

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

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

**Direct Testimony Of A Panel Consisting Of
John Chamberlin, Don Bennett, And Brian Hedman**

On Behalf Of The New York Power Authority

September 2007

I. INTRODUCTION AND PURPOSE OF TESTIMONY

Q. Members of the Panel, please state your names and business addresses.

A. [John Chamberlin] My name is John Chamberlin. My business address is Quantec, LLC,
212 E. Main Street, Suite G, Reedsburg, Wisconsin 53959.

[Don Bennett] My name is Don Bennett. My business address is Don Bennett Management
Consultant, Ltd., 4617 S. 3rd Street, Arlington, Virginia 22204.

[Brian Hedman] My name is Brian Hedman. My business address is Quantec, LLC, 720
S.W. Washington, Suite 400, Portland, Oregon, 97205.

**Q. Please summarize your professional and educational experience – and
whether you have testified before any state or federal regulatory agencies.**

A. [John Chamberlin] I am Executive Vice President of Strategic Services for Quantec, LLC.,
where I am responsible for utility rates, cost of service, and financial planning work. Prior to
joining Quantec in March 2003, I was with KEMA Management Consulting, formerly
XENERGY, Inc. Before that, I was Vice President, Strategy and Planning at PG&E Energy
Services, where I led development of market entry and evaluation models, assessed
product profitability, and evaluated the economic and financial aspects of regulatory and
market rules, among other things.

I joined PG&E Energy Services following the 1997 sale of the consulting company I co-
founded: Barakat and Chamberlin, Inc. ("BCI"). This 150-person firm was a national leader
in utility consulting for more than ten years. At BCI, I led the electric utility consulting
practice, and personally managed numerous rate, cost of service and related assignments
for utilities throughout North America. I have appeared in numerous regulatory proceedings
during the past 20 years, and have testified in several civil proceedings, and before several

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1 state legislative bodies. I am the author of four books, numerous published articles and
2 hundreds of presentations on utility rate, cost of service and related issues. I hold a B.A. in
3 Economics from California State University at Chico, as well as an M.A. and a Ph.D. in
4 Economics from Washington State University. My resume is attached as part of Exhibit ____
5 (NYPA-1).

6 [Don Bennett] I am an independent management consultant, providing financial and
7 strategic management consulting services to the energy utilities industry and other
8 infrastructure businesses. I have served the energy industry for 36 years, first as a financial
9 executive and, for the last 14 years, as a consultant. I was a partner at Arthur Andersen,
10 serving as the head of its National Utility Consulting Group before departing in 1997. Prior
11 to entering consulting, I served in various financial management positions with The
12 Southern Company, the electric holding company in Atlanta, Georgia. I have testified before
13 the Federal Energy Regulatory Commission ("FERC"), this commission and in an
14 international arbitration. I have a Bachelor of Science degree in Industrial Management
15 from the Georgia Institute of Technology (Atlanta, Georgia) and an M.B.A. from the
16 University of North Carolina at Chapel Hill. My resume is attached as part of Exhibit ____
17 (NYPA-1).

18 [Brian Hedman] I am Vice President for Quantec, LLC, where I am responsible for utility
19 rates, cost of service, and other regulatory services. Prior to joining Quantec in February
20 2001, I was Manager of Regulation for PacifiCorp. I was responsible for the development of
21 revenue requirements and demand side regulatory policy. I have testified before the FERC
22 and the regulatory commissions in Utah, Idaho, Montana, Oregon and Washington. I

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received a B.A. in Accounting from the University of Washington and an M.S. in Economics from Portland State University. My resume is attached as part of Exhibit __ (NYPA-1).

We note here that all of the exhibits accompanying our testimony have been prepared by us or under our supervision.

Q. What is the purpose of your testimony?

A. On behalf of the New York Power Authority ("NYPA"), the purpose of our testimony is to present the findings of our review and analysis of the rate case filing made by Consolidated Edison Company of New York, Inc. ("Con Edison" or "Company") in this proceeding. First, we provide a brief, high level overview of our perspective on the magnitude of the Con Edison rate request. Then, we discuss the appropriateness of the approach used by Con Edison in allocating a disproportionate share of the increase to NYPA. Finally, we provide our analysis of several key components of the proposed increase in revenue requirements.

II. OVERVIEW OF THE CON EDISON RATE REQUEST

Q. Do you have some overall thoughts on the Con Edison rate request before we get into some of the specific revenue requirement and rate structure issues?

A. Yes, we do. Con Edison portrays itself as a large and very successful company. The Company provides, and its customers benefit from, some of the highest electric reliability in the country, as cited in Con Edison's own "PowerPoint" presentation presenting the rate case, "Con Edison: Building for New York's Future, Electric Rate Case". But that clearly comes with a cost –some of the highest electric rates in the country as well. And our great concern is the highest rates are proposed to become even higher – by 50.6 % in the first

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Rate Year, and well over 70 % by the proposed third Rate Year in the case of NYPA for its transmission and distribution rates paid to Con Edison.

Q. Please comment on the level of Con Edison's electric rates.

A. Overall electric rates in New York are among the highest in the country, a fact that is well known and is not being challenged here. Now, Con Edison proposes to add substantially to those rates via an exceptionally large and expensive capital expansion plan.

Q. Can you demonstrate how high Con Edison's rates are?

A. Yes, but we want to re-emphasize that we are challenging the proposed increase in rates, not the existing level. We bring up the existing rate comparisons to demonstrate the difficult position in which Con Edison will be placing its customers if the proposed increase, or any substantial portion of it, is approved.

We have several ways to compare electric utility rates, although none of these will provide perfect comparisons, like-customer to like-customer. We first examine the public data as provided by investor-owned utilities to the FERC through the annual filing known as the FERC Form-1. Examining page 304, "Sale of Electricity by Rate Schedules," we find that for the year 2006, of 23 Eastern and Midwestern utilities, primarily the larger ones, Con Edison's average rate was 13.56 cents per KWh, second only to Boston Edison's reported 13.62 cents, and 55% above the average for the group of 8.7 cents per KWh. The average residential rates for Boston Edison and Con Edison are reported as equal to one another at 19.99 cents per KWh. Comparing to other area utilities, we find Public Service Electric and Gas ("PSEG") at an average of 10.02 cents, Jersey Central P&L at 10.63 cents, Philadelphia Electric ("PECO") at 10.80 cents, and on and on. Our statistics are summarized on Exhibit___ (NYPA-2), page 1. All this, we remind the Commission, is

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before the requested rate increase. We believe that placing this cost burden on New Yorkers inevitably places economic pressure on our area.

Q. Do you have other evidence of Con Edison's high current rates?

A. Yes. There are several surveys put out by various utilities and other interested organizations. On the current website of the Area Development Department of PSEG, the Newark, New Jersey-based utility, there is an interactive feature that enables one to calculate the rate for certain consumption levels. Exhibit___ (NYPA-2), page 2 shows the results of one calculation for 100,000 KWh of office use. PSEG is the lowest of 13 Northeastern companies shown, at 10.43 cents per KWh, and Con Edison is the highest, at 17.66 cents per KWh. Other comparisons with different volumes and different customer classes showed the same or similar results.

Another survey has been published quarterly for many years by the Jacksonville Electric Authority ("JEA"), a fairly large municipal utility serving the City of Jacksonville, Florida. The latest version is shown on JEA's current website, and is shown as Exhibit_(NYPA-2), pages 3-4. The JEA survey deals with residential rates, and shows the bill for 1000 KWh. Con Edison is not shown on this survey – the highest instead is San Diego Gas & Electric Co. at 19.25 cents per KWh. The next highest is PECO at 16.40 cents per KWh and PSEG is shown two slots below there at 15.34 cents. The rates in that survey, incidentally, are seen as low as 6.67 cents per KWh for 1000 KWh at the Appalachian Power Company, a subsidiary of AEP Corporation. Even though Con Edison's residential rates averaging 19.66 cents per KWh are not shown on the JEA survey, it adds further corroboration to the argument that Con Edison's rates are very high now, before any additional rate increase.

Q. Please discuss Con Edison's load growth expectations.

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A. The glossy version is that Con Edison's load is growing dramatically, and the aforementioned PowerPoint presentation has dramatic pictures of Times Square, two new baseball stadiums, and other high-profile locations. When examined in light of the facts, however, its proposed increases in construction spending and in operations and maintenance expenses are not justified by the load growth actually projected. In fact, Con Edison's projected growth is less than one percent per year (Exhibit__ (NYPA-2), pages 5-6), below the national average projection of 1.4% for the next two years and 1.5% long-term. (Exhibit__ (NYPA-2), pages 7-8 (U.S. Energy Information Administration data)).

