

JOHN PERKINS - STEAM

1

2 Q. Please state your name and business address.

3 A. My name is John Perkins and my business address is 4

4 Irving Place, New York, NY 10003.

5 Q. By whom are you employed and in what capacity?

6 A. I am Director, Corporate Finance, for Consolidated

7 Edison Company of New York, Inc. ("Con Edison"

8 "CECONY" or the "Company").

9 Q. Briefly describe your educational background.

10 A. I graduated from MIT in 1972 and received B.S. degrees

11 in Economics and Civil Engineering. I received M.A.

12 and M.Phil. degrees in Economics from Yale University

13 in 1974 and 1975, respectively. I took several

14 additional graduate courses in Finance from New York

15 University.

16 Q. Please summarize your professional background.

17 A. I joined Con Edison in 1982. My previous positions

18 have been as Director, Financial Administration,

19 Director, Corporate Planning, Director, Financial

20 Services, and Manager, Financial Services. Prior to

21 joining Con Edison, I was employed by Chase

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1 Econometrics/Interactive Data from 1980-1982 and by
2 the Graduate School of Business of Columbia University
3 (1976-1979), where I taught courses in economics and
4 transportation.

5 Q. Please describe your current responsibilities.

6 A. My responsibilities include preparing the cash
7 forecast and planning and executing financing for
8 Consolidated Edison, Inc. ("CEI"), and its
9 subsidiaries, including Con Edison and Orange and
10 Rockland Utilities, Inc. ("Orange & Rockland"). In
11 addition, I manage the relationships with credit
12 rating agencies and undertake various financial
13 analyses.

14 Q. Have you previously sponsored testimony before
15 regulatory bodies?

16 A. Yes. I have sponsored testimony in Con Edison steam
17 (05-S-1376 and 07-S-1315) and gas (06-G-1332) base
18 rate cases.

19 I have also sponsored testimony on capitalization and
20 cost of capital for Orange & Rockland in Cases 06-E-
21 1433, 05-G-1494, 07-E-0949, and 08-G-1398, in the

1 matter of the securitization of certain deferred
2 balances and testimony on capital structure and rates
3 of return for Rockland Electric Company ("RECO") (a New
4 Jersey public utility subsidiary of Orange & Rockland)
5 before the New Jersey Board of Public Utilities, and on
6 rates of return and capital structure for Pike County
7 Light & Power Company ("Pike") (a Pennsylvania public
8 utility subsidiary of Orange & Rockland) before the
9 Pennsylvania Public Utility Commission.

10 Q. What is the purpose of your testimony?

11 A. My testimony discusses (1) the current financial
12 market environment, (2) the historic and projected
13 capital structure of CECONY and the cost of capital,
14 the current credit ratings of CECONY, the methodology
15 used by the rating agencies to determine these
16 ratings, the rating agencies' comments as to the
17 strength of key financial ratios of CECONY, and the
18 potential impact of reduced ratings. Finally, I
19 discuss the rate treatment of Directors' and Officers'
20 insurance costs.

21

1 notch rating changes over a very short period of
2 time.

3
4 In fact, in the same article (on page 8) Moody's is
5 less than sanguine about the future:

6
7 A second big risk stems from the sector's heavy
8 reliance on unfettered access to the capital
9 markets as a component of its liquidity. The
10 capital markets have accepted this reliance over
11 many decades, and many utility issuers have been
12 all but untouched by the recent and ongoing
13 turmoil in the financial markets. Even so, the
14 reliance on third-party financing remains a
15 critical risk factor—especially as numerous bank
16 credit facilities expire over 2011-2012. The
17 increasing burden on our overall liquidity
18 analysis may eventually stop us from assuming the
19 sector has unfettered access to the capital
20 markets. The dramatic changes in credit
21 availability and the financial institutions
22 require some caution. We believe utilities will
23 see their available borrowing capacity decrease,
24 possibly by as much as 25%-30%; that tenors will
25 shorten, with two-year facilities more widespread
26 than five-year; and that pricing will be
27 substantially higher than today.

28
29 We believe the turmoil impacting the financial
30 institutions will remove about 30% of the utility
31 industry's current available credit which will
32 drop overall liquidity capacity to roughly \$77
33 billion from about \$110 billion—a drop of about
34 \$30 billion. That is a lot of credit capacity
35 coming out of the system.

36
37 Q. Does this Moody's report reiterate its view of
38 the centrality of the regulator to its credit

1 determinations for the industry?

2 A. Yes. On page 5, it states:

3 Because the regulatory benefit is so critical
4 to our ratings, it tends to represent the most
5 important risk factor. While we continue to
6 consider regulatory risk a lower risk today,
7 we believe there are potential longer-term
8 regulatory risks that could emerge on two
9 fronts: Regulatory support for timely recovery
10 could erode; and

11 Regulators could reduce the authorized returns on
12 investments, based on the perception that utilities
13 have lower business risks than other industrial
14 sectors and will find it easier to compete for
15 capital.

16
17 Theoretically, regulators could attack the standard
18 cost of capital arguments that assert competitive
19 ROEs and other returns are necessary to attract
20 capital. Our concern is that regulators could
21 attempt to modify their views on the appropriate
22 returns, since the sector's leverage is already
23 benefited by regulation.

24
25 Q. Are there other markets needed by United States
26 utilities where the effect of the crisis persists?

27 A. Yes. As described by Moody's above the bank loan
28 market has significantly deteriorated, a condition
29 which is likely to persist for some time. Prior to the
30 crisis utilities such as Con Edison were able to
31 arrange a 5-year revolving credit facility with

1 minimal upfront fees (amortized at a basis point or so
2 a year) and annual facility fees in single digit basis
3 points.

4 Today, 5-year facilities are not available and 2-year
5 facilities have facility fees and upfront fees many
6 multiples of what they were. The penalty for having a
7 lower credit rating has also increased.

8 Q. Why are bank revolving-credit facilities important to
9 the Company's financing plan?

10 A. There are four purposes for bank credit facilities in
11 the funding of a utility company like Con Edison.
12 First, the facility directly or indirectly provides
13 the liquidity that allows the Company to raise long-
14 term financing when desirable, not when it has to.
15 This aspect of the facility saves customers money
16 because it eliminates the need to pre-fund spending
17 and reduces the likelihood of funding at the worst
18 times in the market. Second, the facilities allow the
19 Company to issue letters of credit, necessary for it
20 to manage the portfolio of electricity and natural gas
21 purchases made in the wholesale and financial markets

1 on behalf of customers and to keep low-cost variable
2 rate tax-exempt bonds outstanding. Third, the
3 facility is the source of liquidity that assures
4 purchasers of our commercial paper that they will be
5 repaid. This "back up" function permits the Company to
6 access a low-cost source of funds for the day-to-day
7 operation of the business. Finally, the facilities
8 assure the rating agencies that the Company can meet
9 its obligations even if it loses access to the capital
10 markets for a period of time (and thus factors into
11 the credit ratings for the Company).

