliate billings to Con Edison’s element of expenses, such as employee pension and OPEB expense, employee welfare expenses, shared services expense, and all other such expenses.

Uncollectible Expense

Q. How does the Panel address the Company’s request to unbundle uncollectible expense?

A. The Company proposed to remove the portion of uncollectible expense related to fuel and purchased power costs from the delivery revenue requirement. If approved, the Company will recover the uncollectible expense related to energy costs through the Market Supply Charge (MSC) and Monthly Adjustment Clause (MAC), based on actual fuel and purchased power expenses. We agree that unbundling the uncollectible expenses will better match the recovery of the expenses with actual revenue billed, and also reduce the Company’s uncollectible accounts risk due to market prices volatility. We recommend the Commission approve the Company’s request to unbundled uncollectible expense.

Water Expense

Q. Explain your proposed adjustment to water expense.

A. The Company projected an 8.7% annual increase in water expense in 2007 and 2008, based on the statements from NYC’s Water Board. In addition, the Company applied a 4.7% general inflation factor to the forecasted water cost in the rate year. Since the company has separately forecasted increases in water rate, the application of general inflation is not appropriate. We recommend a reduction of $35,000 to the Company’s rate year water expense to reflect the elimination of the general inflation.

Other O&M Expense

Q. Do you have any other adjustments?

A. Yes. In the Company’s response to Staff IR DPS-8, Con Edison it provided Attachment Staff 2-8. On page 1 of this attachment, Deferred Compensation is indicated at $14,146,000. According to the Company’s response to Staff IR DPS-517, the $14.1 million is the electric operations’ allocation of the Stock-Based Compensation of $18 million reflected in Note M on p.103 of Con Edison’s 2006 10-K. The $14,146,000 consists of stock options ($44,815,000), restricted stock ($369,000), performance based restricted stock ($8,084,000), non-officer director deferred stock ($872,000) and other ($6,000). In Note M, it states, ”The Stock Option Plan (the 1996 Plan) provided for awards of stock options to officers and employees for up to 10 million shares of Con Edison Common Stock. The Long Term Incentive Plan (LTIP) among other things, provides for awards of restricted stock units, stock options and, to Con Edison's non-officer directors, deferred stock units for up to 10 million shares of common stock…" On the advice of counsel, it is Commission policy that the recovery of incentive payments may not be recovered from customers. Based on this, the Panel recommends an adjustment of $14.8 million to remove the Stock Options labeled as Deferred Compensation under Other O&M Expense and the associated escalation of 4.7%.

Inflation

Q. Do you have adjustments to inflation?

A. Yes. Based on the Panel's and other Staff witnesses' testimony, we are reducing inflation expense by $814,000.

Property Tax Expense

Q. Does the Panel have an adjustment to rate year Property Tax Expense?

A. Yes.

Q. What is the basis of your adjustment to rate year property tax expense?

A. Our adjustment to the Company's property tax expense reflects our use of actual NYC property tax rates for the 2007-2008 tax year, which became known after the Company filed its case. We also forecasted the tax rates for the 2008-2009 tax year using an escalation factor based on the average growth rates for the past five years.

Q. How did the Company determine its rate year estimate of NYC property tax expense?

A. In its original filing, the Company forecasts the rate year level based on the forecast assessed values of the electric properties, including forecast construction expenditures, and estimated tax rates for properties that are classified as class 3 and class 4. The Company’s estimated tax rates would be held constant at the 2006-2007 level.

Q. Do you agree with the Company’s original assumption regarding tax rates?

A. No, we do not. For the past couple of years, NYC tax rates have actually been declining. For the 2008 fiscal year, NYC approved a 7% decrease in property tax rates. We recomputed the rate year property tax expense using the actual 2007-2008 tax rates and estimated tax rate decreases of 1.61% for Class 3 properties and 2.62% for class 4 properties for the 2008-2009 tax year.

Q. What is the impact on the rate year property tax expense forecast as determined by the Panel?

A. For the rate year, our changes result in a decrease of $37.975 million in the level of property tax expense as compared to the level reflected in the Company's original filing. In its update however, the Company revised its forecast to reflect a $26.388 million decrease from the original level. The Company's updated forecast results from the Company applying the now known 2007-2008 tax rates. In addition, its update reflected the application of actual assessments for the fiscal year 2007-2008 as opposed to the estimated level computed in its original filing and the effects of the Mott Haven Substation that were discussed on page 33 of Company witness Hutcheson's testimony.