Q. Can you comment on Con Edison's capital expenditure program?

A. We have tried to take a step back and look at this case and Con Edison in the context of the broad U.S. electric utility industry. Con Edison asserts that it is different – and it is in many ways, to be sure. Serving New York City and the surrounding area does present challenges, but the company has succeeded in achieving very, very high levels of reliability. We fear now, though, that in its zeal to increase even the current level of service and to prepare for the future, the Company is embarking on a capital spending program and new operations and maintenance programs that require close scrutiny to assure that appropriate levels of reliability are achieved, but that inappropriate and unduly expensive programs which add little to system reliability, are not undertaken. It is very difficult to explain to our customers that, while reliability is at record levels and among the highest in the industry, as claimed by Con Edison itself, the company has found it necessary to increase its proposed capital spending by more than 50% over that of the past three years – years in which Con Edison had among the largest T&D construction programs in the country, when measured by spending versus existing plant balances.

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Q. How do you compare Con Edison's capital spending program to those of other utilities?

A. We keep acknowledging that New York City is different – but it has always been different. So we compared Con Edison's recent capital spending program – the one dealt with in the last rate case – to those of other large utilities by comparing the increase in transmission and distribution plant in service from the end of 2003 to the end of 2006. There are many ways one could run such a comparison, of course, but this one method appears to capture the relative growth issue. Here, Con Edison's growth rate is the highest of the sample of 22 companies, and more than 50% above the average. See Exhibit___ (NYPA-2), page 9. This means that over the past three years, Con Edison added proportionately to its capital base more than any other large company in the industry.

Q. Does Con Edison have any observations about its spending programs compared to other utilities?

A. Yes. Company Witness Hoglund, on page four of his testimony, discusses the magnitude of the funding requirement driven by the construction program. Beginning on line 10, he makes the following statement, "No other U.S. electric delivery utility has invested at this rate." That certainly corresponds with our research on this matter.

Q. Are there similar observations that you make regarding Con Edison's future capital expenditure plans?

A. We are unaware of any single consistent data source for projected capital expenditure programs. Many companies, such as Con Edison, announce those plans either in investor presentations or in their annual reports, or, most certainly, in rate cases. We have examined the aforementioned group and only found eight companies other than Con Edison that have announced their three year capital expenditure plans. Examining this admittedly

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1 too-small sample, we find that Con Edison's announced T&D expenditures for 2007 through
2 2009 are 36% of the Company's 2006 year-end gross T&D plant-in-service, second only to
3 Southern California Edison of the eight companies reviewed, and about one-third higher
4 than the sample average of 27% (See Exhibit_(NYPA-2), page 10). So the Company,
5 which spent more than 50% above the average in the past three years, proposes to
6 continue that trend, spending at a level considerably higher, in proportion, than all but one of
7 the comparable companies for which we were able to obtain information.

8 So New Yorkers have already the highest rates, the proportionately largest construction
9 program, and the highest reliability, and the Company is telling its ratepayers that it simply
10 must engage in this proposed capital expenditure plan.

11 Q. What conclusion can you reach with respect to the rate proposal?

12 We think the entire program must be reconsidered in order to assure that necessary but not
13 excessive improvements are made to ensure the reliability of the company's infrastructure.
14 Decisions as to which specific programs to cut or delay, however, should be the product of
15 detailed studies. We know that the Company increased its T&D investment by 24% from
16 year-end 2003 to year-end 2006, and that the announced construction program amounts to
17 another 36% by the end of 2009. A modest proposal would be to allow the Company to
18 spend at the same rate of increase as in the past three years – cutting allowed construction
19 by one-third. That would reduce rate base in Rate Year 1 by just over one billion dollars,
20 taking one-third of the Company's increase in the book cost of utility plant of \$3.135 billion
21 from its Exhibit__(AP-8), page 1 of 2. That would reduce the overall revenue requirement
22 for Rate Year 1 by over \$200 million. There would be further revenue requirement
23 reductions in future years, of course, as the delayed effects of construction cuts on plant-in-
24 service are realized.

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1 **Q. You mentioned O&M programs as well?**

2 A. Remarkably, if we examine the O&M expense growth of the major electric utilities in the
3 country, we again find that Con Edison's growth, when measured by growth in Distribution
4 O&M expense, we think a legitimate measure for a distribution utility, is among the highest
5 in the country.

6 **Q. Please give us some comparison data.**

7 A. We know that, because of its underground system, Con Edison's O&M expense per MW will
8 be higher than that of other utilities – it is higher, and we do not challenge the absolute level.
9 But, disturbing again, we find that Con Edison's growth rate in Distribution O&M Expense is
10 the highest among our sample other than Carolina Power and Light. Con Edison's
11 Distribution O&M grew at a compounded annual growth rate ("CAGR") of over 12% from
12 2003 to 2006, compared to an average growth of 3.7% among the peer group. Now the
13 Company proposes to grow its Distribution O&M by another 20%, with \$140 million of new
14 programs being offset partially by \$78 million of normalizing adjustments. Overall, the
15 Company proposes to increase its O&M expense by some 30% in the rate year compared
16 to 2006, continuing its very high growth rate. See Exhibit___ (NYPA-2), page 11.

17 **Q. Why did you only compare Distribution O&M Expense?**

18 A. Of course, Con Edison's proposed increases in its operating and maintenance programs
19 extend across the entire business – not just Distribution. In fact, the total of non-production
20 operations and maintenance expense increases is almost \$370 million from 2006 to the
21 Rate Year 1. Because of difficulties in clean data comparisons, though, we elected to
22 compare only Con Edison's Distribution Expense to that of other utilities. We find that
23 Transmission Expense comparisons are difficult because of payments to Regional
24 Transmission Organizations and/or ISO's. In addition, Administrative and General Expense

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comparisons can be very misleading because of the volatility of the pension and other employee benefit expenses, and because of the way some companies record Rents and other general types of expenses, including outside services.

Q. Do you have observations on the specifics of the O&M program?

A. Only in a limited way. In its direct testimony, the Company went through an elaborate discussion and justification for each program. Frankly, we do not doubt the merits of many, if not most, of the programs. What we seriously doubt is the wisdom and the efficacy of doing them all at once, when the Company finds the need to raise prices to the extent proposed in this case.

Q. Do you conclude that Con Edison should cancel its new operations and maintenance programs?

A. We do not believe that we are in a position to opine specifically on internal programs such as these. But we are in a position to opine that the Company's O&M and capital budgets are much, much too high, especially in light of the facts that the Company's base levels and percentage increases in the past three years are at the very highest levels in the industry. These programs are hardly those of a company trying to hold rate increases to minimal levels.

Q. So what should be the impact on Con Edison's proposed rate increase?

A. It is clear that Con Edison's O&M expenses have been growing very rapidly, and the new proposals extend that trend. Con Edison proposes program changes that add over \$300 million, not including labor and general escalation. That is an astounding number to us. If one-half of that growth were cut, it would reduce the rate increase for Rate Year 1 by \$150 million.

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Q. What can you say about Con Edison's financial capability to embark on its planned programs?

A. In some ways, Con Edison can be seen as performing in the "middle of the pack" among its electric utility peers. We must keep in mind that earnings comparisons are quite difficult because many of the peer companies have operations other than T&D utilities, including regulated and/or merchant generation, which can skew the profitability numbers widely in either direction. But investors look at much more than ROE results, and they don't view those numbers in a vacuum.

Q. Please explain yourself.

A. Dr. Morin goes to extensive lengths to explain the concept of riskiness and how it impacts a company's cost of capital (See Con Edison Witness Dr. Morin's testimony, especially pages 27 through 46). We believe that the one of the most important factors that investors evaluate is consistency of performance – the predictability of consistent earnings. If investors buy a AAA-rated bond, they expect it to perform as a AAA-rated bond should – that is, there should be no doubt regarding the timely payment of interest and the repayment of principal. And if an investor buys a common stock that is believed to be a consistent earner with a consistent growth of dividend payments, then there is an expectation that the stock will perform in that manner.