12

13

14

CAPITALIZATION AND COST OF CAPITAL

15 Q. What capital structure do you recommend should be used
16 in this proceeding?

17 A. I recommend the use of the stand-alone capitalization
18 of CECONY in this proceeding.

19 Q. Please describe the stand-alone capitalization.

20 A. Stand-alone capitalization refers to the actual
21 capital structure of CECONY.

1 Q. Does this initial capital structure plus projected
2 financings represent the expected actual investment of
3 capital in the Company?

4 A. It does.

5 Q. Has the Company prepared a rate of return required
6 exhibit?

7 A. Yes. The document entitled "CONSOLIDATED EDISON
8 COMPANY OF NEW YORK, INC. - RATE OF RETURN REQUIRED
9 FOR THE RATE YEAR - TWELVE MONTHS ENDING SEPTEMBER 30,
10 2011," set forth as Exhibit __ (AP-10).

11 Q. Did you provide the interest rate forecasts used as a
12 basis for the cost of debt in this Exhibit?

13 A. Yes.

14 Q. What method have you used to develop interest rate
15 forecasts?

16 A. I used forecasts (based on the consensus of more than
17 fifty economists) of Treasury rates from the
18 publication Blue Chip Financial Forecasts, plus a
19 spread to Treasuries based on current spreads for a
20 new Con Edison issue as supplied by Citigroup, an
21 experienced underwriter of Con Edison debt. For the

1 period until the end of 2010, I applied the Treasury
2 rate forecasts from the November 2009 edition of the
3 Blue Chip Financial Forecasts. For 2011, I used the
4 forecasts from the June 2009 edition (the latest
5 available) of the Treasury rate longer-term forecast.

6
7 At the update stage of this proceeding, I will reflect
8 the most recent data available as well as any new debt
9 that the Company may have issued by that time.

10 Q. Do you have a recommendation for the treatment of
11 variable rate (variable rate demand notes and auction
12 rate notes) tax-exempt debt?

13 A. Yes. I recommend that the true-up of the debt costs
14 for these issues that was established in the 2008
15 electric rate case, and recommended by Staff in the
16 current electric rate case, be continued.

17 Q. If the Commission were to adopt a true-up, what should
18 be included in the true-up?

19 A. The difference between the rates actually prevailing
20 during the rate year and the interest costs set for
21 the tax-exempt debt in this case. The true-up would
22 also be applied to credit support costs such as

1 letters of credit or insurance. In addition, each of
2 the existing issues has associated unamortized
3 issuance costs (representing underwriting fees,
4 insurance premiums, and other costs from the time of
5 issuance). If CECONY decides that calling these
6 issues will reduce total costs or because of
7 government, legal or regulatory requirements to do so,
8 the issuance costs should be amortized over the
9 shorter of the remaining life of the refunded issues
10 or the life of the new issues. The actual cost of the
11 replacement debt issues (including issuance costs and
12 any credit support) and the new interest rate should
13 be trued-up as well.

14

15 **CAPITAL NEEDS AND INVESTOR CONCERNS**

- 16 Q. Please describe the financial challenges facing the
17 Company over the rate period.
- 18 A. The Company faces four inter-related financial
19 challenges (A) the capital intensive nature of its
20 business, (B) its unusually weak cash flows, (C) the
21 restrictions that regulation places on its ability to

1 respond to unfavorable developments in its
2 environment, and (D) its dependence on the market to
3 fund its capital needs.

4 Q. Please discuss the capital intensive nature of the
5 Company's business.

6 A. The Company's business requires significant capital
7 investment every year, its assets are long-lived and
8 the underlying technology, facilities and customer
9 base are mature.

10 Capital intensity is high for electric, gas and steam
11 utilities. According to a recent EEI report, the
12 electric utility industry is second only to railroads
13 in capital intensity. The Company's intensity is all
14 the greater because it serves an urban area. Its
15 capital intensity can be demonstrated by the fact that
16 its ratio of net plant per dollar of revenues is \$1.54
17 versus \$0.62 for the average S&P 500 company and \$.20
18 for the median company. Capital intensity creates
19 extra risk for investors because capital intensive
20 businesses have to recover much larger fixed costs
21 (interest and depreciation) before achieving a return.

1 CECONY also has extraordinarily long lives for its
2 assets. In fact, the United States Securities and
3 Exchange Commission ("SEC") recently questioned the
4 Company about the appropriateness of assuming such
5 long lives. Long-lived assets in the context of rate
6 regulation create two financial challenges for the
7 Company that are also risks for potential investors in
8 the Company's debt and shares. First, their
9 investment horizons for capital recovery must be much
10 longer. For debt investors, utility debt has much
11 longer average maturities than other companies.
12 Equity investors must wait for long-term repayment on
13 their investment. Second, there is a regulatory risk
14 in long-lived assets because U.S. rate regulation
15 limits returns to a fraction of historic tangible book
16 cost rather than replacement or current market value.
17 The Company's depreciation recoveries, which reflect
18 historic tangible net book values, are small relative
19 to its current capital costs, returning only 28% of
20 its capital expenditures in the form of depreciation.
21 Due to the long depreciation lives established in

1 rates, this dynamic is likely to continue for many
2 years. By way of comparison, the average S&P 500
3 company recovered 170% of its capital expenditures
4 through depreciation and amortization. This placed Con
5 Edison in the bottom 5% of companies in the S&P 500
6 that had meaningful recovery rates (placing 464th out
7 of 485 companies). It had the second-lowest recovery
8 rate among the 33 utilities in the S&P 500. The
9 average recovery rate for the S&P 500 utilities index
10 was 48%.

11 The Company's large installed base of aging equipment
12 requires an unrelenting investment in replacement
13 assets. In other industries a much larger portion of
14 investment can be dedicated to new business
15 (generating offsetting revenues) or new technology
16 (lowering costs). Mature assets raise operating costs
17 and increase operating risks, particularly in an
18 environment which requires the highest level of
19 reliability and imposes regulatory penalties for
20 failing to achieve it with no corresponding
21 opportunities to earn rewards for better performance.

1 The technology of the business is also mature,
2 affording little opportunity to significantly reduce
3 invested capital in the business through technological
4 innovation. The need for continuous investment to
5 maintain and improve the system with slight
6 opportunities for demand growth and limited
7 depreciation cash flow means that the Company must
8 seek rate increases and raise new capital to maintain
9 its operations. Replacement capital needs alone
10 substantially exceed the cash generated through
11 depreciation recoveries for the Company. Over the next
12 three years, CECONY will spend well more than six
13 billion dollars in capital investment to replace or
14 upgrade existing facilities versus two and a half
15 billion dollars in depreciation recovery.

16 Investors perceive dependence on regulatory rate
17 increases and continuous access to the market as
18 significant risks, as discussed in the Moody's quote
19 above.