Q. Have you taken into account those new facts?

A. Yes, we revised our forecast to reflect the actual 2007-2008 assessments and to include the effect of the Mott Haven tax benefits. Our adjustment to the Company's originally filed rate year expense is $28.156 million. This adjustment reflects an additional $1.771 million reduction to the Company's August 7, 2007 updated level of property taxes.

Q. Does your proposed adjustment have any other impact on the rate year revenue requirement?

A. Yes. As a result of the changes, the estimated prepayment property tax expense included in the Company's working capital component of rate base should be reduced by $6.636 million. The Company reflected $5.916 million of this change in its August 7, 2007 update.

Reconciliation and Deferred Accounting Property Taxes

Q. On pages 18-19 of Company witness Rasmussen's testimony, he proposes to employ the use of deferred accounting to true-up property taxes to actual expense levels. Do you support the Company's request for reconciliation accounting for property taxes?

A. No. We do not support the proposal to reconcile property tax expense.

Q. Please explain your objection to reconciling property tax expense.

A. Property tax expense can be reasonably forecasted for the rate year and it is very unlikely that the expense will vary significantly from the forecasted levels in the rate year. In fact, a portion of the rate year expense is already known. Given the shortened forecast period, reconciliation treatment is unnecessary.

Q. Regarding the treatment of property tax refunds and assessment reductions, do you agree with the Company's proposal to continue the current 86/14% Customer/Company sharing mechanism?

A. Yes, we do.

Rate Base - Earnings Base Capitalization (EBC)

A. What is the purpose of the EBC calculation?

Q. The EBC is a computation intended to bring rate base and capitalization into phase so that the basis upon which a utility is given an opportunity to earn return reflects only the investor-supplied capital dedicated to public service. Simply stated, the EBC comparison represents the difference between the capitalization, or the earnings base and rate base.

Q. What data is used to calculate the EBC?

A. Traditionally, the EBC is based on data from the Company’s books and records for the historical year or test year. In this instance, the test year is the year ended December 31, 2006.

Q. Please quantify the impact of your proposed EBC adjustments.

A. Our adjustments reduce the Company’s rate year rate base by $202.6 million.

Q. Please explain your adjustments?

A. The adjustments affect two sections of the EBC computation: capitalization and rate base. Upon examining the historical data, we realized that certain items included in the capitalization required adjustment. We recommend the following adjustments to capitalization for interest-bearing items: 1) The exclusion of deferred Retail Access Phase 5 costs in the amount of $1.747 million since there was no remaining balance on the Company’s books in the historical year. 2) The reduction of the deferred Gain on Sale of First Avenue properties by $2.424

million to reflect the electric allocation of the proceeds. 3) The exclusion of deferred Mid-Hudson Site costs amount of $0.434 million, since the balance is non-interest bearing. As we will discuss in greater detail, we also recommend that capitalization be adjusted to reflect the impact of certain pension credits totaling $147.1 million.

To historical rate base, we recommend the following:

1) The historical cash working capital (CWC) allowance is comprised of the total O&M expenses less certain expenses, such as Pensions expense, which require no financing between the time they are recognized for accounting purposes and their recovery from customers. While the per book level of pension expenses, as included in the total O&M, correctly reflects the effects of a Medicare Prescription Part D subsidy, the Company did not take into account this credit when computing the historic CWC allowance. This created a mismatch between the amount included in the total O&M and the amount excluded in the determination of the CWC allowance. The Panel’s

application of the correct expense level in the CWC computation results in an adjustment of $2.942 million, with a correlative effect on the EBC.

2) The pro-forma rate base exhibit used by the Company to determine the rate year working capital includes an allowance for working capital related to Purchased Power. The Accounting Panel indicated on page 83 of its testimony that this allowance was based on a time lag between fuel billed and payment collected from the customers. This working capital allowance however, was not taken into account in the computation of the historical working capital; thus creating a discrepancy. For purposes of consistency, we computed the allowance for the historical year using the same methodology employed by the Company. This adjustment reduces the EBC adjustment by $49.267 million.

3) The Excess Deferred State Income Tax balance was also adjusted by $0.4 million to correct for an error in the calculation of the average balance for the historical year.

In summary, our proposed adjustments result in a decrease in the Company’s EBC adjustment of $202.6 million.

