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

INITIAL BRIEF OF THE DEPARTMENT OF PUBLIC SERVICE STAFF

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November 30, 2007
Albany, New York

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I. EXECUTIVE SUMMARY

Department of Public Service Staff (Staff) respectfully submits this initial brief to the Administrative Law Judges in the Con Edison electric rate case. As will be detailed in the following pages, we believe Con Edison rates should be set for one year and that the rate increase should be no more than $642 million. We believe that the Company’s request for rates is substantially inflated in many areas and Con Edison has shown poor judgment and no restraint on spending requests, staffing requests, rate of return, and additional incentives. The Company’s filing clearly is unprecedented in scope and is in many ways unwarranted.

Staff notes that its revenue requirement figure of no more than $642 million provides for the vast majority of the infrastructure upgrades that the Company requested. In other areas involving staffing level increases, we express doubt as to whether those expenses are necessary. In any event, Staff believes that it is essential that the Company be held accountable for all levels of spending that are funded in rates. In other words, the Commission needs to provide Staff with the mechanisms necessary to ensure that: 1. all new infrastructure initiatives that are funded are actually undertaken and completed for the level of funding forecasted be Con Edison, 2. that the Company's incremental O&M to the extent allowed of as much as $280 is fully carried out, and if not, funds are retained for customers in the future, 3. that any unquantified savings to normal O&M which the company failed to reveal are captured for ratepayers, and finally, 4. that any staffing level increases funded in rates are actually fulfilled by the Company, or the funding will be set aside for ratepayers.

II. BACKGROUND

A. Procedural History

On May 4, 2007, the Consolidated Edison Company of New York Inc. (Con Edison or the Company) filed with the New York State Public Service Commission (Commission) amendments effective June 3, 2007 to its tariff schedules P.S.C. No. 9 – Electricity, P.S.C. No. 2 – Retail Access, PASNY No. 4, and Economic Delivery Service No. 2.[1] In its tariff filing, the Company proposes increases to its delivery service rates that would result in an approximate $1.225 billion, or 11.6% increase to the Company for its annual electric revenues based on forecast data for the

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1 Case 07-E-0523, Consolidated Edison Company of New York, Inc. – Rates, Order Suspending Rate Filing (issued May 23, 2007).

year ending March 31, 2009. The Commission twice suspended the operation of the Company's tariff schedules, first through September 30, 2007.[2]

On June 18, 2007, a preliminary conference was held pursuant to notice.[3] At the conference, the parties presented a proposed litigation schedule, which was adopted by the Administrative Law Judges (ALJs) William Bouteiller, Elizabeth H. Liebschutz and Michelle L. Phillips.[4] The Commission suspended the operation of these tariffs through June 26, 2006.[5]

Pursuant to agreement of the parties and the ruling by the ALJs, on September 7, 2007, Staff and intervenors filed direct testimony addressing Con Edison's rate filings. Rebuttal testimony responding to the previously filed direct testimony was filed on September 28, 2007. Finally, on October 17, 2007, evidentiary hearings were commenced at the Commission's offices located at 90 Church Street in

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[2] Id. The tariffs are currently suspended through March 30, 2008 (Case 07-E-0523, supra, Untitled Order (issued September 21, 2007)).

[3] Case 07-E-0523, supra, Notice of Preliminary Conference (issued May 30, 2007).

[4] Case 07-E-0523, supra, Ruling on Schedule (issued June 25, 2007).

[5] Id.

Manhattan. The hearings continued for two and a half weeks, ending on October 31, 2007.

Although the Company proposed an alternative three-year rate plan in its initial filing, Staff, in its direct and rebuttal case only addressed those aspects of Con Edison's filing that affected a one year rate case (see Section III.A., infra). Staff's direct case contained a proposal that would result in an increase of $618 million for the rate year ending March 31, 2009, reducing the Company's single-year proposal by $589 million.

III. THRESHOLD ISSUES

A. Multi-Year v. One-Year Case

In its filing, the Company proposes a three-year rate plan, commencing April 1, 2008, and ending March 31, 2011 (Tr. 2427, Lns. 2-4). Staff proposes a one-year case and declines to address Con Edison's multi-year proposal. Staff's position is that multi-year rate plans are best developed in negotiations leading to agreement among the parties. Staff's position is reinforced by the Company's stance taken in its direct testimony that although it proposed a three-year rate plan, it did not waive its right file for new rates immediately after the conclusion of this rate case should it determine that the rates set by the

Commission for the first rate year were inadequate or the terms for the other two rate years were unreasonable (Tr. 2428, Lns. 9-20).

Multi-year rate plans have traditionally been developed in the context of joint proposals. The primary reason that multi-year rate plans are normally set only by settled joint proposals is because through negotiations the parties' issues converge to create a product that many parties can support before the Commission. Thus, when the Commission acts, often only relatively small changes, if any, are made to the final result of the parties' negotiations. Accordingly, all the parties, after being provided a forum in which to fully vet their issues, agree that via the joint proposal adopted by the Commission, ratepayers are likely to receive the benefit of rate certainty over a multi-year period, while shareholders are given the chance to earn reasonable profits on terms by which the majority of the parties have agreed are fair to all.

Litigating a multi-year case, however, creates no winners. Because of the gulf that lies between the Company, Staff and the other intervening parties, as discussed below, it is highly unlikely that the Company's proposed rate plan will survive Commission review without modifications that will prove to be unacceptable to Consolidated Edison. In that event and should the Commission make a determination on a multi-year rate plan in this proceeding, customers would not have the certainty usually provided to them in a multi-year plan in that the Company could simply discard the Commission's multi-year design in favor of filing for new electric delivery rates to be effective at the end of the first rate year (effective March 31, 2009). Accordingly, Staff recommends that the Commission reject the Company's three-year rate plan and determine rates for one rate year.

B. Existing Joint Proposal Issues

At this time, we are not aware of any issues from the existing joint proposal that are not already addressed in other relevant sections of our brief which must be addressed here.[6] It is Staff's position that annual compliance filings concerning earnings sharing, cost reconciliations, etc. made pursuant to the existing rate plan will be handled outside the context of this case, and

[6] For example, the Company's rate proposal includes recovery of deferred carrying charges on excess T&D infrastructure expenditures made during the current rate plan that the Company maintains are owed to it via the terms of the 2005 joint proposal. The specifics of that dispute are contained in the Infrastructure section of this brief (see Section V, infra).

any changes to those compliance filings (not already incorporated in this case) will be incorporated in future rate cases. That said we reserve the right to comment on any other matters raised by the parties in our Reply Brief.

1. Provisions of the Joint Proposal

As a general matter, unless specifically noted elsewhere, all elements of the existing joint proposal will be superseded by the Commission's rate order in this case. The 2005 Con Edison Rate Order states that "[t]he vast majority . . . of the terms and conditions . . . will become effective on April 1, 2005, apply through March 31, 2008, and remain effective thereafter until a replacement electric plan is adopted.”[7] However, Staff reserves the right to comment on any other matters raised by the parties in our Reply Brief.

IV. REVENUE REQUIREMENT

A. Other Operating Revenues

Late Payment Charge Revenues

Pursuant to Con Edison’s tariff, P.S.C. No. 9 – Electricity Fifth Revised Leaf No. 52 and Second Revised Leaf No. 53, a late payment charge (LPC) is imposed at the

[7] Case 04-E-0572, Consolidated Edison Company of New York, Inc. – Rates, Order Adopting Three-Year Rate Plan (issued March 24, 2005).

rate of 1.5% per monthly billing period (Tr. 1441, Lns. 12-21). The Company's Accounting Panel testified that Con Edison's LPC revenues have a relationship to billed revenues and economic conditions (Tr. 1441, Ln. 22 - Tr. 1442, Ln. 2), and a three-year average ratio of residential and non-residential LPC revenues to billed revenues can be used to forecast LPC revenues (Tr. 1442, Lns. 3-10).

The Company forecasted late payment charge revenues relying on a historic three-year average of actual LPC revenues. This resulted in projected rate year LPC revenues of $11.897 million for residential customers and $9.432 million for non-residential customers (for a total estimated LPC revenues for the rate year of $21.329 million) (Tr. 1275, Ln. 19 - Tr. 1276 Ln. 2; Tr. 1440, Ln. 23 - Tr. 1441, Ln. 11).

On cross examination, the Company's Accounting Panel confirmed that Con Edison is seeking a 33% rate increase (Tr. 1442, Lns. 11-14). Since LPC revenues have a clear relationship to billed revenues, it is reasonable to conclude that if the Commission grants a rate increase then late payment charge revenues will increase as well. This is especially true with regard to the substantial rate increase proposed by the Company and even the rate increase proposed by Staff.

Indeed, Con Edison, in response to Staff IR DPS-411 (Exh. 100), states that "The Company does not disagree that an increase in revenues resulting from an increased revenue requirement will in all likelihood generate additional late payment charges." The Company's Accounting Panel testified that it expects there would be some correlation between the two (Tr. 1442, Lns. 15-22). Staff recommends that the Commission use a forecast methodology that reflects this relationship. Staff's proposal is to forecast LPC revenues using a three-year average of the ratio of LPC revenues to total revenues. The Company's use of a three-year average of nominal LPC revenues does not reflect this relationship and would have the effect of understating expected LPC revenues in periods with increasing customer rates.

Staff developed a three-year average of LPC ratios of .2704% for non-residential and .4417% for residential. When applied to the forecast revenues, these ratios resulted in LPC revenues of $9.619 million for non-residential and $12.402 million for residential. Staff forecasts total LPC revenues for rate year at $22.021 million which is an increase of $692,000 over the Company's historic three-year average of LPC revenues (Tr. 3553, Lns. 10-19).

Staff recommends these ratios be applied to the revenues after the authorized revenue requirement increase. Application of these ratios results in an additional $1.448 million of non-residential LPC revenues and $.669 million of residential LPC revenues; a total of $2.117 million expected LPC revenues based on Staff's recommended rate increase of $642.099 million. Failure to recognize the rate increase impact on LPC revenues would result in an unjustified windfall for Con Edison.

Fuel Management Program

The Company forecasted Fuel Management Program revenues using the historic level for the 12 months ending December 31, 2006 (Tr. 1277, Lns. 10-16). Actual Fuel Management Program revenues for the 12 months ending December 31, 2004, 2005 and 2006 were $69,000, $245,000 and $98,000, respectively (Exh. 80 (AP-1, Schedule 7)).

The Company conceded that the 2004 and 2005 results could conceivably recur in the rate year and indicated it would not object to a three-year average to forecast Fuel Management Program revenues (Exh. 240 (AP-1), Company response to DPS-300, p. 41). By using the historic level for the 12 months ending December 31, 2006 to forecast the rate year level, the Company understates rate year revenues. Staff's recommendation to use a three-year historic average is a better method for forecasting the rate year level since this method will smooth anomalies and fluctuations evident in any single year. Staff's rate year level forecast for Fuel Management Program revenues is $138,000, an increase of $39,000 (Tr. 3554, Lns. 4-23).

Asset Depreciation Range Deferred Tax Benefits

On August 11, 2006, the Company filed a petition for the disposition of Asset Depreciation Range (ADR) Deferred Tax Benefits for the year 2000 and later, which were not properly accounted for by the Company.[8] Con Edison proposed to defer for customers' benefit the rate impact of correcting the deferred ADR tax balances that were not properly accounted for during the period of 2000-2004, as well as for the recalculation of the overearnings adjustment for the period of 2000-2006. The Company proposed to pass back to customers deferred principal and interest totaling $48.176 million over a three-year period (Tr. 3555, Ln. 12 - Tr. 3556, Ln. 2).

Staff supports the three-year amortization of the ADR Deferred Tax Benefit amount balance to pass back the

[8] Case 06-E-0990, Consolidated Edison Company of New York, Inc. for disposition of 2000 and later Asset Depreciation Range Deferred Tax Benefits not properly accounted for by the Company, Untitled Order (issued September 4, 2007) (ADR Deferred Tax Benefit Order).

benefits to customers. However, at the time Staff filed its testimony, Case 06-E-0990 was pending before the Commission. Therefore, Staff recommended this treatment be subject to update or reconciliation to reflect the final determination by the Commission (Tr. 3556, Lns. 5-12).

In its update and rebuttal testimony, the Company's Accounting Panel reflected in rate base interest on the tax benefits of $0.380 million that was omitted in error in the original filing (Tr. 1387, Lns. 18-19; Tr. 1483, Ln. 19 - Tr. 1485, Ln. 4).

Subsequently, the Commission acted on the Company's petition and directed Con Edison to defer a total of $51.249 million, including interest, for customers' benefit to reflect the rate impact of correcting deferred ADR taxes.[9] Of this amount, $49.069 million is allocated to electric operations. Additional interest of $0.894 million will be passed back to electric customers over three years. Accordingly a $0.298 million ($0.894 million divided by three years) adjustment should be made to Other Operating Revenues to reflect the pass back to customers of interest over the three-year period. A tracking adjustment in the amount of ($0.451 million) should also be made to rate base to reflect the unamortized interest balance. These updates

[9] Id.

reflect the Commission's directives in the ADR Deferred Tax Benefit Order.

Direct Current Incentive Program

The Staff Accounting Panel proposed to utilize unexpended Direct Current (DC) conversion program funding as a rate moderator (Tr. 3557, Ln. 23 - Tr. 3558, Ln. 11). Staff proposes that the entire estimated $9 million surplus be passed back to customers in the rate year and the average unamortized balance should be included as an offset to the Company's rate base. In rebuttal testimony, the Company's Accounting Panel agrees the surplus should be returned to customers. However, the Company proposes to pass the balance back to customers over three years (Tr. 1380 Ln. 8-16). The Company did not reflect the unamortized balance in its updated rate base request and failed to provide any evidence as to why it should not be included.

The two issues in contest are the proper amortization period and the inclusion of the unamortized balance as a rate base offset. Staff considered the Company's requested rate increase impact on customers in making its recommendation for a one-year pass back. Moreover, Staff appropriately reflected the fact the

Company will have use of the funds until they are fully returned to customers by including the balance as an offset to rate base. Con Edison’s approach would result in a cost-free loan to the Company from customers. Staff’s recommendations are reasonable and should be adopted.

World Trade Center Costs

Con Edison seeks to recover $37.2 million of deferred World Trade Center (WTC) related costs in the rate year. The Company’s recovery plan represents a three-year recovery period for certain costs that are an expense in nature ($34.4 million per year) and thirty-year recovery of capital costs ($2.9 million per year). In addition, the Company seeks a cash return on the unrecovered cost by including them in its rate base request. The Company’s request is based on the belief that it will not recover these costs from any other source.

Staff recommends continuation of the current rate treatment until all costs are known and all of the reimbursement issues are settled (Tr. 3564, Ln. 14 - Tr. 3566, Ln. 11). Currently, Con Edison is recovering $14 million per year of deferred WTC costs, and it is permitted to accrue interest on the unrecovered deferred net of tax balance at the current pretax allowance for funds used during construction rate. Staff's recommendation is based in part on the fact that the Company's request includes costs that Con Edison has already recovered or can reasonable expect to recover from other sources. Additionally, the Company's request includes costs for which it has yet to seek reimbursement from a federally-sponsored program (Tr. 3563, Lns. 9-14).

Even after two updates, Con Edison fails to accurately reflect several material known changes that have been acknowledge by the Company. For example, the Company's Accounting Panel acknowledged that it failed to update its rate base request to reflect $70 million of known changes related to World Trade Center costs (Tr. 1450, Lns. 16-23). Company witness Rasmussen testified that including these costs is rate base would cost customers $8.5 million (Tr. 2504, Lns. 11-16). Based on Con Edison's request to include in rate base costs it has already recovered or has an opportunity to recover from other sources, Staff has expressed concern that the Company's proposal could lead to double recoveries and or returns on costs that have already been recovered. Staff's proposed accounting treatment appropriately resolves these concerns and preserves all options for the Commission when it determines the Company's pending petition to defer WTC related costs (Tr. 3565, Lns. 14-23). The Staff recommendations are reasonable, appropriately resolve the deficiencies in the Company's proposal and should be adopted. The Company should be allowed to recover $14 million per year of World Trade Center costs and be authorized to defer interest on the unrecovered balance at the current pretax allowance for funds used during construction rate (Tr. 3565, Lns. 8-14). The Commission should exclude the entire deferred balance from the Company's rate base request.

B. Operations & Maintenance Expenses

Company Labor

Meteorologist

The Company seeks $150,000 salary allowance to hire a meteorologist. The Company indicated that hiring a meteorologist would supplement its subscription weather services by providing an independent review of weather forecasting models to more accurately determine expected local weather conditions (Tr. 3566, Lns. 20-24). According to Con Edison, the current use of weather services can cause the operating staff to unnecessarily react to potential events, or to not react timely when action is required, based upon inaccurate or misleading weather service reports (Tr. 1924, Lns. 18-21). However, Con

Edison has provided no support for this claim nor has the Company cited any actual instances of this occurring. The Company also indicates that an in-house meteorologist would be able to make forecasts before they are made available by the National Weather Service and other weather services (Tr. 1925, Lns. 7-10).

Staff believes that forecasts made by an in-house meteorologist would not have same the accuracy as those of weather subscription services which employ teams of meteorologists and support staff with access to highly sophisticated weather equipment (Tr. 3567, Lns. 3-6). In addition, the Company’s current subscription weather services provide around-the-clock information which would be difficult for a single meteorologist to produce (Tr. 3567, Lns. 1-3).

In Case 04-E-0572, the Company’s last electric case, Con Edison made the same proposal to hire an in-house meteorologist. We note that the Company has still not hired a meteorologist and continues to operate relying on other predictive weather services. The operational inefficiencies cited by Con Edison in using these services apparently have not provided cause for Con Edison management to support the hiring of an in-house meteorologist.

The Company’s current filing does not reflect such savings resulting from the proposed hiring of a meteorologist. Such savings, if they occur, would offset in whole or in part the incremental costs that the company seeks. Moreover, the proposed hiring of a meteorologist appears to be redundant to the Company’s use of other weather services. For these reasons, Staff recommends that the proposal to fund a meteorologist be disallowed.

Shared Services Administration Labor

Con Edison’s Shared Services organization was established in July 2006. The goal of the group is to improve the efficiency and effectiveness of its organizations and affiliates (Tr. 3572, Lns. 6-10). The Company indicated that cumulative labor costs it expects to incur from inception to the start of the rate year is $2.295 million (Tr. 3573, Lns. 2-10). In addition, the Company incurred organizational setup costs and employee training costs as well as costs of employee benefits. Staff requested that the Company provide any and all documents it has regarding actual cost savings that resulted from the Shared Services organization (Tr. 1494, Lns. 7-11). In response to Staff’s on the record request for any and all documents showing cost savings resulting from the Shared Services organization (Tr. 1494, lns. 7-11), Con Edison provided a document entitled “Shared Services Administration Group (response to Staff request to Accounting Panel)”. Con Edison failed to provide evidence of any actual achieved savings. In it, the Company merely indicated that there are projects currently in progress that it expects will generate savings over time. Thus, the Company is unable to quantify any savings at this point. Staff concludes that the Shared Services organizations incremental costs, which are well in excess $2.3 million, have produced no identifiable savings to date. Moreover, no productivity gains are expected prior to the rate year.

The Company estimates that the rate year Shared Services organization labor costs will be about $1.552 million (Tr. 3573, Lns. 11-13). The total of incurred and forecasted costs from the program’s inception date in July 2006 through the March 2009, the end of the Rate Year, is $3.847 million. Approximately $2.805 million of these costs are allocated to electric operations (Tr. 3573, Lns. 13-18). Electric operation’s allocation of forecast rate year labor costs, $1,036,057, less the Company’s proxy savings estimate ($222,000) results in the requested increase in labor costs of $814,000 (Exh. 96 (AP-15)). The

Company reflected 25% of the group’s labor cost as a proxy for expected savings.

Con Edison indicated that it expects that the Shared Services Administration’s costs will be funded by achieved savings within five years (Tr. 1403, Lns. 11-15). By the end of the rate year, the Shared Services organization will have been in existence for nearly three years. If all costs are expected to be offset by savings within five years, Staff believes that it is reasonable to expect that, as of the rate year, achieved savings will at least offset the annual costs of organization (Tr. 3574, Lns. 15-19). As a result, Staff recommends the elimination of the incremental Shared Services Administration Labor Expense ($814,000) which is net of the imputed productivity savings (Tr. 3574, Lns. 20-23).

In addition, and for the same reasons, Staff recommends that the Commission deny recovery of other Shared Service organization costs totaling $276,648 (Tr. 3575, Lns. 7-10).

Finance and Auditing Labor Adjustments

The Company proposes 12 incremental positions in the Finance and Auditing Department totaling $1.405 million, with an electric operations allocation of $1.024 million. The positions are as follows:

- Seven positions for the Tax Department comprised of six Senior Tax Accountant/Attorneys (in Total $750,000) and a Vice President (VP) ($230,000).
- One position for a Financial Reporting Accountant ($80,000).
- One position for a Regulatory Filings Accountant ($80,000).
- Three positions for the Treasury Department comprised of two Senior Analysts (in Total $180,000) and one Lease Administrator ($85,000).

We recommend disallowing the Company’s proposal to add the 12 incremental positions, and, as with other requests for increased staff levels which we believe are unnecessary, we recommend that the Company be held accountable for any increased levels allowed by the Commission.

Seven Positions for the Tax Department

The request for seven additional positions for the Tax Department was based primarily on a KPMG study for allegedly comparable (‘peer’) companies (Tr. 3567, Ln. 24 - Tr. 3568, Ln. 3). The KPMG study indicates that in comparison to companies with similar revenues and presumably similar tax jurisdiction obligations, Con Edison is at the very low end of staffing (Tr. 1400, Lns. 6-8).

In Appendix B of the study, KPMG provides their benchmarking comparisons (Exh. 98, pp. 37-39). We believe the KPMG benchmarking comparisons are unreliable because 80% of the peer group on which KPMG relied were “manufacturers.” Furthermore, the study used 2002 data.

In glaring contrast, in the Company’s publicly available Proxy Statement Form DEF 14A dated April 11, 2007, on page 17, it refers to recommendations from its independent compensation consultant, Mercer Human Resources Consulting, where the Company adopted an electric utility peer group for 2006, which was heavily weighted with companies for the electric power industry. The 2006 Compensation Peer Group includes the following companies: Cinergy Corp.; CMS Energy Corporation; Dominion Resources, Inc.; DTE Energy Company; Duke Energy Corporation; Edison International; Entergy Corporation; First Energy Corp.; FPL Group, Inc.; PG&E Corporation; Reliant Energy Inc.; The Southern Company; and TXU Corp. In other words, the Company uses different peer groups to try to justify higher allowances based upon criterion which seems to change from study to study.

Finally, we also cannot rely on any stated intentions of the Company as to when the positions might be filled, because in the Company’s recent Gas Rate case (Case

06-G-1332) it indicated that it planned to fill all of these positions in the tax department by July 2007 (Case 06-G-1332, Staff Accounting Panel Direct Testimony, p. 21, Lns. 15-17).

Staff recommends that the Company's proposal for filling the seven positions in the Tax Department comprised of six positions at $750,000 annually and the VP-Tax at $230,000 annually be denied based on the Company's premising its request on severely flawed benchmarking, due to the Company's prior failure to fill the positions, and finally, due to the lack of a compelling case for the need to fill the additional positions.

One Financial Reporting Accountant

The Company proposes adding a Financial Reporting Accountant position to coordinate a "plain English" review of its public financial reports in order to review and rewrite the document in a more user friendly format. The Company indicates that re-writing this document is a huge effort, which would help investors and potential investors better understand the Company's business and its financial performance (Tr. 1401, Lns. 7-10). Staff contends that the current format is in a user friendly format that clearly presents the Company's business and its financial performance. There has been no showing that there is a deficiency in this area. Staff recommends disallowing the proposed incremental Reporting Accountant at $80,000 annually as an addition to the Finance and Auditing Staff.

One Regulatory Filings Accountant

The Company proposes adding a Regulatory Filings Accountant at $80,000 annually. The Company indicates that it has been involved in an increasing level of regulatory filings for all of its services, including electric, gas and steam (Tr. 1401, Lns. 17-19). Staff contends that the Company has not provided any documentation, study or analysis of any nature to support or clarify this claim and recommends a disallowance of this position.

Two Treasury Department Senior Analysts

The Company proposes hiring two Senior Analysts totaling $180,000 for the Treasury Department. The Company indicates that these positions will allow the development of financial expertise in the Company and allow for rotation and turnover (Tr. 1402, Lns. 1-7). We are confident that Con Edison already has sufficient staffing levels to allow for rotation and development for financial expertise. The Company has not demonstrated a need in this area. Staff recommends disallowing the hiring of two Senior Analysts for the Treasury Department totaling $180,000, annually.

One Treasury Department Lease Administrator

The Company proposes a need for an additional Lease Administrator at $85,000, annually, contending that its real estate transactions have increased significantly over the past few years and will remain at a high level for the foreseeable future (Tr. 1402, Lns. 10-13). On its face, the Company is not predicting an increase in real estate transactions, but instead projecting that the current level will remain. Since the Company is projecting current transaction levels will continue, there is no justification to increase staffing.

The Company also indicates that the Lease Administrator in Real Estate position will handle cellular antenna attachment requests from wireless telecom providers and that the Commission was reviewing the Company's first Section 70 for these types of transactions. It contends that when it processes new applications, the workload will increase (Tr. 1402, Lns. 17-23). We believe that even if the number of transactions increased in this area, there is no need for more funding, because the expense will be offset by additional revenues. The first cellular antenna attachment noted by the Company was recently addressed by the Commission. In that order, the Commission determined that the rents collected for wireless service attachments should be accounted for in Account 454 – Rent from Electric Property.[10] With the cost of staff for cellular antenna requests from wireless telecom providers being offset by the revenues, there is also no justification for funding of this position. Based on the Company's projection of the workload related to real estate transactions remaining constant, as opposed to increasing, and the workload expenses from cellular antenna requests from wireless telecom providers being offset by the revenues, Staff recommends that the proposal for the Lease Administrator be denied.

Executive Compensation

The Company included salaries and benefits for two recently retired officers in its rate request. The officers retired during the test year (2006). Con Edison has appointed replacement officers whose salaries and benefits costs were also included in the rate request. The Company agreed that the salaries and benefits for the retired officers should be normalized out of the revenue requirement (Tr. 1412, Lns. 15-21). The expense reductions are $769,152 for Labor, $5,710 for Other operations and

[10] Case 07-M-0744, Joint Petition of Con Edison and New Cingular Wireless – Authorizing Installation of Wireless Facility, Order Granting Petition (issued November 8, 2007), p.5.

maintenance expense and $61,000 for Health Benefits which is included in Insurance Expense (Tr. 1413, Lns. 15-17). Staff agrees with the Company’s adjustments which were included in its update.

Payroll Taxes

Con Edison forecasted payroll tax expense using an effective tax rate of 9.79% of labor expense. Staff recommendations, if adopted will result in a $7.4 million reduction in allowable rate year labor expense. Accordingly, we recommend a payroll tracking adjustment equivalent to 9.79% of all labor expense adjustments. The application of the 9.79% tracking adjustment on the $7.4 million is a recommended reduction to payroll taxes of $723,000 (Tr. 3575, Ln. 17 - Tr. 3576, Ln. 8).

Labor Escalation

Staff recommended adjustments to the Company’s labor expense which reduce the expense level by $6,938,000, in 2006 dollars. To derive the rate year expense impact of Staff’s recommended labor adjustments, we multiplied the $6,938,000 by Con Edison’s labor escalation rate of 6.39% to arrive at a recommended labor escalation adjustment, a decrease of $443,000 to rate year labor expense (Tr. 3575, Lns. 13-15).

Duplicate Miscellaneous Charges

Con Edison's rate year forecast of Duplicate Miscellaneous Charges reflected no change from the historic year level. The Company's forecast is inconsistent with its forecast of the underlying costs, which are operations and maintenance expenses. Staff's rate year forecast of Duplicate Miscellaneous Charges reflects general escalation from the historic year level, consistent with the Company's forecast of the underlying expenses. Our adjustment increases the rate year Duplicate Miscellaneous Charges by $896,000. Since Duplicate Miscellaneous Charges offset other expenses Staff's adjustment has the effect of reducing rate year total operations and maintenance expenses. The Company accepted Staff's adjustment and included the correction in its update (Exh. 95 (AP-9 Revised, Schedule 3)).

Pension and Other Post Retirement Benefits (OPEBs)

Con Edison's updated pension and OPEB expense of $81.151 million reflects the latest available actuarial data. (Exh. 95 (AP-9 Revised)) Staff supports the Company's update which represents a $0.974 million reduction from the Company's original pension and OPEB expense request.

C. Employee Welfare Expense

Health Insurance

Ignoring the long-standing Commission policy, Con Edison applied separate inflation factors of 8.0% for medical plan costs and 9.5% for prescription drug costs to develop it rate year expense forecast of medical costs (Tr. 1121, Ln. 24 - Tr. 1122, Ln. 3; Tr. 1136, Ln. 22 - Tr. 1137, Ln. 3).

It is the Commission's long-standing policy to apply the general gross domestic product (GDP) price deflator to forecast health care service costs.[11] The application of a separate escalation factor in projecting health care costs, other than the general inflation factor, is inconsistent with the Commission's practices. This long-standing policy was recently affirmed by the Commission.[12] Our adjustment reflects the latest known (2008) health costs plus general inflation. (Tr. 3578, Lns. 14-24).