20 Q. Please describe how (B) the Company's unusually weak
21 cash flows present a financial challenge.

- 1 A. The Company is, and will continue to be, challenged by
2 its unusually weak cash flows as compared both to
3 other businesses and other utilities. Three factors
4 produce this outcome: (1) the Company receives low
5 depreciation recoveries relative to its capital
6 expenditures, (2) the Company has high capital
7 expenditure requirements relative to the modest growth
8 in its revenues, and (3) regulatory treatment of the
9 Company produces delays in recovering operating
10 expenses. In addition to the large capital needs and
11 modest sales growth, recoveries of operations and
12 maintenance expenses have been deferred over long
13 periods, which would not be possible without
14 regulatory treatment under SFAS 71. The \$1.6 billion
15 historic incurred capital expenditures now subject to
16 Commission review present a financial challenge to the
17 Company and a risk for potential investors in the
18 Company's debt and shares because they represent
19 significant earnings and cash flow risk for the
20 Company.
- 21 Q. Please describe how (C) restrictions on the Company's

1 business imposed by the Commission present a financial
2 challenge?

3 A. The Company is subject to several restrictions that
4 limit its ability to react to unfavorable
5 circumstances. It must provide service as demanded,
6 even if doing so entails significant investment upon
7 unfavorable terms. It cannot refuse to provide service
8 to new or unprofitable customers. It also cannot reach
9 beyond its franchised area to serve attractive new
10 customers. The Company's assets are immovable; unlike
11 those of most companies they cannot be used in a
12 different location or business, their usefulness and
13 profitability are tied to providing utility service in
14 New York. Also, unlike other companies, CECONY has no
15 meaningful ability to retain the advantages of its
16 efforts to improve its efficiency and thus lower its
17 costs of doing business for the benefit of its share
18 investors, as the Commission's rate orders remove a
19 fixed percentage upfront. Any additional efficiencies
20 achieved by management are fully allocated to
21 customers each time rates are reset.

- 1 Q. Please describe how (D) the fact that the Company must
2 continually raise capital increases risk for existing
3 and prospective investors.
- 4 A. The Company must approach the markets for additional
5 new capital on a frequent and recurring basis. Each
6 time, investors will assess the risks they would bear
7 upon investing in the Company due to the challenges
8 identified above. Their assessment of these risks is,
9 and will be, priced in the market each of the numerous
10 times that the Company seeks new capital in the years
11 ahead. To the extent that analysis of risk leads the
12 market to reduce stock price or raise interest rates,
13 the existing investors are disadvantaged and other
14 potential investors are made more wary.
- 15 Q. What is the implication of the above mentioned large
16 capital needs?
- 17 A. To raise this capital at a reasonable cost, CECONY and
18 CEI must remain attractive investments to both debt
19 and equity investors. To remain attractive to these
20 investors, CECONY must receive fair and reasonable
21 treatment from its regulators.

1 Q. How much debt does the Company have outstanding and
2 what type?

3 A. As of September 30, 2009 CECONY had \$9,465,900,000 in
4 long-term debt of which \$8,380,000,000 was unsecured
5 taxable debentures and \$1,085,900,000 was tax-exempt
6 debentures. CECONY had \$427 million of commercial
7 paper outstanding as of the date, and no balances
8 outstanding under its revolving credit facility. It
9 had letters of credit outstanding in an amount of \$339
10 million. Of this amount \$228 million consisted of
11 letters of credit backing the two CECONY tax-exempt
12 bonds.

13 Q. Who owns the debt owed by the Company?

14 A. Thousands of investment managers, insurance companies,
15 pension plans, hedge funds, banks, trust companies and
16 individuals.

17 Q. How do bond investors evaluate CECONY?

18 A. For most investors, the credit ratings assigned by the
19 SEC-recognized credit rating agencies are the
20 threshold basis for evaluating individual corporate
21 credits such as CECONY.

1 Q. What are the current ratings on CECONY debt?

2 A. The long-term debt ratings are A3, A-, and A- by
3 Moody's, Standard and Poor's ("S&P"), and Fitch,
4 respectively. The short-term debt is rated P-2, A-2,
5 and F2, respectively.

6 Q. How much consideration do the rating agencies give to
7 CECONY's regulatory environment when determining
8 credit ratings?

9 A. Because CEI and its subsidiaries are focused on the
10 energy delivery business the rating agencies' risk
11 assessment centers on the Company's regulatory
12 treatment, as stated recently by S&P:

13 For example, for a regulated transmission and
14 distribution company, regulation may account for
15 30% to 40% of the business profile score because
16 regulation can be the single-most important
17 credit driver for this type of company.
18 *Standard & Poor's New Business Profile Scores*
19 *Assigned for U.S. Utility and Power Companies;*
20 *Financial Guidelines Revised, page 6.*

21
22 Q. What led to the recent downgrades of the Company by
23 the ratings agencies?

24 A. Moody's recently downgraded the Company due to both
25 weakened financial metrics as well as a challenging
26 rate environment, as stated below:

1 The two notch downgrade reflects the financial
2 profiles of CEI, CECONY and O&R which are
3 considered weak for their previous ratings and
4 Moody's expectation that the companies are
5 unlikely to be able to significantly strengthen
6 their financial metrics in the near to medium
7 term." said Allan McLean, Moody's Vice President
8 / Senior Credit Officer. The downgrade also
9 reflects Moody's belief that CECONY and O&R will
10 continue to operate in challenging regulatory and
11 operating environments for the foreseeable
12 future. In the context of a weak economy, Moody's
13 believes that recent and future regulatory
14 decisions are unlikely to permit any significant
15 improvement in the companies' financial metrics
16 as regulators attempt to limit the impact of
17 rising cost pressures on ratepayers.
18 *Rating Action: Consolidated Edison Company of New*
19 *York, Inc. (June 29, 2009), page 1*
20

21 Q. How does Moody's view the current regulatory
22 environment for CECONY?

23 A. Moody's described the environment as challenging:

24 Moody's believes that CECONY's regulatory
25 environment has become more challenging in recent
26 years. Our view reflects the steady decline in
27 allowed ROEs as evidenced by the decline in the
28 allowed ROE in CECONY's electric business from
29 the 11.1% that existed through most of the 1990s
30 and the early part of this decade to the 9.1%
31 authorized for the 2009 rate year. While CECONY's
32 allowed electric ROE has increased to 10% for the
33 2010 rate year, the lower level relative to
34 periods prior to the 2006 rate year, will have a
35 negative impact on CECONY's cash flow generating
36 abilities all else being equal.
37 *Credit Opinion: Consolidated Edison Company of*
38 *New York, Inc. (June 30, 2009), page 2*
39

1 They also reacted adversely to the \$60 million
2 austerity program imposed on the Company by the
3 Commission in CECONY's latest electric rate case:

4 Moody's also considers the PSC's requirement that
5 CECONY implement a \$60 million austerity program
6 in connection with its electric rate decision for
7 the year ending March 31, 2010 to be symptomatic
8 of a less constructive regulatory environment.
9 *Credit Opinion: Consolidated Edison Company of*
10 *New York, Inc. (June 30, 2009), page 3*
11
12
13
14

15 Q. What did Moody's say would cause a downgrade to occur?

16 A. Moody's stated:

17 CECONY's ratings could be negatively pressured if
18 there is more deterioration in its financial
19 profile. *Credit Opinion: Consolidated Edison*
20 *Company of New York, Inc. (June 30, 2009), page*
21 *5.*
22
23

24 In the same article Moody's stated that they do not
25 consider it likely that ratings could be upgraded in
26 the near-term.