Prepaid Pension - EBC

Q. Did Con Edison include its prepaid pension expense in its rate base request?

A. Yes. The Company’s Accounting Panel, on page 71, acknowledges that the Company included its prepaid pension expense in its rate base compilation as part of its Earnings base versus capitalization (EBC) measure. The Company indicated that its inclusion is one of the reasons that its earnings base is larger than its rate base.

Q. Does Staff have any concerns with Con Edison's proposed treatment?

A. Yes, the majority of the prepaid pension balance was amassed while the Company was off the Statement of Policy and Order Concerning the Accounting and Ratemaking for Pensions and Post Retirement Benefits Other Than Pensions (Case 91-M-0890, issued September 7, 1993)(Pension Policy Statement). Moreover, a significant portion of the so-called prepaid pension expense does not represent a cash investment for Con Edison.

Q. For what period was Con Edison's electric operation off the Pension Policy Statement?

A. Con Edison went off the Pension Policy Statement, effective April 1, 1997, consistent with the terms of the rate plan adopted by the Commission in Case 96-E-0897. Electric operations returned to the provisions of the Pension Policy Statement effective April 1, 2005.

Q. How large is the prepaid pension expense?

A. Con Edison has accumulated a significant prepaid pension expense balance. As noted by the Company's Accounting Panel, the average balance of the electric prepaid pension expense was $1.144 billion for the historic year ended December 2006.

Q. How do prepaid pension expense balances arise?

A. There are two ways a prepaid pension balance can occur. It can occur when management, at its discretion, makes contributions to, or funds, its pension plan with cash in excess of the rate allowances provided by the Commission. A prepaid pension balance can also occur when a negative pension expense is accrued on a company's books. Con Edison's prepaid pension balance developed as the result of this latter situation rather than the Company actually making cash contributions to the pension fund in excess of its rate allowances. Thus, Con Edison's prepaid pension expense balance is not a cash prepaid expense, but rather the balance sheet effect that results from the accrual of negative pension expense.

Q. Were negative pension expenses reflected in Con Edison's electric rates?

A. Partially. Con Edison electric rates reflected negative pension expense accruals. However, the Company booked negative pension expense accruals well in excess of the levels that were reflected in electric rates.

Q. Were differences between rate allowances and actual pension accruals reconciled and deferred for the benefit of ratepayers?

A. No. Effective April 1, 1997, Con Edison went off the Pension Policy Statement and suspended the reconciliation of rate allowances to actual pension and OPEB accruals. As noted previously, the Company returned to this Policy Statement requirement effective April 1, 2005 for its electric operations.

Q. How did Con Edison's actual pension accruals compare to its rate allowances while the Company was off the Pension Policy Statement?

A. Based on information provided by the Company in its response to Staff IR DPS-478, we determined that Con Edison's actual electric pension expenses were negative $885.6 million for the period it was off the Policy Statement. During this period, rate allowances for electric pensions totaled negative $609.0 million. Therefore, the Company's actual pension expenses were $276.6 million lower than the level set in rates. Since the Company was off the Policy Statement at that time, the benefits of these savings flowed to shareholders, not customers.

Q. Why is the inclusion of the prepaid pension expense balance in rate base problematic?

A. The inclusion of the prepaid pension expense will provide the Company a cash return on the prepaid pension expense balance. A significant portion of the Company’s prepaid pension expense is not associated with any cash outlay. As such, the request to include the non-cash component in rate base has no merit. Moreover, the non-cash component of the prepaid pension expense is not associated with any benefits realized by customers. Customers received a benefit only to the extent that pension credits were reflected in the rates they paid. Con Edison retained pension credits in excess of those reflected in rates since it was not on the Pension Policy Statement and now is attempting to earn a return on the resultant profits it earned while off the Pension Policy Statement. To require customers to pay carrying costs on the portion of a benefit they never received (because it flowed to shareholders) is inequitable and inappropriate.

Q. The Company’s Accounting Panel, starting on page 71, suggests that negative pension costs resulted in a cash financing requirement for the Company. Do you agree?

A. No, not completely. While the Company’s Accounting Panel properly states that negative pension expenses or credits were non-cash, they also suggest that these non-cash credits were used to reduce the Company’s operating costs. As a result, the revenue requirement was reduced and cash flow was reduced. The Company’s argument misses the point, however, because it fails to focus on the fact that the prepaid balances were also derived from differences between the negative pension credits reflected in rates and the even greater negative pension expenses actually booked by the Company. While the Company is correct that cash flow was reduced by the credits reflected in rates, its position does not consider the fact that cash flow was in no way affected by the prepaid balances generated by the even greater negative pension expenses booked by the Company. Put another way, the Company’s position is true only to the extent the pension credits were reflected in rates. Credits in excess of those reflected in rates resulted in non-cash earnings on which the Company now inappropriately seeks to earn a return.