Staff forecasted health insurance costs by taking the latest known information regarding the Company's 2008

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[11] Case 28695, Rochester Telephone Corporation – Rates, Opinion No. 84-27 (issued October 12, 1984), p. 47.

[12] Case 05-E-1222, New York State Electric & Gas Corporation -Electric Rates, Order Adopting Recommended Decision with Modifications (issued August 23, 2006), pp. 54-55; Cases 02-E-0198 and 02-G-0199, Rochester Gas & Electric Corporation – Electric and Gas Rates, Order Adopting Recommended Decision with Modifications (issued March 7, 2003), pp. 23-24.

contract rates and the number of participants as of September 2007 to determine Con Edison's health insurance costs. Staff then escalated the 2008 forecast by the general GDP price deflator to calculate the health insurance costs for the calendar year 2009. A combination of nine-months of 2008 costs and three-months of 2009 costs was used to forecast the health insurance costs for rate year. Staff's approach results in the employee welfare expense level for the rate year of $101.5 million; an increase of $3.9 million from the Company's original requested rate year level for health insurance costs. Staff's forecast is consistent with Commission precedent (Tr. 3579, Lns. 3-16) and should be adopted.

Staff also proposes an adjustment to track the rate year health insurance expense impacts of various Staff adjustments to rate year labor expense. We determined that the adjusted rate year employee benefit expense represented 18.01% of the rate year labor expense. This percentage was applied to the Staff's proposed labor expense adjustments to produce our proposed $1.1 million reduction to rate year employee welfare expense.

In summary, we recommend a rate year employee welfare expense allowance of $100.3 million. Our recommendation tracks the effects of certain recommended labor adjustments and is consistent with the Commission’s long standing policies of using latest known expense levels and GDP to forecast employee medical expenses. As such, Staff’s recommendations should be adopted.

Group Life Insurance Dividends

Con Edison’s rate year group life insurance expense forecast is based on expected gross premium levels. The Company’s forecast is defective in that it fails to consider dividends the Company routinely receives from its provider. The dividends are material relative to the premium level. For example, 2005 dividends received in 2006 were nearly 50% of the 2006 group life premium. Failure to consider such a material refund would have the effect of over stating the Company’s actual rate year cost. Insurance dividends should be considered in determining the rate year expense level to avoid customers funding a cost the Company will not incur.

Dividends are routinely received by Con Edison. Dividends are based on actual death benefits paid by the insurer (MetLife) relative to the insurer’s estimate for a given year. Company’s witness Reyes testified that Con Edison received dividend payments from its group life insurance provider in four of the last five years (Tr. 1162, Ln. 21 - Tr. 1163, Ln. 18). Dividend payments for the years 2002, 2003, 2005 and 2006 were $888,201, $1,495,493, $1,121,854 and $1,140,585 respectively (Exh. 66, Company response to IR CPB-39).

Witness Reyes explained that dividends received from MetLife offset the following year's premiums, thereby reducing the expense in the following year. For example, in 2006 the 2005 dividend was applied by MetLife as a credit to Con Edison's 2006 billed premium (Tr. 1148, Lns. 11-18).

Witness Reyes stated there is no guarantee that the Company will receive a dividend from MetLife (Tr. 1164, Lns. 14-15) and the forecast of group life insurance costs for the rate year includes neither a dividend nor a deficit assumption (Tr. 1166, Lns. 3-8). In 2004, Con Edison had a minor deficit of $3,700 (money owed to MetLife when the deaths are greater than what the carrier projected) (Tr. 1164, Lns. 16-24; Exh. 66, Company response to IR CPB-39). The Company has not provided reasonable justification for not considering routine dividends in the forecast of the rate year expense. Ignoring the trend of the past five years will inappropriately result in higher group life insurance costs that customers would bear.

Staff recommends that a five-year average ratio of dividends/deficits to premiums (46.01%) be applied to the rate year forecast of group life insurance premiums of $1,834,399 (Exh. 64 (HJR-1 Revised), Ln. 2). This approach would result in group life insurance cost for the rate year of $990,302, a reduction of $844,097. This forecast approach properly considers future dividends applicable to the electric operations and ensures that customers do not pay more than the Company's expected net cost.

East River Repowering Project Major Maintenance

Major maintenance expense for East River Repowering Project (ERRP) Units 1 and 2 includes costs for combustion inspections, hot gas path inspections, major inspections, and associated repairs and parts replacement. In its filing, the Company requested to continue the current $7.5 million annual collection from customers to support major maintenance expenses. Con Edison indicated that there will be an estimated $8.683 million of revenues collected but unexpended for major maintenance costs at the end of the current electric rate plan. Con Edison seeks to establish a permanent reserve to fund major maintenance expenses at ERRP. The Company proposes to fund the reserve with the unexpended funds and $7.5 million in annual collections from customers (Tr. 1368, lns. 5-13).

Based on Staff engineering review, the Staff Accounting Panel accepted Con Edison's proposed $7.5

million rate allowance for major maintenance expenses for rate year. However, Staff rejected the Company’s proposal to establish a permanent reserve to fund the expenses. Staff believes that Con Edison can reasonably estimate the amount and has relative control over the timing of the maintenance work. The Company disagreed. In rebuttal testimony, Con Edison’s Electric Production Panel indicated that major maintenance on gas turbine is based on specific operating intervals of factored fired hours (FFH): 12,000 for combustion inspection, 24,000 for hot gas path inspections, and 48,000 for major maintenance, which, on average, occurs every 18, 36, and 72 months of operation, respectively (Tr. 940, Lns. 1-6). However, the Company Production Panel pointed out, that the actual timing of when these durations are achieved is variable, citing weather, unit trips, and other unpredictable factors as examples to impact the timing (Tr. 940, Lns. 7-10). We agree that actual timing of when these durations are achieved may vary, but the degree they vary is not totally unpredictable. It is important to note that the new East River units have been in operation for more than two years (since April 2005). These units have supported Steam operations for two full operating cycles. Con Edison has gained experience in both the timing of actual FFHs and the cost estimates related to major maintenances.

The Electric Production Panel's rebuttal testimony contended that establishment of a reserve will eliminate any inter-generation subsidies, levelize the annual costs and ensure that customers who receive the benefits from ERRP plant pay only the actual maintenance costs to be incurred over the life of the station (Tr. 942, Lns. 6-11). Staff does not believe that reserve accounting proposal addresses the inter-generational issue. For example, during one rate period, if the Company spends more on major maintenance than its reserve, the Company will seek to increase collection from customers in the next rate period. Therefore, customers in the later rate period will pay more and subsidize customers in the prior rate periods. Reserve accounting does not address the inter-generational subsidies related to ERRP major maintenance expenses.

Turning to the $8.683 million of unexpended funds, consistent with the Company, Staff believes the funds should be utilized for customer benefit (Tr. 1506, Lns. 4-5). We differ however in the proposed use of the funds. In Staff's view, since a permanent reserve is unnecessary for ERRP major maintenance costs, the unexpended funds should be returned to customers to mitigate the extraordinarily large rate increase.

Con Edison’s proposal to establish a reserve will provide the Company full true-up protection for major maintenance costs and eliminate all incentive Con Edison currently has to minimize costs. According to the Company’s proposal, “the combination of these unexpended funds and the $7.5 million collected annually should provide the Company with sufficient funds to meet the financial requirements in the years with higher levels of maintenance expenses” (Tr. 942, Lns. 11-15). On one hand, the Company disagrees that it can reasonably estimate the ERRP major maintenance costs and has relative control over the timing of the occurrence of such costs. On the other hand, it can predict just how much is enough several years into the future. In conclusion, Con Edison is simply seeking unwarranted protection from any risk it may be exposed to without regard to the impact on ratepayers. The actual unexpended funds at the end of the current rate plan should be returned to customers as a rate moderator and the unamortized balance should be included as an offset to rate base (Tr. 3582, Lns. 4-6). The Company has not provided reasonable justification for its proposal to establish a reserve and it should be rejected.

Alternatively, if the Commission adopts the Company's proposal to establish a permanent reserve with the $8.683 million of collected but unexpended funds, Staff recommends the Commission reduce the major maintenance rate year allowance to zero. Staff proposes this approach because there is no evidence in the record that indicates that balance in the reserve account would not be adequate to cover the Company's estimated rate year spending on ERRP major maintenance. Moreover, the reserve balance should be subject to interest to compensate customers for the Company's use of the funds until they are spent on the intended maintenance costs.

<u>Fuel Update</u>

The Company's Accounting Panel proposes an update that increases its estimate of rate year gasoline and diesel fuel expense by $908,000. The Accounting Panel claims that the original forecast was based on a weighted average gas and diesel fuel cost of $2.60 per gallon and current market prices are $2.80 per gallon (Tr. 1382, Lns. 13-20). The Company's claim regarding the 2006 average cost of fuel is factually fallacious, according to the data the Company introduced in Exhibit 363. Exhibit 363 reflects that Con Edison actual weighted average cost of gasoline and diesel for calendar year 2006 was $2.77 per gallon not $2.60 per gallon. The Exhibit does confirm that the Company's 2007 average cost per gallon is $2.80 through October. The $0.03 per gallon increase for 2006-2007 equates to a 1% increase in average cost of fuel. Witness Kane indicated the Company applied an inflation factor to project the historic year fuel costs to the rate year (Tr. 1459, Lns 13-17).

The application of the Company's general inflation factor of approximately 2% per annum is above the inflationary impacts the Company has actually realized to date. Since the increase in fuel costs was anticipated and was already reflected in the Company's original forecast, the update is without merit and should be denied.

In addition, the update is not a proper update under the Commission's Statement of Policy on Test Periods in Major Rate Proceedings.[13] The Policy Statement states that "[o]rdinarily, the format used in presenting company budgets of future operations produced for internal purposes will not meet these requirements without substantial modifications."[14] Company work papers provided in support

[13] Case 26821, Statement of Policy on Test Periods in Major Rate Proceedings (issued November 23, 1977) (Statement of Policy on Test Periods).

[14] Policy Statement on Test Periods, p. 8.

of this update (Exh. 103) simply reflect an increase in budget level that the Company allocated to electric operations.

The work papers do no include any basis for the claimed $2.60 historic average cost per gallon, nor do they reflect what the actual historic year 2006 electric fuel expense was. The work papers do not reflect how electric fuel expense was forecast in the company's original filing. Without any of this information, there is no way Staff or any other party could test the veracity of this update. The Policy Statement on Test Periods requires that "staff and other parties in rate cases should be able to retrace projections back to historical source."[15]

In addition to a change in price, the Company's work papers reflect a change in forecast of fuel consumption. However, no basis for the volumetric change was provided by Con Edison (Exh. 103). On cross examination, when Staff counsel questioned the Accounting Panel as to the basis for the forecast change in fuel consumption for the rate year, the Panel was unaware of any basis in the Company's testimony (Tr. 1458, Lns 7-14). That is because there is not any. The Policy Statement

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[15] Id.

requires that “all assumptions, escalation factors, contingency provisions and changes in activity should be quantified and properly supported.”[16]

Therefore, the Company’s update for gasoline and diesel fuel is unsupported and is wholly improper pursuant to the Policy Statement on Test Periods and should be denied.

Informational Advertising- Public Affairs

Con Edison uses advertising and marketing to inform customers and the public about topics such as the need to maintain and enhance the electric infrastructure, energy conservation, and how to contact the Company in the event of an emergency (Tr. 3582, Ln. 23 - Tr. 3583, Ln. 4). The Company seeks an $8.5 million or 81% increase in funding for advertising from the historic year level of $10.5 million. Electric operation’s allocation of this increase of $8,500,000 is $6,897,000. The Company indicates that, in 2006, $3.2 million was spent on the Energy Education Program and $2.8 million was spent on the Working For You Program (Exh. 240 (AP-1), Company response to Staff IR DPS-392c, pp. 50-52). Con Edison indicated that the benefit to customers is that they will have access to

[16] Id.

more information on how they can take control of their energy usage (Exh. 240 (AP-1), Company response to Staff IR DPS-392b, pp. 50-52). Staff believes that this is insufficient to support an increase in Public Affairs expense of 81% and recommends that the request for the $6,897,000 be denied (Tr. 3583, Lns. 18-21). The Company indicated that Department of Public Service Staff issued a report in February 2007, in what is commonly referred to as the Long Island City (LIC) proceeding, in which Staff recommended that the Company improve its communications with customers in the area of outage reporting and service status information (Tr. 3664, Lns. 18-24). The report was not critical of the means upon which the Company communicated with its customers, but rather the message that was delivered (Tr. 3665, Lns. 2-8). Staff does not see an augmentation of the means as addressing the problem (Tr. 3665, Lns. 8-14).

The Staff report did, however, contain recommendations for some modifications to the Company's website. In Section 5.4 Public Affairs Organization there were three recommendations made by Staff, as follow:

> i. Con Edison should, within 30 days of the issuance of this Report, redesign its website so that access to the outage reporting feature is in a prominent location on its website home page.

ii. Con Edison should, by June 1, 2007, be ready to modify quickly its website during emergency events so that essential and up to date information is posted on the home page. The Company should notify Staff when such capability has been implemented.

iii. Con Edison should redesign its website so that heat wave and cold weather specific information is not subsumed in the “storm central” pages.

Staff believes that these changes have already been made, and therefore, would not result in incremental costs in the rate year (Tr. 3665, Lns. 8-14). Staff does not see anywhere in the LIC report a suggestion or recommendation of an increase in funding for advertising and marketing expense.

The Company has simply not supported its proposed advertising program change and customers should not be burdened with bearing the cost, particularly in consideration of the very large rate increase the Company seeks. The nature of the Company’s proposed advertising campaign is controversial as it is very much self-serving (Tr. 3671, Lns. 5-8).

Examples of the type of proposed advertising messages such a “New York has a big appetite for energy, We’re building to feed it”, “New York City: 5.6 million air conditioners…and counting.”, and include the Con Edison logo and “ON IT” theme (Exh. 107 and 108). These messages further explain all that Con Edison is doing for its customers, such as investing $7.5 billion over the next five years, so that power is there “whenever your want it”. Theses messages do nothing for customers other than perhaps provide indications why rates are increasing. Issues of great importance to the Commission and the public such as energy conservation are not part of these ad campaigns.

The Commission has a long-term prohibition of the promotion of the use of electricity through advertising.[17] This prohibition remains in force today, and clearly energy conservation is paramount to the Commission. In its Advertising Policy Statement, the Commission found that the cost of time spent by Staff ferreting through supporting documentation to determine the propriety of a utility’s advertising activities outweighed any benefits gained from such detailed reviews. Instead, the Commission allows in rates a small pool of dollars to cover permissible informational

[17] 17 PSC 1-R, Statement of Policy on Advertising and Promotional Practices of Public Utilities (issued February 25, 1977) (Advertising Policy Statement).

and institutional advertising. The Commission established a range of 1/10 to 1/25 of 1% of operating revenues as acceptable, with the expectation that percentage applied would be in inverse relationship to the size of the company. The specific allowable limits were to be determined in individual rate cases. In developing this policy, the Commission stated that it is not in the interest of anyone to have institutional advertising exacerbate the customer resentment at a time when large rate increases are made necessary by increases in cost that are beyond management's control. The Commission's concerns are no less valid today. Moreover, advertising budgets are clearly within Con Edison's management control.

Con Edison's information and institutional allowance limit was established at 0.06% (6 cents per $100) of operating revenues in Case 27029.[18] Applying the .06% limit to Con Edison's projected revenues after Staff's recommended rate increase results in a maximum advertising rate allowance of $4.472 million. The Company's request for an advertising rate allowance of $22.1 million is nearly five times the limit. Just as

[18] Case 27029, Consolidated Edison Company of New York, Inc. – Rates, Opinion No. 77-3 (issued April 29, 1977).

the Company failed to support its proposed program change of $6,897,000 for the Informational Advertising and its outreach and education request, it failed to provide any justification for exceeding the Commission's established limit on informational and institutional advertising. Staff recommends that the Commission uphold its information and institutional advertising limit. Doing so would result in a rate allowance of $4.472 million or $17.6 million less than the Company seeks.

Insurance Expense

Con Edison requested an increase of $5,353,300 or 22% over its historic year Insurance Expense (Tr. 3584, Lns. 4-6). The Company is forecasting a 10% per annum increase in insurance premiums. However, the trend over the past three years clearly indicates declining costs. Insurance expense for the years 2004-2006 was $27,220,800, $24,931,200 and $24,071,400, respectively (Tr. 3584, Lns. 1-3). The Company forecasted a 17% increase for excess liability insurance premiums from June 2006 ($10,514,000) to June 2007 ($12,198,000). The 17% forecasted by the Company proved inaccurate since the actual premium for June 2007 was $10,821,132, an actual increase of 2.9% over June 2006 (Tr. 3584, Lns. 11-18). Staff relied on the actual increase in excess liability insurance premiums as a proxy for all insurance costs as it is the single largest premium, representing over one third of the Company’s total annual insurance expense and is the latest available information.

Staff observed that several premiums that Con Edison forecasted to increase actually declined (Tr. 3584, Lns. 19-23). As such, we view Con Edison’s forecast using a positive growth rate for all insurance premiums as excessive. Staff’s approach is more reasonable than Con Edison’s approach, because it relies on a recent actual known premium change. Staff’s proposed use of the actual Excess Liability Premium 2.9% annual growth rate results in a reduction to rate year insurance expense of $3,752,129 (Tr. 3584, Ln. 23 - Tr. 3585, Ln. 3). The Company’s use of a 10% per annum increase in premiums grossly overstates the Company’s costs by ignoring actual known information and declining trend for the past three years in its insurance costs. Staff’s recommendations are reasonable and should be adopted.

Finally, Staff recommended a $61,000 reduction insurance expense to reflect the elimination of costs related to two recently retired officers (Tr. 3571, Lns.

13-23). The Company will no longer incur these costs and failed to normalize them out of the historic year costs.

Interference Expense

In its direct testimony, Con Edison proposed a rate year allowance for interference expenses of $106.433 million (Exh. 84 (AP-5, Schedule 1, p. 3 of 6, Ln. 42)), an increase of $52.458 million from the historic year. The Company's August update reduced the proposed interference expense by $2.862 million. The Company also proposed revising the reconciliation process contained in the 2004 Rate Plan. The Company proposed changing the method of reconciliation relating to interference expense in order to eliminate the 2.5% dead-band around the rate year estimate and proposed a full reconciliation of interference costs (Tr. 1171, Lns. 16–17).

In our direct testimony, Staff recommended an adjustment of $11.586 million to the Company's updated interference expense for a rate year expense of $92 million (Tr. 3592, Lns. 12–14). With the exception of labor expense, discussed below, the Company's rebuttal testimony accepted Staff's allowance adjustments (Tr. 1195, Lns. 10-13). In addition to the adjustments to the rate year interference allowance, Staff recommended that the Company be allowed to reconcile its actual interference expense up to the rate allowance, deferring any over-recovery for future refund to customers. Interference expense in excess of the rate allowance should be borne by the shareholder (Tr. 3593, Lns. 2-8). Staff recommendation was based on the magnitude of the Company's rate request, coupled with the fact that the rate year forecast for interference expense is 27% greater then the average interference expense over the last four years. This proposal would encourage Con Edison to coordinate its interference expenditure work closely with New York City in order to ensure efficient use of resources (Tr. 3593, Lns. 8-11).

In his rebuttal testimony, Company witness Thomas Gencarelli took exception to Staff's determination that the rate year forecast for interference expense is 27% greater then the four-year average (Tr. 1199, Ln. 20 - Tr. 1200, Ln. 2). Mr. Gencarelli's rebuttal testimony on this issue should be entirely disregarded because, as the witness acknowledged on cross examination, he did not review Staff's work papers in preparing his testimony (Tr. 1215, Lns. 6-8). Staff's determination that the rate year forecast for interference expense is 27% greater that the four-year average is correct and accurate.

Con Edison opposes Staff's reconciliation proposal (Tr. 1196, Ln. 19 - Tr. 1197, Ln. 13). On cross examination, the Company contrasted a Staff position on the reconciliation methodology in the recent Con Edison gas rate case[19] to Staff's reconciliation proposal in this proceeding (Tr. 3658, Ln. 21 - Tr. 2659, Ln. 3). In that gas rate case Staff supported a reconciliation methodology similar to the Company's proposal in this proceeding. However, in view of the 27% increase in the level of interference expense from the historic average, Staff believes that a change in the method of reconciliation is warranted since there is such a substantial change from historic cost levels.

Additionally, like its Manufactured Gas Plant (MGP)/Superfund costs, the Company claims that the interference expenses are beyond its control and should be subject to full reconciliation (Tr. 1197, Ln. 1-6). However, as reflected in its response to Staff IR DPS-377 (Exh. 240, p. 39), the Company has demonstrated that it does have an ability to influence its MGP costs, as evidenced by its delaying MGP work at the W. 45th Street Gas Works Site (USS Intrepid). Staff's reconciliation proposal is intended to foster the Company's ability to influence

[19] Case 06-G-1332, Consolidated Edison Company of New York, Inc. – Gas Rates, Order Adopting In Part The Terms And Conditions Of The Parties Joint Proposal (issued September 25, 2007).

the projected rate year interference projects.

Finally, Con Edison raised an issue with the level of Company labor included in the Staff’s rate year interference expense (Tr. 1196, Lns. 9-15). In its forecast, the Company forecasted interference labor at 4.3% of the Electric Department’s interference expenses, based on the historic ratio of interference labor to total electric interference expense (Exh. 67 (TMG-1)). However, the Company’s proposed methodology would result in a double count of the incremental interference labor. Con Edison claims that because of the increase in interference work, additional company labor should be allocated to interference expense. However, the increase in interference labor should result in a corresponding reduction to the rate year Company labor expense item (Exh. 84 (AP-5, Schedule 1, p. 3 of 6, Ln. 16). Con Edison did not do this, thus the double count. In our direct testimony, Staff increased the test year labor costs included in the historic year interference expense by the labor escalation factor, thereby making the Company whole for its rate year labor costs (Tr. 3593, Lns. 8-9).

Site Investigation and Remediation

In its direct testimony, Con Edison’s Accounting Panel projected rate year Manufactured Gas Plant site investigation and remediation (SIR) expense of $50 million (Exh. 84 (AP-5, Schedule 1, p. 3 of 6, Ln. 49)), an increase of $42 million. The Company’s rate year allowance was developed by amortizing the incremental bridge-period (April 1, 2007 through March 31, 2008) SIR costs, in excess of the current allowance, and the projected rate year SIR costs over a three-year period (Exh. 164, Schedule 4, p. 3 of 3). The Company claimed this methodology was consistent with the methodology used in the 2004 Rate Order (Exh. 240 (AP-1), p. 7 of 106).

In our direct testimony, Staff made several adjustments to the requested rate allowance to capture changes in the Company’s projected rate year and bridge period SIR work (Tr. 3593, Lns. 16-22). We revised the bridge period to accommodate a slippage of a project out of the bridge period (Tr. 3594, Lns. 1-15). Staff removed two projects from the rate year because the Company indicated that these projects would not be completed in the rate year (Exh. 240 (AP-1, pp. 46-49)). Staff also made an adjustment to capture the benefit of Brownfield Cleanup Program (BCP) tax credits to be paid to Con Edison during the rate year (Exh. 240 (AP-1, pp. 44-45)). Additionally, Staff recommended a five-year amortization period, instead of the three-years proposed by the Company. Staff noted that in its understanding of the current electric plan, the SIR allowance was developed using a five-year amortization period, not a three-year period (Exh. 242 (AP-3)). Staff's adjustments to rate year SIR totaled to $25.7 million (Exh. 241 (AP-1, Schedule 8, p. 2, Adjustment No. 2j)).

In its rebuttal testimony, the Company reflected Staff's adjustments, with the exception of the BCP tax credit (Tr. 525, Lns. 5-7). Staff continues to support the reduction of the rate year SIR allowance for the BCP tax credit. The credit, of which $.3 million is allocated to the electric department, should be returned to electric customers because the credit is calculated based on the level of capital invested in the cleanup of certain sites – capital that was paid for by customers (Exh. 240 (AP-1, pp. 44)).

In light of the substantial increase in the requested level SIR expense, and in an effort to mitigate current customer bill impacts, Staff supports the continuation of a five-year amortization instead of the Company's proposed three-year amortization (Tr. 3598, Lns. 9-14). Staff's proposal to change the amortization period from three-years to five-years is reasonable and should be adopted.

Postage

In its direct testimony, Con Edison's Accounting Panel proposed to increase historic year postage expense by 7.6%, to reflect the average increase in United States Postal Service rates that went into effect on May 14, 2007 (Exh. 83 (AP-4, Schedule 1, p. 3 of 6, ln. 56)). Furthermore, the Company then applied the general escalation factor to arrive at the projected rate year postage expense, an increase of an additional $0.6 million (Exh. 83 (AP-4, Schedule 1, p. 3 of 6, ln. 56)). In our direct testimony, we eliminated the inflationary escalation from the rate year postage allowance (Exh. 241 (AP-2, Schedule 8, p. 2 of 5, Adjustment No. 2k)). The May 2007 postal rate increase was designed to carry the Postal Service through the fiscal year September 2008. The Postal Service has not announced any intention to seek an increase in rates thereafter. Staff's review of the last ten Postal Service rate increases, dating back to February 17, 1985, reveals that the average period between increases is 32 months (Tr. 3600, Ln. 22 - Tr. 3601, Ln. 7). Therefore, on this basis alone, the Commission should reject the Company's proposed escalation in rates.

Additionally, the increasing use of the internet should help ameliorate the effect of future postal rate increases. Based on data provided by the Company (Exh. 240

AP-1), pp. 5-6)), the average number of customers that receive their monthly Con Edison bills via e-mail (e-bill) has increased by 470% from 2004 through June 2007. In 2004, only 0.7% of total customers received e-bills; in 2006 that number increased to 3.1%. Staff projects that that number could exceed 5% in the rate year (Tr. 3601, Lns. 13-19). The Company's rebuttal testimony did not respond to Staff's adjustment to the rate year postage allowance. Staff recommends the elimination of the $0.6 million inflationary escalation as it is not likely to occur. Furthermore, Staff's adjustment is conservative in light of the fact that increases in e-billing activity can result in additional postage savings.

Regulatory Commission Expense

The Company's Accounting Panel reflected a known change of $284,000 for regulatory commission expenses for the rate year. This was based on the latest known level of the Public Service Commission assessment based on a letter dated August 10, 2007, entitled Statement of Revised Assessment (Tr. 1383, Lns. 6-9; Tr. 3640, Ln. 21 - Tr. 3641, Ln. 5).[20]

Staff agrees with the Company's use of the latest known PSC assessment to forecast the rate year expense.

[20] Public Service Law (PSL) § 18-a.

However, the Company’s forecast methodology changed in its update. The Company’s initial filing included refunds that it routinely receives from the PSC. The PSC annually bills utilities based on an estimated assessment in January, a revised assessment in August, and a final assessment in October. For example, the PSC bills a utility company in January for the estimated assessment for the 2007-08 state fiscal year ending March 31, 2008 based on the adjusted intrastate revenue from the 2005 calendar year. Then, the PSC recalculates the assessment based on the adjusted intrastate revenues from the 2006 calendar year. Finally, the PSC reconciles the estimated utility assessment of costs billed to the utility company to actual expenditures for the 2006-07 fiscal year ending March 31, 2007 in October.

The PSC issued its Final Statement of Assessment on October 19, 2007 (Exh. 243) that reflects a refund to Con Edison of 5.86% of the original assessment level. This refund is in line with the past experience - the historic four-year average of refunds is 5.25% (Tr. 3641, Lns. 5-24).

Staff recommends an adjustment to the Company’s revised forecast for the PSC assessment to reflect the historic four-year average of refund level of 5.25%. We estimates this will reduce the Company's updated rate year forecast for the PSC assessment by $1.1 million (Tr. 3641, Ln. 24 - Tr. 3642, Ln. 6). Staff recommends the total regulatory commission expense level for the rate year be $26.427 million.

Rents – ERRP Carrying Charge

This line item represents Con Edison's electric operations share of the ERRP carrying charges, including rate of return, depreciation, and taxes. The ERRP is combined steam and electric plant benefiting both electric and steam operations. The entire cost of the project was charged to Steam operations. Steam operations charges electric operations roughly 66.4% of the carrying costs of the investment as an inter-departmental rent. The Company's update reflected the actual ERRP plant in service balance as of July 31, 2007 as well as some corrections to its original filing and the August 2007 preliminary update. Staff accepts the Company's update, which increased electric rent by $4.01 million (Exh. 95 (AP-9 Revised) Schedule 3). However, this change does not effect the electric delivery rate revenue requirement, because Con Edison collects ERRP carrying charges through its Monthly Adjustment Clause (MAC). The Company's update appropriately reflected an equal increase in forecast MAC revenues, which fully offset the projected increase in expense. Staff understands that there are no contested issues remaining here.

Shared Services

The shared service expense reflects net billings between Con Edison and its affiliates for certain corporate costs and direct services performed or allocated between Con Edison and its affiliates, including Orange and Rockland Utilities, Inc. (O&R) and Con Edison's holding company, Consolidate Edison, Inc. (CEI). The Company's original development of shared service cost assignment included several errors. Correction of these errors reduced the rate year net shared service expense by $1.674 million from the originally filed amount (Tr. 1381, Lns. 3-4). Con Edison's update reflects Staff's recommend corrections (Tr. 1381, Ln. 3). Therefore, the issues appear to be resolved.