27
28 While Moody's does not consider it likely in the
29 near-term, an upgrade in CECONY's rating would
30 likely require evidence of a less challenging
31 regulatory environment combined with a
32 strengthening of CECONY's credit metrics
33

1 Q. What does Fitch say about the financial ratios and
2 ratings?

3 A. In their "Fitch Comments on NYPSC Rate Decision for
4 Con Edison Co of New York" (23 Apr 2009) Fitch states:

5
6
7 The good news for investors is the announced
8 return on equity (ROE) of 10%, which on the
9 surface appears to offer a boost from the
10 9.1% allowed a year earlier in a punitive
11 rate order. However, the base rate increase
12 allowed will not enable CECONY to earn a 10%
13 ROE unless the company can succeed in
14 reducing expenses by \$60 million from the
15 company's projected level. In Fitch's
16 estimate, if the company cannot deliver the
17 expense cut, the ROE might only equate to
18 around 9.5%.

19
20 and

21 In addition to the base rate increase, the
22 PSC authorized a temporary increase of \$198
23 million in order to compensate CECONY for
24 new assessments that the State of New York
25 has imposed on utilities in the state to
26 address state budget deficiencies. The
27 assessment is so recently imposed that it
28 was not factored into CECONY's original
29 request or subsequent September 2008 revised
30 application. While it is helpful that CECONY
31 will be able to recover this new and
32 unexpected tax, the bad news is that the
33 utility will collect revenues for New York
34 State rather than base rates that compensate
35 investors.

1

2 Q. Why are allowed returns on equity and allowed equity
3 as a proportion of the capital structure important to
4 debt investors as well as equity investors?

5 A. Debt investors are concerned about the amount of
6 equity subordinate to them in the capital structure
7 and the returns available for stockholders for two
8 primary reasons. First, if a company is able to
9 attract new stock investment, it increases the debt
10 investors' likelihood of being paid interest and
11 principal when due. Second, returns for stock
12 investors provide a cushion when the business is
13 struggling. In difficult times, cash payments to this
14 part of the Company's capital can be suspended until
15 the business improves.

16 Q. Are bond ratings the correct indicator of the risks to
17 shareholders?

18 A. No. Shareholders, unlike bondholders, only have a
19 residual claim to the resources and income of the
20 Company, and thus face risks even in well-rated
21 companies. If returns are inadequate, the bondholder

1 may suffer a loss from a credit downgrade. The
2 stockholder will suffer the loss directly. Efforts by
3 the Commission to limit the upside potential of the
4 shareholder through the elimination of incentives and
5 other opportunities, combined with the removal of
6 true-ups and implementation of enhanced penalties
7 exacerbate the effect of lowered allowed returns.

8
9 Q. Please comment on recent events and how they have
10 reinforced the need for a strong financial condition
11 at CECONY.

12 A. The recent turmoil in the financial markets, which has
13 no source in the operations of the Company or of the
14 utility industry, is indicative of the volatility of
15 the cost and availability of capital. Long-term bond
16 spreads had widened by as much as 400 basis points for
17 very good credits and many hundreds more for poorer
18 credits. On the short end of the maturity spectrum,
19 access to commercial paper markets became difficult or
20 sometimes impossible for all but prime borrowers, a
21 status that has become more tenuous for CECONY due to
22 its A-2/P-2 (Standard and Poor's/ Moody's) rating for

1 commercial paper. At the height of the crisis, A-2/P-2
2 borrowers generally did not have access to commercial
3 paper borrowings. The few that did paid rates more
4 than 300 basis points above those paid by A-1/P-1
5 borrowers.

6 The seizing up of the commercial paper market was
7 relieved by the Federal government's effective
8 backstop for the highest rated (A-1/P-1) commercial
9 paper issuers. This backstop—together with reduced
10 issuance by asset-backed vehicles and corporations—has
11 allowed the commercial paper market to improve over
12 the past several months. Today even a relatively small
13 and less well-rated issuer, such as Orange & Rockland
14 again has access to commercial paper borrowing. There
15 is a significant risk on the horizon for the
16 commercial paper market. Several large investment
17 managers asked the SEC to prohibit money market funds
18 from investing in commercial paper rated A-2 or P-2.
19 If the SEC were to institute this prohibition,
20 CECONY's access to the commercial paper market could
21 be compromised.

1 If CECONY lost access to the commercial paper market
2 borrowing costs would increase as the Company relied
3 more upon long-term debt, which is more expensive. In
4 addition, the Company would more often issue debt on
5 less attractive terms because it lacked the
6 flexibility to postpone issuance. The recent past has
7 demonstrated how important maintaining a strong credit
8 rating and investor confidence can be.

9 Q. In the Company's 2007 electric rate case (Case 07-E-
10 0523) did the Staff Finance Panel make assertions
11 concerning the ability of the Company to maintain
12 its credit ratings in the face of that Panel's
13 recommendations?

14 A. Yes, they did. In their testimony (p. 66) they
15 asserted that the credit metrics would continue to
16 support an A rating. In fact, they speculated that
17 the addition of a regulatory decoupling mechanism
18 ("RDM") for the electric business might even lead to
19 an upgrade. Of course no such mechanism has been
20 granted to the highly weather-dependent steam
21 business.

1 Q. Were they correct in their assertion?

2 A. They were not. Standard and Poor's dropped the entire
3 CEI group by one notch and Fitch by two notches.
4 Moody's placed the entire CEI group on Negative
5 Outlook. So while CEI and the competitive businesses
6 have never reduced the utilities' credit quality, the
7 Commission's rate decisions for CECONY have
8 demonstrably hurt CEI and the competitive businesses'
9 credit quality.

10 Q. Did the Staff' Finance Panel make assertions
11 concerning the ability of the Company to maintain its
12 then-current credit ratings in the 2008 electric
13 case?

14 A. Yes, they stated (p. 45):

15 We believe that our capital structure
16 recommendations should be adequate to maintain
17 ratings for its senior unsecured debt
18 obligations within their respective "A"
19 categories.

20

21 Q. Were they correct in their assertion?

1 A. No. In June 2009, on the heels of the Commission's
2 rate order for CECONY's electric service, Moody's
3 dropped the ratings of the Company and its
4 affiliates by two notches.

5 Q. Is the Company in danger of further ratings
6 decreases, with correspondingly higher debt costs at
7 all times and reduced access to markets in time of
8 crisis?

9 A. Yes. Low allowed rates of return and a reduction in
10 the ability to actually earn those rates of return
11 place continued pressure on cash flow coverages of
12 interest and debt, already cited as weaknesses by
13 the credit rating agencies. In addition, the
14 agencies perceive such actions as signs of a
15 deteriorating regulatory environment and are less
16 tolerant of the Company's mediocre cash flow ratios.