Q. And how does Con Edison's stock perform?

A. Con Edison's common stock is one of the most consistent and predictable performers in an industry of typically consistent and predictable performers. We have compiled some highlighted statistics from a well-known source, the *ValueLine Investment Survey* – these are from *ValueLine* editions published between June and August of this year. *ValueLine* rates the safety and stability of each common stock on three measurements, those of

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Earnings Predictability, Financial Strength and Stock Price Stability. We observe that Con Edison's common stock looks very strong by all those measures.

Q. Please elaborate on that.

A. For Stock Price Stability, *ValueLine* rates Con Edison a perfect 100, where the average rating is 80. There are only three other utilities with a perfect 100 rating in the list of 20 utilities: Southern Company, Wisconsin Energy and DTE. For Financial Strength, *ValueLine* rates Con Edison an outstanding A++, the only one of our sample that is accorded that high rating (and none of the 59 utilities covered in the above-cited editions of *ValueLine Investment Survey* had that rating other than Con Ed). Only Exelon (parent of PECO and Commonwealth Edison) had an A+. The average rating for the 20 companies that we reviewed was approximately a B++. And the Earnings Stability rating also was very high for Con Edison, although this is the one measure in which the Company did not lead the sample. Its Earnings Stability rating was 85, well above the average of 70, but below the 90's accorded Exelon and Semptra (parent of San Diego Gas and Electric) and the 95 accorded Southern. See Exhibit___ (NYPA-2), page 12.

Q. Do you have further observations on Earnings Stability?

A. Yes, we do. We examined the historical ROE's for the *ValueLine* sample and found that the standard deviation divided by the mean, a standard measure of relative volatility where a lower percentage means less volatility, had Con Edison near the top, with a ratio of 15%, trailing only Southern Company at 14% and FPL at 8%. See Exhibit___ (NYPA-2), page 13. Further, in examining Southern's website we found an interesting observation. We cite Southern's presentation to investors entitled, "Southern Company Overview, Credit Suisse First Boston 2007 Energy Summit, February 6, 2007" page 50 of 52 of a PowerPoint-type of presentation. See Exhibit ___ (NYPA-2), page 14. On that page, entitled, "Southern's

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Returns Among Highest for Level of Risk,” Southern cites a statistic that relates Total Shareholder Return (“TSR”) to earnings volatility, to demonstrate its earnings stability. Note that only Con Edison exceeds Southern’s high score by that statistic, which Southern attributes to information published in *ValueLine*.

Q. Why is this discussion relevant to the Con Edison rate case?

A. The relevance to this rate case is that Con Edison already has one of the most stable financial situations in the industry and it is trying to make it considerably more stable.

Q. How is Con Edison attempting to make its earnings even more stable?

A. This rate case is replete with measures that will take much of the remaining volatility out of Con Edison’s earnings. First and foremost, the RARIM proposal (which we will discuss in some detail later) certainly will help to stabilize earnings, by keeping the revenue per customer at a constant level, other than for weather or economic growth reasons. There are a number of revenue adjustment mechanisms listed in Company Witness Rasmussen’s testimony. The Company has had the benefit of an unusual adjustment – the treatment of capital expenditures coming out of the Joint Agreement basically allowed the Company to create a Regulatory Asset out of expenditures above an allowed level. Con Edison now is attempting to incorporate those deferred assets into its rate base. In its proposal for the current case, Con Edison proposes that the deferred accounting treatment for the capital expenditure program be dropped, *but only if the entirety of the capital expenditure program in the rate proposal is adopted*. Otherwise, Con Edison proposes to keep what is effectively a “Construction Spending Adjustment Mechanism.” Finally, and probably second in importance only to RARIM, is the New York regulatory practice of a completely forecast test year. Very few utilities in the country have the luxury of assuring the completion of a rate case and the ability to set rates in place at the beginning of a forward-looking test year.

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Incidentally, we do not oppose the use of the forward-looking test year, we think it is a sound regulatory practice, and it certainly helps lead to earnings stability, which is desirable. But this Company simply is piling on measure after measure to ensure a very high level of earnings stability. At some point, the stock begins to look like a fixed income security in the mind of the investor – certainly not a security with the risk-reward comparisons that one would expect to find even in conservative, relatively low-risk common stocks.

Q. What is your conclusion with respect to Earnings Stability?

A. If a substantial portion of the revenue adjustment mechanisms is allowed, then Con Edison's allowed return on equity must be adjusted downward. The average allowed return in the past 1-1/2 years for the electric utility industry nationwide has been 10.3%, according to statistics published by the Edison Electric Institute in its "EEI Q2 2007 Financial Update, Rate Case Summary". See Exhibit___ (NYPA-2), page 15. The level allowed to Con Edison should be well below that, and the 9.5% to which we understand the Company agreed in the recent gas case would appear to be a reasonable starting point.

Q. Please summarize the impact of Con Edison's proposed rate changes on NYPA's governmental customers.

A. We would like to begin by highlighting the magnitude and source of the proposed rate increase. As shown on Exhibit __ (NYPA-2), Page 16, Con Edison proposes to raise delivery rates for NYPA's governmental customers by \$152.3 million in Rate Year 1 alone— or *51% from current rates*. NYPA's 51% increase is considerably more than that of Con Edison's other customers, who (assuming the rate request is granted) will see an aggregate increase of 35% in their Rate Year 1 delivery rates, despite the fact that NYPA's load has been growing more slowly than that of Con Edison's other customers. This proposal to

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increase the NYPA tariff costs by 51% has a very substantial and extremely burdensome impact on NYPA's municipal and other public customers that is unjustified during a time of limited government resources and economic and energy marketplace uncertainty.

Q. What are your overall recommendations regarding this increase?

A. We recommend a number of revenue requirement and Electric Cost of Service ("ECOS") adjustments that reduce the size of Con Edison's overall rate increase by \$647 million, as well as reduce the size of the increase for NYPA's governmental by \$122.5 million and Economic Development Delivery Service/ Power for Jobs ("EDDS/PFJ") by \$7.8 million.

Q. Have you examined the source of the disproportionate increase in NYPA's rates relative to Con Edison's other customers?

A. Yes. The disproportionate increase – whereby NYPA's governmental customers receive an increase that far exceeds that of Con Edison's other customers as a whole – is based on the results of Con Edison's 2005 ECOS study and the "two-step" process it uses. The first step utilizes the ECOS study results to align class revenue responsibilities at the current rate levels. The second step allocates the proposed revenue requirement increase based on the realigned revenues. As a result of this two-step process, the ECOS study results are responsible for \$41.3 million of NYPA's proposed rate increase, as shown on Exhibit ____ (NYPA-2), Page 17. Specifically, the exhibit shows that if NYPA did not have a purported revenue deficiency based on the 2005 ECOS, then NYPA's proposed increase would be "only" \$111.0 million – based on Con Edison's proposed \$1.225 billion increase for the 2009 rate year. This is still a very sizable increase, but substantially less than the proposed \$152.3 million.

Q. What approach are you proposing?

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A. For the reasons set forth below, we propose that any rate increase granted to Con Edison should be allocated to the classes on an equal percentage basis (i.e., without reliance on the 2005 ECOS results). Under our proposal, the rate increase would be allocated in the manner shown on Exhibit __ (NYPA-2) page 17, which reduces NYPA's share of the proposed increase by \$41.3 million.

III. SUMMARY OF FINDINGS AND RECOMMENDATIONS

Q. Please summarize your findings and recommendations regarding Con Edison's proposed rate increase to NYPA's governmental customers.

A. Our findings and recommendations are as follows:

1. We believe that it would be inappropriate to use Con Edison's 2005 ECOS in this proceeding. The proposed rate increase (or, for that matter, any future increase) should *not* be based on Con Edison's ECOS study since the results do not follow the most basic cost-causation principles. Accordingly, we recommend that any rate increase granted to Con Edison should be spread uniformly among the NYPA, EDDS/PFJ and Con Edison customer classes.
2. Alternatively, failing outright dismissal of the ECOS results, we believe that the 2005 ECOS should be modified substantially to correct for several items. First, we propose several adjustments based on the improper allocation of costs to NYPA, such as Research and Development ("R&D") expenses. Next, we recommend changes to several key allocations, such as the high tension (D04) and low tension (D08/D09) allocators which better reflect cost-causation principles for all customers. Further, we recommend that the 2005 ECOS revenue deficiency be based on an

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1 authorized rate of return. Finally, we have proposed certain “contemporaneous”
2 adjustments to the ECOS allocators that better reflect cost responsibility during the
3 effective period of the proposed rates. These adjustments more closely align costs
4 to the 2009 revenue requirements. Our suggested changes would reduce NYPA’s
5 delivery revenue increase by \$52.7 million, as shown on Exhibit __ (NYPA-3), Page
6 1.