Incentive Compensation

Following long-standing Commission precedent[21], Staff proposed an adjustment to offset $14.146 million of Con Edison's proposed Incentive Compensation Expenses,

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[21] Cases 02-E-0198 and 02-G-0199, Rochester Gas & Electric - Electric and Gas Rates, Order Adapting the Recommended Decision with Modifications (issued March 7, 2003) (2003 RG&E Rate Order).

consisting primarily of performance based restricted stock (Tr. 3606, Ln. 5 - Tr. 3607, Ln. 9). The Company's direct testimony did not explicitly identify or attempt to justify the Incentive Compensation expenses contained in its forecasted Rate Year. Instead, the expenses were listed under Other O&M Expenses.

In the 2003 RG&E Rate Order, the Commission stated "[t]here is no precedent for recovery of executive incentive payments in a litigated rate case. They have been approved only twice in settlements, with associated productivity offsets. This is an expense that should not be charged to customers" (2003 RG&E Rate Order, p. 13).

Furthermore, the issue of incentive compensation has been addressed by the Commission for other jurisdictional utilities. Incentive compensation was reviewed in the 1991 National Fuel Gas Distribution Corporation rate order.[22] In the Order, the Commission states:

> Since, in this case, the goals are related to financial parameters, it is only reasonable to expect that, if those goals are met, there will be cost savings, which have not been reflected in the revenue requirement. In that case, the savings would offset the costs of the plan, and the plan would be self-supporting. Failure to reflect those savings would provide the Company a windfall at the ratepayer expense.[23]

The Commission's decisions regarding incentive compensation are reasonable and logical. It has correctly

[22] Case 90-G-0734, et al., Opinion 91—16 (issued July 19, 1991) (1991 NFG Rate Order).
[23] Id. at 8.

concluded that incentive plans are self-supporting and must be matched with associated efficiency gains. Consistent with Commission practice, the incentive compensation amounts should be offset with associated productivity. Our adjustment reflects Commission precedent and correctly offsets the Company's incentive compensation expense of $14.146 million. Staff's adjustment should be adopted.

Uncollectible Expense

The Company's rate year uncollectible expense was based on the projection of write-offs as 0.55% of revenues (Tr.1292, Lns. 22-24). The ratio was developed with a three-year average of uncollectible write-offs from 2004 to 2006. Applying this ratio to the rate year forecasted revenue produced a $12.294 million decrease to the historic year level (Tr. 1293, Lns. 1-2). Staff accepts the Company's rate year uncollectible expense forecast of $37.124 million.

The Company also proposed to unbundle the uncollectible expense (Tr. 2443, Lns. 1-3). With this proposal, the Company will remove around $18.8 million in uncollectible expense related to fuel and purchased power costs from the delivery revenue requirement, based on the 0.55% uncollectible ratio and the rate year projected Market Supply Charge (MSC) and Monthly Adjustment Clause (MAC) revenues, including revenue taxes (Tr. 2444, Lns. 1-

10). The Company will recover the energy related uncollectible expense through the MSC and MAC, based on the 0.55% uncollectible ratio and actual fuel and purchased power expenses.

Staff agrees that unbundling the uncollectible expenses will better match the recovery of the expenses with actual revenue billed, and also reduce the Company's uncollectible accounts risk due to market price volatility. We recommend the Commission approve the Company's request to unbundled uncollectible expense. However, the actual amount removed from the base delivery revenue should be subject to the Commission's final determination on the projected rate year MSC and MAC revenues related to fuel and purchased power costs.

Water Expense

The Company's rate year water expense was developed by applying an 8.7% per annum growth rate to the historic year expense (Tr. 923, Lns. 22-24). However, the Company also applied the general inflation rate to the forecasted water expense level to develop its rate year expense. Inflationary impacts were double counted by Con Edison, once with 8.7% increases in both 2007 and 2008, and again through the general inflation rate of 4.7%. Staff proposes a $35,000 adjustment to eliminate the 4.7% general inflation rate impact (Tr. 3605, Ln. 23 – Tr. 3606, Ln.2). Staff's adjustment is reasonable as it removes the double count of inflation contained in the Company's request.

Property Tax Expenses

Staff has proposed an adjustment of $1.771 million to the Company's rate year property tax expense (Tr. 3609, lns. 21-24). In general, this tax is computed by applying tax rates to the assessed values of properties for two classes of property - class 3 and class 4. The remaining difference between Staff's and Company's computations is the projected tax rates for the rate year. Both Staff and the Company rely on historic five-year average tax growth rates to forecast future tax rates.

Staff's growth rate determination starts with tax rates that were in effect at the end of the 2002-2003 tax year and reflects all actual changes through tax year 2007-2008. Annual variations in tax rates were simply averaged to arrive at Staff's proxy tax rate growth rate. Staff's computed five year average actual tax rate changes were decreases of 1.61% and 2.72% for class 3 & 4 properties, respectively (Tr. 3608, Lns. 20-24)

Con Edison developed its growth rates starting with 2001-2002 tax rates, computing variations in rates in effect at the beginning of 2002-2003, ignoring variations between the fiscal years 2002-2003 and 2003-2004, and continuing with the annual variations for the remaining periods through the 2007-2008 tax year. Company witness Hutcheson indicated that the reason for excluding single year effects from the average was that “The city imposed a significant (i.e., 18.5%), across-the-board mid-year tax increase in the middle of the 2002-2003 fiscal year. In my forecast, I ignored this huge tax rate increase as not being representative of “normal” tax rate changes” (Tr. 0690, Lns. 4-8). Thus, the Company suggests that Staff’s method is not correct because it considers the effects of the rate increase that occurred in mid-year 2002-2003. We disagree. Staff’s average growth rate determination starts with tax rates in effect after the extraordinary 18.5% tax rate change. The tax rate hike would have affected Staff’s growth rate determination if the rates in effect prior to the mid-term rate increase were included in the computation. Since the rates in effect prior to the rate hike were not included in Staff’s computation, the effect of the hike is by default not reflected in Staff’s five-year average. Both Staff’s and the Company’s growth rate computations normalize or exclude the effect of the large abnormal mid-term rate increase. Con Edison’s method needlessly complicates the process and relies on stale 2001 vintage data. The development of our growth rate is superior to Con Edison’s since it properly considers the most recent five years of actual property tax experience. Accordingly, Staff’s rate year forecast of property tax expense should be adopted.

<u>Property Tax Reconciliation</u>

Company witness Rasmussen proposes to continue, with modification, the use of deferred accounting to true-up actual property tax expense to the expense level allowed in rates (Tr. 2435 - Tr. 2436). Staff does not support the Company’s proposal. Traditionally, utilities are not allowed true-up protection in a single year rate case. Due to the shortened forecast period, property taxes can be reasonably forecasted and it is unlikely that a significant variance from the forecast level will occur. In fact, the actual 2008 assessments as well as the actual 2007-2008 tax rates are known. Therefore, actual property tax expense for a portion of the rate year is known. The period of forecast is limited to the remainder of the rate year. Due to the limited period of forecast it is unlikely that a material variation will occur. True-up accounting is not necessary and should be denied. The Company has not provided adequate justification in support of its request for true up accounting. Con Edison's request should be denied.

D. Rate Base

Earnings Base Capitalization (EBC)

Conceptually, the EBC is intended to adjust historic rate base to the level of investment or capitalization supporting it. Staff proposed a number of adjustments to the Company's EBC computation (Tr. 3612 - 3614). We believe that three contested issues remain. The first issue is the prepaid pension issue that we address separately. The second issue relates to Staff's proposed adjustment related to the First Avenue sales proceeds. The final issue relates to Con Edison's claim that Staff's proposed adjustments have a circular effect on capitalization.

For purposes of determining the EBC adjustment to rate base, Staff proposes an alternative treatment of the deferral related to the First Avenue sale. Con Edison allocates the deferred gain to electric on a current basis. Staff uses a proxy allocation based on the following assumption: This transaction affects four parcels of properties. The Commission, in Case 01-E-0377, approved the Company's proposal to use the historical pre-sale use of three parcels as basis to allocate the proceeds to electric, gas and steam divisions.[24] As for the forth parcel, the Waterside property, the Commission has yet to decide on the allocation of the associated proceeds. We believe our proxy allocation is reflective of the situation at the time of sale and parallels that of the other parcels as opposed to the Company's allocation of the deferred gain on a current basis.

On cross examination of the Staff Accounting Panel, Con Edison questioned whether Staff allocated any portion of its electric earning base adjustments to the Company's gas and steam departments (Tr. 3658 Ln. 25 - Tr. 3659, Ln. 6). The Company line of cross examination appears to imply that there are secondary effects of Staff's proposed EBC adjustments that Staff failed to consider. More specifically, that a change to the earnings base of one department affects the Company's total rate base and, in turn, the allocation capitalization. Generally, Staff agrees with such reasoning. The capitalization of Con Edison is recorded on a total company basis. To determine EBC, total capitalization has to be allocated between electric, gas and steam, respectively.

[24] Case 01-E-0377, Joint Petition of Con Edison and FSM East River Associates LLC – Property Transfer, Order Approving Transfer Subject to Conditions (issued May 20, 2004), p. 79.

Generally, the proportional rate bases of electric, gas and steam are used to allocate capitalization. So, it follows that a change in electric rate base could change the allocation of capitalization. However, Con Edison's logic is flawed because the adjustments that Staff proposed would have similar impacts on gas and steam operations (Tr. 3659, Lns. 7-13). Therefore, the overall impact on the allocation of capitalization for purposes of measuring EBC would be minimal, if any. The effort required to refine the calculation would require a detailed review of the gas and steam departments' earnings bases. Such effort would be unprecedented and is not justified here. Staff's ECB adjustments are properly calculated and supported and should be adopted.

Prepaid Pension Expense

Con Edison included its prepaid pension balance in rate base as part of its earnings base versus capitalization adjustment. The Company's Accounting Panel suggests its inclusion is one of the reasons the Company's earnings base is higher than rate base (Tr. 1328, Lns. 9-12). In other words, the earnings base capitalization adjustment increases rate base as opposed to the traditional reduction to rate base. Con Edison initially argues that the inclusion of the prepaid pension expense in rate base is appropriate because it was created as a result of negative pension cost or credits. The non-cash pension credits offset other operating costs but did not provide Con Edison cash to fund the operating costs. As a result, the Company indicates that it had to finance the value of the credits in order to fund the costs of ongoing operations (Tr. 1328, Lns. 14-22). The implication is that since the Company had to finance the credits that produced the prepaid pension balance, it is entitled to earn a return on the prepaid pension balance.

Staff supports a portion of the Company's request, however, and recommends an adjustment to address the effects of certain pension credits Con Edison recorded while off the Commission's Pension Policy Statement.[25] Staff established that for the period Con Edison's electric operations was off the Commission Pension policy statement (April 1, 1997 through April 1, 2005) the Company's actual pension expense totaled a negative $885.6 million (Tr. 3618, Lns. 3-7). Staff also established that a total

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[25] Case 91-M-0890, Development of Statement of Policy Concerning Accounting and Ratemaking Treatment for Pensions and Postretirement Benefits Other than Pensions, Statement of Policy and Order Concerning the Accounting and Ratemaking for Pensions and Post Retirement Benefits Other than Pensions (issued September 7, 1993)(Pension Policy Statement).

negative pension expense of $609 million was reflected in rates (Tr. 3618, Lns. 7-9).

We support the Company's request to the extent that pension credits were reflected in rates since customers received the benefits through lower rates. However, since the Company was off the Pension Policy Statement, the credits in excess of the levels reflected in rates flowed to shareholders, not customers (Tr. 3618, Lns. 12-14). Staff recommends a rate base adjustment of $141.9 million to eliminate the value of pension credits that flowed to shareholders so that customers are not required to pay a return on benefits that they did not receive. To require customers to pay carrying cost on a benefit they never received, because it flowed to shareholders, is inequitable and inappropriate (Tr. 3618, Ln. 17 - Tr. 3619, Ln. 13). Furthermore, there is no cash outlay associated with the benefits shareholders retained (Tr. 3618, Lns. 19-21).

We do agree, however, with Con Edison's proposition that negative pension costs resulted in a cash financing requirement for the Company. This is true to the extent that credits were reflected in the rate setting process. Non-cash pension credits were reflected in rates. As a result, the Company's revenue requirement and cash flows were reduced. Cash costs that were offset by non-cash pension credits had to be financed. However, the Company's cash flow was in no way affected by pension credits in excess of the levels reflected in rates. Pension credits in excess of those reflected in rates simply resulted in non-cash earnings on which Con Edison is now inappropriately seeking to earn a return (Tr. 3620, Lns. 6-18). The request to include a non-cash component in rate base is completely without merit.

In rebuttal testimony, the Company's Accounting Panel takes issue with Staff's recommendation and cites the 2004 electric, 2003 gas and 2003 steam rate plans as precedent for the rate treatment it seeks –- specifically that the prepaid pension balance will not be eliminated from the Company's earnings base or capitalization (Tr. 1391, Ln. 17 - Tr. 1392, Ln. 4). Con Edison argues that the Joint Proposal in Case 04-E-0572 permanently addressed the issue of past pension credits and there is no basis for revisiting the issues in this case or any future rate cases.

Ironically, the Company's Accounting Panel acknowledges that the rate plan in Case 04-E-0572 was the result of negotiations that resolved many complicated issues related to the Company's accounting for pension credits as well as other issue (Tr. 1392, Lns. 5-10). However, a fact the Company conveniently ignores it that the Joint Proposal contains a provision that explicitly precludes any party from relying on or referring to the resolutions or positions contained therein as precedent before the Commission or before any court of law. Similarly, the Company ignores the fact that the issue of prepaid pension expenses was revisited in the Company's 2005 steam rate case (05-S-1376) and 2006 gas rate case (06-G-1332). Indeed, Mr. Kane agreed that Staff made recommendations in these gas and steam rate cases that were consistent with its position here in (Tr. 1468, Lns. 21-23).

Staff does not dispute that the Joint Proposal in Case 04-E-0572 proposes that the prepaid pension balance will not be eliminated from the Company's earnings base or capitalization for ratemaking purposes. However, the rate plan described in that Joint Proposal had a definitive term – April 1, 2005 through March 21, 2008. Mr. Kane acknowledged that in fact during this term the prepaid pension expense was not eliminated from the Company's earnings base or capitalization for ratemaking purposes (Tr. 1466, Ln. 20 - Tr. 1467, Ln. 4). Staff's recommendation in this case has no impact on the 2004 Rate

Plan. Staff's recommendation, if adopted, would be effective on April 1, 2008.

The issue in dispute has only been addressed in joint proposals to the Commission. None of the prior resolutions establish precedent and, therefore, are not relevant here. This is the first litigated case in which the Commission has an opportunity to decide the issue and the Commission should decide the issue on the merits. The Company's inappropriate attempts to establish "precedent" using historic joint proposals should be given no credence.

In an effort to confuse the issue, Con Edison raises the negotiated $100 million pretax charge which resolved a number of issues related to pension accounting (Tr. 1392, Lns. 10-15; Tr. 1393, Lns. 3-8). This charge resolved a number of complex issues related to pension accounting including, but not limited to, true-up accounting for pension and OPEB costs and the treatment of past pension credits for the term of the rate plan. The reconciliation or true-up accounting for pension and OPEB costs proved to be an extremely valuable provision of the current rate plan for Con Edison. In fact, Mr. Kane testified that Con Edison has or expects to defer $229 million of pension and OPEB under-recoveries over the three-year term of the current rate plan (Tr. 1481, Lns. 3-

9). Moreover, the Company is seeking recovery of that $229 million in under-recoveries from customers in this case (Tr. 1482, Lns. 6-11).

The Company's Accounting Panel faults Staff for not recognizing the customer benefit resulting from the Company including the pretax charge as part of the current electric rate plan (Tr. 1393, Lns. 3-8). First, Staff notes that the pretax charge was negotiated to resolve a vast number of issues, most notably the reconciliation protections for pension and OPEB costs. Second, as Mr. Kane concedes, the revenue requirements in the 2004 Rate Order included the prepaid pension balance (Tr. 1466, Ln. 20 - Tr. 1467, Ln. 5). As such, Staff did not consider the prepaid pension expense treatment as having any adverse impact on the Company's cash flows. Therefore, no adjustment to the Company's capitalization was made.

Staff's proposed $141.9 million in adjustment represents the gross $276.6 million pension over–collection, reduced by $47.3 million of benefits potentially shared with customers and $87.4 million of income taxes the Company paid on the resulting retained earnings enhancement. The over-collection of pension costs enhanced the Company's earnings. During the period Con Edison was off the Pension Policy Statement, it shared excess earnings with customers in two rate years. After considering the earnings that were potentially shared with customers, Staff calculates that the Company retained $229.3 million of the over-collection (Tr. 3621, Ln. 10 - Tr. 3622, Ln. 5).

Con Edison calls into question our calculation of the adjustment by suggesting that Staff imputed a “cap” on the level of shared earnings in certain rate years (Tr. 1393, Lns. 9-15). The Company’s claim is without merit. Our analysis was to determine the level of shared earnings that were potentially related to pension over-recoveries. Since any number of items could contribute to Con Edison’s higher than allowed level of earnings, we measured the level of shared earnings with and without the pension over recoveries to determine the maximum impact pension cost could have had on earnings sharing. Staff conservatively offset its proposed adjustment with the impact that the maximum of pension over recoveries could have had on shared earnings. Staff’s adjustment is properly derived and the Company’s criticism is without basis.

Con Edison’s Accounting Panel calls for an update to Staff’s proposed adjustment based on a recent Commission decision in Case 06-E-0990. The Company argues that the Commission’s decision in that case impacts excess earnings sharing in rate years ended March 31, 2003 and 2004 respectively. Moreover, Con Edison suggests that Staff’s adjustment should reflect the resulting higher level of shared earnings that will be passed back to customers (Tr. 1394, Lns. 2-8).

Staff would support Con Edison’s recommendation if the resultant customer benefits had anything to do with pension credits or pension cost over-recoveries. The subject matter in Case 06-E-0990 was a Con Edison tax accounting error (Tr. 1482, Ln. 12 - Tr. 1483, Ln. 8). Clearly, the customer benefits have nothing whatsoever to do with pension costs and, therefore should not be considered in Staff’s recommended adjustment.

Finally, the Company’s Accounting Panel suggests that customers somehow benefited from its pension over-recoveries because Con Edison was able to delay filing for a rate increase or sought lower increases when it did file for rates (Tr. 1394, Lns. 9-14). On cross examination, neither the Company’s Accounting Panel, nor Con Edison’s counsel, in his attempt to testify, were able to provide any evidence to support these claims (Tr. 1485, Ln. 5 - Tr. 1489, Ln. 14). The Company’s claims are clearly not true and should be given no weight. They represent nothing more than an attempt to cloud the record.

In summary, Staff's recommended adjustment is properly derived and reasonably reflects the investment or financing requirement related to Con Edison's prepaid pension expense for electric operations. The Company's earnings opportunity should be limited to the cash flow impacts of negative pensions that benefited customer directly through rate setting or indirectly through shared earnings. Pension credits retained by Con Edison results only in paper earnings and no financing requirement. Staff's adjustment is necessary to ensure that customers do not paid carrying cost or a return on benefits that they never received.

Business Incentive Rate (BIR) Discount

Con Edison included $3.339 million of lost revenues related to Business Incentive Rate (BIR) discounts in rate base in its direct testimony and update filing. No basis was provided for its inclusion. Con Edison's Accounting Panel simply indicated that the balance is expected to remain the same for the rate year (Tr. 1329, Lns. 19-21). According to the Company's response to Staff IR DPS-304 (Exh. 240 (AP-1), p.42) the Company deferred lost revenues between November 2003 and August 2005 related to the discounts provided customers taking services under the Company's Business Incentive Rate Program.

The rate base item represents the unrecovered net-of-tax balance of the deferred lost revenues. We note that the Company is not seeking recovery of the deferred lost revenues in this or any other proceeding (Exh. 240, p.42 (AP-1)), Company response to Staff IR DPS-304). Staff recommends that the deferred revenues be excluded from rate base because the Company failed to provide any proof of Commission authorization to defer the lost revenues. Con Edison cites the 2000 Merger Order as evidence of Commission authorization of the establishment of a regulatory asset to account for the lost revenue associated with BIR discounts.[26] However, the 2000 Merger Order also includes language that explicitly requires the Company file support for its classification of lost revenue before they can be considered recoverable. The 2000 Merger Order states that "(p)rior to such recovery, the Company will file with the Commission's staff, and provide copies to economic development administrators of BIR programs (EDAs), the basis for classifying BIR additions as "retention" load for purpose of determining such revenue shortfalls."[27]

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[26] Case 00-M-0095, et al., Joint Petition of Con Edison and Northeast Utilities for Approval of a Certificate of Merger, Opinion 00-14, (issued November 30, 2000) (2000 Merger Order).

[27] 2000 Merger Order, "Settlement Agreement", pp. 27-28.

The distinction between new business and retention discounts is of critical importance to determine the level of lost revenues pursuant to the rate plan. In Staff IR DPS-304 (Ex. 240, p. 42 (AP-1)), we requested that the Company provide copies of any petitions it filed with the Commission seeking authorization to establish a regulatory asset to account for the lost revenues related to BIR discounts. The Company failed to provide any evidence of such filings or Commission orders. Since Con Edison has failed to meet its burden of demonstrating that the deferred balance is proper and authorized by the Commission, Staff recommends that entire $3.339 million balance be removed from rate base.

Excess Deferred State Income Taxes

Due to a statutory change in New York State income tax rate Con Edison deferred for customers' benefit $12.576 million of excess deferred State Income Taxes (SIT). Effective January 1, 2007, the New York State corporate income tax was reduced from 7.5% to 7.1% (Exh. 240 (AP-1, p. 86, response to Staff IR DPS-505)). These taxes were collected from customers and deferred at the higher tax rate and will be paid in the future at a lower rate (Tr. 3624, Lns. 17-23). Staff proposed to refund the benefits to customers in the rate year to mitigate the impact of Con Edison's large rate increase. The impact of the refund was reflected as $20.745 million increase (Tr. 3625, Ln. 5) to other operating revenues and $6.263 million increase (Tr. 3625, Ln. 7) to the rate base. Con Edison agrees that the benefits belong to customers, but proposes a three year pass back period (Tr. 1423, Lns. 4-7; 18-24). In its rebuttal testimony, the Company's Accounting Panel argues that passing back the available credits in a single year will produce what is often called the "hockey stick" effect (Tr. 1423, Lns. 21-24). That means that rates would be kept artificially low for the period of one year and then rise dramatically thereafter as all available credits have been exhausted (Tr. 1424, Lns. 1-3). However, the Company ignores the fact that it is seeking a $1.2 billion rate increase in this proceeding, the largest "hockey stick" in the Company's history. Our $20.745 million proposed refund in a single year is miniscule in comparison to either the Company's proposed rate increase of $1.2 billion or Staff's lower rate increase proposal. The Commission should adopt Staff's proposal to refund customers all the excess deferred SIT in the rate year.

Long Island City (LIC) Outage Costs

Con Edison included certain costs associated with the July 2006 equipment failures and power outages that occurred in the Long Island City Network. The capital restoration costs, damaged equipment costs and the Company’s claimed reinforcement and planned capital costs were all included in the Company’s rate base request (Tr. 3625, Lns. 12-15).

The Commission ordered a formal review of Con Edison’s acts and omissions leading up to and during the Long Island City network events.[28] Given the pending prudence review, we believe that it is premature to provide Con Edison with recovery of and a return on Long Island City investments (Tr. 3626, Lns. 5-9). Accordingly, the Staff Accounting Panel recommended that all costs related to the Long Island City events be excluded from this rate case pending resolution of the prudence review (Tr. 3626, Lns. 11-14). The prudence review is still ongoing and may not be resolved before the Commission considers the Company’s rate request.[29]

[28] Case 06-E-0894, et al., Proceeding on Motion of the Commission to Investigate the Electric Power Outages in Con Edison’s Long Island City Network, Order Commencing Prudence Investigation (issued April 18, 2007).

[29] However, in the event that the prudence review is concluded prior to Commission consideration of this rate case, Staff supports an update to reflect the outcome (Tr. 3626, Lns. 14-18).

Since the LIC prudence review is not yet resolved, Staff argues that Con Edison may defer carrying charges on the $53.59 (Tr. 3627, Lns. 3-7) net plant balance at the authorized cost of capital rate that is determined appropriate by the Commission in this case (Tr. 3626, Lns. 18-22). In addition, we recommend that the Company be authorized to defer depreciation accruals of $1.05 million (Tr. 3627, Lns. 7-9) annually on Long Island City investments. Both deferrals would extend until such time as the prudence determination regarding the investments is made by the Commission (Tr. 3626, Lns. 22-24).

LIC Deferred Carrying Charges (2004 Rate Order)

Carrying costs on Long Island City investments and retirement costs have been and continue to be deferred pursuant to the terms of the 2004 Rate Order (Tr. 3627, Lns. 19-24; Tr. 3638, Lns. 1-15). The 2004 Rate Order permits the Company to defer carrying charges (13.95% annually) on incremental net transmission and distribution investments. LIC outage capital expenditures and retirement costs were captured in this reconciliation process (Tr. 3628, Lns. 13-15). Carrying charges deferred in rate year two of the current rate plan were recovered by Con Edison by the application of customer credits. The

Company is seeking recovery of estimated carrying charges for rate year three of the current rate plan over the next three years. The current electric rate plan provides that the application of customer credits to deferred costs is subject to audit and prudence review. Given that the underlying costs are subject to a formal Commission ordered prudence review, Staff recommends the Commission require Con Edison to reverse the application of credits on Long Island City related carrying costs pending the Commission's prudence determination. Moreover, Staff recommends separate deferral of rate year three carrying charges on Long Island City related costs and elimination of recovery in this case pending the Commission decision on prudence (Tr. 3630, Lns. 3-21).

These recommendations will preserve the Commission's options on the recoverability of Long Island City costs and, at the same time, protect the customers' and the shareholder's interests. Staff's proposal insulates the Company's earnings from any impact until the Commission makes its determination on prudence. Once that determination is made, any and all rate making impacts can be addressed in the Company's next rate review. Staff's recommendations are reasonable and should be adopted.

E. Other Rate Base Items

Change of Accounting Section 263A

Con Edison changed its method of determining the capitalization of certain costs for tax purposes by adopting the “simplified service cost method” (SSCM) in 2002 (Tr. 3631, Lns. 7-16). As a result of this change, the Company reduced its current tax expense by $318 million (Tr 3631, Ln. 21 - Tr. 3632, Ln. 2). The Internal Revenue Service (IRS) challenged Con Edison’s tax deductions. Con Edison expects it will be required to repay, with interest, a portion of its past SSCM tax benefits and to capitalize and depreciate over a period of years, costs it previously deducted under SSCM (Tr. 3631, Ln. 11 - Tr. 3632, Ln. 7).

The Company’s rate base reflects the effect of deductions it took for tax years 2002-2005 (Tr. 3632, Lns. 7-9). The Company recently took the deduction on its 2006 tax return (Tr. 1517, ln. 2-3). However, the IRS has disallowed the deduction for 2006 as well (Tr. 1516, Ln. 16 - Tr. 1517, Ln. 10).

The Company’s rate base includes average accumulated deferred taxes for the rate year of $298 million associated with the tax accounting changes made under Section 263A of the Internal Revenue Code (Exh. 87 (AP-8, p. 1 of 2, Ln. 45) and Exhibit 94 (AP-8 Revised, p. 1 of 2, Ln. 27)). This reflects the deduction claimed for tax years 2002-2005, but not 2006 (Tr. 3631, Ln. 11 - Tr. 3632, Ln. 9).

In June of 2007, the Company and the IRS agreed to enter into settlement discussions to attempt to resolve the SSCM tax benefits claim for calendar years 2002 through 2004. The settlement negotiations are ongoing. Since the resolution of this matter was pending at the evidentiary hearings, Staff recommended that the Company provide an update (Tr. 3633, Lns. 4-8). The Company's witness Kane stated that the Company would provide an update to reflect the outcome of a settlement with the IRS regarding the deferred tax balance as soon as it is known (Tr. 1517, Lns. 11-17). If a settlement is not reached between the IRS and the Company, the Commission should reflect the actual book balances which include the deductions for 2002-2006.

First Avenue Proceeds

Con Edison proposes to refund electric customer's share of an estimated gain and associated interest that resulted from the sale of certain First Avenue properties. The Company proposes to pass back the benefit over three-years. (Tr. 1330, Ln. 19-24). Staff does not object to this proposal. However, since the Commission has yet to act on the Company's accounting and ratemaking proposal for the sale, the exact benefit due customers has not been determined (Tr 3635, Ln. 7-12). If the Commission determines that customers are entitled to a larger benefit, Staff recommends that the Company be required to defer the additional benefits for customers (Tr. 3635, Ln. 19-24). Staff’s proposal is reasonable in light of the pending Company petition.

Netting of Regulatory Assets and Liabilities

The 2004 Rate Plan permits Con Edison to net regulatory assets and regulatory liabilities at the end of each rate year. The Company seeks to continue annual netting in this case (Tr. 2441, Lns. 16-26). Staff opposes the netting option in the context of a single year rate case. Instead, Staff recommends that the Commission determine the disposition of any deferred balances in the Company’s next rate case (Tr. 3636, Lns. 13-17).