17 Q. Please discuss how Moody's now views the New York
18 regulatory environment.

1 A. On pages 2 and 3 of Credit Opinion - Consolidated
2 Edison Company of New York, Inc." (June 30, 2009)
3 Moody's states:

4
5 Moody's believes that CECONY's regulatory
6 environment has become more challenging in recent
7 years. Our view reflects the steady decline in
8 allowed ROEs as evidenced by the decline in the
9 allowed ROE in CECONY's electric business from
10 the 11.1% that existed through most of the 1990s
11 and the early part of this decade to the 9.1%
12 authorized for the 2009 rate year. While CECONY's
13 allowed electric ROE has increased to 10% for the
14 2010 rate year, the lower level relative to
15 periods prior to the 2006 rate year, will have a
16 negative impact on CECONY's cash flow generating
17 abilities all else being equal.

18
19 Moody's views the PSC's ongoing audit of
20 approximately \$1.6 billion of CECONY's
21 electricity capital spending during the 2006-2008
22 rate years as evidence of a potentially more
23 challenging regulatory environment. Moody's notes
24 that while the PSC has approved the collection of
25 approximately \$237 million of revenue for the
26 rate year ended March 31, 2009 and \$254 million
27 for the current rate year in connection with
28 these expenditures, those revenues are subject to
29 refund in the event that the PSC concludes that
30 all or a portion of the capital spending was
31 imprudent. If any portion of these revenues is
32 ultimately clawed back, CECONY's financial
33 profile would be adversely impacted and, more
34 importantly, Moody's would view this as further
35 evidence of less constructive relations with the
36 company's key regulator. Should this occur,
37 Moody's expects that negative rating actions for
38 CECONY, CEI and O&R could follow.

- 1
2 Q. Has Moody's quantified its view of New York
3 regulation?
- 4 A. Yes. In its August 2009 rating methodology
5 publication "Regulated Electric and Gas Utilities"
6 it breaks down the ratings factors contributing to a
7 particular company. For each factor it assigns a
8 letter rating with the same scale as its corporate
9 debt ratings. Among the factors it analyzes is
10 Regulatory Supportiveness.
- 11 Q. What rating does it give to Regulatory
12 Supportiveness for CECONY?
- 13 A. It gives a Baa rating, which, along with the
14 relatively weak CECONY financial ratios, puts
15 pressure on the maintenance or improvement of
16 CECONY's debt ratings.
- 17 Q. Please explain why it is important for Con Edison to
18 maintain its current debt ratings.

1 A. First, the Company has a significant continuing
2 construction program which must be met in large part
3 by debt financing. As witness Hevert discusses, the
4 cost differences between companies with different
5 credit ratings remain wide. More important, the risk
6 remains that access to credit markets will be
7 restricted for lower quality credits.

8 In addition, a part of Con Edison's financing
9 program is made up of short-term borrowing through
10 its commercial paper program. Such borrowing is
11 highly sensitive to credit quality and credit market
12 conditions.

13 Q. Have there been any other impacts from the drop in
14 Con Edison's debt ratings besides increases in
15 financing costs?

16 A. Yes. Under current NYSERDA rules, Con Edison cannot
17 issue or remarket tax-exempt debt unless either the
18 Company or a credit support provider is rated at
19 least A, by S&P, A2 by Moody's, or A by Fitch, or
20 the debt is supported by a letter of credit or

1 insurance that has one of these ratings. Con Edison
2 does not qualify due to its current ratings. In
3 turn, the traditional bond insurers have suffered
4 drastic ratings reductions or are unable to insure
5 Con Edison debt. Letters of credit are very
6 difficult to arrange at reasonable prices, and make
7 tax-exempts uneconomic.

8 Q. Who owns the Company?

9 A. CECONY has one shareholder, CEI. CEI in turn is owned
10 by 72,000 registered shareholders. Registered
11 shareholders are the individuals or businesses whose
12 names are listed on the shareholder register of CEI.

13 Q. What are the characteristics of the registered
14 shareholders?

15 A. Institutional investors owned approximately 43% of
16 CEI's 275 million shares outstanding as of September
17 30, 2009, while individuals owned 57%. Institutional
18 investors often own shares for the benefit of others.
19 These investors purchase CEI shares for the benefit of
20 their investors who, in turn, may be pension funds and
21 individual investors. Since pension funds exist for

1 the benefit of the individual participants in their
2 plans, it makes sense to think of the ultimate
3 beneficiaries of share ownership in CEI and
4 derivatively in CECONY of being millions of
5 individuals who may own shares directly, invest in
6 U.S. stock mutual funds, or receive or expect benefits
7 from pension plans or life insurance policies.

8 Q. What do these people who own the Company provide to
9 it?

10 A. They provide the capital that the Company needs above
11 and beyond what debt investors are willing to provide.
12 Their capital allows the Company to use the goods,
13 wages, services and borrowings that bring safe,
14 reliable energy utility service to the Company's
15 customers. Without these share investors, the
16 Company's customers would have to pay currently for
17 all of the costs of the services they receive.
18 Instead, customers can delay payment effectively by
19 promising to pay these investors a greater amount in
20 the future. Therefore, instead of paying for a new
21 substation as it is constructed, for example,

1 customers can plan to pay for that asset over the
2 subsequent decades during the time they benefit from
3 its operation.

4 Q. What do these share investors expect in return for the
5 benefit customers receive from their capital
6 investment?

7 A. They expect compensation either in the form of a
8 periodic payment (or dividend) or in an increase in
9 the value of the business, or both.

10 Q. How do share investors in regulated utilities set
11 their expectations for compensation?

12 A. The return expectations of share investors in rate-
13 regulated energy utilities are grounded in the bargain
14 termed "the regulatory compact." The regulatory
15 compact's essence is that share investors forgo the
16 monopoly rents they would otherwise enjoy in return
17 for the institutionalization of their monopoly in an
18 exclusive franchise, and a fair and equitable return
19 on the capital they have invested.

1 Q. What standards exist to help share investors and
2 regulators determine whether a rate-regulated utility
3 offers a fair and equitable return?

4 A. The general standards for a fair and equitable
5 return for investors in utility shares are well-
6 established in the United States. The underlying
7 requirement for fair treatment for share
8 investors has been recognized for years. It dates
9 back to the Bluefield and Hope cases.

10 The key point is that in neither case is there a
11 specific limitation to looking only to the financial
12 health of utilities when looking at enterprises with
13 "similar risks." And, as has been pointed out many
14 times in prior New York rate proceedings, comparisons
15 to other utilities introduces an incurable circularity
16 to the assessment of an appropriate level of returns.

17 Q. How would a potential share investor evaluate the
18 return limitations on New York utilities as to their
19 magnitude, timing and probability?