7 3. We also recommend that if the Commission decides to rely on the Con Edison’s
8 2005 ECOS study, then the rate of return tolerance band used in the study should be
9 changed from +/-10% to +/-20%. The use of a tolerance band is a long-standing
10 practice at the Commission, generally within a range of +/-10% to +/-20% based on
11 the Commission’s underlying confidence in the ECOS; its methodology, data and
12 results. Based on the apparent instability of Con Edison’s ECOS, its extreme
13 sensitivity to changes in assumptions and data, the fact that a 10% reduction in the
14 2005 earned return still exceeds the 2005 authorized return and the substantial
15 uncertainty regarding the ECOS impact of Con Edison’s proposed infrastructure
16 investments, we recommend the use of a +/-20% tolerance bandwidth. A +/-20%
17 tolerance bandwidth would reduce NYPA’s increase by \$23.0 million, as shown on
18 Exhibit __ (NYPA-3), page 2 based on Con Edison’s proposed level of revenue
19 requirement increase.

20 4. We recommend that NYPA not be allocated any portion of Con Edison’s demand
21 side management program costs, nor R&D expenses, in keeping with established
22 NYPSC precedent. NYPA provides its own DSM and R&D activities, and its
23 customers should not be required to pay twice for these functions.

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5. We also recommend several specific revenue requirement and rate base adjustments that will reduce Con Edison's overall proposed increase by \$646 million.

IV. GENERAL FAILINGS OF THE ELECTRIC COST OF SERVICE (ECOS) STUDY

Q. Please summarize your primary concern with the 2005 ECOS.

A. Our primary concern is that the ECOS modeling process is dependent on its underlying assumptions. As we will demonstrate below, the results are highly volatile depending on what assumptions are incorporated and how they are applied. Such volatility violates the basic principles of sound rate structure such as stability, predictability and fairness in the apportionment of total costs to different ratepayers (See Principles of Public Utility Rates, Bonbright et al, Second Edition, 1988).

Q. How do you propose to overcome these shortcomings?

A. We propose that the revenue increase be allocated equally across all customer classes or, alternatively, that the bandwidth used to develop the ECOS revenue deficiency be expanded to 20% to reflect the uncertainty inherent in the model.

V. SPECIFIC FAILINGS OF THE ELECTRIC COST OF SERVICE STUDY (ECOS)

Q. Would you please state your specific concerns regarding the 2005 ECOS?

A. We have the following specific concerns regarding the 2005 ECOS.

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- 1 1. NYPA's 2005 ECOS revenue deficiency should not be based on the actual 2005 system
2 rate of return of 9.03%. In determining any such deficiency, it should be based upon the
3 8.08% rate of return authorized for the rates-in-effect period. Otherwise, NYPA will be
4 charged, during 2009, for revenues allegedly owed, but not billed to NYPA during 2005
5 and at a level that would have allowed Con Edison to significantly exceed its authorized
6 return.
- 7 2. Con Edison calculates the coincidence factors for SC 65 HT and SC 85 HT in a manner
8 that is inconsistent with the calculation for all other classes.
- 9 3. Con Edison's approach of taking the higher of the summer and winter Non-Coincident
10 Peak (NCP), except for SC-7, SC-12 and SC-12 (TOD) service classes, has no
11 analytical basis, and appears to be inconsistent with Con Edison's planning approach
12 and generally accepted rate design principles.
- 13 4. Con Edison's approach of taking the average of the Individual Customer Maximum
14 Demands (ICMD) and NCP and including a diversity adjustment for the residential
15 classes has no analytical basis, and appears to be inconsistent with Con Edison's
16 planning approach and generally accepted rate design principles.
- 17 5. Con Edison allocates R&D costs to NYPA in the same manner as its other customers,
18 without regard for the fact that NYPA performs its own R&D, including participation in the
19 identical R&D organizations, namely, the Electric Power Research Institute ("EPRI") and
20 the New York State Energy Research & Development Authority ("NYSERDA"). These
21 costs have been historically excluded from Con Edison's allocation to NYPA, and should
22 be treated the same in this case.

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6. Con Edison does not adjust for the change in functionalization between 2005 and 2009 despite the fact that the infrastructure plans are designed to invest more heavily in distribution plant (for which NYPA receives a smaller allocation) and less heavily in transmission plant (for which NYPA receives a larger allocation).

To address these concerns, we have recommended changes that would reduce NYPA's delivery revenue increase by \$52.7 million.

Q. Would you please explain your position regarding the rate of return used in the 2005 ECOS in more detail?

A. Con Edison calculates NYPA's deficiency based on the actual 2005 rate of return of 9.65%. This approach inappropriately increases NYPA's revenue deficiency by establishing a rate of return target that significantly exceeds Con Edison's authorized return of 8.08% for the period the rates were in effect. We recommend that the revenue deficiency analysis be based on the rate of return authorized during the effective period for the new rates – i.e., the rate of return approved by the Commission. As shown in Exhibit __ (NYPA-4NYPA-4), Page 1, the impact of our recommended approach would lower NYPA's delivery revenue increase by \$21.8 million.

There is no basis for using the actual 2005 rate of return. The theoretical problems with this approach are exposed if we assume for the moment that Con Edison's proposed rate of return for the 2009 rate year is 6.5% - which is the same as NYPA's in the 2005 ECOS. In these circumstances, NYPA would show a revenue deficiency in the ECOS (because the deficiency would be based on the historic rate of return) while at the same time NYPA would be generating a rate of return equal to Con Edison's proposed rate of return of 6.5%. In

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fact, in case 96-E-0897 Con Edison's settlement panel described adjusting the 94 ECOS to match the authorized return:

First, revenues were adjusted to reflect rates in the first year of the previous settlement agreement, and to produce an overall system rate-of-return equal to the allowed rate-of-return in that year. This adjustment is needed to ensure that the study shows a rate level corresponding to the allowed rate of return.

Failing to adjust the 2005 ECOS to the authorized rate of return borders on retroactive ratemaking.

We do not believe that simply relying on 2005 data to support 2009 revenue requirements without any attempt to compare revenue and cost structures is appropriate. Therefore, to address our concerns about overstating the revenue deficiency and possible retroactive ratemaking, we recommend that the NYPA revenue deficiency (if any) be based on the rate of return authorized during the effective period for the new rates – i.e., the rate of return approved by the Commission.

Q. Do you have a general observation regarding the load data used to develop the various allocators?

A. Yes, while we believe that Con Edison used the best available data in constructing the class representations and the subsequent allocators, we would be remiss if we didn't point out that much of the underlying data used to develop these estimates is based on sampling design and metering capabilities that are representative of the current transmission and distribution system. These same data are used by Con Edison as the basis for estimating NYPA's class load contributions and, hence, in the development of the allocators. While NYPA has recognized the deficiency of its data and has launched an aggressive redesign of

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their Governmental Load Research program, the necessary reliance on inadequate data further suggests that the band of uncertainty around the ECOS results should be broad.

Q. Would you please explain your position regarding the transmission allocator used in the 2005 ECOS in more detail?

A. Con Edison calculates the system peak responsibility that is used for the transmission demand allocator based on a class coincident peak calculation (Con Edison Exhibit_ERP-2, Reports 2, 3 and 4). The class coincident peak calculation for all classes other than SC 65 HT and SC 85 HT is derived by dividing the average coincident kW per customer for the class by the average non-coincident kW per customer for the class (Con Edison Exhibit_ERP-2, Report 2A). For class SC 65 HT and SC 85 HT the class coincident peak calculation is unspecified (Con Edison Exhibit_ERP-2, Report 2C).

Q. Does Con Edison include high tension customers in the calculation of the class coincidence factors in other instances?

A. Yes, it appears that only SC 65 and SC 85 are singled out for adjustment.

Q. Did Con Edison indicate why these classes were treated separately?

A. Con Edison indicates that reason is that in general, traction load shapes are not available for all stations across all days in July and August (or December and January). See Exhibit____ (NYPA-4), page 2.

Q. Did you perform an analysis of the load data for these classes?

A. Yes. While we did find that there are 10% to 20% missing data readings we were able to construct load shapes and recalculate the coincidence factors for these classes from the load data.

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Q. Did you recalculate the transmission allocator using a consistent class coincidence peak methodology across all of NYPA's classes?