Con Edison provides three reasons why the Commission should reject Staff’s recommendation: 1) The Company claims netting is important from a financial reporting standpoint; 2) Con Edison argues that Staff’s position that the Commission should determine disposition of deferred balance in the next case is equally applicable in the terminal year of a multi-year rate plan. However, netting is permitted in the last year of the current rate plan; 3) It would be unfortunate if the sole reason for the

Company to file a rate case is to address deferrals (Tr. 2466, Ln. 13 - Tr. 2467, Ln. 7).

Con Edison’s Controller, Mr. Rasmussen, suggests that netting is important from a financial reporting perspective because it provides investors a clearer understanding of the Company’s true financial assets and liabilities (Tr. 2441, Lns. 18-26). However, he concedes that a simple note in publicly issued financial statements could serve the same purpose. As a practical matter, it is just his and the Company’s preference to eliminate the deferred balances from the balance sheet (Tr. 2504, Ln. 23 - Tr. 2505, Ln. 8). The Company’s balance sheet housekeeping preferences are not a legitimate basis for the requested treatment.

The Company attempts to establish precedent for the proposed netting by referencing the terms of the 2004 Rate Plan. However, netting is provided for under the Joint Proposal, which was the result of negotiations among various parties. As discussed above, the Joint Proposal in that proceeding contains a provision that explicit bars parties, including the Company, from relying on it as precedent. The Company’s attempt to do so should be rejected. Moreover, Mr. Rasmussen acknowledged that netting was not traditionally available to Con Edison and that it was permitted for the first time in the current electric rate plan (Tr. 2505, Lns. 9-22).

Con Edison’s suggestion that deferrals could be the sole reason for the Company to file a rate case is misleading. Mr. Rasmussen indicated that having large deferred asset and liabilities on the balance sheet would not be a sole reason to file a rate case. He indicated that having a large deferred asset (costs) without any offsetting credits <u>could be</u> a driver of a rate case (Tr. 2514, Lns. 3-8 (emphasis added)). However, Mr. Rasmussen indicated that the level of a Company’s earnings in more determinative as to whether it would file for rates. For if the return the Company was earning was appropriate in its view, Con Edison would not file a rate case because of the existence of deferred balances (Tr. 2515, Lns. 2-5). In addition, Mr. Rasmussen conceded that the Commission could authorize netting on request, outside the context of a rate case (Tr. 2510, Lns. 7-11). Finally, as a practical matter the Company’s concern over a deferral driven rate filing is a red herring. It is a fact that Con Edison has filed a rate case every time it has been not been precluded from doing so under a multi-year rate plan or the PSL for at least the last 20 years (Tr. 2510, Lns. 2-6).

Furthermore, the Company's netting request should be rejected in view of the level of supporting documentation for deferred balances that the Company has been providing under the netting approach allowed under the 2004 Rate Order. The information Con Edison has been providing is patently insufficient for Staff to advise the Commission as to whether the netting performed by the Company is correct and clearly insufficient when compared to the level of information provided and required in rate cases, before netting was permitted (Tr. 2506, Ln. 8 through Tr. 2508, Ln. 24). The lack of supporting documental impedes Staff's review of the deferred balances (Tr. 2506, ln. 15 – Tr. 2508). In fact, the Company now files little in the way of documentation to support a request for netting (Exh. 170; Tr. 2506, Lns. 2-21). Finally, the netting of deferred costs and credits limits the Commission's options in rate cases. Traditionally, the Commission has determined the time frame in which deferred balances are disposed of the context of a rate filing. Netting prevents the Commission from using its discretion to determine disposition and timing of such deposition of the netting of regulatory assets and liabilities.

F. Sales Volume and Revenue Forecast

Con Edison's forecast of electric sales volume for the rate year is 58,541 Gigawatt hours (GWhs) for the entire system. For major service classifications, Con Edison's sales forecasts were produced from its econometric models. Generally speaking, most of the Con Edison models are acceptable under econometric standards. However, Staff found that corrections should be made in a few areas of the Con Edison methodology. Staff's recommendations result in an adjustment of 220 GWhs, equivalent to about $12.2 million in delivery revenues (Tr. 4897, Ln. 12).

1. SC 1 Model

Staff found that Con Edison's Service Class (SC 1) model excludes a key economic variable (Personal Income) and includes a dummy variable that cannot be justified. This results in a substantially understated forecast for SC 1. Staff's model corrects these problems and produces a more accurate forecast when compared to the recent actual data.

a. Personal Income Variable

The key economic variable that the Company fails to include in its SC 1 model is personal income. By economic principles, the energy consumption of residential households is dependent on electricity price and personal income. Residential customers use electricity indirectly through their appliances. The ownership of larger homes or apartments and more appliances is largely dependent on personal income. Therefore, a residential forecasting model generally includes a personal income variable, and most of the electric utilities in New York State have done so in their rate cases.[30]

The Company agrees that the use of a personal income variable is "theoretically sound" (Tr. 576, Lns. 5-6), but it argues that Staff's methodology introduces estimation errors that may affect the accuracy of the forecast. The Company alleges that Staff's method is arbitrary and the converted quarterly figures may not reflect the actual quarterly figures (Tr. 576, Lns. 13-16).

Staff used a conversion methodology built into the econometric software that both the Company and Staff used to develop their respective sales forecasts. The method is fairly standard and among the few widely used in the forecasting industry.

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

Con Edison also asserts that the personal income data for 2006 is an estimate that may not match the actual. The Company objects to Staff's forecast because the Company does not know how the accuracies of the sales volume forecasting models are affected by the use of estimated data (Tr. 576, Ln. 16 - Tr. 577, Ln. 2).

The quarterly personal income data for 2006 and beyond were estimated by Economy.com and provided by Con Edison. As such, the Company should have the same confidence in the estimates of personal income as in the other economic variables provided by Economy.com. As to the effects of using estimated personal income on the accuracies of the sales volume forecasting models, a sales volume forecasting model should properly recognize economic principles so that the estimated model is as close as possible to the theoretically true model.[31] A key economic variable should not be rejected because of allegation of data estimation errors. Comparative to known model specification errors, data estimation errors are considered to be secondary and can be addressed with econometric techniques. Furthermore,

[31] The Company witness mischaracterized the accuracy of the sales volume forecasting models as accuracy of data and quarterly pattern representation (Tr. 594, Ln. 17 - Tr. 595, Ln. 15). Also, the Company seems to have a pre-determined forecast and concerned that the use of personal income might affect the accuracy of the forecast (Tr. 594, Ln. 17 - Tr. 595, Ln. 15).

the personal income figures that Staff used are the best available data.

b. Dummy Variable

Another problem with Con Edison's residential model is the use of a dummy variable that the Company claims captures the weather impact on sales in the summer months of 2005 and 2006 (Exh. 28, p. 1). The methodology is flawed as the use of the dummy variable cannot be justified based on the record.

No special event other than the weather in 2005 and 2006 was documented to have significantly affected sales volume. Since the Con Edison SC 1 model already contains weather variables, any impact of weather variations to sales volumes during these two summers should be explained by the variations of the included weather variables.

The Company attempted to justify the dummy variable methodology by showing the changes in the relationship between the system daily sendout to daily cooling degree days (CDD) (Exh. 29, pp. 2-3). These charts show that the slope of the sendout-to-CDD relationship has increased since 2004. The Company interprets the changes in slope as additional reaction in sales volume to the weather (Exh. 29, p. 1).

The Company's daily sendout analysis does not support its dummy variable methodology, because the sendout data is not comparable to sales data for SC 1 in many respects. For example, the sendout and sales are measured on a different basis, and their responses to weather variations do not match (Tr. 602-603). Also, in the sendout analysis, both the sendout and CDD are raw data and in original format, so the charts in Exhibit 29 depict linear relationships between the sendout and CDD. In addition, the SC 1 sales volume was transformed into a logarithm and modeled as a non-linear function of CDD. The change in the "slope" of the relationship between the sendout and CDD may not be considered significant after the sendout is transformed into a logarithm, because the scale of the measurement has changed for the sendout. Furthermore, the sendout data is for all customers, while the SC 1 sales volume is modeled on a per customer basis. The growth in the number of customers is just one of several factors that may have affected the change to the sendout chart. Other factors include economic activities, prices, and appliance additions.[32]

[32] Con Edison's sendout model includes number of customers, number of employment, weather variables, and price of electricity as explanatory variables.

Another aspect of the incomparability of the sendout data to SC 1 is that the total sendout is for the entire Con Edison system, including all Con Edison and NYPA customers. The analysis does not show that the changes come from SC 1, which is only a small portion, or 26%, of the entire system for the third quarters of 2005 and 2006. The Company's sendout analysis has no basis for justifying its use of a dummy variable for the SC 1 model.

The Company does not consider the hot summer of 2005 and the few hot days in 2006 as significant to the forecasting models of other service classes, as it does not include such a dummy variable in the models for other residential and commercial service classes. Con Edison does not even include the same dummy variable in the total sendout model (Tr. 603, Ln. 6 - Tr. 604, Ln. 2; Exh. 31, p. 1). This fact reveals that, if properly modeled, the impact of the summer weather of 2005 and 2006 to sales volume can be explained by the independent variables without resorting to a dummy variable methodology.

Finally, further reason to reject the company's proposed use of a dummy variable in the SC 1 model is the fact that the Company defined one dummy variable for two vastly different summers, 2005 and 2006. As a result, the estimated impacts to SC 1 sales volume are identical for these two vastly different summers (Tr. 610, Ln. 8 to Tr. 611, Ln. 3). The summer of 2005 was hotter than normal and 2006 was, overall, cooler than normal. Because the dummy variable does not even distinguish between above-normal or below-normal summer weather, it is difficult, if not impossible, to relate the dummy-captured impact to weather in the summers of 2005 and 2006.

2. Appliance Saturation and Actual Sales

Con Edison used data for recent appliance additions to justify its proposal for the infrastructure capital expenditure, citing the contribution in load growth of 900,000 room air conditioners added over the past five years and a projection of the continuous growth in the next five years (Exh. 33, pp. 7-8; Exh. 265, p. 1). Yet Con Edison seems to be reluctant to relate the appliance saturations to its revenue forecast. Con Edison either did not model appliance additions or denies the relationship between sales run up and appliance saturations. The Company even asks that its appliance study should not be given any weight by the trier of fact in determining a sales forecast in this proceeding (Tr. 3915, Lns. 12-14). We find that the higher growth rates are consistent with the recent run up in appliance saturation and sales growth. The projection is also in line with Staff’s belief that the higher responsiveness in sales to weather will not decrease (Exh. 36, p.2; Tr. 620, Ln. 2; Tr. 3900, Lns. 3-12).

Indeed, Con Edison's appliance survey does show that there is a significant increase in the saturation rates in 2005 and 2006 for many cooling and electronic appliances (Exh. 263, p.7).[33] This information shows that the additional response of sales to weather experienced in 2005 and 2006 is permanent in nature, not temporary as Con Edison claims (Tr. 580, Lns. 6-10). As such, the elevated response in sales will remain in the forecast where the weather is assumed to be normal. In fact, as discussed below, the additional response of sales to weather remained in a cooler than normal summer, Summer 2007.

The Company contends that Staff did not define the surge in appliance saturation and how the conclusion was made from the data. The Company is incorrect. The significant increases in saturation rates in 2005 and 2006 are apparent if one does a simple calculation of the average annual rate of change for the projection for 2006

[33] Exhibit 263 shows that the following appliance saturation grew at higher rates in either 2005 or 2006 than that projected for 2006-2011 on an annual basis: secondary, tertiary, and central room air conditioners, attic fans, television and electronics, dishwashers, driers, and microwave ovens. We believe that the forecasted growth rates for 2006-2011 were based on the historical average.

to 2011 and compares it with those of 2005 and 2006 (Exh. 263, pp. 7-8).

Furthermore, Con Edison argues that consumers may not use the added cooling appliances during normal weather (Tr. 579, Lns. 15-18). The Company's argument is misleading and self-contradictory based on the evidence adduced at the hearing. No appliances in Exhibit 34 were claimed by the Company's Forecasting Panel to be related only to warmer than normal weather. In fact, they all were considered by Con Edison's Forecasting Panel to be weather sensitive and contributing to normal weather load (Tr. 612, Lns. 14-19; Tr. 616, Lns. 16-20).[34] An increase in appliances unarguably leads to higher usage of energy during normal weather.

The Company is also incorrect in arguing that the recent significant changes in the saturation rates would have been captured by the constant term of the model (Tr. 580, Lns. 4-6; Tr. 606, Lns. 9-16). The constant term shows the average growth rate of sales volume at an annual rate of 1.3%. In contrast, the actual annual rates of change in the weather normalized sales for the third quarter for 2006 and 2007 were both around 6% (Tr. 618,

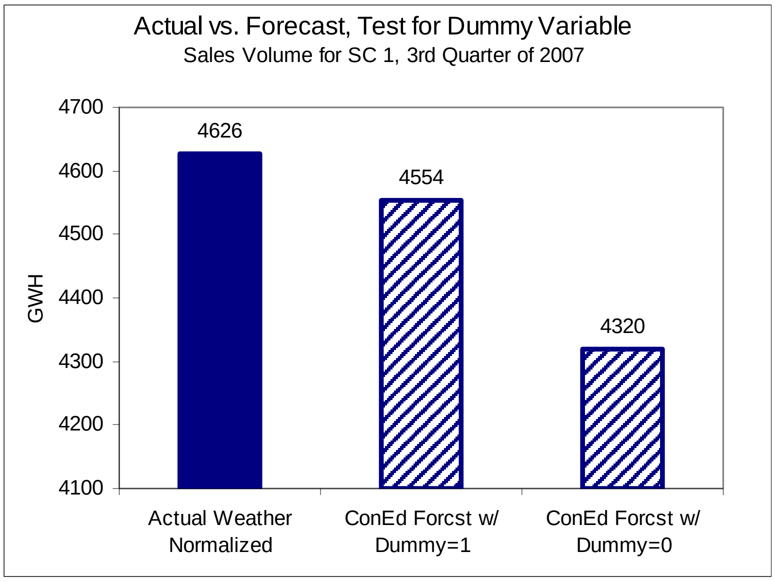
[34] The Company defines base load as the sales level when all the variables are at their normal levels, including weather.

Lns. 11-21; Tr. 619, Ln. 4 - Tr. 620, Ln. 3). As discussed later, we show that Con Edison's forecast is understated by a significant margin, which confirms that its model does not capture the recent significant growth in appliance saturation.

Con Edison also claims that Staff did not provide any data or study to support that the level of responsiveness will remain high when weather returns to normal. The Company's claim is false. Staff did provide a statistical analysis showing that the higher level of responsiveness in sales was carried over from 2005 to 2006 in our forecast evaluation test (Tr. 3900, Ln. 13 - Tr. 3901, Ln. 10; Exh. 264, p. 1).

The Company misinterpreted Staff's forecast evaluation analysis. When the model was estimated for a shortened sample up to 2005, the estimated higher level of the sales responsiveness captured by the dummy variable is only from 2005. Assigning the dummy variable a value of 1 in the ex post forecast for 2006 means that the impact captured by the dummy variable remained in the third quarter of 2006.

In fact, the impact captured by the dummy variable also remained in 2007 when we compared Con Edison's forecast with actual data for the sales volume for the third quarter of 2007 (see Chart below).[35]



As such, if the Company's proposed dummy variable was of any use at all, only assigning it a value of 1 for the forecast could the Company's methodology be consistent with the permanent impact of appliance additions on sales forecast.

Because the Company's SC 1 model does not contain any variable to reflect appliance saturations (Tr. 606, Lns. 17-21; Exh. 32, p. 1), and because it does not contain a personal income variable to capture the impact of ownership of appliances and larger homes as discussed earlier, the

[35] Source of the data for the Chart: Exh. 36, p. 1 and Exh. 263, pp. 11-12. Con Edison's forecast for SC 1 with D2005603=1 is 234 GWhs higher than that with D2005603=0 for the calendar year 2007. The difference is all in the third quarter. The 4,320 GWhs is the model forecast net of DSM.

Company's forecast is understated. As shown in the above chart, the Company's forecast is already understated by more than 300 GWhs for 2007.

3. Forecast for Normal Weather

The Company's forecast for CDD is incorrect and does not match its 30-year historical average as defined for the normal weather. Staff's adjustment to these weather variables leads to an upward revision to the forecasts for all SCs that have CDD as an input.

The Company included weather data for all months of the year when developing its models, but used data only for May through October when developing the forecast for CDD (Tr. 624, Lns. 18-21). The inconsistency resulted in a forecast below the normal by 23 to 27 CDD per year (Exh. 264, p. 2).

The Company does not deny the fact that only the CDD data for May through October were used in calculation of the normal weather, the CDD for other months were either set to be 0 or not used (Exh. 30, Attachment 2, p. 17; Tr. 621, Ln. 10 - Tr. 622, Ln. 14; Tr. 627, Ln. 18 - Tr. 628, Ln. 4). In defending its weather forecast, the Company focused its argument on the daily CDD within a month and the weather transition between the winter season and summer season (Tr. 622, Ln. 15 - Tr. 626, Ln. 8). It argues that the 30-year average is smoothed so that normal CDD shows a gradual increase into summer and gradual decrease out summer (Tr. 585, Lns. 15-17). It also asserts that its method is consistent with the practice of the National Weather Service Bureau (Tr. 585, Lns. 11-15).

Arguing why CDD should be smoothed within a month or a quarter is irrelevant for the sales forecast. A daily CDD analysis would only be useful in tracking day-by-day energy consumption related to gradual increases in cooling activities. The more relevant data is the total CDD for the month or quarter used by the Company to develop sales volume forecast by the month or quarter. In order to produce an unbiased sales forecast, the data that Con Edison used to estimate the weather forecast must be consistent with the data it used to develop the sales forecasting models.

The Company is also incorrect in referencing the practice at the National Weather Service Bureau. The CDD created by the National Weather Service Bureau is 65-degree based, whereas Con Edison's CDD is 57.5-degree based. While the level of the 65-degree based CDD in April may be negligible, the 57.5-degree based CDD is not. As the record shows, Con Edison's 57.5-degree based 30-year average CDD for April alone amounts to 15 (Exh. 37, p. 2).

4. Forecast for Number of Customers

Staff also recommends an adjustment to the "number of customers" forecast for SCs 1, 2, and 7. For SCs 2 and 7, the Company's forecast is based on recent trends (Tr. 558, Ln. 23 - Tr. 559, Ln. 1). Staff's forecast is based on the Box-Jenkins method and also reflects the long term trend (Tr. 3906, Lns. 3-7). For SC 1, Staff used the same methodology as the Company, but based on a different model. Staff's models produce more accurate forecasts for all the three classes than the Company's models when compared the recent actual data for 2007 (Exh. 264, p. 3).

Con Edison only disputes Staff's model for SC 1 and disagrees that Staff's model is superior in goodness-to-fit or performs better in forecast evaluation (Tr. 583, Lns. 2-7). The Company contends that it is not valid to use R-square to measure the goodness-to-fit because Staff's model does not have the same dependent variable as Con Edison's (Tr. 583, Lns. 11-12). It asserts other statistics should be used in this situation and the Company's model is better under these other statistics (Tr. 583, Ln. 20 - Tr. 584, Ln. 3).

The Company's assertion is unfounded. The other statistics cited by the Company, including log-likelihood, Akaike Information Criterion, and Schwarz Criterion all depend on the unit of measurement of the dependent variable. If the Company claims that the R-square is invalid for comparison, then it follows that the other statistics that the Company used are invalid, too.

Con Edison also does not agree that Staff's SC 1 model performs better in forecast evaluation. The ex post forecast evaluation involves using a subset of historical data to estimate the same model and evaluating the accuracy of the model forecast for recent historical sales volume. Staff used the data through 2004 to estimate the model and evaluate the forecast for 2005-2006 (Tr. 584, Lns. 14-19). The Company instead used data through 2003 to estimate the model and evaluated the forecast for 2004-2006 (Tr. 584, Lns. 12-14). It asserts that although Staff's model performed better in a two-year ex post forecast, the Company's model performed better in a three-year ex post forecast (Tr. 584, lns. 14-19).

The Company's assertion has no bearing on evaluating the forecasting performance. The ex post forecast is to evaluate how accurately a model predicts recent history. Two years has been the conventional time frame of the ex post evaluation for a quarterly or monthly sales forecasting model and Con Edison used it in the previous electric rate case (Case 04-E-0572). An ex post forecast further back into history is less valid as it is more distant from the current situation.

5. Price Deflators

Another drawback of Con Edison's models is the inappropriate use of a price deflator to convert the price of electricity in real terms. Con Edison used the Consumer Price Index (CPI) for Urban Wage Earners and Clerical Workers for the New York Metropolitan Statistical Area for all service classes (Tr. 3906, Lns. 12-17). The method is wrong in two respects. First, CPI should be only used for residential customers, since it measures overall price increases of goods and services for residential consumers. For commercial and industrial customers, the chained GDP price index should be used, as it measures the price increases of all goods and services. Second, even for the residential customers, the CPI for a broader group, or the CPI for All Urban Consumers for the New York Metropolitan Statistical Area should be used. The CPI for All Urban Consumers covers 87% of the population, whereas the CPI for Urban Wage Earners and Clerical Workers covers only 32% of the population (Tr. 3908, Lns. 1-14; Exh. 266, p. 2). Therefore, Staff's CPI is more representative of Con Edison's residential customers than the Company's CPI. Con Edison accepted the changes in price deflators that Staff proposed (Tr. 586, Lns. 13-14). It estimated that the effect on sales forecast is minimal (Tr. 586, Lns. 14-15).

Conclusion

Staff proposed adjustments correct the problems with Con Edison's forecasting models, as discussed above. Our forecast is more reasonable and more accurate when compared to the Company's forecast and therefore the Company's forecast should be rejected in its entirely and Staff's sales forecast should be adopted.

G. Cost of Capital

1. Capital Structure

The Company and Staff use different methodologies in order to determine the appropriate capital structure that the Commission used to establish the overall rate of return on Con Edison's electric rate base. The Company relies on a "stand-alone" methodology, while Staff starts with a consolidated capital structure and subtracts non-utility investments at certain ratios in order to arrive at a recommended utility capital structure. The differing methodologies currently result in the Company proposing a 48.68% equity ratio and Staff recommending a 47.98% equity ratio (Exh. 90, (AP-11), Schedule 1; Tr. 3712, ln. 20). The revenue requirement implications of this disagreement are in the $9-13 million range, depending on the cost of equity assumed in the calculation and the level of rate base that the resulting return is applied to.

a. Con Edison's "Stand-Alone" Methodology

The Company's Accounting Panel developed its rate year capitalization estimate based on an approach that began with Con Edison's "stand-alone" capital structure (Tr. 1354, Lns. 15-21). The stand-alone capital structure is the capitalization reported on the Company's books for Consolidated Edison Company of New York, Inc. This stand-alone capital was then projected through the end of the rate year based on the Company's assumptions regarding construction expenditures, refunding needs and internal cash flows. The projection was then used to develop the average capital structure for the rate year (Tr. 1355, Lns. 1-6).

The Company's projected rate year capital structure is 48.88% long-term debt, 48.68% common equity, 1.21% preferred stock, and 1.23% customer deposits (Exh. 90, (AP-11), Schedule 1). This estimate has not been updated since the Company's direct testimony was filed.

Company witness Hoglund testified that the Commission "has established a decisive precedent in its National Grid/Keyspan merger order" by approving a capital structure which is not based on that of a parent company (Tr. 2901, Lns. 14-16). However, the approved capital structure in that proceeding was simply one part of a Joint Proposal which the Commission approved (with modifications). The issue of appropriate capital structure was not specifically decided on by the Commission in that case, and the degree of financial insulation in the final order undermines any assertion that Grid/Keyspan was a "decisive precedent".

Mr. Hoglund also testifies that "Recent CECONY rate agreements have applied the utility's stand-alone capitalization" (Tr. 2902, Lns. 19-20). This is also incorrect. Rates for each of Con Edison's operating divisions (electric, gas, and steam) were set by the Commission adopting, in whole or in part, joint proposals by the parties in those proceedings. Each of those rate plans used 48% as the equity percentage. This was agreed to by Mr. Hoglund during the hearings in this case (Tr. 2978, Lns. 5-8). Con Edison did not have a 48% stand-alone equity ratio at the time rates were set for each of the Company's utility divisions (Exh. 193, p. 13; Exh. 194, p. 13; Exh. 195, p. 12).

Contrary to Mr. Hoglund's testimony, Commission precedent regarding the calculation of a capital structure in a litigated rate case has clearly been to start with the parent company's capital structure and to adjust it assuming reasonable levels of debt and equity for non-utility operations. This is the methodology which was most recently employed by the Commission in the recent Orange & Rockland Utilities, Inc. (O&R) electric rate case.[36] It was also the method used by the Commission in the New York State Electric and Gas Corporation electric rate proceeding.[37]

b. Staff's Concerns with Stand-Alone Approach

As Staff's Finance Panel described in its direct testimony, the use of a stand-alone capital structure for utility subsidiaries does not necessarily reflect rational capitalization policies or actual equity employed, thus, the results may not be reasonable (Tr. 3715, Lns. 2-22). Further, the use of a stand-alone capital structure may obscure the fact that non-utility investments are not financed at reasonable levels (Tr. 3715-3716). Absent proper ratemaking, there is an incentive for a utility holding company to shift equity away from non-utility operations and into regulated operations in order to

[36] Case 06-E-1433, Orange & Rockland Utilities, Inc. – Electric Rates, Order Setting Permanent Rates (issued October 18, 2007).

[37] Case 05-E-1222, New York State Electric & Gas Corporation – Rates, Order Adopting Recommended Decision with Modifications (issued August 23, 2006).

receive a higher allowed return for the regulated business. Therefore, the use of a stand-alone capital structure in isolation is not appropriate.

c. Staff’s Capital Structure Approach

Staff’s approach to determining a reasonable capital structure for the rate year starts with the reported capitalization ratios for Con Edison, Inc. (“CEI”, the parent company), Con Edison, and O&R (Exh. 250, (FP-3), p. 1, columns 1-3). The capital reported for each of the stand-alone utilities was then subtracted from the parent company’s capital, with the remainder being the financial profile of CEI’s non-utility operations and assets.

This calculation found that CEI’s non-utility operations were financed with 51.3% equity, slightly lower than the combined equity ratio of CEI’s utilities (Exh. 250, (FP-3), column 5). Given the nature of the unregulated subsidiaries (a retail energy services company, a wholesale supply company, and a company which owns and operates generation and infrastructure investments), it is not reasonable to have equity ratios which are lower than those supporting regulated operations. To do so places an inordinate burden on regulated utility operations to support the credit rating of the holding company, while non-regulated operations enjoy better access to capital, and either don’t support the credit rating of the holding company at all, or support it at a lower level.

CEI’s non-utility subsidiaries face the risks of competition and have higher business risk than Con Edison’s utility subsidiaries. In addition, to support the same credit rating that utility operations should support, non-utility subsidiaries need a higher equity ratio. In response to Staff IR DPS-237 (Exh. 248, (FP-1)), Company witness Morin agreed that non-utility investments have higher business risk than utility investments. The financial guidelines published by Standard & Poor’s (S&P) (Exh. 251, (FP-4), p. 5) show that less risky operations, such as regulated transmission and distribution (T&D) investments, are able to have less equity than riskier investments (such as the energy–related non-utility investments of CEI) for each given bond rating.

Given the higher risks of CEI’s non-utility operations, one would expect that they would be financed with significantly higher levels of equity than the regulated T&D assets. Staff therefore imputed a higher equity ratio for the non-utility investments and subtracted these revised levels of capital from the consolidated capital structure to arrive at a “utility” capital structure (Exh. 250, (FP-3), column 7).

Staff based its revised capitalization ratios for the non-utility investments on the S&P guidelines (Exh. 251, (FP-4), p. 5) for A-rated companies with a business profile score of “8”. The business profile score of “8” was chosen since most of CEI’s non-utility investments are in power generation, and most such companies are designated as having a score of “8” or “9” (Exh. 251, (FP-4), p. 4). The A-rating was based on Mr. Hoglund’s direct testimony as to the need for improved financial ratios in order to maintain an “A” rating and the consequences of not doing so (Tr. 2885-2887, 2890). In addition, Mr. Hoglund states that the Company’s “proposal is filed assuming the Company would maintain an A-rating” (Tr. 2949, Lns. 8-9).

Mr. Hoglund states that the Company believes ratepayers should support financial ratios strong enough to ensure an “A” rating from S&P even while non-regulated investments are financed such that they would not achieve an “A” rating if they were stand-alone entities (Tr. 2950-2951). Staff disagrees with this approach. S&P considers the consolidated capital structure of a company when determining a company’s credit rating. In order for Con Edison to maintain an “A” rating, its consolidated capitalization ratios must be adequate. If the Company invests in non-utility operations and finances them with low levels of equity, then the utility must have extra equity in order for the total consolidated Company equity to be sufficient to maintain it rating. Customers of the regulated businesses should not have to support more equity capital than they would if there were no non-utility investments. If the Company maintains its stance on this issue, it is clear that they expect customers to support the credit rating for non-regulated operations with higher rates than are necessary.

Staff used the mid-point of the S&P financial guidelines for a company with a business profile score of “8” and an “A” credit rating to determine reasonable levels of debt and equity. The guidelines call for total debt to be between 35% and 42%, with the mid-point being 38.5% (Exh. 251, (FP-4), p. 5). This would mean the mid-point for the equity ratio would be 61.5%.