20 A. There are four significant factors in an equity
21 investor's assessment of New York utility regulation:

1 (1) headline rate of return on equity, (2) the
2 likelihood of earning that return, (3) the symmetry of
3 potential earned equity returns, and (4) the
4 restrictions the regulator places on the scope of the
5 business. To make this assessment, a potential share
6 investor will start with the basic parameters of the
7 rate orders from the state.

8 Q. How is the first identified return consideration
9 addressed by New York rate orders?

10 A. The first factor, the level of returns on equity, is
11 important for an equity investor because it provides
12 the most visible indication in the rate order of the
13 regulator's willingness to balance the needs of
14 investors and customers.

15 Q. Can investors readily measure the degree to which a
16 regulatory regime fairly rewards share investors?

17 A. In New York, yes. The Commission has a clear and long-
18 standing policy of setting returns relative to the
19 historic tangible book value of the investors' shares.
20 Information about returns on share book values for
21 publicly-traded United States companies is readily

1 available to investors from public sources as a basis
2 for comparison.

3 Q. How does Con Edison compare to this universe of
4 alternative investments?

5 A. Con Edison does not fare well in the comparison. When
6 looking at historical performance over a five-year
7 period, CEI had a return on book equity that placed it
8 in the bottom 27% of S&P companies.

9 Q. Have you prepared an exhibit to show this?

10 A. Yes, please refer to my Exhibit ___ (JEP-1).

11 Q. Are companies typically valued by investors at their
12 tangible book value?

13 A. No. Exhibit ___ (JEP-2) shows the current market
14 to tangible book ratios for those S&P companies
15 with positive book equity. CEI's market to book
16 is in the bottom 8% of this universe for this
17 important measure of investor perception of
18 prospects, even after a massive financial crisis
19 which most severely affected the financial sector
20 and other industries

21 Q. How would an investor assess the second factor: the

1 likelihood of actually earning the headline equity
2 return?

3 A. The investor would analyze the adjustments made to
4 actual Company costs that are allowed to be recovered,
5 imputed productivity that may or may not be achieved,
6 and any arbitrary "austerity" adjustments.

7 To the extent that such adjustments to real costs are
8 made, the headline rate of return is unlikely to be
9 achieved.

10 Q. How would an investor assess the third factor: the
11 symmetry of potential returns?

12 A. There is ample opportunity through penalty-only
13 performance mechanisms, an absence of any meaningful
14 positive incentives, and one-way true-ups of costs--
15 burdens which have increasingly been imposed in New
16 York rate decisions--to realize significantly worse
17 returns than the headline authorized return. All of
18 these aspects of New York rate orders create asymmetry
19 in expected returns, which a rational potential share
20 investor would judge as reducing his or her expected
21 return. We have not found evidence that these burdens

1 are common in other jurisdictions in the country,
2 where the peers that are the basis for the
3 Commission's DCF and CAPM results operate.

4 Q. Have equity investor concerns about New York
5 regulation been quantified?

6 A. Yes. New York State regulation has been ranked as
7 43rd out of 48 in terms of support for equity
8 investors (Barclay's Capital "Utilities - Capital
9 Management", July 16, 2009).

10

11

SUMMARY

12 Q. Please summarize your testimony on the financial
13 challenges for the Company.

14 A. Witness Hevert has presented the Company's case
15 calculation of a required equity return for Com
16 Edison. My testimony concerns the financial
17 challenges and the need to maintain access to
18 financial markets at reasonable cost. There is a
19 perception on the part of both equity and debt

1 investors that the New York regulatory environment
2 has become a difficult one in which to operate. Such
3 a perception, if it continues, will make financing
4 needed expenditures more expensive in normal times
5 and less certain in times of financial crises.

6 **VI. DIRECTORS AND OFFICERS INSURANCE**

7 Q. What is Directors and Officers ("D&O") insurance?

8 A. D&O insurance protects, consistent with New York State
9 law, the Company and its directors and officers from
10 claims and litigation brought against them for good
11 faith decisions made by directors and officers in
12 their corporate capacities.

13 Q. Why does Con Edison need D&O insurance?

14 A. The Company has maintained D&O insurance since 1966 to
15 transfer significant potential risk of loss from the
16 Company to stable insurers. This insurance is
17 important to the Company's effort to recruit and
18 retain qualified officers and directors to manage the
19 Company. Potential officers and directors expect D&O
20 insurance to protect against the litigation exposure
21 that attends the responsibility of boards and

1 management of companies, especially large, public
2 utility companies.

3 Q. Is D&O insurance a customary business expense for U.S.
4 public companies?

5 A. Yes. D&O insurance is essentially universal among
6 U.S. public companies. The Commission did not disturb
7 the finding by administrative law judges in the
8 Company's last electric case that more than 99% of all
9 types of companies buy this insurance.

10 Q. Is the purchase of D&O insurance a legitimate business
11 expense of the Company?

12 A. Yes. D&O insurance protects the Company and its
13 ability to provide utility service to its customers,
14 by transferring the litigation risk to its officers
15 and directors for good faith decisions to a third-
16 party carrier. The Company also purchases this
17 insurance to attract and retain qualified individuals
18 to manage the Company. There is no doubt that our
19 customers benefit from a well-managed company. The
20 universality of corporate indemnification of directors
21 and offices, and of D&O insurance to redistribute the

1 risk of such indemnity to better bearers of the risk,
2 make this type of insurance a threshold requirement to
3 the Company's ability to attract and retain qualified
4 directors and officers.

5 Q. Are there other reasons supporting the purchase of D&O
6 insurance?

7 A. Yes. Shifting this risk insulates the financial
8 stability of the Company and its ability to provide
9 utility service to its customers. If the Company
10 lacked D&O insurance, the investment community would
11 view the Company as having greater risk which would
12 increase the Company's cost of capital. That cost
13 would be reflected in higher utility rates. Though a
14 key purpose of D&O insurance is to protect the Company
15 from litigation risk, in the long run the appropriate
16 coverage level of D&O insurance keeps utility rates at
17 a level lower than they otherwise would be.

18 Q. Does the Commission recognize D&O insurance as a
19 reasonable business expense?

20 A. While the Commission adjusted recovery of this expense
21 in the last electric rate case, which the Company has

1 challenged, as discussed below, the Commission does
2 accept that D&O insurance is a reasonable business
3 expense.

4 Q. Please describe the coverage under the Company's D&O
5 insurance.

6 A. The Company purchases \$300 million of total D&O
7 insurance, which is comprised of \$250 million of
8 standard ABC coverage supplemented by \$50 million of
9 stand-alone Side A coverage. The standard policy
10 coverage contains three coverage components. Coverage
11 A protects and defends individual officers and
12 directors for claims against them should the Company
13 fail to provide indemnification. In such a case a \$0
14 deductible applies. Coverage B of the policy
15 reimburses Con Edison for all amounts incurred to
16 indemnify our directors and officers as required or
17 permitted by applicable common or statutory law, or
18 under our charter or by-laws, in which case a \$5
19 million deductible applies. Coverage C of the
20 standard policy covers Con Edison for securities
21 claims against it. A \$5 million deductible also

1 applies to Coverage C.