A. Yes. Using all of the meters available in the load data provided by NYPA to Con Edison we recalculated the class coincidence factors for the SC 65 and SC 85 classes including the high tension subclass. Using this methodology makes the SC 65 and SC 85 class coincidence factors consistent with those of all of Con Edison's other service classes. We then recalculated the transmission allocation factor using the revised class coincidence factor. This adjustment lowers NYPA's delivery revenue increase by \$4.8 million. See Exhibit ____ (NYPA-4), pages 3-4.

Q. Would you please explain your position regarding the high tension allocator used in the 2005 ECOS in more detail?

A. Con Edison's proposal to allocate high tension costs on the basis of the proposed D04 allocator is inappropriate. This allocation factor represents the highest summer or winter established demands for all Con Edison service classes except for the SC-7, SC-12 and SC-12 (TOD) service classes, where summer-only demands are used. We believe the use of the winter demands is inappropriate, as is the special treatment for service class SC-7, SC-12 and SC-12 (TOD). As shown on Exhibit ____ (NYPA-4), page 5-6, the impact of our recommended approach would lower NYPA's ECOS delivery revenue increase by \$1.3 million.

There are no studies or analyses supporting Con Edison's D04 allocator in this proceeding. Nothing has been presented to support the premise that system planners have substantially integrated winter demands into their design when designing Con Edison's high tension system. In fact, the evidence is to the contrary. For those classes with substantially higher

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winter peaks (relative to their summer peaks), Con Edison relies only on the summer peaks. This approach (of using just the summer peaks) is actually consistent with Con Edison's statement that "...the high tension system is generally summer peaking." See Exhibit ____ (NYPA-4), page 7.

Using summer peaks is also consistent with the National Association of Regulatory Utility Commissioners' ("NARUC") Electric Utility Cost Allocation Manual, January 1992, page 97, which states, "The load diversity at distribution substations and primary feeders is usually high. For this reason, customer-class peaks are normally used for the allocation of these facilities." Thus, we recommend modifying Con Edison's highest of summer/winter NCP to use the summer NCP only.

Q. Would you please explain your position regarding the low tension allocator used in the 2005 ECOS in more detail?

A. Con Edison's proposal to allocate low tension costs on the basis of the proposed D08/D09 allocator is inappropriate. The allocation factor is based on the average of non-coincident maximum 60 cycle class demands and individual customer billing demands at the point of input to the low tension network line transformers for summer and winter seasons. A special adjustment to this allocator is made for the Con Edison service classes SC-1, SC-1 (WHTG) and SC-7 to allow for the diversity of individual customer loads in multiple dwellings. No adjustments were made for NYPA customers. The D08/D09 allocator was developed using a 75% weighting of the non-coincident demands and 25% of the billing demands for these three classes.

We believe that the averaging of the NCP and ICMD for developing the D08/D09 allocator is inappropriate. We also believe that the special diversity adjustment made for certain rate

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classes is inappropriate. First, Con Edison has produced no studies or analyses that support the D08/D09 allocator in this proceeding. Specifically, nothing has been presented to support the premise that system planners rely on the NCP demands for designing the low tension system. It is apparent that Con Edison's system planners must rely on the ICMD demands for the low tension system since, as Con Edison states, the closer the grid equipment is to the customer the greater the importance of ICMD. See Exhibit ___ (NYPA-4), page 8. Less apparent is what role, if any, the class NCP should play in designing the low tension system. As Con Edison states, the further the grid equipment is from the customer, the greater the importance of class NCP. We certainly agree with Con Edison in using the NCP for allocating costs related to the high tension system because the NCP is generally used in designing high tension systems. And this approach is typical for use in allocating primary distribution costs (see NARUC's Electric Utility Cost Allocation Manual, January 1992, page 97). But without supportable studies or analysis on how the NCP is used in the planning of Con Edison's low tension systems, we believe that the NCP should not be used in allocating the costs of the low tension system. Instead, we propose that the D08/D09 allocator be based on the ICMD. This approach is also consistent with NARUC's Electric Utility Cost Allocation Manual, January 1992, which states on page 97, "The facilities nearer the customer, such as secondary feeders and line transformers, have much lower load diversity. They are normally allocated according to the individual customer's maximum demands."

As to the special diversity adjustment, while we believe that Con Edison's argument may have some theoretical merit, Con Edison has not provided any data or studies to support the reasonableness of the adjustment. Nothing has been presented to show that the NCP/ICMD weighting for the SC-1, SC-1 (WHTG) and SC-7 service classes should be

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75%/25%, as proposed by Con Edison, or for that matter, 90%/10%, or 100%/0%.

Furthermore, we believe that by already incorporating the NCP into the calculation (which reflects a measure of diversity) and then applying a diversity adjustment, Con Edison effectively is double counting. The NCP itself, which calculates maximum class demand, includes diversity for the apartment house example cited by Con Edison in Exhibit __ (NYPA-4), page 8. (The fact that no diversity adjustment is made for NYPA, which serves apartment buildings with multiple meters, is yet another flaw in this allocator.) Thus, we recommend rejecting both the averaging of the NCP and ICMD for developing the D08/D09 allocator – as well as the proposed diversity adjustment. As shown on Exhibit __ (NYPA-4), pages 9-10, the impact of our recommended approach would lower NYPA's ECOS delivery revenue increase by \$16.8 million.

Q. Would you please explain your position regarding the R&D costs used in the 2005 ECOS in more detail?

A. Con Edison's proposal is to allocate R&D costs to all customers, including NYPA, since all customers generally benefit from the research activities of organizations such as EPRI and NYSERDA. See Exhibit __ (NYPA-4) page 11. NYPA's portion of the R&D amount is roughly \$1.3 million, as shown on Exhibit __ (NYPA-4) page 12.

The proposed treatment is unfair to NYPA since NYPA pays dues to many of the same organizations as Con Edison, including EPRI and NYSERDA. Over the last two years, NYPA has spent over \$10 million on R&D-related activities, including paying over \$9.8 million to EPRI and NYSERDA – the same organizations that make up a significant portion of Con Edison's R&D expenditures. To have NYPA pay these dues again would constitute double counting. Thus, we propose excluding the R&D amount from NYPA's cost of

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service, which would lower NYPA's delivery revenue increase by \$3.1 million. See Exhibit_(NYPA-4) page 13.

Q. Please explain your position regarding the functionalization of costs used in the 2005 ECOS in more detail.

A. As discussed above, Con Edison's two-step process results in an unreasonably high allocation of the rate increase to NYPA. One of the primary reasons for this is that the ECOS study relies on historic information (i.e., 2005 data) to establish future rates (i.e., 2009 rate year). Perhaps under a business-as-usual approach this method might make sense. But the next five years will be anything but business as usual since Con Edison proposes to spend roughly \$9.5 billion on infrastructure improvements. See Con Edison workpapers to Con Edison Exhibit_(AP 6&7). This impacts the 2005 ECOS in general and NYPA in particular in that the proposed investments are not in the same proportions of functional categories as has occurred historically. In fact, the proposed investments are heavily weighted toward distribution as opposed to transmission investments. Since NYPA receives a smaller allocation of distribution as compared to transmission costs, this obviously has an impact on the cost of serving NYPA. As a result, we believe that an adjustment should be made to account for this difference. As shown on Exhibit __ (NYPA-4), pages 14-15, our proposed adjustment would lower NYPA's delivery revenue increase by \$4.9 million. As discussed, the ECOS bases each class percentage cost responsibility on the specific functional weights associated with 2005 plant in service. The huge proposed new investments shift the weighting of the functional categories of rate base. In order to allocate costs fairly, the cost responsibility shares should reflect the functional weights during the rates-in-effect period. Our adjustment is derived by adjusting Con Edison's plant-

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in-service amounts included in the 2005 ECOS study by the projection of plant additions to calculate a revised revenue deficiency for NYPA.

Q. Would you please summarize the impact of your specific adjustments to the 2005 ECOS?

A. Yes, the impact of our adjustments to the 2005 ECOS is to lower NYPA's delivery revenue increase by \$52.7 million as shown in Exhibit _ (NYPA-3), Page 1.