After subtracting reasonable levels of debt and equity associated with non-utility investments from the consolidated amounts, Staff arrived at a “utility” capital structure for a point in time (June 30, 2007). In order to reflect an accurate estimate of the rate year average capital structure, Staff used the information available in the Company’s Accounting Panel workpapers as well as exhibits submitted by O&R in Case 06-G-1433 (Exh. 252) to reflect the changes in debt and equity balances the Company was forecasting for the period between June 30, 2007 and March 31, 2009 (Exh. 250, p. 2). Using the average rate year balances for each type of capital, the resulting capitalization ratios were determined and used in the calculation of a weighted-average cost of capital.

Staff's approach resulted in a recommendation of a 49.65% long-term debt ratio, a 47.98% equity ratio, a 1.13% preferred stock ratio, and a 1.24% customer deposit ratio (Exh. 250, (FP-3), column 9). The recommended equity ratio is nearly identical to the 48.0% ratio used to set rates for each of the Company's utility divisions over the past several years (Exh. 248, (FP-1), response to Staff IR DPS-265).

It is important to keep in mind that Staff's debt ratio recommendation is on the strong end of the range recommended by S&P in its financial guidelines for a company of Con Edison's risk level (Tr. 3724-3725). In addition, Staff's recommendation is very conservative when compared to the debt levels of other utility companies, which on average have much greater business risk. For instance, Staff's proxy group (updated to reflect the addition of one company due to a bond rating change) is expected to have an average equity ratio of 49.5% in 2008

(Attachment FP-A, update of Exh. 253 (FP-6)). These companies have, on average, a business profile score of “5”, meaning they are much riskier than Con Edison, with a business profile score of “2”. Despite the large risk difference, our recommended equity ratio is only 1.5% lower than the proxy group’s expected 2008 average. Our recommendation actually exceeds the expected average common equity ratio of Dr. Morin’s proxy group (Tr. 3725, Lns. 22-24).

In the Company’s direct testimony, Mr. Hoglund provided an exhibit which showed equity ratios allowed in various cases since 1992 (Exh. 187, (RH-1), p. 1). In response to Staff IR DPS-265, Mr. Hoglund provided information which showed that the average equity ratio approved by regulatory commissions throughout the United States over the last three years of the data, 2004-2006, was 47.87%, with the average for 2006 being 50.07% (Exh. 248, (FP-1), response to Staff IR DPS-265). Mr. Hoglund has acknowledged that Con Edison is one of the safest utilities in the country (Tr. 2883, Lns. 18-23), and that fact is supported by an examination of bond ratings and business profile scores for Staff’s proxy group (Attachment FP-A, update of Exh. 253 (FP-6)). Staff’s recommended equity ratio of 47.98% is only slightly lower than the average equity ratio allowed in 2006, even though the Company’s need for an “equity cushion” is much less than that of the average utility given its low business risk.

The Company’s response to the fact that average equity ratios allowed in 2006 are slightly higher than they have requested is to state that their “request for an equity ratio of 48.68% is outmoded and could be increased in subsequent rate filings” (Tr. 2909, Lns. 7-9). So, regardless of the level of risk, Con Edison is stating that it should receive the national average, no matter what the rate impacts are on customers. The Company’s mindset of “entitlement” can also be seen in the testimony regarding return on equity, as discussed below and in the areas of incentives for conservation, management bonuses, and dramatic increases in construction spending without accountability.

Finally, Mr. Hoglund has stated in his rebuttal testimony that “Staff assumes that the equity and debt in the non-regulated portion of CEI’s business will not change from the levels at June 30, 2007.” (Tr. 2907, Lns. 10-13). This is incorrect. Staff’s methodology subtracts out non-utility investment at reasonable debt and equity ratios given the nature of the businesses. As Mr. Hoglund acknowledged under cross-examination, Staff’s adjustment would decrease should the Company's non-utility investments be funded with more equity than they were on June 30, 2007 (Tr. 2951-2952).

In conclusion, the Commission should use Staff's equity ratio recommendation to determine an appropriate capital structure. The recommendation is in-line with what other utilities (nearly all riskier than Con Edison) are currently operating under, is well-within the guidelines for an A-rated utility with Con Edison's business profile score, and is nearly identical to the equity ratio that has been in place at Con Edison's utility divisions for several years. Our proposed equity ratio will not result in a credit downgrade or a loss of access to reasonably priced capital.

2. Cost of Equity

There is significant disagreement between the Company and Staff as to what return on equity (ROE) the Commission should employ when establishing the overall rate of return (ROR) on Con Edison's rate base. The Company testified that an ROE of 11.5% is reasonable (11.2% for a one-year case) (Tr. 2634, Lns. 12-15; Tr. 2635, Lns. 5-6). Staff's updated ROE recommendation, as discussed below, is 9.0%. The revenue requirement implication of this disagreement is in the $267-278 million range, depending on the capital structure assumed in the calculation and the level of rate base that the resulting return is applied to. Every ten basis points (or 0.1%) difference in the ROE equates to approximately $10.7 million, given Staff's capital structure and rate base recommendations.

The remainder of the return on equity portion of the brief will address the Company's return on equity methodologies, the problems inherent in its approach, Staff's return on equity methodologies, the adjustments Staff makes to its return on equity calculation, and the reasons why the Commission should adopt Staff's recommended return on equity approach.

a. Proxy Groups

It is generally accepted that proxy groups should be used when estimating the cost of equity. By using a group of proxy companies, the impact of any irregularities in any one company's data is diminished. The general goal of such a proxy group is to develop one which is similar in risk to that of the company one is trying to estimate the cost of equity for while maintaining a reasonably sized group, one with enough companies to ensure individual vagaries are smoothed out.

i. Company Proxy Groups

Company witness Morin used two proxy groups in his discounted cash flow (DCF) methodologies. The first was 17 investment-grade companies which S&P has deemed electric distribution companies and which are covered by the publication *Value Line* (Tr. 2621, Lns. 20-22; 2682, Lns. 21-23). The group can be seen on page three of Exhibit 176. The second proxy group is the *Moody's Electric Utility Index* (Tr. 2683, Lns. 5-10). This index has not been updated or changed since 2002 since Moody's changed ownership (Tr. 2612, Lns. 19-20). The group can be seen on page 1 of Exhibit 179. For his Capital Asset Pricing Model (CAPM), Dr. Morin looked at the average beta of several groups and ended up using one that matched his S&P group (Tr. 2605, Lns. 1-5).

Staff has several concerns with Dr. Morin's proxy groups. Approximately half of the companies in his S&P-based proxy group derive less than 70% of their revenue from regulated utility operations. Some of the companies derive less than half of their revenues from utility operations (Tr. 3732-3733). The *Moody's Electric Utility Index* proxy group members have not been updated since 2002. They may or may not represent an "average" utility at this point. Dr. Morin states that he has not checked to see if the companies that make up this index are still investment-grade (Tr. 2685, Lns. 8-11).

In our direct testimony, we pointed out that Dr. Morin's proxy groups are riskier than Con Edison's electric operations (Tr. 3732, Lns. 19-21). Dr. Morin states in his rebuttal testimony that such a criticism is "strange and quite unwarranted" given that his proxy group's average beta is less than that of Staff's proxy group and the average bond rating of his group is slightly higher (Tr. 2666A-34, Lns. 2-5). Staff does not dispute that its proxy group is also riskier than Con Edison electric (in fact, that is why Staff has proposed a credit quality adjustment), Staff was merely pointing out that Dr. Morin's groups are riskier than Con Edison's electric division.

ii. Staff Proxy Group

Staff's Finance Panel devised a proxy group with, on update, 30 companies. All are investment-grade, are paying dividends, are covered in *Value Line*, have no merger activity, and receive over 70% of their revenue from utility operations (Tr. 3728, Lns. 6-16). This proxy group, along with each company's bond rating and business profile score, can be seen in Attachment FP-A (update of Exh. 253, (FP-6)). Staff's direct testimony had a proxy group of 29 companies and can be seen in Exhibit 253. One company's bond rating was upgraded since Staff filed its direct case, hence the update.

Staff's proxy group has an average bond rating of between BBB and BBB+. It has an average business score of 5.0. Given that Con Edison has a bond rating of A/A+ and a business profile score of "2", the group is clearly riskier than Con Edison electric. Such a trade-off is necessary, however, in order to have a proxy group large enough to be meaningful.

The Company has offered no criticism as to the approach Staff took in developing its proxy group. The Commission should adopt Staff's proxy group methodology since it ensures only investment-grade companies which derive substantial portions of their overall revenue from utility operations are included in the group. This is the same methodology the Commission has recently utilized in Case 06-E-1433.[38]

b. ROE Methodologies

The Company employed three separate approaches to arrive at its 11.5% recommended cost of equity, all of which are problematic. The Company presents a DCF approach, a CAPM approach, and a risk premium approach (Tr. 2587, Lns. 19-22). The ROE recommendation includes a 30

[38] Case 06-E-1433, supra., pp. 10-11.

basis point stayout premium as part of a request for a three-year rate plan (Tr. 2635, Lns. 5-6). The Company has no adjustment for credit quality differences between its proxy group and Con Edison electric (Tr. 2634, ln. 6). The Company includes flotation costs in its estimates. There is a 20 basis point adjustment made to the DCF results (Tr. 2627, Lns. 10-13) and a 30 basis point adjustment to its CAPM results (Tr. 2608, Lns. 21-22).

Staff’s Finance Panel employed two equity costing methodologies, a DCF and a CAPM. It weighted the results as the Commission has in prior litigated rate cases, with two-thirds of the result being from the DCF methodology and one-third from the CAPM methodology. On update, Staff’s recommended ROE is 9.0%, as shown on page 3 of Attachment FP-B (update of Exh. 255, (FP-8)). This result includes adjustments related to the proxy group’s credit quality, issuance expenses, and the impact of a revenue decoupling mechanism (RDM).

i. Company’s DCF Methodologies

The Company conducted four different DCF analyses. It used the two proxy groups described earlier (S&P distribution utility utilities and *Moody’s Electric Bond Index* companies) and applied the growth estimates of *Value*

Line and Zacks Investment Research (“Zacks”) to each of the proxy groups (Tr. 2621-2623).

The inputs to determine the cost of equity (Ke) estimate was the dividend yield, dividends divided by price (D_1/P_0), and a growth estimate (g) (Tr. 2620, ln. 21). The equation is as follows: $Ke = (D_1/P_0) + g$. The price used was the current price (Tr. 2622, Lns. 5-14). Dr. Morin argues that using the current price uses the best indication of future prices (Tr. 2622, Lns. 7-8). However, the current price may reflect investor reaction to data which is not yet built into your growth estimate due the estimate being stale. This is especially true if using data that is only updated once every three months, such as *Value Line* information.

The dividends used were the current dividends increased by the growth rate (Tr. 2622, Lns. 3-4). Instead of expected dividend growth, Dr. Morin used analysts’ long-term growth forecasts contained in *Value Line* and Zacks (Tr. 2623, Lns. 14-16). Dr. Morin states that he did not consider using dividend growth rates because “it is widely expected that utilities will continue to lower their dividend payout ratio over the next several years” (Tr. 2625, Lns. 3-4). Dr. Morin was asked in Staff IR DPS-243 for citations of such expectations, and he provided none (Exh. 248, (FP-1), response to Staff IR DPS-243).

In addition, in the same IR response, Dr. Morin stated that he did not know Con Edison’s plans regarding dividend payout ratios. As Dr. Morin does not know the dividend payout future of Con Edison, the company he is working for and a company with one of the highest dividend payout ratios in the utility industry (Exh. 248, (FP-1), response to Staff IR DPS-244), it is strange that he is then able to state with certainty what will happen throughout an industry and use that belief to ignore cash flow expectations in a discounted cash flow methodology.

Dr. Morin also states that utility “dividend growth has remained largely stagnant in past years” and thus dividend growth rates are “unlikely to provide a meaningful guide to investors’ growth expectations for utilities in general” and “investors’ attention has shifted from dividends to earnings” (Tr. 2625, Lns. 12-18). However, in response to Staff IR DPS-244 (Exh. 248, (FP-1), response to Staff IR DPS-244), Dr. Morin provided a calculation that the average annual dividend growth over the past five years was 7.1%, while the average annual earnings per share (EPS) growth was 5.6%. The ten-year average annual dividend growth rate has been 3.1% (Exh. 248, (FP-1), response to Staff IR DPS-244).

Dr. Morin’s statement that dividend growth has been stagnant is proven false by his calculation of dividend growth over the previous five years. He has provided no support for his statement that investors’ no longer focus on dividends when pricing a stock. Dividends of most utilities are stable and predictable, a fact companies tout to investors. For instance, on Con Edison’s web site, they are extolling the fact that the Company’s dividends have increased for 32 consecutive years (Exh. 197, p. 29).

The Company uses growth rates of 6.4% to 7.2% in its DCF calculations. These are very high growth rates to assume. As was mentioned, the ten-year average annual growth rate in dividends has been 3.1%, while the EPS growth has been 3.4% per year over the same time period (Exh. 248, (FP-1), response to Staff IR DPS-244). Dr. Morin is using short-term estimates of earnings growth rate estimates, ones that are approximately twice as high as recent ten-year averages. Dr. Morin has provided no evidence that such an assumption is reasonable.

Using the four DCF methodologies, the Company calculated the cost of equity to be 10.2%-11.2%. It then adds 20 basis points to each result as an issuance expense adjustment (Tr. 2627, Lns. 9-13, 19-23; Tr. 2628, Lns. 7-10, 13-16). The four methods produce an average return estimate of 10.9%, including issuance expenses (Tr. 2633, ln. 19).

Dr. Morin proposed the same DCF methodology in Case 06-E-1433, and the Commission rejected it in that case, stating, "Orange & Rockland's use of a single stage earnings per share growth as the appropriate DCF growth rate is not reliable, and we will not adopt it here. The company has not demonstrated any link between its earnings per share growth estimate and the future dividend growth of the proxy group based on the actual dividend pay-out policies of the companies in that group. Moreover, there is no evidence suggesting that Orange & Rockland's earnings growth rate estimate is sustainable over time."[39] The Commission should reject such an approach in this proceeding as well.

ii. Staff's DCF Methodologies

Unlike the Company's DCF methodology, Staff employed a model which recognized that short-term expectations do not necessarily equal long-term expectations. Staff also used dividend growth estimates, as opposed to earnings growth estimate (Tr. 3734, Lns. 4-10). Staff used a two growth

[39] Id. at pp. 9-10.

DCF methodology which uses short- and long-term growth estimates for dividends and then solves for the discount rate that equates the current stock price to the stream of all future dividends (Tr. 3733, Lns. 15-24). This discount rate is the cost of equity. The model relied upon a six-month average stock price and *Value Line* data for earnings per share, dividends per share, book value per share, and the amount of stock outstanding for each of the proxy companies (Tr. 3733, Lns. 5-14).

The short-term growth rate was based on *Value Line* analysts' expectations of dividends over the next five years. The long-term, or sustainable, growth rate is based upon each company's forecasted retention of earnings and their growth in common stock balances (Tr. 3734, Lns. 4-10). The sustainable growth rate is 5.07%, on update (Attachment FP-B, p.2, update of Exh. 255 (FP-8)). This is nearly identical to the average of the five- and ten-year dividend growth rates calculated by Dr. Morin for his proxy group (Exh. 248, (FP-1), response to Staff IR DPS-244).

Staff's methodology reflects actual investor expectations, based on the direct observation of utility equity investors' behavior (the pricing of stock given expected dividend streams). Investors and companies (not just utilities) often use cash flow methodologies when determining returns. Bond investors price bonds to achieve certain yields, given expected interest payments. Companies use cash flow expectations to determine if "hurdle rates" for investments can be met.

The use of a six-month average stock price is reasonable for several reasons. First, the spot price (current market price) may be an aberration. Using a longer period will smooth out any "noise" associated with stock prices. In addition, Staff's methodology relies upon *Value line* data to determine growth rates. It is possible that this data, which is updated only every three months, could be stale. By including the stock price when the data was first published in the average price of the stock, Staff is matching the price to when growth estimates used by investors' were published. In fact, the Commission recently adopted the use of six-month price data in Case 06-E-1433, stating that, "However, use of the six-month data does serve to limit volatility, and it assures better alignment of the dividend yield calculation and the underlying data used to estimate investors' expected growth."[40]

[40] Id. at p. 11.

Staff used the annual dividend DCF model, as the Commission did in Case 06-E-1433.[41] Staff is conservative by using 2008 as the first year of dividends, even though the stock price is, on average, from mid-2007.

Staff's DCF methodology, when updated, results in a cost of equity of 8.57% (Attachment FP-B, p. 2, update of Exh. 255 (FP-8)). The Commission should incorporate the results of this DCF methodology when setting Con Edison's return. As we have discussed, the DCF methodology has been used by the Commission in recently litigated rate cases, it recognizes that short-term expectations may not be sustainable in the long-run, and it uses actual investor behavior to calculate its ROE estimate.

iii. Company's CAPM Methodologies

The Company uses two CAPM methodologies, the "traditional" CAPM and an "empirical" (or "zero-beta" CAPM) CAPM (Tr. 2600, Lns. 11-12). These are the same two CAPM methodologies used by Staff (Tr. 3737, Lns. 3-5). However, Staff believes that a key component of any CAPM calculation, the market risk premium, is grossly overstated by the Company.

The traditional CAPM methodology calculates a required return based on three inputs: The rate of return on a risk-

[41] Id. at p. 11.

free investment (Rf), the level of systematic risk for an investment (B, known as “beta”), and the expected market risk premium of the market (Rp). The risk premium is the amount the stock market, as a whole, is expected to earn more than the risk-free rate. The calculation can be represented as:

Required Return = Rf + (B * Rp)

The Company uses a risk-free rate of 4.8%, based on the 30-year Treasury bond yield in March 2007 (Tr. 2604, Lns. 1-2). While Staff uses an average of the ten- and 30-year Treasury bond yields over a six-month period, the yield curve is sufficiently flat so that there is little practical difference between the two approaches. This is especially true when betas are near 1.0, at which point changes in the risk-free rate do not result in any change in the required return estimate produced by the model.

The beta, or the correlation of the return of a stock to the market, used by the Company is also similar to that used by Staff. Dr. Morin uses a beta of 0.91. This is much higher than betas have been in the recent past. Dr. Morin states that over the past ten years, “We have seen a steady escalation in the betas of the utilities from the .7 level to nearly one.” (Tr. 2679, Lns. 23-25).

The Company uses a market risk premium (MRP) of 7.6%. This is an average of historical and forward-looking studies of long-term risk premiums (Tr. 2605, Lns. 16-17). The historical study is one by Ibbotson Associates, which looked at the historical MRP over the period of 1926 to 2005. The study found that stocks have achieved returns of 7.1% more than the income portion of long-term Treasury bonds (Tr. 2605, Lns. 18-22).

The problem with the use of a historical MRP study is that it does not necessarily reflect the current investment climate. It is an average of return differentials between bonds and the stock market over periods much different from today. Many in the financial community believe that the equity risk premium has been decreasing over time and is currently very low. An example of this viewpoint can be seen in an article entitled "*The Shrinking Equity Premium*", by Professor Jeremy Siegel (Exh. 257, (FP-10)). The Commission has found the Ibbotson Associates data to be "stale and much less reliable than the up-to-date estimates available from Merrill Lynch."[42]

The forward-looking MRP study conducted by Dr. Morin calculates a MRP of 8.1%. This is calculated by adding the current average stock market dividend yield (1.328%) to a

[42] Id. at p. 12.

projection of dividend growth of 11.27%. Dr. Morin then increases this 12.55% market return estimate to account for a forward dividend yield and the recognition of quarterly dividends, rather than annual. He arrives at a return of 12.89%, from which he subtracts his 4.8% risk-free rate to arrive at a risk premium of 8.1% (Tr. 2608, Lns. 2-15).

We find it interesting that Dr. Morin is not willing to use dividend growth estimates in his DCF calculation, but is willing to use one in his MRP calculation. Perhaps it is because he has found a growth rate he likes (11.27%). Dr. Morin has produced no evidence that such a high growth rate is sustainable. The Commission recently determined that the same growth rate estimate was unreliable, and we request that the Commission do so again.[43]

In response to Staff IR DPS-246 (Exh. 248, (FP-1), response to Staff IR DPS-246), Dr. Morin states that he considered two other MRP's when developing his CAPM result. He cites a report by Dimson, Marsh, and Staunton which calculated a 7.0% MRP for the United States for the period of 1900-2000. He also cites a study by Harris, Marston, Mishra, and O'Brien which calculated a 7.2% MRP over the period of 1983-1998.

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[43] Id. at p. 13.

Staff's Finance Panel pointed out in its direct testimony that Dr. Morin cited an older version of the Dimson, et al., study (Tr. 3740-3741). The study was updated through 2005 and the MRP had decreased to 6.5% (Exh. 258, p. 18). Dr. Morin has acknowledged that the 2001-2005 returns were much lower than 1900-2000 (Tr. 2676, Lns. 6-15). He has also acknowledged the updated study in his rebuttal testimony (Tr. 2666A-28, Lns. 3-5). As Dr. Morin states in his direct testimony, risk premium studies should encompass "the longest possible period for which data are available" (Tr. 2614, Lns. 16-17).

Staff's Finance Panel also has pointed out the flaw in relying on the Harris, et al. study (Tr. 3741, Lns. 16-22). This study covers only the years 1983-1998. It is a rather short time period, and does not cover the most recent eight years. As the 2005 update of the Dimson, et al., study has shown, MRP's in the 2001-2005 period were very low. Dr. Morin states that one needs to use "very long time periods to get a better handle" (Tr. 2676, Lns. 14-15). This study does not use a long time period.

There are also other MRP estimates that have been introduced into the record during this proceeding (Tr. 3742-3743). Exhibit 259 ((FP-12), p. 36) contains a Duke University chief financial officer (CFO) survey which shows that CFO’s are expecting a MRP of 3.5%. Staff relies on Merrill Lynch’s *Quantitative Profiles*, which calculates a MRP of approximately 5.9% currently (Exhibit 256, (FP-9), p. 44).

In his rebuttal testimony, Dr. Morin attempts to quantify the “reverse” MRP estimates implicit in 178 regulatory decisions from 1997-2006 (Tr. 2666A-30, Lns. 1-2). Starting with the average risk premium in the decisions of 5.6%, and assuming an average beta of 0.8, Dr. Morin calculates an implied MRP of 7.0% has been approved by Commissions through the country (Tr. 2666A-30, Lns. 2-5).

Dr. Morin acknowledges that his study does not take into account any details of the rate plans, such as their term (Tr. 2678, Lns. 11-19). So Dr. Morin assumes that a higher MRP is implied by a regulatory commission when, actually, a stayout premium is included in an allowed return. He also assumes a higher MRP when a commission approves a rate plan “settlement” in which a higher allowed ROE has been allowed due to some concession on costs or higher level of sales by the utility. In short, basing MRP calculations on allowed utility ROEs, given the many factors that go into such numbers, is unreasonable and does not support his use of a 7.6% MRP in the CAPM calculation.

Given the inputs used by the Company, the traditional CAPM result is 11.7% [4.8% + (7.6% * .91)]. To this, Dr. Morin adds 30 basis points for issuance expenses (Tr. 2608, Lns. 19-23). The Company also calculates an empirical CAPM. This is similar to the traditional CAPM, using the same inputs, however it is weighted with 25% of the estimate assuming a beta of 1.0. With issuance expense costs, the Company arrived at a rate of 12.2% (Tr. 2612, Lns. 1-4). The Company than averaged the two CAPM results to arrive at 12.1% (Tr. 2612, ln. 7). This is the CAPM result the Company used in determining the 11.2% recommended ROE for a one-year case.

Staff recommends that the Commission again find the Company’s CAPM analysis, in particular its MRP approach, unreliable and reject it.

iv. Staff’s CAPM Methodologies

Staff employed the same two CAPM methods which the Company used, with different inputs. Staff’s risk-free rate is the average of 10- and 30-year Treasury bond yields. For the six months ended October 2007, that rate is 4.86% (Attachment FP-B, p.3, update to Exh. 255, (FP-8)). Staff’s proxy group beta is 0.95, on update (Attachment FP-B, p.3, update to Exh. 255, (FP-8)). As has been discussed, betas throughout the utility industry have increased dramatically in recent years. In Con Edison's last electric rate case, Case 04-E-0572, Staff's proxy group had an average beta of 0.70.

The major difference between the Company and Staff regarding the CAPM is regarding the correct MRP to use. Staff uses the market return estimate provided by Merrill Lynch in its *Quantitative Profiles*. This report uses a multi-stage dividend discount model ("Implied Return") and a CAPM model ("Required Return") to calculate an expected return for the S&P 500 each month. The risk-free rate is then subtracted from the return estimate to arrive at the MRP. The October 2007 average market return estimate is 10.75% (Exh. 256, (FP-9), p. 44). Subtracting a 4.86% risk-free rate results in a MRP of 5.9%. This method of calculating a MRP has been approved by the Commission in several cases, most recently in Case 06-E-1433.[44]

Using the inputs described, Staff's traditional CAPM result is 10.46%. Our zero-beta (or empirical) CAPM result is 10.53%. The average is 10.50%, and this return is used by Staff in determining our ROE recommendation (Attachment FP-B, p. 3, update of Exh. 255, (FP-8)).

Staff recommends that the Commission adopt its CAPM methodology when determining the appropriate ROE to use in

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[44] Id. at 13.

the calculation of Con Edison's overall cost of capital. As discussed above, the MRP is reasonable, and has been approved by the Commission in several previous cases.

v. Company's Risk Premium Methodologies

The Company uses two risk premium methodologies, a historical risk premium and an allowed risk premium (Tr. 2620, Lns. 6-12). The historical analysis uses the *Moody's Electric Utility Index* as a proxy for the utility industry. The returns from long-term Treasury bond yields are subtracted from the returns of the *Moody's Electric Utility Index* for each year (until the index stopped being updated in 2002) (Tr. 2612, Lns. 12-20). The average risk premium for the period of 1931-2002 is 5.6%. Using a 4.8% risk-free rate and 30 basis points for issuance expenses, Dr. Morin arrives at a return of 10.7% (Tr. 2613, Lns. 1-5).

Staff has highlighted several concerns with the Company's historical risk premium in its direct testimony (Tr. 3758-3759). As Dr. Morin points out, his approach assumes that the risk premium is constant over time (Tr. 2614, ln. 11). Dr. Morin has assumed that the actual returns from a defunct index of companies less the return of long-term Treasury bonds over the same time period is a reasonable proxy for the return premium expected by investors for Con Edison's electric division in 2008-2009. This methodology makes the assumption that Con Edison's risk is exactly equal to the risk of the utilities in the index and that the risk premium for such a utility has not changed.

Dr. Morin has testified that today's electric utility industry is "rapidly changing" (Tr. 2596, ln. 16), so much so that the DCF is "problematic for use in estimating cost of equity at this time" (Tr. 2596, ln. 20). In addition, we have already discussed the dramatic decrease in MRP seen over the 2001-2005 period in the Dimson, et al., study (Tr. 2676, Lns. 6-15). We have also discussed the belief by many financial experts that MRPs has been decreasing over time and is currently very low (Exh. 257, (FP-10)). Staff does not believe that the many assumptions needed for Dr. Morin's historical risk premium to apply to Con Edison are valid at this point in time.

Dr. Morin has provided no studies or analyses to determine the extent to which Con Edison today is more or less risky than whatever companies were in the Moody's index during the years of the analysis (Tr. 3758, Lns. 15-21). He has also provided no studies or analyses to determine the extent to which the risks of Treasury securities have remained at the same level relative to the risks of the companies that were in the index (Tr. 3758-3759).

The Company also has conducted an allowed risk premium study (Tr. 2615, Lns. 4-7). The ROEs approved by regulatory Commissions throughout the United States from 1997-2006 were compared to the long-term Treasury bonds at the time of each ROE decision. The average spread between the Treasury yield and the allowed ROEs was 5.5% (Tr. 2615, Lns. 14-15). Dr. Morin has cited an inverse relationship between allowed risk premiums and interest rates (Tr. 2616, Lns. 2-4). He states that when interest rates are low, risk premiums approved are generally higher. Therefore, given today’s low-interest rate environment, he declares that a 5.9% risk premium is appropriate (Tr. 2617). Given a 4.8% risk-free rate, Dr. Morin calculates a 10.7% cost of equity estimate. Since both of his risk premium methodologies arrived at a 10.7% cost of equity, he uses that as the risk premium result when deriving his overall ROE recommendation (Tr. 2620, Lns. 6-8).

Staff has testified to several flaws in Dr. Morin’s allowed risk premium analysis (Tr. 3759-3760). As Dr. Morin states in his response to Staff IR DPS-240, part B (Exh. 248, (FP-1), response to Staff IR DPS-240, part B), there is no attempt to factor in the average risk level of each utility, such as comparing companies with similar credit ratings to Con Edison. Many of the returns no doubt reflect stayout premiums in multi-year cases, similar to the one advocated by Dr. Morin in this proceeding. In addition, there are numerous variables which can lead to a company receiving a higher ROE in a negotiated settlement, such as the level of expense reconciliations allowed or the sales forecast that is agreed to. Dr. Morin has testified that approximately 75% of the cases he has testified in in recent years have resulted in negotiated settlements (Tr. 2680, Lns. 15-23).

As we pointed out in testimony, the Commission has rejected the use of the risk premium methodology due to the circularity of using other commissions' return allowances in setting the return for a New York utility (Tr. 3757, Lns. 9-13).