Q. How do you propose to remedy this situation?

A. We propose that the Commission consider the portion of the prepaid pension balance that is equivalent to the pension credits that were not reflected in rates as a non-regulated asset. We propose to adjust the Company's capitalization to eliminate the capital supporting this non-regulated asset. We reflected our adjustment in the EBC adjustment to the Company's rate base. This adjustment is necessary to ensure that the Company only has an opportunity to earn a return on its cash investments.

Q. What is the amount of your proposed adjustment?

A. Our proposed adjustment to the Company’s EBC is $147.1 million.

Q. How did you calculate your adjustment?

A. We calculated that, for the period April 1997 through March 2005, Con Edison’s actual electric pension expense was $276.6 million less than the amounts provided for in rates. This over-collection increased the Company’s electric earned return. For two rate years during the period the Company was off the Pension Policy Statement, the Company shared excess earnings with customers pursuant to the terms of its rate plans. After considering the benefits customers potentially realized via shared earnings, we calculated that Con Edison retained $248.1 million of difference between its actual electric pension expense and the level that was reflected in rates. We recommend that the net-of-tax amount of this difference, $147.1 million, be reflected as an adjustment to the Company's capitalization supporting electric operations.

BIR Discount – Recovery

Q. What is the nature of the Business Incentive Rate (BIR) Discount balance reflected in the Company’s rate base?

A. This item reflects discounts provided to customers taking service under the Company’s Business Incentive Rate (Rider J). According to the Company’s response to Staff IR DPS-304, the Company, between November 2003 and August 2005, deferred for future recovery lost revenues resulting from BIR discounts. This line item in rate base reflects the unamortized net-of-tax balance of the deferred lost revenues.

Q. Is the Company seeking recovery of the lost revenues in this case?

A. No, the Company did not propose amortization of the deferred balance. Rather, the Company included the entire net-of-tax balance in rate base.

Q. Is the Company's approach inappropriate?

A. The Company referred to the proposal in Cases 00-M-0095, 96-E-0897, 99-E-1020 (dated October 2, 2000, pages 27-28, approved by the Commission on November 30, 2000) (Proposal) as evidence of Commission authorization of the establishment of a regulatory asset to account for the lost revenues associated with BIR discounts. However, the Proposal also included this language on page 27, "Prior to such recovery, the Company will file with the Commission's Staff, and provide copies to economic development administrators of BIR programs (EDAs), the basis for classifying BIR additions as 'retention' load for purpose of determining such revenue shortfalls." The distinction between new business and retention discounts is of critical importance to determine the level of lost revenues pursuant to the rate plan. Staff is not clear whether the Company ever made such a filing as required by the Proposal and Commission Rate Order. In Staff IR DPS-304, we requested that the Company provide copies of any petitions it filed with the Commission seeking authority of the establishment of a regulatory asset to count for the lost revenues related to BIR discounts. The Company did not provide any. With the issues of classification and measurement of lost revenues related to BIR discounts unresolved, we propose to remove the $3.339 million line item from the rate base.

Excess Deferred State Income Taxes (SIT)

Q. What is your concern regarding excess deferred SIT?

A. The New York State corporate income tax rate was reduced from 7.5% to 7.1% effective January 1, 2007. The Company’s rate filing reflected the new tax rate in its computation of state income taxes, Exhibit___(AP-9). However, the Company did not address the impact of the tax rate change on accumulated deferred SIT. Due to the lower current income tax rate, prior deferred tax balances are now overstated. Taxes will be paid in the future at the new lower rate. Therefore, the Company books reflect excess deferred income taxes. The excess was funded in rates. The Company's response to Staff IR DPS-505 indicates that excess deferred SIT for electric operation was $12,562,707. We propose the excess deferred state income taxes be passed back to customers as a rate moderator. This adjustment is reflected as an increase to Other Operating Revenue of $20.7 million and a reduction to the deferred tax balance in rate base in the amount of $6.3 million.

Long Island City Outage Costs

Q. Has Con Edison included costs associated with the July 2006 Long Island City (LIC) Power Outage in the rate case request?

A. Yes. The Company has included the capital restoration costs, damaged equipment retirement costs, capital reinforcement costs and other planned capital work in its rate base request. As such, the Company is seeking a cash return on the investments as well as related depreciation expense from ratepayers.