VI. RATE OF RETURN TOLERANCE BANDWIDTH USED IN 2005 ECOS

Q. Please explain your position regarding the rate of return tolerance bandwidth.

A. Our conclusion is that the 2005 ECOS does not produce a fair and appropriate allocation of costs in this case. Here are the facts:

- The 2009 revenue and cost structure will vary significantly from the 2005 revenue and cost structure that underlies the 2005 ECOS.
- The ECOS results are extremely sensitive to small changes in demand assumptions – e.g., the D08/D09 allocator is responsible for allocating almost \$3.9 billion of plant in service; thus, a 0.1% change in the allocator would result in a change of \$3.2 million. And, as discussed above, we believe that several key allocators were inappropriately developed by Con Edison.
- The ECOS was developed using an earned return that is significantly higher than the authorized return. In fact, the current +/- 10% bandwidth is insufficient to encompass the authorized return.

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Consequently, the 2005 ECOS is not a reliable tool for ratemaking. Nevertheless, if the Commission decides to use the 2005 ECOS, we believe that a wider tolerance band must be employed to recognize the volatile nature of this study, its underlying assumptions and methodology, and its data. And, while NYPA is the "victim" in this case, the volatile nature of the ECOS is likely to result in inappropriate allocations of costs to others in future proceedings. To address this concern, we believe the use of a wider, +/-20% bandwidth is appropriate. This change alone would reduce the NYPA deficiency shown in the 2005 ECOS by \$23 million, as shown on Exhibit __ (NYPA-3) page 2. We note that in Rochester Gas and Electric's rate case (Cases 02-E-1098 & 02-G-0199), the Staff proposed, the ALJ adopted and the Commission approved a wider tolerance band of +/-20% to avoid rate changes in that case that might need to be reversed in a future case.

VII. REVENUE REQUIREMENT ADJUSTMENTS/DEPRECIATION

Q. Con Edison is requesting a substantial increase in its overall depreciation rates. Do you have any comments on that?

A. Yes. This appears to be another method for the Company to increase its rates in a relatively low-profile manner. We noticed in the previous electric rate case, (04-E-0572) that the Company witness seemed to be taking every possible opportunity to increase the company's overall depreciation rates. Like this time, that witness presented a very elaborate and detailed study and went through an account-by-account analysis, finding the need to increase the rate in many accounts, with very few decreases. Those rates were rejected totally in the Joint Agreement, and the Company continued on the previous depreciation rates.

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Now the Company and its witness are trying a different tack – resting the request for higher depreciation primarily on some instances of higher removal costs – costs that typically have been recovered by netting them, on a projected basis, against salvage values, thus often developing a “net negative salvage value,” and including those values in the depreciation calculation.

Q. What is your opinion of the Company’s position on depreciation and its net negative salvage values.

A. Given the characteristics of the Company’s underground network, it must be acknowledged that removal costs could be higher than they have been historically. For equipment that is being placed underground with a projected life that is measured in decades, it probably is unrealistic to even guess at what residual values or removal costs might be when the equipment finally does reach the end of its useful life. So our suggestion for removal costs would be to capitalize them as incurred – and recover those costs when they are known and verifiable. Otherwise, we are arguing continuously on a subject that cannot be answered now – but most definitely will be answered in the future.

Q. Con Edison points to a problem with subsidization of current ratepayers by those in the future if negative salvage costs are not recovered now. What is your response to that issue?

A. We should not charge today’s ratepayers for future costs that are simply unknowable. Another point is that, typically when equipment is removed, it is replaced by new equipment – either as a simple replacement or an upgrade. Those costs, of course, are capitalized and charged to then-current customers. The accounting, and the logic, seem simple and compelling that removing old equipment in order to make way for new would be all part of capitalization of the new equipment. Obviously the new, about-to-be-capitalized equipment

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could not be installed without removing the old. That would be the time to calculate and account for the cost to remove the old equipment. Otherwise, we are simply charging today's customers for inflation that may or may not be incurred, and for part of the cost to install new equipment from which today's customers will never see any benefit.

Q. What other issues do you see in Depreciation?

A. Due to changes in its depreciation rates, both for the net salvage value issues cited above, as well as some proposed changes in average service lives, the Company claims a deficiency in its Accumulated Depreciation, and proposes to recover those costs over a fifteen-year period. Of course, if we reject all the increases in Depreciation rates, then there should be no reserve deficiency.

Q. So what is your conclusion with respect to Depreciation Expense?

A. The entirety of the company's claim for \$100 million in increased Depreciation Expense should be disallowed, in our opinion.

VIII. RATE BASE ADJUSTMENTS/CASH WORKING CAPITAL ALLOWANCE

Q. Have you reviewed the Con Edison filing with respect to the inclusion of Working Capital in rate base?

A. Yes, we have.

Q. What are your observations with respect to Con Edison's Working Capital position?

A. Con Edison has taken a calculation that it calls the "FERC one-eighth formula," (Con Edison Accounting Panel direct testimony, page 68, line 19) which is 1/8 of certain cash operations and maintenance expenses, as its approximation for cash working capital, in addition to a separate summation of prepayments and materials and supplies.

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1 **Q. What is wrong with that calculation?**

2 A. The problem with the formula as applied in this case is that it produces a result that is not
3 representative of the real working capital requirements of the Company.

4 **Q. Please explain.**

5 A. Working capital is a real business need – the need for cash funds to manage day-to-day
6 operations. The biggest requirement for working capital for almost all businesses, and this
7 certainly includes Con Edison, is to fund accounts receivable. However, the Company is on
8 another side of numerous transactions – it is a payer – to its trade vendors, to its
9 employees, and to its taxing authorities, – all these are current liabilities that the Company is
10 effectively borrowing on a monthly basis, just as it is effectively lending to its customers,
11 through their monthly bills.

12 **Q. What guidance does FERC offer on this computation?**

13 A. FERC has accepted the 1/8 formula as a guideline in the past. However, more recently,
14 FERC appears to regard the 1/8 formula as a maximum, or a guideline if no party objects.
15 In its “Rate Case Filing Manual” for gas companies, dated January 1997 (no similar
16 document appears to exist for electric companies), FERC states under its instructions for
17 SCHEDULE E-1, COMPUTATION OF CASH WORKING CAPITAL ADJUSTING RATE
18 BASE,

19 “Show the computation of cash working capital claimed as an adjustment to the gas
20 company’s rate base. Any adjustment to rate base requested must be based on a
21 fully-developed and reliable lead-lag study. The components of the lead-lag study
22 must include... *Cash working capital allowances in the form of additions to rate base*

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may not exceed one-eighth of the annual operating expenses, as adjusted, net of non-cash items.” (emphasis added)

Q. Are there FERC regulations with respect to cash working capital for electric companies?

A. Yes, in 18 C.F.R. 35.13(h)(12), under “Filing of Rate Schedules and Tariffs”, there are the following instructions with respect to the inclusion of Cash Working Capital in the rate base:

“Cash working capital. The utility shall indicate average monthly working cash requirements that reflect the extent to which day-to-day operational utility service revenues are received later or earlier than cash disbursements necessary to provide the services, with an explanation of how such requirements are derived.”

This strongly suggests that the inclusion of Cash Working Capital in the rate base is a function of the timing differences between cash receipts and cash disbursements, which is the reason that a lead-lag study is often the preferred method for this calculation. Public utility commissions in New Jersey and Texas, to cite two of which we are immediately aware, require lead-lag studies to support cash working capital claims.

Q. Does Con Edison have a lead-lag study available?

A. Con Edison indicated in the above-cited testimony that it uses the “FERC one-eighth formula” in lieu of a lead-lag study. Also, in response to the interrogatory from CPB, Question 30, as to why a lead-lag study is not prepared and when the last one was prepared, Con Edison responded as follows: “The Commission accepts the calculation of the cash working capital requirement using the FERC 1/8th Formula in lieu of such an

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analysis. A lead-lag study is not required by the Commission and has not been prepared by the Company for inclusion in a rate filing for at least 30 years.”

Q. Do you have a way to estimate cash working capital requirements in the absence of a lead-lag study?

A. We did not have access to all the information needed to perform a detailed calculation, but we can and did perform a reasonable estimate based on balance sheet accounts. We believe that our estimate is substantially superior to the simplistic one-eighth formula. It certainly shows through time that the Company’s needs for cash and other highly liquid assets are less than suggested by the “one-eighth formula.”

Q. Please describe your approach.

A. Essentially, we used balance sheet numbers for certain current asset and current liability accounts. These suffer the shortcomings of not being specific to either gas or electric, for the most part, and of not being available more frequently than quarterly. Given those limitations, though, we developed estimates based on the Company as a whole, and then reasonably inferred a position for Con Edison’s electric business.