Dr. Morin has offered no support for the theory that the risk premium approach he advocates is applicable to Con Edison and that the risk premium hasn't changed over time. Staff recommends that the Commission reject the use of any risk premium analysis, as it has in the recent O&R electric rate case and has before that.

c. ROE Methodology Results

Both Staff and the Company agree that there is more than one way to estimate the cost of equity (Tr. 3727, Lns. 5-9; Tr. 2579, Lns. 11-13). Staff has used a DCF approach and two CAPM methodologies, while the Company has used four DCF, two CAPM, and two risk premium methods. We will explain why Staff's proposal is the one the Commission should adopt.

i. Company's ROE Result

The Company has recommended an 11.2% ROE for a one-year case (Tr. 2633, ln. 20), and an 11.5% ROE for a three-year case (Tr. 2635, Lns. 5-6). The 11.2% ROE recommendation is an average of the DCF results (10.9%, on average), the CAPM results (12.1% on average), and the risk premium results (10.7% on average) (Tr. 2633, Lns. 16-20).

In our brief, Staff has pointed out the flaws in Dr. Morin's DCF growth rates, his CAPM market risk premium, and the use of risk premium analyses.

As was mentioned, the Company has no adjustment for credit quality differences between its proxy group and Con Edison electric (Tr. 2634, ln. 6). Dr. Morin stated very clearly in his direct testimony that his goal was to find the cost of capital for Con Edison's electric operations (Tr. 2581, Lns. 9-16). His DCF and CAPM equity costing methodologies have relied on a proxy group with an average bond rating of BBB/BBB+ and an average business score of 4.9 (Tr. 3732, Lns. 19-24). Despite the large difference in risk between Con Edison (A/A+ rated and a business profile score of “2”) and his proxy group, Dr. Morin proposes that Con Edison equity investors would require the same return as those investing in the proxy group.

This is despite the fact that he has also testified that, “If there are differences in the risk of the investments, competition among firms for a limited supply of capital will bring different prices.” (Tr. 2586, Lns. 12-14). He also states, “it’s well proven in finance that the relationship between risk and return is a linear one.” (Tr. 2681, Lns. 10-12) Staff notes that Dr. Morin has recently proposed a 20 basis point credit quality adjustment to his proxy group in O&R’s current electric rate case, Case 07-E-0949.

It is well documented that bond investors require a higher return to invest in riskier companies. Given that “shareholders are at the bottom of the food chain” when it comes to receiving a return on their investment, according to Dr. Morin, it follows that shareholders would require an even greater premium to invest in a riskier stock (Tr. 2682, Lns. 11-12).

ii. Staff’s Unadjusted ROE Result

Staff has weighted the DCF methodologies result (8.57% on update) as two-thirds of the total overall ROE and the CAPM average (10.50% on update) as one-third of the total, to arrive at a ROE of 9.21% before adjustments (Attachment FP-B, p. 3, update to Exh. 255, (FP-8)). This relative weighting has been approved by the Commission in multiple rate cases (Tr. 3755, Lns. 1-24), most recently in O&R's electric rate case, Case 06-E-1433.[45]

The DCF methodology has long been the favored approach to calculating the cost of equity at commissions throughout the country. The methodology is able to use readily available data to calculate ROEs by using investor behavior (the pricing of stocks) to determine ROE requirements. As we discussed earlier when describing Staff's DCF methodology, investors and many different types of companies use often use cash flow methodologies when determining returns (bond investors pricing bonds to achieve certain yields, companies determining if "hurdle rates" can be achieved). The inputs of the DCF generally change only slightly over time for utilities, as utilities are a mature industry.

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[45] Id. at 14.

Staff has advocated the use of a CAPM equity costing methodology consistently for the past 13 years.[46] However, over that time Staff has always advocated giving the CAPM less weight in the overall ROE calculation than the DCF. This has primarily been due to the subjectivity of the MRP. There are over two dozen published MRP estimates, and just the ones on the record in this case range from 3.5% (Tr. 3742, ln. 21) to 8.1% (Tr. 2606, ln. 13). In addition, there are uncertainties over which measurement to use for certain MRP estimates, such as the Ibbotson Associates historical MRP (Tr. 2605, Lns. 19-24).

Until recently, the beta to be used in the CAPM methodology was not a controversial issue. Betas have traditionally been in the range of 0.7 or lower (Tr. 2680, Lns. 5-7). As has been mentioned, in Con Edison's last electric rate case, Case 04-E-0572, Staff's proxy group had

[46] Case 06-E-1433, supra.; Case 05-S-1376, Consolidated Edison Company of New York, Inc. – Steam Rates, Order Determining Revenue Requirement and Rate design (issued September 22, 2006); Case 04-E-0572, Consolidated Edison Company of New York, Inc. – Electric Rates, Order Adopting Three-Year Electric Rate Plan (issued March 24, 2005); Cases 03-G-1671 and 03-S-1672, Consolidated Edison Company of New York, Inc. – Gas and Steam Rates, Order Adopting the Terms of a Joint Proposal (issued September 27, 2004); Cases 02-E-0198 and 02-G-0199, Rochester Gas and Electric Corporation – Rates, Order Adopting Provisions of Joint Proposals With Conditions, (issued May 20, 2004); and Case 95-G-1034, Central Hudson Gas and Electric Corporation – Rates, Opinion 96-28 (issued October 3, 1996).

an average beta of 0.70. Now Staff is using a 0.95 beta. This “beta creep” means that the CAPM methodology’s return calculation has increased dramatically over the past three years. For instance, applying a 0.95 beta instead of a 0.7 beta in the CAPM calculation increases the average CAPM result by 120 basis points.

Under Staff’s methodology, a 120 basis point increase in the CAPM result would bring about a 40 basis point increase in the overall ROE recommended. As we discussed earlier, such a change in the recommended ROE currently results in customers paying an additional $42 million in rates ($10.7 million per 10 basis points). However, this beta shift is occurring primarily because of the increase in risk in non-New York utilities. As can be seen in Attachment FP-B (update of Exh. 255, (FP-8)), page 1, no utility in the proxy group has a beta lower than Con Edison’s. New York customers are paying for the growing risk of out-of-state utilities. Bond ratings have fallen, so much so that a sufficiently sized proxy group composed of just A-rated companies is impossible to construct.

The results incorporating this “beta creep” continue to be applied to the return of Con Edison electric. This, despite the fact that Con Edison has shed nearly all of its production plant, which Dr. Morin has acknowledged is riskier than T&D assets (Tr. 2684, Lns. 24-25). The beta is based on the return of entire companies, which includes non-utility investments. As utilities have more and more invested in non-utility operations their risk profile increases, leading to higher betas. That result leads to New York utility customers paying an additional amount for the cost of capital when the CAPM methodology is employed. So, while we are trying to calculate the return required to invest in Con Edison's electric business, the methodologies used to calculate that return are impacted by some changes in the utility industry which do not apply to Con Edison, and New York State in general.

Given the relative pros and cons of each equity costing methodology, Staff recommends that the Commission once again adopt the two-thirds DCF, one-third CAPM result Staff has calculated.

iii. Staff's Credit Quality Adjustment

The return of 9.21% calculated by Staff (Attachment FP-B, p. 3, update to Exh. 255, (FP-8)) is a calculation of the return which investors require, on average, to invest in the proxy group companies. However, as Dr. Morin has explained (Tr. 2581, Lns. 9-16), we are trying to calculate the cost of capital for Con Edison electric, not the proxy group. An adjustment must be made if the proxy group's risks or other circumstances differ from Con Edison's.

The proxy group receives over 10% of its revenue from non-utility investments (Attachment FP-B, p. 1, update to Exh. 255, (FP-8)), which the Company concedes are riskier than utility investments (Exh. 248, (FP-1), response to Staff IR DPS-237, part h). The vast majority of the companies in Staff's proxy group also have production plant (Tr. 3788, Lns. 22-24). As the Company states, "the power production function is deemed to be riskier than the pure T&D function, as a general proposition." (Tr. 2684-2685)

These differences in risk can be seen in the bond ratings and business profile scores assigned to the companies in the proxy group. For Staff's proxy group, the average bond rating is slightly higher than BBB and the average business profile score is 5.0 (Attachment FP-A, update of Exh. 253, (FP-6)). Con Edison, meanwhile, has an A/A+ bond rating and a "2" business profile score.

A basic financial principle is that the level of return required by an investor is dependent on the level of risk, as Dr. Morin explained in his testimony (Tr. 2580-2581). As Staff's Finance Panel explained in its direct testimony, debt investors currently require a 20 basis point increase in return to go from the risks of Con Edison

(A/A+ rating) to those of the proxy group (BBB/BBB+ average rating) (Tr. 3746, Lns. 3-9). The return requirement of bondholders for various levels of risk can also be seen in Exhibit 358.

As Dr. Morin testified, shareholders only get their dividends if a company's bondholders are paid first (Tr. 2682, Lns. 11-12). Given shareholders' subordination to bondholders, their risk is greater that they will receive less income than projected. This means that equity investors would demand even higher differentials in return for a given risk difference.

Staff has calculated that equity investors require an additional 29 basis points of return to accept the risks of the proxy group relative to the risks of Con Edison's electric division, for which the Commission is determining the cost of capital (Tr. 3746, Lns. 9-18). This adjustment is approximately 10 basis points per credit rating notch difference. The Company has criticized this adjustment by showing the impact of this adjustment on bond yields (Tr. 2666A-31, Lns. 17-21). This is an apples-to-oranges comparison, taking an adjustment that could be expected of shareholders' return requirements and applying it to bond yields. Such an adjustment exists for bonds already, as seen in the yield differentials for various bond ratings.

Staff’s adjustment is simply acknowledging that such differentials exist for equity investors as well.

iv. Staff’s Issuance Expense Adjustment

Staff also proposes a 20 basis point increase to the proxy group return to account for Con Edison electric’s need to issue equity during the rate year (Tr. 3749, Lns. 10-11). This 20 basis point adjustment is equal to the issuance expense adjustment proposed by Dr. Morin in his DCF calculations, although his result was calculated in a different manner (Tr. 2628, Lns. 9-10, Lns. 15-16).

Staff’s issuance expense adjustment takes into account Con Edison’s plan to issue $600 million of equity during the rate year (Tr. 2881, ln. 19). Staff has estimated that the issuance costs will be approximately three percent of the funds raised, or $18 million. This percentage is in-line with the average flotation costs for issuances of over $500 million estimated by Dr. Morin in his direct testimony (Tr. 2655).

The estimated cost of $18 million was spread across the $9.0 billion of equity that Staff believes supports CEI’s utility operations (Exh. 250, (FP-3), p. 1, column 9). $18 million divided by $9 billion leads to a 20 basis point increase in equity cost.

This method of calculating issuance expenses has been approved by the Commission in the past, most recently in O&R's electric rate case, Case 06-E-1433.[47]

v. Staff's RDM Adjustment

Staff proposed an RDM that would reconcile the Company's actual sales to the amount of sales forecasted by Staff witness Liu (Tr. 3749, Lns. 21-23; Tr. 3965, ln. 9 – Tr. 3966). This proposal would eliminate the risk of weather-related sales variation from the sales forecast, as well as non-weather related usage per customer variations (Tr. 3966, ln. 22 – Tr. 3967, ln. 2; Tr. 3972, Lns. 12-20). By eliminating these variations, the Company will have a safer risk profile. Such a proposal is not currently considered in Con Edison's bond ratings or its business profile score.

Almost none of the companies in Staff's proxy group have an RDM in place for their electric operations. Dr. Morin has testified that "there are only three outstanding decoupling mechanisms in the electric utility industry as we speak today" (Tr. 2686, Lns. 7-9). In addition, almost no electric utilities have weather normalization clauses (WNC). Dr. Morin had testified that half of electric utilities have such clauses (Tr. 2686, Lns. 15-17). He was

[47] Id. at p. 15.

asked to provide a source for this estimate (Tr. 2687, Lns. 2-4). His response, sent by the Company on November 13, 2007, stated that Dr. Morin had misspoke and that "weather adjustment mechanisms are fairly rare for electric utilities." (Attachment FP-C)

Staff's RDM proposal makes the risk differential between the proxy group and Con Edison electric even greater than it currently is. Staff considered multiple ways to quantify the risk reduction brought about by Staff's RDM proposal (Tr. 3752-3753).

We considered the possibility that there might be a credit rating change due to the RDM. Rating agencies have long viewed RDMs as a favorable way to strengthen financial ratios when conservation programs are adopted. Also, weather normalization clauses are viewed as positive given their ability to decrease variations in revenue. As Staff showed in its direct testimony, even in the recent past the Company's ROE was impacted by nearly 100 basis points due to weather fluctuations (Tr. 3750-3751). As Mr. Hoglund testified, the risk of weather fluctuations is seen by investors as being symmetrical (Tr. 2953, Lns. 11-15). In other words, the likelihood of lower sales leading to lower ROEs is the same as higher sales leading to higher ROEs.

As the Company has pointed out, RDMs and WNCs are rare for electric utilities at the moment. However, rating agencies have already touted the ability of such mechanisms to protect financial metrics (Exh. 196, p. 3). The implementation of an RDM which not only captures conservation effects on usage but also weather effects and all other potential sales volatility will be viewed as a positive by the rating agencies.

A one-notch credit rating increase would lower equity return requirements by approximately ten basis points, as was discussed in regard to a credit quality adjustment (Tr. 3746, Lns. 17-18).

Another way to quantify the potential impact on cost of capital, should Staff's RDM proposal be adopted by the Commission, would be to consider the capital structure requirement given such a mechanism. Since the Company would have the major cause of variations to its return eliminated, the need for an "equity cushion" to protect from downswings would be reduced (Tr. 3752, Lns. 16-19). Given the Company's new risk profile, the Company could have a slightly lower equity ratio and a higher debt ratio. A change in the debt ratio of 2.7%, to have the debt ratio be in the middle of S&P's recommended range for an A-rated company with a business profile score of "2", would have the same overall rate of return impact as a 20 basis point reduction to the allowed ROE (Tr. 3752-3753).

As can be seen, a ten basis point reduction in ROE to reflect the RDM's impact on the Company's risk profile is conservative and an adjustment of at least that amount should be adopted by the Commission as recognition of the risk reduction afforded by Staff's RDM proposal.

vi. Staff's ROE Recommendation

Staff's updated ROE recommendation, after all adjustments, is 9.0% (Attachment FP-B, p. 3, update of Exh. 255, (FP-8)). This is based on a 9.21% return requirement for the proxy group, less a 29 basis point credit quality adjustment, plus 20 basis points to account for issuance expenses, less 10 basis points as an RDM adjustment. The result, 9.02%, is rounded off to 9.0%. This is the cost rate for equity that would be used in developing the Company's overall cost of capital.

vii. Company's Criticism of Staff's ROE Recommendation

Company witness Morin criticizes Staff's ROE recommendation as being outside the range of "recently allowed ROEs for electric utilities" (Tr. 2666A-13, ln. 4). To support this argument, Dr. Morin has produced a table showing that the companies in Staff's proxy group have an average allowed ROE of 11.09%, per data from AUS Utility Reports (Tr. 2666A-12). As the cross examination of Dr. Morin showed, this AUS data is flawed, stale, and not relevant as a comparison to a one-year return for Con Edison's electric division.

The data Dr. Morin used in his calculation was from the July 2007 AUS Utility Reports (Exh. 181). A check of its accuracy has revealed several mistakes and stale information. The data shows Con Edison with an allowed ROE of 10.87% (Tr. 2668, Lns. 6-12). As Dr. Morin testified, Con Edison's utility divisions' allowed ROEs at the time of the publication were 10.3%, 10.3%, and 9.8% (Tr. 2668, Lns. 13-17). Dr. Morin was unable to explain why the data was flawed (Tr. 2668, Lns. 20-22).

Dr. Morin acknowledged that the 11.6% ROE listed in the data for the company ALLETE was approved in 1994 (Tr. 2669, Lns. 11-17). An ROE approved 13 years earlier is not "recent" and in no way should be relied upon as indicative of current investor expectations. Most of the allowed ROEs listed in the data do not provide the date the ROE was approved. Regulatory Research Associates (RRA) data provided by Dr. Morin in his workpapers (Exh. 182) show ROEs that were approved throughout the United States in 2005 and 2006. Most of the returns listed in the AUS data are not found in the RRA data. Dr. Morin acknowledged that many of the AUS-reported ROEs he used as “recently authorized” were approved prior to 2005 and could be as much as ten years old (Tr. 2672, Lns. 15-20).

Not only is the data either incorrect or stale, it also sometimes lists an earnings sharing threshold as an “allowed ROE”. For instance, for the company NSTAR, the AUS data reports a 12.5% allowed ROE. As NSTAR’s Form 10-Q from September 30, 2006 shows, the 12.5% is an earning sharing threshold (Exh. 183, p. 22).

Many of the returns listed are for multi-year rate plans, where a stayout premium is usually included. Dr. Morin has acknowledged that he does not know which of the allowed ROEs are for companies that have WNCs or RDMs (Tr. 2674, Lns. 10-22). As we have already discussed, almost no electric utility rate plans have such features. The rate plans where the ROEs listed were approved do not resemble the proposal of Staff in this proceeding, mainly a one-year case with a RDM which reconciles all usage variations, including those due to weather.

Finally, the companies listed are those found in Staff’s proxy group. As has been discussed, these companies, on average, are significantly riskier than Con Edison electric. The returns allowed for companies of such risk must be adjusted to account for the risk difference between them and Con Edison.

The use of a list of ROEs with incorrect data, returns from over a decade ago, sharing thresholds listed as allowed ROEs, returns based on multi-year plans, returns for companies without RDMs and WNCs, and for companies riskier than Con Edison electric does not in any way shed light on a reasonable ROE recommendation for Con Edison’s electric division in this proceeding.

viii. Book Values and Market Values

Company witness Hoglund, on rebuttal, criticizes the practice of applying an ROE based on market data to the book value of the Company (Tr. 2910-2913). This argument is odd, given that the Company’s prefiled case applied its market-based ROE recommendation to the book value of the Company as well (Tr. 2693-2694). This is the methodology that has been followed by the Commission for decades. Dr. Morin states that it is “universal practice” to apply return estimates developed using market data to book value (Tr. 2694, Lns. 16-17). He states this in his book, *New Regulatory Finance*, that doing so is a reasonable way to set fair and reasonable utility rates (Tr. 2694, Lns. 18-23).

Company witness Hoglund offers no adjustment to the recommended ROE based on his opinion that returns estimated using market data should not be applied to book values. To make an adjustment to the recommended ROE based on the market-to-book (MTB) ratio of a company would create a situation where companies with higher MTBs would receive higher ROEs. This in turn would lead to an increase in their stock price (due to higher earnings), which would lead to an even higher MTBs. This would lead to an even larger adjustment when rates are reset. Essentially, such a practice would create an upward spiral for a company's ROE. The reverse is also true. Companies with low MTBs would receive lower ROEs relative to other companies. This would lead to lower stock prices, and thus even lower MTBs. There would be a downward spiral (Tr. 3782, Lns. 12-24).

Dr. Morin testifies that the DCF methodology understates the cost of equity when the MTB ratio is greater than one (Tr. 2592, Lns. 1-14). However, the fact that the MTB ratio is greater than one is an indication that returns being allowed exceed the Company's cost of capital. Investors are willing to pay more than book value because they believe that returns will be higher than allowed returns. Dr. Morin explains this in his on page 359 of his book, *New Regulatory Finance*. In addition, he testified that "…a regulatory commission should set rates at a level sufficient to create equality between the return on physical asset investments and the company's cost of capital" (Tr. 2581, Lns. 4-6).

Investors are well aware of the ratemaking methodologies employed by the Commission and other commissions throughout the United States. These methodologies whether in a litigated rate case or as the result of a multi-year joint proposal, have been followed for years. And MTB ratios have exceeded one for over a decade. Con Edison's return has been set without any adjustment for MTB ratios and the Company has continued to be able to access billions of dollars of equity capital at reasonable terms.

The long form DCF result for Con Edison shows that investors are willing to invest in the Company, even when the expected return is relatively low. This is because of the level of risk of the Company, based on its business model, its management, and the regulatory support found in New York. While the Company has pointed out that DCF returns may be underestimated, it has not addressed the impact that recent dramatic changes in utility betas have had on the allowed returns of the Company.

3. Overall Rate of Return

Attachment FP-D (update of Exh. 249, (FP-2)) shows the 7.29% after-tax rate of return Staff is recommended the Commission use for setting rates in this proceeding (updated from the 7.25% recommended in Staff's direct testimony). This weighted-average cost of capital differs significantly from Con Edison's recommended 8.53%. The primary reason for this difference is Staff's recommended ROE of 9.0%, as compared to the Company's 11.5%. As was discussed earlier, Staff also assumed a slightly lower equity ratio and a slightly higher debt ratio than the Company used.

Staff has not adjusted the Company's cost rate for long-term debt or preferred stock. We updated the cost rate for customer deposits to 3.76% (from 3.65%) to reflect the 2008 rate mandated by the Commission in October 2007.

4. Impact of Recommendation on Credit Quality and Access to Credit

The Company stated that, "Raising capital will be challenging, particularly if the Company will be seeking these large amounts of capital from investors while offering weak credit protection measures for debt investors and substandard returns and prospects for stock investors."

(Tr. 2881-2882) Staff's recommendation will allow Con Edison to continue to access the financial markets at reasonable terms. Staff pointed out that our capital structure and cost rate recommendations, along with other Staff recommendations, are consistent with achieving such access because they produce financial parameters consistent with an "A" bond rating (Tr. 3760, Lns. 18-23). Staff's return recommendation is consistent with how returns have been determined by the Commission in the past, and such decisions have always allowed the Company access to capital at reasonable terms.

Staff pointed out that for the two major cash flow ratios used by S&P, Con Edison is expected to be on the high-end of the A-range to the low-end of the "AA" range for a company with a business profile score of "2" (Tr. 3763, Lns. 4-20). The Company has provided estimates for what its financial ratios will be for the rate year (Exh. 248, (FP-1), response to Staff IR DPS-263). When these are compared to the financial guidelines published by S&P (Exh. 251, (FP-4), p. 5), it is clear that Con Edison's cash flow ratios are strong. Earlier we discussed that Staff's recommendation regarding Con Edison's debt ratio puts it on the strong end of an A-rating (Tr. 3764, Lns. 2-16).

The Company stated that New York returns are substandard and that the amount that the returns trail the national average has increased slightly from 1992-2006 (Tr. 2888, Lns. 19-21). Mr. Hoglund provided a graph showing allowed returns in the United States and New York from 1992-2006 (Exh. 187, (RH-1), p. 2). This graph shows returns generally decreasing to their lowest point in 2006, with New York's returns falling slightly faster than the national average over this time period. Neither of these results should be a surprise to investors.

The ten-year Treasury bond rate has dropped from over 7% to below 5% over that time period. The cost of capital has declined dramatically in recent years. In addition, Staff has highlighted many reasons why New York returns have decreased slightly faster than the national average since 1992 (Tr. 3768-3769). In 1992, most utilities in the United States were A-rated. Now, less than 20% of parent companies are. While the national average bond rating has decreased dramatically, New York utilities' bond ratings have fared better. Con Edison and Central Hudson Gas & Electric are A-rated. Energy East is rated BBB+. All of the major electric companies in New York have a business profile score of "2" or "3", indicating they are involved in the least risky of all utility operations. The New York utilities no longer own significant amounts of production plant, which is considered riskier. Finally, investors may feel that regulatory policies in New York lead to better protections against non-regulated activities having a negative impact on a utility, thus leading to lower required returns.

Mr. Hoglund testified that should a downgrade occur, it will increase costs an additional $6 million in the rate year (Tr. 2890, ln. 6). This example assumed a downgrade from “A” to “BBB”, a three-notch downgrade. The $6 million estimate is roughly equivalent to a change in ROE of six basis points. Mr. Hoglund testified incorrectly that a downgrade from “A” to “BBB” would lead to a 75 to 100 basis point increase in debt costs (Tr. 2974, Lns. 5-6). As Exhibit 358 shows, such a downgrade would currently only impact the Company’s future borrowing costs by approximately 25 basis points, even assuming the downgrade was three notches (as opposed to a downgrade to just “A-“).

The Company both overstated the likelihood of a downgrade as well as the financial impact of such a downgrade. As Staff pointed out in our direct testimony, maintaining an unnecessarily high ROE (such as 11.5%) in order to maintain a bond rating is not cost efficient, especially at a cost of over $250 million (Tr. 3771, Lns. 1-7).

5. Conclusion

Staff's recommended cost of capital balances the need to maintain the Company's access to capital markets at reasonable terms with the level of rates customers must pay. While the Company has supported its ROE recommendation by stressing the need for strong financial ratios, "gold plating" such ratios comes as a high cost to customers when there is over $6 billion of equity involved. Staff's recommendation keeps Con Edison's financial profile strong while minimizing the rate impact on customers. The Commission should adopt Staff's cost of capital methodology for Con Edison's electric division.

V. INFRASTRUCTURE INVESTMENT

A. General

Background

When Con Edison filed its request that resulted in the joint proposal and order underlying the Company's current rate plan (04-E-0572), the Company filed proposed Transmission and Distribution (T&D) capital expenditures for the years 2005 and 2006 on a calendar year basis, however, the term of the rate case was in the time frame of

April 1, 2005 through March 31, 2008, as each rate year extends the 12 months starting April 1, and ending on the following March 31. Therefore, within Staff’s Infrastructure Panel (SIP) direct testimony Staff estimated the Company’s proposed rate year one (RY1) T&D capital expenditures to be $936 million (Case 04-E-0572, SIP Testimony, p. 9, Lns. 4-8).

Additionally, Staff stated that they further estimated a RY1 (April 1, 2005 through March 31, 2006) capital expenditure budget of $737 million, as compared to the Company’s rate Filing T&D capital expenditure request of $936 million, a difference of approximately $200 million (Case 04-E-0572, SIP Testimony, p. 28, ln. 22 - p. 29, ln. 2). The SIP asserted that the projects that supported the company's $936 million request should be undertaken and need to be accomplished, but questioned the Company's ability to complete all of the work identified within the allotted time. As a result, the SIP determined that the T&D capital expenditure budget needed to be set at an attainable level ($737 million) based on the Company's past performance. Because Staff viewed the projects proposed by the Company as necessary, the SIP proposed that the Company receive deferral and recovery authorization for its actual expenditures.

As part of the Joint Proposal in Case 04-E-0572, the Company was allowed in rates a budget for T&D capital expenditures of $774 million for RY1, $825 million for RY2, and $876 million for RY3.[48] The summation of all three rate years produced a total T&D capital expenditures budget of $2.475 billion for the time frame of April 1, 2005 through March 31, 2008. The Company was allowed to defer the carrying costs related to capital projects above and beyond what was embedded in rates. Additionally, the Company agreed to file on or before May 1, 2005 and thereafter by January 31 of each year a report on its annual T&D expenditures. This report would help Staff and other Signatory Parties monitor the company's progress in investing in T&D capital projects and provide information used to review the expenditures in light of the true-up of the budget to actual expenditures.

Within these annual reports, the Company provided actual project by project expenditures compared to the previously forecasted amounts, along with newly updated project budgets for the upcoming year. This information was provided on a calendar year basis, not in terms of the actual rate years. The Company did not however, provide a

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[48] Case 04-E-0572, Con Edison Rates – Electric, Staff Statement in Support of Joint Proposal, filed with the Secretary for the Commission.

comparision to the originaly forcasted capital budget amounts filed in 04-E-0572. The following table shows a comparision of the originaly forcasted budget as filed in case 04-E-0572 for each year, updated forcast amounts provided by the Company within the annual reports, the actual expenditures for each given year, along with the differences between the three categories and associated totals.

Con Edison Capital Budget & Expenditure Comparision

Category	**2005**	**2006**	**2007**	**Totals**
Original Forecasts	920	1011	1050	**2981**
Updated Forecasts	997	1182	1337	**3516**
Actual Expenditures	1018	1263	1471*	**3752**
Original vs Update Diff.	77	171	287	**536**
Update vs Actual Diff.	20	81	134	**235**
Original vs Actual Diff.	98	252	421	**771**

* Actual expenditures for 2007 were forcasted out through the end of the calendar year (2007) using the actual year to date numbers through 7/31/07.

As shown, Con Edison's annually updated budget forcasets for the 2005 to 2007 time frame totaled approximately $536 million above what was originally forcasted within the rate case. The Company's actual expenditures exceeded that updated budget forecast by $235 million for a total difference of $771 million from the originaly filed rate case budget forcast.

Comparing the Company’s actual T&D capital expenditures for 2005 and 2006, along with year to date expenditures through July 2007 converted to rate year expenditures ($1080 for RY1, $1371 for RY2, and $1704 for RY3) to the T&D expenditures allowed within the Joint Proposal ($774 million for RY1, $825 million for RY2, and $876 million for RY3), Con Edison is expected to spend approximately $1.68 billion more than what rates were set on through the timeframe of the existing Joint Proposal.

Based on the actual T&D capital spending during the current rate plan, the Company deferred approximately $60 million and $138 million of carrying charges on excess T&D expenditures in the the first and second rate year respectively. As allowed by the Joint Proposal adopted by the Commission in case 04-E-0572, the Company applied available customer credits aginst those deferred balances at the end of each respective rate year. In the current case, the Company projected that carrying charges on excess T&D expenditures for the final rate year of the current plan would amount to approximately $198 million. The Company proposed to amortize the collection of this deferral over a three year period commencing April 1, 2008 which Staff did not take issue with.