2 Q. Please address the types of activities covered by D&O
3 insurance.

4 A. D&O insurance protects the Company and its directors
5 and officers from claims arising from decisions and
6 actions by the directors and officers. I emphasize
7 that, under New York State law and the Company's
8 bylaws, the Company can only indemnify an officer or
9 director for an act committed in "good faith."
10 Therefore, the Company would not, as a matter of law
11 and adherence to its own bylaws, indemnify an officer
12 or director for an act not committed in good faith.
13 In other words, no claim can even be made to an
14 insurance company by the Company for reimbursement for
15 indemnification of an act not committed in good faith.

16 Q. What claims are excluded from D&O coverage?

17 A. D&O policies typically exclude claims arising out of
18 deliberate, fraudulent, criminal or malicious acts,
19 claims in which the director or officer has gained a
20 personal profit to which the director or officer was
21 not legally entitled, and claims involving any profit

1 from illegal insider trading. The policies typically
2 do not cover dishonest, inappropriate, or willful
3 criminal acts committed by directors and officers.

4 Q. What claims does D&O insurance cover?

5 A. These policies cover the typical daily good faith
6 business decisions, made by officers and directors
7 related to management and operation of the business.

8 Q. Have you prepared or caused to be prepared under your
9 direction an exhibit entitled "Consolidated Edison
10 Company of New York, Inc. - Cost for Levels of D&O
11 Insurance" which shows the cost of the Company's
12 insurance?

13 A. Yes. It is attached as Exhibit__ (JEP-3)

14 Q. Please describe this exhibit.

15 A. The exhibit shows the specific cost for each level of
16 coverage. For example, the exhibit shows that the
17 first \$235 million of coverage above the applicable
18 deductible is the sum of the first five layers of
19 coverage or \$3,536,005.

20 Q. Please describe how companies determine the
21 appropriate amount of D&O insurance coverage.

1 A. The appropriate amount of D&O insurance coverage for
2 any company is a function of many factors such as the
3 riskiness of its operations, the location of its
4 operations, the volatility of its cash flows and share
5 price, its industry sector, and the D&O loss trends in
6 that industry. Another critical factor is whether a
7 Company is a public or private company. If the
8 company is public, the size of its market
9 capitalization is a factor. An individual company's
10 evaluation of these factors determines a prudent level
11 of coverage. That evaluation cannot be reduced to a
12 simple comparison of that company's coverage with the
13 average amount of coverage maintained by companies in
14 a particular industry or with a particular market
15 capitalization.

16 Q. What steps has Con Edison taken to determine its
17 appropriate amount of D&O insurance coverage?

18 A. To make decisions as to amounts of coverage, the
19 Company obtained the advice of professionals in the
20 field. In 2005 our D&O insurance program was reviewed
21 by outside counsel (Dickstein-Shapiro-Morin) with

1 insurance expertise. Based on that firm's review, Con
2 Edison increased its overall coverage to \$300 million,
3 the level of coverage it still has today. In
4 addition, we reconfirm with our insurance brokers
5 (Willis and Marsh) that our D&O insurance costs and
6 policies are reasonable and in line with similar
7 companies.

8 Q. Do Willis and Marsh provide written confirmation of
9 this advice?

10 A. Yes. I have attached as Exhibit __ (JEP-4) letters
11 from Willis and Marsh.

12 Q. Please describe these letters.

13 A. We asked Willis and Marsh, firms with expertise and
14 knowledge of these decisions by other companies, their
15 view of our amounts of coverage. They stated that in
16 view of the Company's size, market capitalization and
17 potential exposure to D&O claims, coverage of \$300
18 million is appropriate.

19 Q. What steps does the Company take to control the cost
20 of this insurance?

21 A. Prior to each renewal the Insurance Department and

1 Senior Management review with our broker: a) the
2 current D&O market conditions; b) lists of insurance
3 carriers, those with which the Company currently works
4 and those not, which may offer a competitive choice;
5 c) the financial stability and claims-paying
6 reputation of each of these insurance carriers; d) our
7 goals for the renewal; e) other possible program
8 structures; f) coverage specifics and g) and the
9 marketing process itself. Our goal is appropriate
10 coverage terms and conditions at a fair and equitable
11 market premium from table and secure insurers. We
12 work closely with carriers to secure the most
13 competitive pricing for each level of insurance.

14 Q. What other steps does Con Edison take to test the
15 reasonableness of the financial limits of its D&O
16 coverage?

17 A. Con Edison compares its coverage with other utilities
18 to test whether our amount of coverage is within the
19 range of coverage of other American utilities roughly
20 similar to Con Edison in size.

21 Q. Does the Company's survey support its level of

1 coverage?

2 A. Yes. In 2004, the Company first gathered confidential
3 information from other large utilities on their D&O
4 coverage limits and has since repeated this survey
5 periodically. The Company's survey of large utilities
6 has the benefit of capturing two of the several
7 factors indentified as more important in determining
8 the appropriate amount of coverage for a company,
9 namely industry sector and size. I caution that
10 although these factors are important to the
11 determination of the appropriate amount of coverage,
12 they are not the basis for setting our coverage
13 limits. The survey merely tests our amount of
14 coverage. We set our coverage limits instead in
15 consultation with the professional expertise of
16 insurance brokers and outside counsel specializing in
17 the field.

18 Q. What were the results of the Company's most recent
19 survey?

20 A. In our 2009 survey, Exhibit __ (JEP-5), we found that
21 half of the fourteen utility companies—with market

1 capitalization of approximately \$10 billion or more -
2 the Company's size - secured total D&O limits of \$300
3 million or more. Our 2009 survey shows that two
4 utilities increased their coverage limits to \$300
5 million or more since the previous survey in 2006.
6 The survey also shows that the trend for utilities has
7 been to increase D&O coverage. The average coverage
8 amount in our latest survey for the fourteen utilities
9 with current market capitalization of over \$10 billion
10 is \$271 million. The median limit in our 2009 survey
11 of the fourteen utilities with a market cap about \$10
12 billion amounts to \$275 million and the mode, or most
13 frequent, limit of the fourteen in this group was \$300
14 million. The average company in the survey increased
15 its coverage by 3.9% per year from 2004 to 2009, and
16 the utilities with approximately \$10 billion or more
17 in market capitalization increased their coverage
18 limits by 4.3% per year over the same period. Growing
19 the average, median and modal coverage limits from the
20 calendar year to the rate year at the compound annual
21 growth rate of 4.3% produces implied coverage limits

1 of \$286 million, \$290 million and \$316 million.

2 Q. Please explain why you provide these figures when you
3 testify that these calculations do not form the basis
4 for the Company's decision as to what amount of
5 coverage is appropriate.

6 A. The various algebraic comparisons, which do not form
7 the basis for the Company's decision on coverage
8 limits, do tell us that our decision comports
9 generally with our peer group.