Q. Do you have any concerns with the request?

A. Yes. The Company’s actions before, during and after the July 2006 equipment failures and power outages in the LIC Network are under review in a prudence proceeding (Case 06-E-0894). On advice of counsel, the Commission has the authority to determine whether a utility’s costs of service should be borne by the utilities’ ratepayers or its shareholders, with shareholders being held responsible for those costs that a utility “imprudently” incurred. Given that the Commission has commenced a proceeding to review the prudence of the Company’s conduct, it is premature for the Company to request recovery of and a return on these investments at this time.

Q. What do you recommend?

A. We recommend that all costs related to the 2006 Long Island City outage be excluded from Con Edison’s revenue requirement pending resolution of the prudence proceeding. If the proceeding is completed prior to the Commission’s consideration of the rate case, then we recommend an update to reflect the outcome of the prudence case. If that proceeding is not completed, we recommend that the Company be authorized to deferred carrying charges on the net plant balance at the cost of capital rate approved in this case. In addition, the Company should be authorized to defer related depreciation accruals on the plant additions.

Q. Have you identified the outage related costs included in the Company’s rate request?

A. The Company has included $49.6 million of LIC related investments its rate year plant in-service balance and $4.77 of retirement costs in its depreciation reserve in its rate base request (see response to Staff IR DPS-479). In addition the Company is seeking a depreciation allowance of $1.05 million for LIC related investments. We recommend that all these cost be eliminated from the Company’s revenue requirement at this time.

Q. Do you have any other concerns regarding outage related capital costs?

A. Yes, we do. The Company has and continues to accrue carrying costs on LIC outage related investments and retirement costs.

Q. Please explain.

A. Pursuant to the terms of the Company’s current electric rate plan, the Company is authorized to defer the revenue requirement impact of any variation in the actual T&D net plant balance from the level provided in rates. Specifically, the Company is authorized to defer carrying charges at an annual rate of 13.95%, representing the combination of the Company's allowed pretax rate of return and composite depreciation rate. The outage occurred and the majority of the capital retirement and replacement costs were incurred during the second rate year (12 months ended March 2007) of the current electric rate plan. As a result of significant capital expenditures in excess of the levels provided for in rates in first rate year and continuing through the second rate year, Con Edison deferred significant carrying charges on incremental T&D investments. The outage related investments and retirement costs were captured in this reconciliation process.

Q. Why is the T&D capital reconciliation relevant to this rate case?

A. The Company is seeking recovery of deferred and projected transmission and distribution infrastructure carrying charges in two forms in this case. Pursuant to the current rate plan, reconciled items, charges or credits, are to be deferred and recovered or passed back to customers after the expiration of the plan in a manner determine by the Commission. The rate plan also provides that at the end of each rate year, subject to audit and prudence review, the Company may apply any available credits to offset deferred charges. At the end of each of the first two rate years, Con Edison provided written notification to the Director of the Office of Accounting and Finance regarding the offset of deferred debits and credits. These letters reflected the offset of deferred carrying charges on incremental net transmission and distribution net plant with then available credits. Therefore, absent an adjustment here, Con Edison will have already recovered the carrying charges it accrued on the LIC Outage related capital costs in rate year two. Since a determination regarding the prudence of the underlying costs has yet to be made, we believe that it is not appropriate for the Company to recover carrying charges thereon at this time. In addition, the Company is seeking recovery, over three years, projected carrying charges on incremental T&D investment, including outage related costs for rate year three of the current rate plan.

Q. What does the Panel recommend?

A. As to the carrying charges accrued during rate year two, we recommend that the Company be required to reverse the application of credits equivalent to the level of carrying charges applied to outage related costs pending the Commission's prudence determination. If the costs are determined to be prudently incurred, then the application of the credits can be restored. If the costs are determined to be imprudent, then the credits will be available for future disposition as determined by the Commission. As to the carrying charges accrued during rate year three, we recommend that they be separately deferred pending the Commission's decision on prudence. Therefore, we have eliminated the amortizations of the deferred carrying costs from the revenue requirement and the unamortized balance from the Company’s rate base.

Other Rate Base Items

Accumulated Deferred Taxes –

Change of Accounting Section 263A

Q. Do you have any concerns that may impact the deferred federal income taxes reflected in the Company’s rate base in this case?