Q. Please describe the study in detail.

A. Please refer to Exhibit ____ (NYPA-5), page 1. By using quarterly balance sheet numbers from December 31, 2005 through December 31, 2006 for the Company as a whole, as reported in the SEC Form 10-Q filings, we can see that the Company’s cash working capital needs are much less than proposed. For those past five quarters, accounts receivable, customer and other, averaged \$1.257 billion. To this, we would add Other Current Assets, which averaged \$538 million for the five quarters, and cash and other temporary

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investments, which averaged \$129 million. This totals, then, \$1.924 billion of current assets other than prepayments and materials and supplies, all at the corporate level. We adjust for Con Edison's electric T&D business by using the ratio of electric T&D plant in service to total utility plant in service. See Exhibit ___ (NYPA-5) page 2, which we calculate to be 73.7%. That adjusts the total elements of working capital other than prepayments and materials and supplies down to \$1.418 billion. To that total, we add the Con Edison calculation for Materials and Supplies of \$93 million and Prepayments of \$222 million. This brings the total Working Capital Assets to \$1.733 billion.

Q. So is that your recommendation for working capital?

A. No, for we find considerable funding sources on the other side of the balance sheet. Again using quarterly data from the 10-Q's, we took five accounts as providing the current liabilities that provide a source of capital to pay for current assets. Those accounts are accounts payable, taxes accrued, interest accrued, wages accrued and other current liabilities. For the past five quarters, the average of those five accounts was \$1.829 billion, and adjusted those to approximate a Con Edison T&D total of \$1.348 billion. The difference between Working Capital Assets of \$1.733 billion and Working Capital Liabilities of \$1.348 billion, then, would be \$385 million, which would be our recommended level of allowed Working Capital. That is \$178 million less than the Company's requested \$563 million.

IX. RATE BASE ADJUSTMENTS/EXCESS RATE BASE OVER CAPITALIZATION

Q. Do you have other adjustments to rate base?

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A. Yes, we do. We would like to discuss the “Excess Rate Base over Capitalization” (EBCAP), an adjustment that Con Edison has made that increases rate base by \$382 million.

Q. What is your issue with EBCAP?

A. This appears to be more or less a historical artifact in Con Edison’s rate cases. It appears that the EBCAP adjustment began in 1975 in a Niagara Mohawk case in which rate base exceeded capitalization. The Commission made an adjustment that kept the company from earning returns on a base larger than the company’s capitalization itself. Today, that situation appears to be reversed for Con Edison – the claimed rate base is smaller than capitalization.

Q. Con Edison has made a calculation of EBCAP and come up with a negative number – effectively increasing rate base to equal adjusted capitalization. What is wrong with that?

A. We believe that effectively renders pointless the entire rate base calculation. The rate theory is that customers should pay for the use of assets dedicated to their service – known as the “used and useful” doctrine. Con Edison is given ample opportunity to show a rate base that serves its customers. We see no reason to simply adjust that number upward to an artificial level – to equal the Company’s capitalization.

Q. Can you tell us what gives rise to the EBCAP adjustment?

A. Basically, it is a function of the entirety of the balance sheet. But, in reviewing the corporate balance sheet, we look for asset items that are not included in the normal calculation of rate base. If there are items classified in accounting as assets, then there must be offsets on the liability side of the balance sheet, since the two sides must be equal. We have reviewed the working capital calculation in the previous discussion. Con Edison’s calculation of cash

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working capital has no basis on the balance sheet, but the Company's insistent use of the "FERC 1/8th Formula" provides a claim for several hundred million of rate base above the amount that can be otherwise demonstrated.

Q. Even with the inclusion of Con Edison's Working Capital calculation, why is there still an excess of capitalization over rate base?

A. It basically comes down to the existence of a very large amount of Regulatory Assets on Con Edison's balance sheet. A large portion of the Regulatory Assets – almost half, or \$1.9 billion, relates to unrecognized pension and other postretirement costs, with another \$157 million in pension and other postretirement benefits deferrals. These are accounting entries mandated under SFAS No. 158, according to the Company's explanation in its 2006 Annual Report. We can expect that these assets will be subject to wide swings in the future, as gains and losses in the company's \$8 billion pension fund will be reflected on the current balance sheet. Since this is a function of financial market fluctuations, it hardly becomes the basis for sound ratemaking, especially projecting three years into the future. We should note that the financial markets have been through a period of considerable upheaval in recent weeks, with the S&P 500, a commonly used and cited index of large capitalization stocks, losing over 10 % of its value on an intraday basis before recovering over half of that loss (as of August 24, two weeks before the filing date for this testimony). Con Edison's pension funding is covered appropriately in rates. In our view, though, the violent fluctuations in asset values have no place in the ratemaking process. In short, we must say that we do not believe that the Company has met the burden of demonstrating that this portion of rate base is required to meet the customers' needs, and recommend that the Commission not accept that adjustment.

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1 **X.** Revenue Requirement Adjustment/Transmission Congestion Credits

2 **Q.** **Con Edison proposes to continue to credit customers with \$60 million per year in**
3 **Transmission Congestion Credits, with a true-up for amounts above or below that**
4 **total. Do you agree with this treatment?**

5 **A.** No, we do not. Transmission Congestion Credits, or TCC's, have been averaging over
6 \$150 million per year, according to Con Edison. In its response to our interrogatory, NYPA-
7 49, Con Edison said that TCC's for the three years since the last rate case were \$99 million
8 in 2004, \$207 million in 2005 and \$149 million in 2006. We propose that Con Edison use
9 \$150 million per year as the TCC credit embedded in rates. This appears to be another
10 method of Con Edison to bolster its cash flow. As shown on Exhibit ____ (NYPA-6), the
11 impact of our recommended approach would lower NYPA's delivery revenue increase by
12 \$11.8 million.

13 **XI.** REVENUE REQUIREMENT ADJUSTMENT/MANUFACTURED GAS PLANT

14 **Q.** **Do you have other issues with respect to Con Edison's claims for revenue**
15 **requirements?**

16 **A.** Yes, we have a problem with the way Con Edison proposes to treat its Manufactured Gas
17 Plant ("MGP") remediation costs.

18 **Q.** **Please explain.**

19 **A.** There are two issues here – the Company's Accounting Panel proposes to amortize the
20 projected cost of \$189.8 million, \$149.4 million of which is proposed to be allocated to
21 electric operations, over a three-year period, increasing annual revenue requirements from

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electric operations by \$41.6 million over those three years. I see no justification for that rapid recovery of a legally required cost – one whose origin was many decades ago. Instead, that cost should be amortized over a much longer period – 20 years or more.

Q. And you have another issue with MGP treatment?

A. The main problem is this: Why are we even discussing MGP in an electric rate case – and especially for NYPA, in a rate case dominated by T&D issues? Manufactured gas plants are an artifact of the gas business, not electricity. Think of it in this way – if there were an investor-owned gas distribution company counterpart to Con Edison, as there are in many cities around the US, we would not be discussing the MGP issue in an electric rate case. This is a gas-driven cost, and it should be recovered from gas customers.

Q. What has Con Edison said about the rate treatment of the MGP issue?

A. The Company's response can be paraphrased as: "We've always done it that way. Why change?" The specific language responding to our question, NYPA 49, was as follows: "This is the Company's understanding of longstanding Commission practice absent circumstances that would justify a different allocation. We see nothing in this rate filing that would justify deviation from this longstanding practice."

Q. Do you see any reason to deviate from this "longstanding practice"?

A. Yes, we do. Early in this testimony we referred to the very high current level of Con Edison's rates even before the proposed increase. This, the treatment of MGP costs, is one more example of the company loading as much cost into as short a time period as possible. We believe the Company should be looking for ways to get costs off the electric customers, not keep piling them on.

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Q. Please summarize the impacts of your proposed adjustments to Con Edison's rate base.

A. Combining our recommendations of a \$178 million reduction with respect to cash working capital and the \$382 million reduction of negative EBCAP, we recommend that the requested rate base for the rate year 2006 be reduced by \$560 million. This adjustment to requested rate base would reduce Con Edison's rate increase request, based on its requested cost of capital, by approximately \$68 million. This, of course, is in addition to the earlier proposed cuts in rate base due to reduced construction expenditures.