On cross, the Staff panel noted that during the current rate plan, Staff reviewed the Company’s annual infrastructure budget reports. (Tr. 4106, Lns. 16-24). The budget reports included information for each specific project including forecasted budgets, actual expenditures, total costs incurred from the beginning of each project, status, and detailed explanations for variances above 15% of budget expectations. Staff met with the Company periodically each year to discuss the annual Budget Report. As a result of these meetings, Staff concluded that the projects were necessary and reasonable for the Company's T&D infrastructure.

Staff also met with the Company on several occasions since 2005 to discuss other related infrastructure projects including the periodic budget reviews. During cross, the Staff Infrastructural Panel mentioned some of the meetings Staff conducted (Tr. Page 4107, Ln. 5-7). Based on Staff’s review, the projects completed to date were necessary for the Company to meet its obligation to provide safe and adequate service.

The magnitude of the spending levels during the current rate plan is unprecedented and well in excess of that amount expressly contemplated by the last rate plan. The Staff process to date was well-described by the Staff Infrastructure Panel on cross-examination.[49] Because of the size of the investments made and notwithstanding the review already conducted, a closer scrutiny of the Company's T&D capital expenditures, including all proposed projects and programs can be justified. Indeed, to ensure that the Company is held accountable for its rate allowance for electric infrastructure improvements going forward, Staff proposes to increase its monitoring of the Company's capital and O&M expenditures. This Staff proposal would require the Company to file with the Commission a quarterly report providing detailed information on budget spending. This would include, for each project, the forecasted amount, the actual expenditures, and detailed explanations on variation between forecasted and actual expenditures, and construction schedules.

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[49] At these meetings Staff analyzed in greater detail the progress on each project, reconciled budget variances between current and previous spending forecasts, inquired as to why new additional projects were begun, received additional explanation as to why certain project costs exceed budget forecasts, and reviewed why slippage occurred for construction work. Staff was provided a ten year load relief study on construction costs, and also made site visits to various substation construction projects in order to get a better appreciation for those projects. (TR Page 4108, Ln. 3-6).

With respect to the pending 2004-07 investments, Staff's investigation thus far has found no reason to conclude that these expenditures were not necessary for the Company to provide safe and adequate service. Nevertheless, Staff recognizes that the Commission may conclude that further review of the deferred amounts is necessary before allowing recovery of such through rates, the Commission could order such a review.

Normally, utility expenditures are assumed to be an exercise of reasonable managerial judgment and Staff is obliged to demonstrate a tenable basis for raising the issue of imprudence before the utility can be called upon to defend its conduct. Staff notes, however, that pursuant to page 10 of the 2004/05 Joint Proposal and the resulting Commission Order, recovery of the Company's deferred expenditures was explicitly made subject to "audit and prudence review." Accordingly, because of the exceptional scope of the capital expenditures which could be subject to deferral and because of the nature of the deferral mechanism, the agreement itself may shift the burden to the Company for proving prudence in the first instance.

Notwithstanding the question of who has the burden of proof, there are, without further investigation, some concerns over the Company's capital expenditure practices.

For example, Staff is concerned that the Company may not have been benchmarking its expenditures to compare the cost of projects completed in-house versus those projects being done by a contractor. Such concern may ultimately suggest that the Commission should continue the deferral of these expenditures or use some other temporary technique to postpone a final decision on the recovery of these expenditures.

Should the Commission decide to defer a final decision on the investments, then the Commissions could adopt a rate plan at the March session that denies recovery of the deferral pending further review. A new proceeding could be commenced to undertake the necessary review. If the Company files a new rate case in April 2008, or shortly thereafter, the new proceeding could be resolved in coordination with the completion of that rate case, if not sooner.

<u>Annual true-up for shortfalls between budget and actual expenditures</u>

In its filing, Con Edison proposed to eliminate the current true-up mechanism of capital budget expenditures if its proposed forecasted T&D budget is accepted. (Tr. 2430, Lns. 15 -19) Staff, instead, has proposed that, if after an annual review of capital expenditures and forecast budget allowances, the Company has spent less than its allowance, the difference be deferred as a ratepayer credit, with interest accruing at an appropriate rate. (Tr. 3994, Lns. 15-21) This proposal would apply to the capital T&D budget in aggregate, with the exception of some programs (noted in Staff's pre-filed testimony) that Staff has carved out for particular individual review.

Staff's proposal is reasonable because the deferral protects customers from shortfalls in capital spending by Con Edison and ensures that the company does not earn a return on investments that it has not actually made. Also, by not automatically allowing the company to defer expenditures above the forecast budget, as adjusted by staff, it assigns to Con Edison the responsibility for keeping within its forecast for plant additions and ensures that customers will not pay for plant that is not in service.

Transmission and Switching Stations Capital Budget

Con Edison filed a proposed capital budget of approximately $262 million for its transmission and switching stations budget category, nearly doubling its current forecast budget of $137 million for 2007. In response to Staff IR 466 (Exh. 273, p. 143 of 190), the Company provided a history of its budget forecasts and actual expenditures for years beginning with 2004 through present. The response showed that for this category, for years 2004 – 2006, the Company’s budgeting performance relative to its actual expenditures has been poor; its actual expenditures as a percentage of budget forecasts range from about 64% to 49%. Staff then used this historical data and averaged the ratios of actual expenditures to forecast budgets for years 2004 – 2006, deriving a ratio of 58.44%. Staff then applied this ratio to the Company’s budget forecast of $262 million to set a budget allowance of approximately $153 million for the rate year.

The Company in it its rebuttal states that “While a historically based reduction approach could be used for high volume and repeatable programs, it is inappropriate for transmission activities which involve large projects, predominately with service dates defined by system need.” (Tr. 1920, Lns. 17-21) The Company’s argument misstates Staff’s adjustment and should, therefore, not be given any consideration.

Staff’s methodology does not use historic spending levels to set future spending allowance levels. In other words, Staff is not averaging past amounts and deriving an allowance level, as the magnitudes of the past amounts are not a factor in this analysis. Instead, Staff’s methodology assesses the company’s forecasting proficiency, with regard to project dates and cost levels, as determined by its forecasts versus its expenditures. Because there is no evidence that the company has improved its ability to accurately forecast expenditures for this category, past performance, to the extent consistent deviations can be found, is a reasonable indicator of future results.

Further, in its rebuttal, the Company states that “Staff's proposed reduction would effectively limit all transmission system investment to only work associated with M29, emergency response, and completion of in-progress work. It would prohibit the necessary investment in all other projects needed to support a reliable transmission system and infrastructure.” (Tr., Lns. 7-12).

The Company’s statement is not accurate. Staff's proposed reduction is based on the Company's own past performance of continually under-spending its budgeted amounts in this specific cost category. If during the rate year the Company determines that it needs to invest more than Staff's proposed amount to provide safe, adequate and reliable service, it would be obligated to do so. The Company would then include such completed projects in ratebase in the Company’s next rate case filing.

Substation Projects

Obsolete Transformer Program

In pre-filed testimony, Staff recommends that Con Edison's proposed obsolete transformer program expenditures be reduced from $17.2 million to $15.0 million due to historical under spending and fluctuating budgeting by the Company. (Tr. 4011, Ln. 18 - Tr. 4012, Ln. 11).

In Con Edison's rebuttal testimony, the Company states that the estimated cash flow requirements for the program are based on anticipated specific future needs, and that funds provided should not be based simply on historical expenditures. (Tr. 1934, Lns. 1-20).

Staff does not disagree with the need for the programs, but does question the Company's historical under-spending for this program and its budgeting practices related thereto. Since the program's inception in 2005, the budgeting amounts for this program have fluctuated from $5.0 million in 2005, up to $17.0 million in 2006, down to $10.0 million in 2007, and now back up to $17.2 million for 2008, while exhibiting under-spending by approximately $2.0 million for both 2005 and 2006.

Spare Transformer Program

As stated in Staff's pre-filed testimony, Con Edison provided Staff with an addendum early in August which included additional capital expenditures for the spare transformer program. (Tr. 4012, Ln. 12 through Tr. 4013, Ln. 14). This addendum increased the capital expenditures for the spare transformer program from the original $16.5 million up to $21.2 million. With very little supporting data provided with the Company's addendum, Staff asked for more detailed justification along with a detailed cost break-down for each project. (DPS-498, Exh. 273, Tr. 4058). On August 30, 2007 the Company responded to DPS-498 with some additions to the original work papers along with an update to transformer cost information previously provided in DPS-440 (DPS-440, Exh. 273, Tr. 4058). This information however did not explain or justify the additional expenditures requested by the Company. Given the timeframe in which Staff received this information and the lack of information provided, we proceeded with our testimony, not taking into account the proposed expenditure changes submitted in August, but instead relying on the proposed expenditures filed back in May. Staff additionally, recommended that the original expenditure amount proposed by the Company of $16.5 million be reduced to $14.0 million to better average out the total three year expenditure amount proposed by the Company.

In Con Edison's rebuttal testimony, the Company reiterated the expenditure updates included in the August Addendum, stating that this action was based on a re-evaluation of the adequacy of the current spare transformer inventory due to continuing long lead times for major equipment and the recent failures at the Rainey substation. (Tr. 1911, Ln. 5 - Tr. 1912, Ln. 2). Additionally, the Company states that transformer materials and costs have been increasing over recent years as a factor for the increase in expenditures.

Staff does not dispute the overall justification for this program. The original budgets proposed by the Company, however, are reduced greatly after 2008 from $16.5 million, down to $12 million for 2009 and 2010. Staff's adjustment to the recommended level of $14.0 million better averages out the total amount originally proposed by the Company. With regard to the updated expenditures, the Company has failed to provide enough information to support the claims made within information request responses and rebuttal testimony. The updated cost information provided within DPS-498 (Exh. 273) did not support the incremental increase from the Company's response to DPS-440 (Exh. 273).

Additionally, the Company has not specifically stated why the recent transformer failures at the Rainey substation warranted an entire re-evaluation of the spare transformer inventory or what actually caused the transformer failures. If the transformers were already nearing the end of their service life, then such information should have been available from the beginning and would not warrant reassessment of the entire spare transformer program. Finally, the Company states that transformer materials and costs have been increasing over recent years. (Tr. 1935, Lns. 4-5). Staff does not dispute this fact, but notes that such an increase is not something new and has been apparent since well before the Company's filing in May 2007. Thus, the Company should have already factored such an increase in cost in its original filing.

Accordingly, Staff's original recommendation for an adjustment from $16.5 million down to $14.0 million has not changed given the Company's additional information and rebuttal testimony in regards to the spare transformer program.

Category Alarms Program

In pre-filed testimony, Staff recommends that Con Edison's proposed category alarms program expenditures be reduced from $2.25 million to $1.0 million due to historical under-spending by the Company. (Tr. 4013, Ln. 15 through Tr. 4012, Ln. 11).

In Con Edison's rebuttal testimony, the Company states that the existing alarm panels located within substation are approaching life expectancies and replacement parts for these panels are becoming hard to find or unavailable. (Tr. 1951, Lns. 4 through Tr. 1952, Ln. 15). Therefore, the Company is accelerating the replacement program from two alarm systems per year to four to reduce the number of emergency replacements needed.

Staff does not disagree that the program is needed, however, it does question the Company's historical under-spending for this program given the claim that these alarm systems and associated parts are approaching their end-of-service life. In recent years, the Company has continually under-spent their forecasted budgets for this program and has yet to spend more that $812,000 on the program in a single year. (DPS-123, Exh. 273, Tr. 4058). While spending in 2003, 2004, and 2006 together only totaled just over $1.0 million. (Id.).

Remote Terminal Unit (RTU) Replacement Program

In pre-filed testimony, Staff recommends that Con Edison's proposed RTU replacement program expenditures be reduced from $4.0 million to $3.0 million due to historical under spending by the Company. (Tr. 4014, Lns. 6-19).

In Con Edison's rebuttal testimony, the Company states that the existing RTU located within transmission substations are approaching life expectancies, and that replacement parts for these panels are becoming hard to find or are becoming unavailable. (Tr. 1959, Ln. 1 - Tr. 1961, Ln. 6). In addition to improved reliability, the Company states other areas such as communication and security features will be improved through this program.

Staff does not disagree with the need for this program, however, it does question the Company's historical under-spending for this program given the claim that these alarm systems and associated parts are approaching life expectancy levels. Since the programs inception in 2006, the Company had budgeted $1 million for both 2006 and 2007, while only spending a total of approximately $500,000 through July of 2007. (DPS-466, Exh. 273, Tr. 4058). Given the reliability issues and other improvements stated by the Company, Staff would have expected the Company to fully spend the budgeted amounts in previous years instead of accelerating the program now as proposed.

<u>Substation Loss Contingency Program</u>

In pre-filed testimony, Staff recommends that Con Edison's proposed substation loss program expenditures be reduced from $2.0 million to $1.0 million due to historical under-spending by the Company. (Tr. 4014, Ln. 20 through Tr. 4015, Ln. 7).

In Con Edison's rebuttal testimony, the Company states that this program is geared towards the loss of any one of a number of selected transmission substations. (Tr. 1961, Lns. 10 - Tr. 1962, Ln. 8). Planning and procurement of spare equipment in advance will allow for a more rapid restoration of electric service. (Id.). The Company continues to state that a reduction in funding will extend the time needed to complete this important initiative. (Id.).

Staff does not disagree with the program's need, however, Staff does question the Company's historical under-spending for this program given the Company's claim of importance. Since inception in 2004, the Company had budgeted a total of $1.0 million for this program and only spent a total of approximately $250,000. (DPS-123, Exh. 273, Tr. 4058). Despite this, the Company is requesting $2.0 million per year going forward. Additionally, there are other spare equipment programs that the Company has proposed that would help ameliorate the loss of a transmission substation, such as the spare transformer program and the various spare equipment programs.

Enhancing Substation Reliability Program

In pre-filed testimony, Staff recommends that Con Edison’s proposed substation reliability enhancement program expenditures be reduced from $12.5 million to $10.0 million due to the significant increase in proposed spending for this program. (Tr. 4015, Lns. 8-21). Previous budgeting and spending was in the range of $4-7 million for this program, however the Company is now requesting an increase to $12.5 million. (Id.). Although Staff does not argue the justification for this program, and even considering an acceleration in Company efforts, the Company’s proposed budget far exceeds the past spending for this program without providing sufficient justification. Therefore, Staff recommends an adjustment down to $10.0 million to better reflect historical spending patterns in the absence of more detailed information, especially since Con Edison did not comment or discuss this program in rebuttal testimony.

Facility Improvement Program

In pre-filed testimony, Staff recommends that Con Edison’s proposed facility improvement program expenditures of $6.0 million be eliminated due to project overlapping and limited historical spending information. (Tr. 4015, Ln. 22 through Tr. 4016, Ln. 22).

In Con Edison's rebuttal testimony, the Company states that this program provides funding to establish permanent work locations for employees working out of temporary office locations and also funds other large scale improvement projects such as improvements to facades, foundations, retaining walls, lifts & platforms, floors, heating & ventilation, lighting, and plumbing. (Tr. 1952, Lns. 17 - Tr. 1958, Ln. 22). The Company also states that although the scope of the Small Capital and Facility Improvement programs are similar, each program funds discretely different projects that are different in size and cost. (Id.). The Small Capital program funds projects less than $500,000, while the Facility Improvement program funds projects above $500,000. (Id.). The Company provided a list of projects for both the Facility Improvements and Small Capital programs within information request responses DPS-145 & 489 (Exh. 273). The Company also states that they provided Staff with historical spending data in response to DPS-125 (Exh. 273).

After reviewing all the information provided by the Company pertaining to this program, we still maintain our original recommendation to eliminate the proposed $6.0 in expenditures. Staff’s concern with project overlapping does not only pertain to the actual scopes of the programs and projects as discussed in our original pre-filed testimony (Tr. 4015, Ln. 22 through Tr. 4016, Ln. 22), it also consists of the budgeted amounts for the programs. In response to DPS-145 (Exh. 273), the Company provided a list for each of the Facility Upgrade and Small Capital projects included in the programs. For the Facility Upgrade program, the project list totaled approximately $14.5 million, while the Company’s work papers proposed $6.0 million for 2008-2011 for a total of $24.0 million. For the Small Capital program, the project list totaled approximately $7.0 million, while the Company’s work papers again proposed $6.0 million for 2008-2011 for a total of $24.0 million. Therefore taking the total amounts listed by the Company in response to Exh. 273, the projects listed total approximately $21.5 million. This amount is less than the Company’s total proposal for either one of the programs. Accordingly, Staff believes that the projects listed under both programs could be completed with the amount budgeted for only one of those programs.

Aside from the foregoing, the Company states that they provided Staff with historical spending data for the Facility Upgrade program through its response to DPS-125

(Exh. 273). The Company’s statement is misleading in that the Company’s response to DPS-125 (Exh. 273) provided historical spending information for the Company’s Substation Structures Upgrade program which does include the Facility Upgrade Program, but also for four other programs listed under the same category of Substation Structural Upgrades. In DPS-145 (Exh. 273), the Company was asked for historical spending data since the programs inception and the Company’s response was that these cash flow requirements are not developed at this project level. Therefore, given the reasons stated above, Staff’s recommendation was to eliminate the Facility Improvements program on the basis of redundant projects, overlapping budgets, and lack of past spending history.

Paper Insulated Lead Cover Cables

Twenty-eight percent of the Company’s primary feeders are Paper Insulated Lead Cover (PILC) cables. The average age of the PILC cables is 46 years.[50] During the 1999 Washington Heights investigation Staff deemed PILC cables connected to sensitive stop joints to be less reliable than

[50] 06-E-0894 Comprehensive Report on the Power Outages in Northwest Queens in July 2006; Pg. 2-11.

other primary feeders in Con Edison service territory.[51] In fact, Con Edison stated in its testimony (Tr. 1798, Lns. 21-23) that PILC cable has been identified as having higher failure rate than solid dielectric cable.

During the 2006 Queens Outages, PILC cables contributed to 8 of the 22 primary feeder failures in the LIC network.[52] Apparently, PILC issues have become a reoccurring problem. The Company's PILC removal program involves replacement through various feeder work activities. This "program" is not fully planned, but rather relies on emergency repairs and work associate with load growth. Con Edison can no longer ignore the fact that PILC cables associated with sensitive stop joints have increasingly become a factor in primary feeder failures, and needs to accelerate the removal process.

Prior to its last rate case, 04-E-0572 the Company made minimal effort to remove the PILC cables remaining in its system. Staff did not find Con Edison's performance acceptable and the Company now proposes to accelerate its removal of PILC cables, resulting in a date of completion

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[51] Case 99-E-0930 Proceeding on Motion of the Commission to Investigate the July 6, 1999 Power Outage of Con Edison's Washington Heights Network.

[52] 06-E-0894 Comprehensive Report on the Power Outages in Northwest Queens in July 2006; Pgs 2-6 and 5-102.

moving from 2024 to 2020. Con Edison proposes a budget of $39 million per year to achieve this goal, requiring it to remove 900 additional sections on top of 1700 sections of PILC cable per year. Despite the Company's acceleration of the program, we do not find that the Company's proposed budget is justified and recommended a $9 million reduction to more appropriately reflect the increased number of PILC sections to be removed each year.

Con Edison agrees with Staff that the PILC cables should be accelerated but took issue with Staff's adjustment made to the Company's proposal in that Staff's reduction would slide the completion date back closer to the original date of 2024. (Tr. 1930, Lns. 3-15). Con Edison stated that on average the PILC program is budgeted (approximately $23 million) to remove approximately 1,300 sections annually and another 400 sections during emergency repairs. The Company further states that it has requested an additional $16 million to accelerate the removal of the PILC cables (Tr. 2139, Lns. 1-21).

When Staff asked the Company during cross if removing approximately 2,600 PILC sections per year would be closer to $33 million rather than $39 million, the Company said that sound about right (Tr.2140, Lns. 10-16).

The $33 million is more reflective of the amount of cable sections to be removed in order to accelerate the completion of the PILC removals by 2020. Staff finds this amount to be reasonable and will allow for an increase of $3 million more above the original adjustment of $30 million.

Network Transformer Replacement

Con Edison is proposing network transformer replacement programs for transformers operating at three levels: above 125% of their normal and emergency ratings; between 115% and 125% of their normal and emergency ratings; and between 100% and 115% of their normal and emergency ratings. The Company’s proposed budget for the first two replacement programs (all transformers operating above 115%) is appropriate. We do not find that the Company’s budgeted amount for replacing transformers operating between 100% and 115% is justified. Staff recommended in its testimony that the budgeted amount for the transformers operating less than 115% of their normal and emergency ratings be reduced to $25.733 million in labor and $31.215 million in purchases.

Con Ed stated in its re-direct (Tr. 5424, Lns. 10-12) that the cost of a transformer and a network protector is about $34,000 and $22,500, respectively. Staff disagrees with this statement. Based on the testimony workpapers for ED2 purchases titled "Projected Requirements as Forecasted by Regions and Energy Services", the cost of a transformer and a network protector is $40,436 and $27,092, respectively. Therefore, the purchase cost for 274 units (transformer and network protector) should be $18,502,672, not $15,500,000 (Tr. 5424, Lns. 15-16). The Company also stated that Staff cut the transformer purchases from 274 units to 137 units (Tr. 5426, Lns. 16-24). Staff disagrees with this statement. Staff never stated in testimony or cross that the adjustment for transformer purchases was based on 137 units (or $15,500,000). Staff provided workpapers to the Company indicating that the adjustment was based on 218 transformers and 211 network protectors, from the load relief program, amounting to $14,531,460.

Staff objects with the Company's assertion that Staff essentially cut the total transformer purchases for all categories of network transformer work by 50% (Tr. 5424, Lns. 20-24). It was, and still is, Staff's intention to adjust only for load relief work.

Con Edison asserts that Staff's position to reject the proposal for transformers operating between 100% and 115% above contingency rating is not consistent with our approach to other load relief programs (Tr. 1933, Lns. 11-

13). Staff disagrees with the Company's assertion that Staff's position is not consistent with past load relief programs. Staff simply made the point that delving into an aggressive program at such a high cost would not be prudently wise without historical data or proof that 274 transformers is in fact the amount to be replaced. Staff understands that at some point in time the transformers operating between 100% and 115% above contingency rating will eventually have to be replaced. Staff's adjustment suggests a sample amount of transformers should be replaced and thereby establishing some historical data to go by. That is why Staff did not eliminate the network transformer replacement program in its entirety.

After careful review of Staff's work paper calculations, Staff has incorrectly calculated the adjustment for transformer purchases by taking into account not only for load relief work, but for all work associated with emergencies and new business. Staff's intention was to adjust only for load relief work. In essence, Staff should have taken the difference between the Company's transformer purchase amount of $66,063,000 and Staffs proposed adjustment of $14,531,460. This would yield a Staff allowance of $51,531,540 to the Company, not $31,215,460 that was originally allowed. Therefore, the allowance to Con Edison should be further adjusted by $20,316,540.

Street Light Isolation Transformer

Under the Street Light Isolation Transformer project Con Edison proposes the installation of isolation transformers in the base of metallic streetlights in New York City to reduce the number of stray voltage incidents associated with streetlights. (Tr. 1820, Ln. 13 - Tr. 1822, Ln. 13) Con Edison would remain owners of these transformers while DOT will be responsible for the maintenance. (Exh. 273; DPS-323 & DPS-493).

The Company proposal to install these units on a four year plan is expected to eliminate approximately 78% of the stray voltage conditions. Staff review found this program justified, however, we believe that the Company's program needs to be more refined. We recommend that the Company's proposed funding be made available, however, it should be clarified that it is solely the Company's responsibility to install these transformers in the service box and to maintain them for increased safety, not NYCDOT. (Tr. 4024, Ln. 11 - Tr. 4025, Ln. 19).

In response to the Staff proposal, Con Edison does not believe that it should be held responsible for the maintenance of the isolation transformers. The Company believes that requiring Con Edison to shoulder maintenance cost for the transformers located inside City owned street lights poses an unnecessary burden on our ratepayers and would lead to delays in troubleshooting and repairing lamps from avoidable work handoffs between the Company and NYCDOT. (Tr. 1938, Lns. 3-19) Con Edison has also requested an increase in funding to cover increased cost of equipment and labor from $6.1 million to $10.95 million annually. (Tr. 1917, Lns. 4-12)

Con Edison has misinterpreted Staff's recommendation which is to install the isolation transformers in the service boxes owned by Con Edison and to maintain these transformers, not those owned by NYCDOT. This requirement provides an increased level of safety and eliminates the need to coordinate work schedules with NYCDOT. Staff believes that placing the isolation transformers in the base of the streetlight may not mitigate some of the serious stray voltage that is produced in the duct that runs from Con Edison's service box to the streetlight. By moving the location of the isolation transformer to the service box, it would provide increased protection to the public.

Staff recommends an allocation of $10.95 million to this program for the rate year. The installation cycle will then be extended to account for the change in cost associated with Staff recommended change to the program. Keeping the funding level at $10.95 million but extending the installation cycle will provide the most benefit to rate payers because once these isolation transformers are installed, its significantly low replacement rate will allow the public increased safety for a longer period of time.

Vented Manhole Cover

The build-up and ignition of gases within an underground structure can affect public safety if the structure cover becomes dislodged. In order to mitigate the build up of gases and limit the severity of the incident, Con Edison developed and has been installing a vented cover on its manholes in a four-year program that is planned for completion in 2008. (Tr. 1817, Ln. 16 to Tr. 1818, Ln. 8).

The Company's program is scheduled to be finished during the first rate year. However, considering the planning, work, uncertainty, and time required to complete the remaining non-standard covers, Staff has proposed an adjustment to the $8 million submitted by Con Edison to $3 million for the rate year. (DPS-302; DPS-458; and Tr. 4025, Ln. 20 - Tr. 4026, Ln. 12)

Con Edison states that Staff's deferral of the Company's funding level will slow the replacement of both standard and non-standard covers by one year when the goal is to expeditiously replace these covers and improve public safety. (Tr. 1937, Ln. 19 to Tr. 1938, Ln. 2).

The recommended funding level does not hinder the replacement of standard covers. The Company needs more time to properly prepare, plan, and replace the non-standard covers. Non-standard covers are the minority and the funding level is independent of the time required to ensure proper replacements of these covers.

Pumping Plant Improvement and Environmental Risk

The Pumping Plant Improvement program and Environmental Risk are both continuing programs under the environmental category for substations. Under Pumping Plant Improvement there will be facility upgrades and replacement of older pumps, pump controls, control panels, alarm panels, leak detectors, and chart recorders. (Tr. 1826, Ln. 1 to Tr. 1827, Ln. 23). Environmental Risk covers projects to minimize the impact that Con Edison’s substation facility may have on the environment. (Tr. 1824, Lns. 4-20).

Staff review found that Con Edison's actual expenditures were not aligned with past budgeted amounts.

(Exh. 273, DPS-466). Staff's recommended funding was determined by taking the average actual expense and then increasing it by half the difference of the rate year proposal and the average actual expense. Staff recommended the Pumping Plant Improvement program be decreased to $5 million from the $8.5 million proposed and the Environmental Risk program be reduced to $2 million from the $3.5 million proposed. (Tr. 4027, Lns. 6-23). This amount will allow Con Edison to pursue these projects over an extended period of time.

The Company stated the combined $5 million reduction would decrease the level of funding below historical expenditure levels for the environmental category. Maintaining the requested level of funding for the environmental category will ensure that previously identified and emergent environmental projects, as well as important dielectric system improvements, are addressed in a timely manner, thereby mitigating the risk and consequences of environmental events and ensuring continued safe and reliable operation. (Tr. 1938, Ln. 20 to Tr. 1941, Ln. 23).

Staff's adjustments were made on a project by project basis, not by category. The Company's statement that this reduction will place the Environmental category below historical expenditure level is irrelevant. What the Company fails to mention is that the proposed budget by Staff is higher than actual expense from 2004 to 2006 for Pumping Plant Improvement and Environmental Risk. Staff has not made adjustments to any other project under the environmental category for substations. Additionally, one of the main drivers for past funding under the Environmental category, SPCC (Spill Prevention Control and Countermeasure) Plan for Transmission Cable System, has dropped from its peak of $7.75 million to $0.5 million for the rate year. (Exh. 273, DPS-466). This change in required funding for SPCC Plan for Transmission Cable System is driving the overall drop in funding under the Environmental category. Staff believes that this funding level is not warranted and recommends its reduction noted above.

Oil Minders

The Oil Minder program under distribution systems prevents network transformer oil from being discharged into the sewer system. Staff recommended a reduction to $500,000 from $600,000 to be more aligned with actual expenditures. (Exh. 273, DPS-466).

The Company responded that this funding reduction will lengthen the completion time which is not warranted because the program’s purpose is to ensure the environmental integrity of vaults by reducing the risk of oil entering the municipal sewer system. (Tr. 1937, Lns. 11-18).

Staff finds no consistency in the number of units installed by Con Edison on a yearly basis from 2004 to 2006. (Exh. 273, DPS-324). The reduction recommended by Staff allows the Company to continue with this program at a reasonable pace that does not overly-burden the Company’s customers.