10 Q. The Company did not conduct a D&O insurance survey
11 every year since 2004. Can you comment?

12 A. Yes. The Company does not believe that an annual
13 survey is necessary. Further, the Company is unaware
14 of any industry event(s) that would have indicated
15 that survey would have been a worthwhile use of
16 resources in either 2007 or 2008.

17 Q. Please summarize the result of the steps taken to
18 assess the Company's amount of D&O insurance.

19 A. Our experts recommended and reconfirmed the amount of
20 insurance for the Company, taking all of the
21 individual characteristics of Con Edison into

1 consideration. Next, our survey shows that our
2 coverage limits are very close to the average amount
3 for large utilities. The survey also shows that of
4 the utilities in our size range, half have \$300
5 million or more in coverage. We believe it reasonable
6 that the insurance coverage for the largest American
7 distribution utility, serving the largest, most urban
8 city in the United States, should be no lower than the
9 midpoint of other large utilities.

10 Q. You mention Con Edison's characteristics. Are there
11 others you have not listed?

12 A. Yes. We also take into account the following facts
13 about the Company: a higher portion of its assets are
14 proximate to the general public, its capital needs are
15 large and ongoing, its customers and Commission hold
16 it to unequalled standards, it serves the nation's
17 financial center and it has a significant base of
18 customers in high-rise buildings for whom reliable
19 electricity service is especially critical for daily
20 life.

21 Q. Can the appropriate amount of the Company's coverage

- 1 be properly determined based on an average of other
2 utilities' coverage limits?
- 3 A. No. Using an average assumes that operating
4 circumstances, location and the numerous other
5 differences among companies have no bearing on the
6 appropriate level of D&O coverage. Such an approach
7 contravenes a ratemaking process based on each
8 utility's characteristics. Use of an average fails to
9 reflect the real costs to the Company for any expense,
10 just as using an average here fails to capture the
11 Company's reasonable costs for D&O insurance.
12 Reducing the amount of D&O insurance to a numerical
13 formula represents too simplistic an approach to a
14 more complicated undertaking.
- 15 Q. Are other elements of the Company's rates set based on
16 average costs of other utilities?
- 17 A. No, they are not.
- 18 Q. The Towers Perrin D&O survey has attracted comment in
19 the Company's recent electric cases. Could you
20 address its usefulness?
- 21 A. Interest in this survey is probably unavoidable

1 because it appears to be the only public report on
2 U.S. corporate D&O insurance practices. The report,
3 however, provides little useful information for this
4 proceeding beyond the undisputed fact of the
5 universality of this insurance. In fact, in the most
6 recent survey, issued on September 9, 2009, of the
7 2,599 participants in the survey, only 12 were
8 publicly-traded utilities, and only 6 of the 2,599 had
9 more than 2,500 employees. As to asset size, at year
10 end 2008, Con Edison had assets of \$33.5 billion, in
11 contrast to the threshold amount of \$10 billion.
12 Towers Perrin provides no information on the types of
13 assets of the participants, which could be financial
14 or intangible in nature in contrast to the Company's
15 assets physically employed in energy generation,
16 transmission and distribution in densely populated
17 urban and suburban areas. Comparing the coverage
18 limits for phantom companies, with essentially no
19 known shared qualities with Con Edison, simply cannot
20 be the means to judge the coverage limits appropriate
21 for this particular company.

1 Q. Are there any other factors which contribute to the
2 limited utility of the Towers Perrin survey to this
3 case?

4 A. Yes. Towers Perrin lacks sufficiently clear cross
5 sections of the self-selected participants in the
6 survey to link any company's coverage limits to that
7 of Con Edison. We do not know, for example, whether a
8 participant is a public or private company, whether a
9 participant is in an industry with greater or lesser
10 D&O risk or whether a participant's cash flow or share
11 price is subject to volatility. Only one participant
12 falls into the survey category of between 10,001 and
13 25,000 employees. As noted above, only twelve of the
14 companies are publicly traded utilities.

15 Q. Did the Commission in Con Edison's last electric base
16 rate case permit full recovery of D&O insurance
17 expenses?

18 A. No, as I will discuss further below. The Commission
19 authorized recovery of half of the costs of what it
20 found to be the reasonable coverage level. The
21 Company has petitioned for rehearing on this issue, as

1 has Central Hudson in its case. For the reasons
2 stated in our petition, as well as my testimony here,
3 we believe the decisions are in error and that
4 reliance on them is misplaced.

5 Q. In the Company's last electric base rate case, the
6 Commission determined that D&O coverage for Con Edison
7 should be \$200 million. Do you agree with that
8 finding?

9 A. No. That finding appears to have been based on a
10 superficial comparison of our coverage limits with
11 information misapplied from a 2007 Towers Perrin
12 survey and our survey. The Commission otherwise
13 distinguishes the operations and capital costs of the
14 State's various utilities. Individual utilities
15 should be able to consider their own circumstances
16 when determining the coverage limit for an insurance
17 policy. As described above, based on professional
18 guidance, supported by appropriate benchmarking and
19 taking into account the particular nature of this
20 Company, the limits maintained by the Company are
21 appropriate and reasonable.

1 Q. The Company was permitted recovery of 50% of the cost
2 of D&O insurance that the Commission deemed reasonable
3 (i.e., the cost of \$200 million of coverage. Do you
4 agree with this determination?

5 A. No. In its order in the Company's last electric rate
6 case, the Commission continued to recognize D&O
7 insurance as reasonable business expense. Contrary to
8 that finding, the Commission accepted arguments that
9 such an expense should be divided between customers
10 and shareholders. Consistent with the absence of a
11 rational basis for such analysis, the Commission
12 stated "no particularly good way to distinguish or
13 quantify the benefits of D&O insurance to ratepayers
14 from the benefits to shareholders."

15 Q. Is there a basis in regulatory practice for this
16 approach?

17 A. No. We are unaware of any basis in regulatory
18 practice for creating this sort of distinction between
19 the beneficiaries of insurance a utility purchases to
20 protect itself, its balance sheet and its customers.
21 The Commission's suggestion (Order, pp. 91-92) that

1 customers should bear less than the full amount of the
2 cost of D&O insurance because shareholders, not
3 customers, elect directors and officers, leads to the
4 troubling premise that rates can only reflect the
5 costs of doing utility business if customers make the
6 decision to incur them. The flaw in this approach is
7 fundamental. Customers neither manage the Company nor
8 make its decisions. There is no rational basis for
9 customers to receive service at rates that do not
10 reflect all of the costs prudently incurred by the
11 Company in providing that service. Customers and
12 shareholders benefit equally from all costs incurred
13 by the Company in order to provide safe and reliable
14 service, maintain financial health, and retain and
15 attract talented directors and officers to make the
16 decisions necessary to continue the operation of the
17 business. The Commission could not articulate a basis
18 to differentiate between these benefits because the
19 interests of customers and shareholders are
20 inextricably intertwined in this respect.

21 Q. Does this conclude your testimony?

JOHN PERKINS - STEAM

1 A. Yes, it does.