Q. Please summarize your recommendations with respect to Con Edison's overall revenue requirements.

A. We have recommended reductions to Con Edison's overall revenue requirements in six areas: rate base reductions due to reduced construction, operations and maintenance expense, depreciation, appropriate level of transmission congestion credits, treatment of the Manufactured Gas Plant and rate base reductions due to working capital adjustments and the elimination of the EBCAP. We estimated the impact of a one-third cutback in the increases in construction expenditures as a revenue requirement reduction of at least \$200 million. Reducing O&M expense would add another \$150 million of reduction. The depreciation expense reduction is \$100 million, the transmission congestion credit is \$86.5 million, the MGP expense reduction is \$41.6 million and the revenue requirement impact of the two adjustments to rate base is \$68 million, summing to a total revenue requirement reduction of \$646 million.

XII. DEMAND SIDE MANAGEMENT PROGRAM COSTS

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Q. Is Con Edison proposing to change their methodology for allocating costs associated with their demand side management programs?

A. Yes. Con Edison is proposing to recover program costs from NYPA. This is a change from the cost recovery instituted in the last rate plan.

Q. Is it appropriate to allocate DSM costs to NYPA?

A. No. NYPA has conducted an aggressive DSM program for many years. In fact, since 1991, NYPA has completed more than 1,200 DSM projects at a cost of over \$700 million. NYPA has a long term agreement with its customers to finance at least \$100 million of DSM projects annually through 2017. Consequently, NYPA customers are already paying for and have access to DSM programs. It would be inappropriate to allocate additional Con Edison DSM program costs to the NYPA customers, as it is unlikely that NYPA customers could participate in both the NYPA and Con Edison programs. Additionally, because NYPA has offered a comprehensive DSM program for more than 15 years, it is likely that much of the potential savings available from NYPA's customers has already been achieved through NYPA's program.

Q. What is the impact on NYPA's potential price increase?

A. Con Edison is proposing \$103 million in program funding, an additional \$10 million in administrative funding and potentially \$36 million in incentives over the three year rate period. These amounts are in addition to the \$1.225 billion base rate increase (for the first year). Included in the base rate increase is \$9.3 million in program labor costs. Con Edison proposes to allocate these costs on an per kWh basis. Allocating the estimated \$160 million based on the 2005 ECOS kWh sales allocators would result in \$28.4 million of additional costs being assigned to NYPA over the three year rate period.

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1 **Q. Has Con Edison provided details of its proposed programs?**

2 A. No. Con Edison simply describes the types of programs: 1) programs to achieve demand
3 reduction through permanent energy efficiency for targeted T&D deferral; 2) programs
4 designed to reduce demand through the Company's service territory and; 3) development of
5 new initiatives. Both types of programs are expected to provide permanent load reductions.

6 **Q. Based on the two types of programs described by Con Edison, is it appropriate to**
7 **allocate the program costs on a per KWh basis?**

8 A. No. The programs are designed to reduce demand and will thus reduce demand based
9 costs. Consequently, if any costs were to be allocated to NYPA, it would be more
10 appropriate to use a demand based allocator.

11 **Q. Is Con Edison's proposed shareholder incentive mechanism appropriate?**

12 A. No. There are two aspects of the shareholder incentive mechanism that are particularly
13 troubling. First, the mechanism is asymmetrical. While it may be appropriate to provide
14 shareholder incentives for meeting or exceeding aggressive DSM targets, it is equally
15 appropriate for there to be penalties for failing to achieve the targets. Con Edison's proposal
16 is to accrue an incentive for every MW achieved regardless of whether it is achieved in a
17 cost effective manner or whether Con Edison meets its DSM targets.

18 Second, the calculation of the proposed incentive is problematic. Con Edison proposes to
19 receive 20% of the net resource benefits for MW achieved up to its annual goal and 30% of
20 the net resource benefits for MWs in excess of its annual goal. Additionally, Con Edison is
21 proposing to continue the current \$22,500 per MW (adjusted upward for inflation) for
22 NYSERDA related savings and any value associated with greenhouse gas reductions. The

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1 calculation of the incentive on a net benefit basis would result in shareholder incentives in
2 excess of \$36 million assuming a benefit-cost ratio of 2.5 to 1. See Exhibit___ (NYPA-7).
3 This amount is dependent on the calculation of the benefit-cost ratio. While the costs of the
4 program may be readily discernable, the benefits are derived through assumptions of
5 achieved savings and avoided costs. Consequently, basing the incentive on net benefits will
6 result in a contentious debate over the calculation of the achieved savings and appropriate
7 avoided costs.

8 **Q. Has Con Edison indicated why such a significant incentive is required to initiate the**
9 **DSM program expansion?**

10 A. No. Many utilities nationwide, including NYPA, are operating successful and aggressive
11 DSM programs in the absence of any shareholder incentive mechanism. Con Edison has
12 not testified why an incentive mechanism is necessary for the successful implementation of
13 its programs.

14 **XIII. REVENUE ADJUSTMENT AND RATE INCENTIVE MECHANISM**
15 **(RARIM)**

16 **Q. Have you reviewed the Con Edison filing with respect to its proposed Revenue**
17 **Adjustment and Rate Incentive Mechanism (RARIM)?**

18 A. Yes, we have.

19 **Q. And what are your thoughts on RARIM?**

20 A. First, we should say that we are supportive of DSM programs, and understand and agree
21 that the Company must have incentives in place to support those programs. We disagree,

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1 though, that the incentives must be only one-way – that is, there should be some aspect of a
2 “stick” along with the “carrot” that Con Edison proposes.

3 As Con Edison Witness Rasmussen points out, RARIM should not be viewed as a purely
4 stand-alone mechanism. We think it is particularly important to view RARIM in the context
5 of yet another “profit assurance mechanism,” with which this case is replete. By decoupling
6 sales from revenue, except for weather and new customers, Con Edison further insulates
7 itself from earnings volatility. In light of all of the various other mechanisms designed to
8 insulate Con Edison from market risks, an approval of the proposed RARIM should be
9 coupled with a significant reduction in the allowed return on equity, which appears to be
10 becoming much more like a “guaranteed return on equity,” as discussed earlier in our
11 testimony. We note that in a very recent case involving the Potomac Electric Power
12 Company (“PEPCO”) before the Maryland Public Service Commission, in one of the few
13 cases of an electric utility in the US that has had a decoupling mechanism approved, the
14 allowed ROE was decreased by 50 basis point (0.50%) specifically associated with the
15 implementation of the decoupling mechanism.

16 **Q. What are your thoughts regarding the specifics of the RARIM proposal?**

17 A. Con Edison, we think, provides a mixed message to its customers in advocating economic
18 development, with its attendant electric demand growth, which operates at cross-purposes
19 with the avowed intention of a decoupling mechanism.

20 **Q. Do you have further thoughts on RARIM?**

21 A. Yes. Con Edison proposes to perform decoupling on a per-customer basis, normalized for
22 weather. Thus, they intend to “remain at risk” for any variation in sales calculated to be due
23 to weather, but will surcharge to customers any positive or negative amount due to most
24 other variations in sales. It is unclear why Con Edison seeks to adjust the RARIM for

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1 weather related variations in sales. Witness Rasmussen argues that Con Edison requires
2 whatever “excess revenues” are produced during periods of hot weather to pay for
3 investments needed to support summer peak loads. However, the rates themselves are (or
4 should be) designed to do just that. No other electric decoupling mechanism to our
5 knowledge has had a weather “carve out”, and it is unclear why RARIM should.

6 Also, we are troubled by the proposed treatment of NYPA and EDDS as a class with 1
7 customer each for the purposes of calculating the RARIM surcharge. The effect of this
8 approach is to “lock in” NYPA and EDDS revenues – any changes in usage will flow directly
9 into a RARIM adjustment. This will have a particularly deleterious effect on DSM activities
10 for NYPA customers. Any reduction in usage will flow directly through the RARIM
11 mechanism, resulting in an offsetting surcharge, completely eliminating the economic
12 incentive to the customer.

13 Also, the proposed RARIM allows Con Edison to retain revenues associated with economic
14 development activities, and with the development of certain, unspecified “environmentally
15 sound” programs. What the Company is essentially proposing is a mechanism that allows
16 them to retain the benefits of load growth, while insulating themselves from risks associated
17 with reduction in load.

18 Finally, NYPA has had its own DSM program in place for many years. As described above,
19 it invests significantly in DSM activities on behalf of its customers. Con Edison’s proposed
20 RARIM mechanism will result in a surcharge to NYPA exactly offsetting the savings flowing
21 from these DSM efforts, and therefore should not be approved.

22 **Q. Does this conclude the Panel’s testimony?**

23 **A.** Yes, it does.