A. Yes. The Company’s rate base includes average accumulated deferred taxes for the rate year of $298 million associated with tax accounting changes made under Section 263A of the Internal Revenue Code. Starting in 2002, Con Edison began to use the “simplified service cost method”. This permitted the Company to obtain expense deductions for costs and assets that would have otherwise been depreciated over a 15 to 20 year period. As noted in the Company’s Annual Report filed with the Commission “In August 2005, the Internal Revenue Service (IRS) issued Revenue Ruling 2005-53 with respect to when federal income tax deductions can be taken for certain construction-related costs. The Company used the ‘simplified service cost method’ (SSCM) to determine the extent to which these costs could be deducted in 2002, 2003, 2004 and 2005, and as a result reduced its current tax expense by $318 million. The Company expects that it will be required to repay, with interest, a portion of its past SSCM tax benefits and to capitalize and depreciate over a period of years costs it previously deducted under SSCM.” The electric rate filing reflects the deduction claimed for tax years 2002–2005, but not 2006. The rate filing simply reflects an amortization of historic deductions. The rate case assumptions are consistent with actual book balance through February 2007 after which the actual balances are significantly lower. It is our understanding that the Company has been working with the IRS to resolve the disputed deductions as well as the future applicability of the Section 263A for Con Edison. In July, the Company was optimistic that it would have an agreement with the IRS on these issues by August. The 2006 income tax return will be filed in September. At this point, Staff is not sure whether the Company will claim a Section 263A deduction or not. We are concerned that the Company's estimate may not reflect the level of actual deferred tax balances for the rate year.

Q. Does the Panel propose to adjust rate base?

A. No. Since the resolution of this matter is still pending and there is a potential for a significant disallowance we recommend that the Company provide an update based on the latest available information. The update should reflect any related offset to the ADR/ACRS/MACRS rate base balances. Should a resolution with the IRS be reached during the course of this proceeding, the Company should notify the parties and, depending upon the current status of the proceeding, an update should be required of the Company.

Federal Income Taxes (FIT)

FIT for Electric Production

Q. Does the Panel have any issues with the FIT for electric production?

A. Yes. Neither the Company's original filing nor its preliminary update reflects the IRS Code 263A - Capitalized Overhead (263A) reduction in the electric production revenue requirement schedule. In response to Staff IR DPS-183, the Company provided the current amortization of 263A deferred taxes applicable to electric production plant, which is $1.325 million. The response indicated that this amount was included in the FIT schedule for the overall revenue requirement. Staff proposes to allocate $1.325 million to the Company's production revenue requirement computation.

Q. How will your proposed change impact the Company's revenue requirement?

A. The relocation of 263A reduction to electric production revenue requirement schedules does not affect the overall revenue requirement, because the amount was included as part of the total 263A reduction in the Company's overall revenue requirement. The relocation affects the allocation of the revenue requirement between delivery revenue requirement and the MAC revenue requirement.

First Avenue Proceeds

Q. On pages 73 through 74 of the Company's Accounting Panel testimony, the use of the after-tax gain from the sale of Con Edison's First Avenue Properties is discussed. On page 91, the interest related to these proceeds is discussed. Do you agree with the Company's proposals?

A. Con Edison is proposing to refund the Company's estimate of the net gain and associated interest from the sale of the First Avenue Properties to customers over a three-year period. While we do not object to this proposal, it should be noted that the Commission has not yet acted on the Company's proposed accounting and ratemaking for the net proceeds of the First Avenue Properties in Case 01-E-0377, and therefore, the exact level of proceeds available to be returned to electric customers has not yet been determined. Pending the resolution of that proceeding, the refund amount proposed by the Company for the rate year can be used as a placeholder and updated to reflect the Commission's decision in that proceeding. In the event the Commission does not rule on the level of gains until after the Commission issues an order in this rate proceeding, Staff recommends that the Company be required to set aside such additional gains for return to customers in a subsequent rate case.

Deferred Accounting

Q. On page 18 through 25 of his testimony, Company witness Rasmussen seeks to employ the use of deferred accounting to true-up a number of items and to continue the annual netting of outstanding deferrals. Does the Panel support the Company’s requests?

A. The Panel’s recommendations on deferred accounting for pension and OPEB expenses, environmental remediation, interference expenses, property taxes, and World Trade Center costs have already been addressed in our testimony. We object to the Company’s request to continue the annual netting of deferrals in a one-year rate plan. The Commission should determine the disposition of any deferred balances in the Company’s next rate case.

Q. Does this conclude your testimony at this time?

A. Yes.