Storm Hardening and Response

Osmose C-Truss (DPS-371)

In workpapers, the Company proposes to change its 12 year pole inspection cycle to 10 years to be in line with industry practices. From Staff review, the Company has forecasted a rejection rate for poles that is above the actual historical rejection rate. (Exh. 273, DPS-371). This has resulted in the Company budgeting for C-Truss at levels that is not commensurate with past expenditure levels. An adjustment was derived by taking the highest actual expense and prorating it for a 10 year cycle. Staff then increased this amount by half the difference between the prorated calculation and Con Edison proposed funding. Staff recommends $1.3 million; a decrease from the proposed $1.7 million. (Tr. 4029, Ln. 18 - Tr. 4030, Ln. 12).

According to the Company, the rejection rate used in the calculations is from an Engineering study. (Tr. 1942, Ln. 13 to Tr. 1943, Ln. 16). Additionally, Staff calculated its recommended reduction based on the Company capital expenditure for 2006. The expenditures provided by the Company for 2006 accounted only for capital expenditures from C-truss work. (Id.). The proposed funding covers the C-trussing of 7 percent of the population and the replacement of 1 percent of the poles not correctable by C-trussing. (Id.). The Company did not provide historical pole replacement data because its work management system did not track separately the pole replacements due to Osmose inspections. (Id.). The 1 percent pole replacement rate used to estimate funding was derived from the Osmose inspection of Queens in 2004. The results showed that 1.3 percent or 117 of 8841 poles were rejected non-restorable poles. (Id.).

Staff requested the 2003 Osmose study that derived the 7 percent rejection rate and the studies done to determine the appropriate pole inspection cycle. The Company has yet to provide this information. Accordingly, Staff finds no reason to alter the recommended adjustment.

#4, #6 Self Supporting Wires

Under the #4, #6 Self Supporting Wire capital program, copper wires and self-supporting aerial cable will be replaced to improve system performance reliability on a 20 year plan. (Tr. 1840, Ln. 19 to Tr. 1841, Ln. 16) Staff recommended funding reduction to $2.3 million from $3.4 million. (Tr. 4031, Lns. 3-9) based on actual historical expense found to be repeatedly lower than budgeted. (Exh. 273, DPS-381 and DPS-466).

The Company stated the funding requested was a conservative estimate. The estimated cable footage was derived only from the primary conductors, but does not take into account the system neutral, and the cost estimate is for the smallest and least expensive cable. Accordingly, funding reduction to this program will unjustifiably lengthen the duration of the program. (Tr. 1944, Ln. 13 - Tr. 1945, Ln. 9).

The reduction recommended by Staff allows the Company to continue with this program at a reasonable pace without while balancing the interests of the Company’s customers in mitigating rate shock.

Three Phase Gang Switch

The Company plans to replace defective switches based on an estimated amount of old and mechanically deficient devices under the Three Phase Gang Switch Replacement program. (Tr. 1838, Ln. 7 to Tr. 1839, Ln. 7). Based on the past years of replacement data provided, the number of switches that actually required replacement is not consistent with the Company's estimated 20% replacement. (Exh. 273, DPS-400). Staff recommended an adjustment taking into account the number of replaced switches that reduces the Company's proposed $400,000 to $300,000. (Tr. 4031, Lns. 10-23)

It is the Company’s position that Staff made an incorrect statement regarding the Company's estimated 20 percent replacement. (Tr. 1945, Ln. 11 to Tr. 1946, Ln. 2). Staff’s 20 percent figure was derived as a conservative estimate based on a recent inspection of approximately 100 gang switches in Brooklyn-Queens that yielded closer to a 35 percent repair rate. (Id.). Additionally, the estimated 20 percent rate is for pro-active replacement of switches going forward. (Id.).

Staff believes that ten years of data is more reliable than an inspection of just 100 gang switches in only one operating area. Additionally, the adjustment recommended by Staff still provides for more replacements than were done by the Company in the past.

Rear-Lot Pole Elimination

This program involves the elimination of poles located in the rear of customer's homes. The Company plans to relocate such facilities over 20 years. (Exh. 273, DPS-397; Tr. 1844, Lns. 4-16). We believe that this program does provide a benefit, although when compared to other programs we found it to be of less importance. Therefore, we recommend a reduction to half of the Company's proposal for a total of $1.2 million. (Tr. 4032, Lns. 1-10).

The Company believes the program is essential because of increased loads, access delays for upgrades and repairs, and for the safety of employees entering limited access rear-lots. Additionally, the 50 percent reduction recommended by Staff would, stretch the program from 20 years to 40 years, placing strain on an already undersized system. (Tr. 1946, Ln. 4 to Tr. 1947, Ln. 9)

Staff finds that restrictions should have been set prior regarding developments and pole location, which would have prevented this problem from occurring. Staff’s recommended funding level attempts to balance Company concerns with customer expectations regarding unreasonable rate increases.

Enhanced 4 KV Grid Monitoring

This program covers installation of a power quality and battery monitoring system at 4 kV Unit Substations that will eliminate manual testing and inspection and provide enhanced monitoring and alarm functions. (Exh. 273, DPS-368). In January 2007, the Company submitted a budget estimate of $425,000 per year for this program in response to Staff's investigation of the Long Island City outage. (Exh. 273, DPS-466). This has increased by $1 million for the first rate year. The Company has not provided sufficient basis for the need to increase funding by $1 million. Thus, Staff then made an adjustment reducing funding to $1 million from the Company's $1.5 million requested. (Tr. 4032, Ln. 11 to Tr. 4033, Ln. 7)

It is the Company’s position that a sufficient basis was provided for the proposed funding. Con Edison reiterates the cost breakdown of the $1.5 million proposal and states the proposed reduction will prevent the Company from deploying this technology in all our 4kV Unit Substations by the end of 2011. (Tr. 1947, Ln. 11 to Tr. 1948, Ln. 10).

It is Staff’s position that just providing a breakdown of how the $1.5 million was derived is not sufficient. A reason needs to be given for why this technology needs to be deployed in such a manner on an annual basis and the significance of having this project completed by the end of 2011. Because the Company has not provided such information, Staff made its recommended adjustment to the Company’s proposal.

Four kV UG Reliability

Con Edison proposes a 15 year program to replace cables with failures, which the Company has estimated to be 62% of total current 4 kV primary risers. Our review of how the Company derived the 62% found errors in its calculation based on the Company's explanation in DPS-379. (Ex 273). Accordingly, we recommend reducing by half the funding for this program, resulting in funding of $600,000. (Tr. 4033, Lns. 8-18)

Con Edison disagrees with Staff's adjustment. The failure rate is 3.15 percent per year. The Company’s proposal is to replace the cable on risers that have previously failed and renewing risers that will fail in the future. The proposed program would include researching the root cause of the cable joint and termination failures and would begin a plan to replace poor performing cable and equipment. In addition Con Edison has proposed to accelerate the riser replacements. Setting the program length to 15 years will result in renewing 62 percent of the in service risers. (Tr. 1948, Ln. 11 to Tr. 1950, Ln. 12)

The Company derived 62% by taking 23.4 estimated annual riser failure rate based on 5 years of data and extrapolated over the next 20 years to get 468 risers. (Exh. 273, DPS-379). In DPS 379, the Company stated that the 20 year time frame was selected because it represents the approximate time between riser upgrades based on growth. The proposed program is for replacement of failed risers, not riser upgrades based on growth. Therefore, the use of the 20-year time frame is not appropriate for determining information about failed risers and taking an average of the past 5 years of failed service risers to get an annual count of riser failure rate does not research the root cause of failures. Thus, Staff continues to recommend its reduction in the allowance for this program.

Transformer Purchase

This program covers transformers and other associated equipment used for a storm event. Since Con Edison did not track this item separately in the past and its necessity is dependent on the number of storm events, the amount of transformers to be purchased is uncertain. (Exh. 273, DPS-364). Based on the foregoing and the prorated 2007 expense, Staff recommends an adjustment decreasing the Company's proposed funding to $8 million from $8.56 million. (Tr. 4034, Lns. 7-17)

Con Edison states that the basis for the reduction is ill-advised since having sufficient equipment is essential for emergency response and the ability to maintain electric service. (Tr. 1950, Lns. 14-22)

Staff disagrees and maintains that tracking such information separately would lead to a better foundation for certainty as to how much money is needed to fund this program. As that information is unavailable, Staff recommends that its adjustment be adopted.

Advanced Technology

In pre-filed testimony (Tr. 4035, Ln. 17 through Tr. 4036, Ln. 20), Staff recommends that Con Edison's proposed expenditures associated with following Advanced Technology programs be reduced as shown below to better average out the overall three year expenditures originally proposed by the Company. Each of these programs showed a much higher first year expenditure amount that then dropped off over the next two years. All of these programs are new and therefore do not have any historical spending data available for comparison. Given that fact, Staff recommends taking an average of the proposed three years expenditures and setting the level at that.

- **Secondary Visualization Model (SVM) program:** We recommend an adjustment from the proposed amount of $5.2 million, down to $3.7 million.

- **Distribution Control Center Upgrades program:** We recommend an adjustment from the proposed amount of $5.0 million, down to $2.67 million.
- **SCADA system program:** We recommend an adjustment from the proposed amount of $1.5 million, down to $1.0 million.

In Con Edison's rebuttal testimony (Tr. 1962, Lns. 11 through Tr. 1962, Ln. 11), the Company contests each of Staff's adjustments and states that the reductions appear to be based arbitrarily on the basis of historical expenditures or on Staff's unsupported views as to whether the Company requires or can expend the amount requested to fulfill the program objectives.

Again Staff does not disagree with the objectives behind the programs, however, Staffs continues to be concerned about the magnitude of expenditures proposed within the first year followed by a sharp reduction in expenditures thereafter for each of these newly created programs. Implementing an averaging mechanism to these programs still allows for the initiation of the programs in the beginning stages, while not putting so much financial emphasis on each program right up front from the start.

Updated Substation Capital Expenditures

In Staff's pre-filed testimony (Tr. 3999, Ln. 23 through Tr. 4001, Ln. 3), Con Edison provided Staff with an addendum early in August which included additional capital expenditures for some substations projects and programs. This addendum increased the capital expenditures for the Support Economic Growth category from the original $382.2 million up to $453.264 million, and increase of approximately $71 million. With very little supporting data provided with the Company's addendum, Staff asked for more detailed justification along with a detailed cost break-down for each project (Exh. 273, Tr. 4058). On August 30, 2007 the Company responded to Exhibit 273 with some additional work papers, however the information provided lacked the detailed justification and cost break-downs Staff had requested. Given the timeframe in which we received this information and the lack of information provided, we proceeded with the testimony, not taking into account the proposed expenditure changes submitted in August, but instead relying on the proposed expenditures filed back in May.

In Con Edison's rebuttal testimony (Tr. 1900, Ln. 4 through Tr. 1911, Ln. 4), the Company reiterated the expenditure updates included in the August Addendum, stating the expenditure increases along with some further justification than was previously given in response to Exhibit 273.

The supplied information, however still lacked the detailed cost break-downs that Staff had originally requested and require to complete the detailed analysis of the changes as was previously done for the originally filed expenditures. Until this information is provided by the Company and Staff is able to review the material, no additional expenditures should be approved.

True-up for Storm Hardening and Response, Advanced Technology, and Process Improvement

In the Company's initial filing, it proposed numerous new programs and/or expansions of existing programs under Storm Hardening and Response, Advanced Technology, and Process Improvement. For 2007, the Company has budgeted approximately $28.9 million towards these categories combined. (Exh. 273, DPS-466) In the January submission, the Company stated an estimated $35.7 million for these categories for the rate year. Then in the rate case, the Company requested roughly $88.9 million for these categories combined. (Exh. 273, DPS-466). With this significant increase in programs and funding request, Staff finds that a true-up is warranted for these areas separate from the other categories.

The Company finds this true-up unnecessary noting that adequate justification for this asymmetrical true-up mechanism and adequate explanation for how it would operate was not provided by Staff. The Company also maintains that these mechanisms should be rejected if Staff is attempting to limit the Company's historical flexibility to reprioritize projects and modify project specific funding within the context of an overall infrastructure program. (Tr. 1991, Lns. 4-22).

Staff notes that Con Edison has proposed many new programs in these areas with numerous cost estimates. Some cost estimates have little or no historical spending data for the basis of the proposed budgets. In addition, the proposal for the rate case is significantly more than what was estimated in the Company’s January budget estimates provided within the context of the Long Island City Outage investigation. (Exh. 273, DPS-466).

Although Staff agrees that these projects are warranted, Staff believes that Con Edison should be accountable for its budgets and expenditures in these critical areas. Staff believes these programs are extremely important and wants the proper mechanisms in place to ensure that the money will actually be used where the Company has proposed to spend it. Therefore, to ensure implementation of these programs, Staff continues to maintain that any un-spent funds in each of these categories category be credited back to ratepayers.

VI. COST OF SERVICE

A. Con Edison's ECOS

The Company filed an Embedded Cost of Service Study (ECOS), which Allocates the Company's cost to the full service, New York Power Authority (NYPA) and Economic Development Delivery Service (EDDS) service customer classed based on an analysis of the rate base and operating expenses for the calendar year 2005. Exhibit 7 (ERP-1) The Company made a special adjustment, to recognize the higher load diversity, to the DO8, Low tension–Overhead, and DO9, Low Tension–Underground, allocation factors using 75% weighting of the non-coincident demand and 25% weighting of the individual customer billing demands for the SC1 and SC7 classes. (Tr. 343, Lns. 15-20) According to the company, the 75%/25% weighting is intended to recognize the higher load diversity of these two classes but the Company did not support this special adjustment with a formal load diversity study. (Tr. 344, Lns. 12-13)

Staff recommends that the Company be required to include a load diversity study to support the appropriate adjustment to the DO8/DO9 allocators for SC1 and SC7 classes when it submits an ECOS study in the context of its next rate filing. (Tr. 4888, Ln. 21 to Tr. 4889, Ln. 3) Due to the lack of a diversity study, Staff recommends that a 15% tolerance band be applied to the ECOS study submitted in this case. (Tr. 4888, Lns. 17-21)

During cross-examination, the Company accepted Staff's recommendation to perform a load diversity study that justifies the 75%/25% or some other ratio to apply when calculating the DO8 and DO9 allocators for the SC 1 and SC 7 classes in future ECOS studies. (Tr. 344, Ln. 22 to Tr. 345, Ln. 21).

Monthly Adjustment Clause and Market Supply Charge

The Company proposed to move several supply-related cost components from the Monthly Adjustment Clause (MAC) to the Market Supply Charge (MSC). (Tr. 228, Lns. 8-17).

The MSC allows the company to recover the market value of the capacity and energy it purchases on behalf of its full-service customers. The MSC is estimated and posted every three months, for the subsequent three month period based on forecasted sales and supply-related costs. The Adjustment Factor-MSC reconciles the difference between the estimated MSC and actual supply-related costs on a one month lag.

Staff recommends that the Company's MSC reflect the market value of supply and the Adjustment Factor–MSC be used to reconcile the difference between the actual market values and the Company's cost of electric supply. Staff believes that providing the actual market price of electricity will provide customers with information to make decisions on their consumptions and on competitively priced alternative supplier offers. (Tr. 4909, Lns. 18-22)

No party, including the company, has raised an objection to Staff's proposal. Staff recommends that the Commission order the Company to file a plan within 60 days to revise its MSC charge so that it reflects actual day-ahead market prices that were in effect during each customer's billing period. That plan should identify specific issues that will need to be resolved and include a proposed schedule of implementation.

Merchant Function Charge and Purchase Of Receivables Discount

The Commission's Policy Statement on Unbundling (Case 00-M0504 – Unbundling Track, issued August 25, 2004) states that the Commission's goal in unbundling is "to establish cost based competitive rates that would afford customers accurate price signals." Staff's interpretation of this statement is that rates are to be cost based and provide accurate price signals. Each part of Staff's approach in addressing Con Edison's merchant function charge (MFC), purchase of receivables (POR) discount rate, and bill issuance and payment processing (BIPP) charge follows the intent of the Policy Statement.

Staff reviewed the Company unbundling of competitive services and found them generally sound. (Tr. 4898, Lns. 5-

7) However, we proposed that Con Edison merge its two MFCs into a single charge and that the single MFC and POR discount both be calculated by including the commodity-related credit and collection costs. (Tr. 4900, Lns. 5-9) The Company had proposed to use a two-part MFC, where the "credit and collection related MFC component" would be paid by all customers billed by Con Edison, regardless of commodity supplier. The other portion of the MFC contained commodity procurement, information resources (IR), education and outreach, and uncollectibles associated with commodity and would only be paid by customers purchasing their commodity from Con Edison. (Tr. 4898, Ln. 18-Tr. 4899, Ln. 6)

The basic premise underpinning the retail provision of commodity is that the ESCO is providing all the services and performing all of the functions of a retail merchant, including billing and payment processing, customer care, and credit and collections and assumes all risk for failure to collect billed revenues. (Tr. 4900, Lns. 12-18) For this reason, the price or rate charged by retail commodity ESCOs should reflect the full cost and related risks of providing these services. By only charging full service customers the "credit and collection related MFC component," along with the other costs contained in the remainder of the MFC, the ESCO becomes responsible for addressing these costs.

In the POR process, the ESCO is subcontracting with the utility to perform certain functions that otherwise would be performed by ESCO back office personnel, including credit and collections activities. Therefore, the POR discount should be calculated to reflect all the commodity-related activities that the utility will be performing on behalf of the ESCO. This is designed to fully reimburse the utility for the costs that would otherwise be borne by the ESCO to do these functions for themselves. (Tr. 4901, Lns. 4-15) Further, to keep credit and collections outside the MFC would distort the price signals to customers of the commodity, which has been artificially lowered to exclude those credit and collection expenses. (Tr. 4902, Lns. 1-4)

Con Edison was willing to implement the changes to the MFC that Staff recommended. In the recent Joint Proposal for the Company’s natural gas service and in collaborative work with Staff on its unbundled bill format, the Company had already supported this chage for its gas operations. (Tr. 4902, Lns. 12-17) Further, in response to Staff IR-410.1 (See Exhibit 326, RP-1), Con Edison indicated that it is amenable to adopting the same resolution in this proceeding that it agreed to in that case. In the rebuttal testimony of Con Edison's Electric Rate Panel, the acceptance of Staff's proposal for the MFC and POR discount was confirmed. (Tr. 288, Lns. 3-8)

<u>Bill Issuance and Payment Processing</u>

The Commission addressed the issues related to bill issuance and payment processing (BIPP) twice, once in regard to billing credits in the Billing Proceeding (Cases 98-M-1343 and 99-M-0631, order issued and effective May 18, 2001 – Billing Order) and again in the Competitive Opportunities Case – Unbundling Track (Case 00-M-0504). It addressed issues related to how all charges, including the BIPP, should appear on customers' bills in its Order Directing Submission of Unbundled Bill Formats in Case 00-M-0504 – Unbundling Track, issued February 18, 2005 (Unbundled Bill Order). This order followed the resolution of unbundling issues in the Commission's Policy Statement in the same proceeding, issued August 25, 2004 (Unbundling Policy Statement). In both cases, the Commission ruled that the customer should only pay a utility for BIPP service when receiving both commodity and delivery from the utility for all commodity services taken. When the customer receives a consolidated bill from the utility (a bill that includes ESCO charges), the utility should collect a billing fee equal to the amount of the BIPP charge from the ESCO or ESCOs.

Where a single ESCO serves the customer for either all commodity or one of two commodities taken, it is required by Commission policy to pay the entire BIPP fee. (Tr. 4904, Lns. 11-19) In this instance the customer should not be charged by the utility for billing services. Where there are two ESCOs serving the customer, one for electricity and one for natural gas, the ESCOs would each pay half of the BIPP fee and again the customer should not be charged by the utility for billing services. (Tr. 4905, Lns. 6-11) The Unbundled Bill Order states:

> Since the billing charge is for a competitive service and is not charged to retail access customers receiving consolidated bills, from either the utility or the ESCO, it should not be subsumed within delivery. (Unbundled Bill Order, page 23, emphasis added)

However, Con Edison proposes to charge combined electric and gas customers and their ESCOs each half of the BIPP amount where the Company provides one commodity service and an ESCO provides the other. (Tr. 292, Lns. 4-18) This does not comply with Commission orders and policies on the application of these charges and fees. Staff proposed that Con Edison should conform to the Commission policy and that its tariff should be amended to state that customers are only assessed a BIPP charge when taking all commodity from Con Edison. The Company's billing service agreement with ESCOs should be similarly amended to state that ESCOs taking consolidated billing service from Con Edison are responsible for paying the BIPP fee, either in full or as split with any other ESCO also serving that customer on the same consolidated bill. (Tr. 4906, Ln. 15-Tr. 4907, Ln. 5)

The Company disagreed with Staff and filed rebuttal Electric Rate Panel testimony. This testimony argued that charging half the amount to customers and half to ESCOs in this situation was appropriate because:

1. the Company still needs to render a bill for one commodity, (Tr. 292, Lns. 4-11)
2. Staff is inconsistent in charging two ESCOs half the BIPP charge when they both serve the same customer, but charging either the whole charge if the other didn't serve that customer, (Tr. 294, Lns. 16-17)
3. an adverse incentive for taking competitive service for a second commodity is created in that there is no resulting additional BIPP savings, (Tr. 294, Ln. 21-Tr. 295, Ln. 4) and
4. Con Edison's proposal in this case was modeled on the Company's Gas Rate Plan as set forth in Appendix D of the Gas Joint Proposal. (Tr. 297, Lns. 10-18)

The first point used by the Company Electric Rate Panel does not comply with the Commission's Unbundled Bill Order, as cited above. The Commission clearly stated there that the billing charge is not charged to retail access customers receiving consolidated bills. There was never any language in that order or other unbundling orders from the Commission that customers receiving consolidated bills could be charged half the fee under the circumstances outlined by Con Edison. Further, Con Edison is rendering a bill for the delivery of two commodities even when the ESCO or ESCOs provide both electric and natural gas commodities to that customer. The point is not whether a utility is rendering a bill, but rather the nature of the bill that is being rendered. The Commission determined that the ESCO should pay for all BIPP costs on a consolidated bill and the utility should not charge the customer as well.

The Company Electric Rate Panel's second point, that Staff is being inconsistent, falls under its own weight. As Con Edison's Electric Rate Panel fully admitted under cross examination, the Commission initially used BIPP credits instead of charges and Con Edison applied them exactly as proscribed by the Commission and as the Staff proposes for the BIPP charge here. (Tr. 325, Lns. 4-24) (Tr. 326, Lns. 12-16) Further, even the Company Electric

Rate Panel agrees that the Staff proposal and Commission's policy for the predecessor BIPP credit are fully consistent. (Tr. 329, Lns. 19-23) Staff's proposal would charge an electric ESCO the exact same amount for billing, and provide the same benefit to customers, whether that ESCO serves an electric only customer or a dual service customer. Only when a second ESCO serves does this change the situation. The benefit to the customer remains the same, but the ESCOs split the BIPP fee as the two retailers share the same billing services and the utility remains whole for its costs with no over collection.

The third point raised by Con Edison is the "adverse incentive" for customers to seek a second ESCO for a second service. The BIPP charge is not a customer incentive. It is an allocation of utility costs. The Con Edison Rate Panel agreed under cross examination that the BIPP charge is an unbundling of the Company's costs to bill. (Tr. 332, Lns. 11-24) If there were to be any "incentive" it should be designed to induce ESCOs to bill for services themselves.

The Company's Electric Rate Panel stated that Appendix D of the recent natural gas JP, "unequivocally" supports its position and that they modeled their BIP proposal for electric on that JP. (Tr. 297, Lns. 10-18) The BIPP is mentioned twice in Appendix D. The first cite states that "Dual service customers will pay no more than $0.47 for gas BPP." Staff fully agrees with this statement and its proposal is in full agreement with it. A dual service customer will either pay $0.47 for the natural gas portion of BIPP costs or it will pay nothing. As the Con Edison Electric Rate Panel agreed under cross examination, the statement does not address what that customer will pay for its electric BIPP costs. (Tr. 339, Lns. 18-24) Staff maintains that the Commission's policy is that the electric portion of BIPP costs for a dual service customer will be identical to the natural gas portion – that the customer will either pay $0.94 for BIPP or it will pay nothing at all.

Con Edison's Electric Rate Panel also points to Table 4 of Appendix D to the Gas Joint Proposal as part of its unequivocal evidence that its proposal for BIPP here is the only correct interpretation. Yet examination of that document determines again that the portion of BIPP costs paid by electric ESCOs is not addressed. Further the table is internally inconsistent. The two portions of the table that pertain to dual service are entitled: "Dual Service (Gas and Electric) BPP charges for accounts served by a single ESCO (one ESCO for both Gas and Electric)" and "Dual

Service (Gas and Electric) BPP charges for accounts served by Two ESCOs (one ESCO for Gas and another ESCO for Electric)." Clearly then, these tables are designed to illustrate only cases where the dual service customer receives all its commodity from either one ESCO or two. Yet the labels on the sides of these tables indicate not only several types of ESCO billing, but also situations where the utility provides either or both commodities. Even where section B of Table D indicates that the customer is being served by one ESCO for both commodities and both are on Utility Single Bill (POR), the ESCO is only charged $0.47 for BIPP while the customer is charged nothing. While that may be true of the natural gas portion of the BIPP costs, the ESCO should be paying BIPP charges for both commodities, not just $0.47. While the table is claimed by the Company Electric Rate Panel to "unequivocally" support its proposal, it at best is merely confusing.

Finally, when the Commission accepted the JP, it clarified in its Order that the BIPP charge was "account level" not commodity level, as for the MFC. (Case 06-G-1332, Order Adopting in Part the Terms and Conditions of the Parties' Joint Proposal, issued and Effective September 25, 2007, page 9) The Con Edison Electric Rate Panel has also read the Order (Tr. 340, Lns. 15-20). While the

Company Electric Rate Panel characterizes the Commission's orders on this issue as "unclear" (Tr. 329, Lns. 15-16), this reiteration of long-standing Commission policy should be enough to convince the Company that there should be a single BIPP charge for a single bill, not one specifically for electricity that is higher for single service than dual service customers, and that only customers receiving both commodities from Con Edison should pay it. Staff's proposal should be adopted.

VII. REVENUE DECOUPLING MECHANISM

A. Weather Normalization

The Company's RARIM contains a provision that the actual delivery revenue will be normalized for weather before reconciliation. That is, any sales impact as a result from warmer or cooler than normal weather will be removed from the actual delivery revenue for reconciliation. By doing so, the Company maintains that it bears the risk for all electric sales variations resulting from weather under the RARIM as it does now.

In justifying this provision, the Company claims that "the weather normalization calculation provides an important 'matching' of hot weather expenses and revenues" (Tr. 1578, Lns. 1-13). It also asserts that the provision will not eliminate the upside potential in earnings expected by the investors for the periods of above normal temperatures (Tr. 1578, Ln. 14 – 1579, Ln. 7).

Staff objects to the Company’s weather normalization provision. A RDM should not be designed to segregate the weather factor over which the Company has no control. If the overall rate plan is to allocate a given amount of risk to the Company, it is better to allocate risks that induce the Company to behave more efficiently.

In addition, we do not see a matching of hot weather expenses and revenues for the past two years. The record shows that the weather related expense-revenue ratio was 1 to 7 for the summers of 2005 and 2006. The estimated incremental costs associated witho above-normal weather were roughly $10 million, whereas the estimated incremental revenues totaled more than $68 million (Exh. 272, Pg.2, Tr. 3969). From this fact it is not difficult to see why Con Edison wants to keep the revenues associated above normal weather.

Staff also noted that the Company’s revenue forecast is based on normal weather but did not adjust its test year data to exclude warm weather related costs. The Company contends that the cost should not be adjusted for weather because it needs to prepare for “potential” high temperature (Tr. 1609-11). Following the line of the Company's reasoning, the high costs related extreme weather has been built in its cost forecast and will be compensated through revenue requirement. Staff sees no reason to allow Con Edison to retain the extra revenue associated with warmer-than-normal weather, when its revenue requirement has already factored in the expenses associated with the record high temperature.

Regarding investor expectations for higher earnings from above-normal weather, the Company did not do any study to support its claim. (Exh. 272, Pgs. 7-8). In any case, investors should be neutral regarding the weather effect on earning expectations, since weather deviations could go either above or below the normal level with comparable probability.

Staff sees an over complex procedure when RDM is involved in weather normalization. Con Edison's weather impact calculation starts with a sophisticated statistical methodology that has flaws as discussed below. The next three stages involve various allocations between sales and sendout, calendar days and billing days, days and months and quarters, as well as service classes (Exh. 161). These multi-state allocations at such high frequencies would introduce mismatches and create complexities and potential areas of disagreement, making the Company's proposal operationally cumbersome, if not entirely unworkable.

Staff also believes that without the weather normalization provision, the incentive to use weather to game the sales forecast in the rate case is greatly reduced or eliminated.

The Company contends that no gaming is possible because the sales forecast will be scrutinized by all parties in this proceeding and be decided ultimately by the commission. It claims that Staff is questioning the rate-making process rather than the implementation of the revenue decoupling (Tr. 1598-1599).

The Company is wrong. Parties in this proceeding do not have the opportunity to review weather normalization calculations during the implementation of the RDM. The first step of the Company's weather normalization calculation is to develop the regression models to determine the daily weather impact used to compute monthly weather normalized sales. These models will not be developed until the actual data are available for the rate year (Exh. 161). As such, parties will not have the opportunity to review the weather normalization calculation.

It is for this part of the RDM implementation process that Staff believes that close on-going regulatory oversight auditing efforts are required. Otherwise, the methodology proposed by the Company may give a biased estimate for weather impact if the models are not properly specified.

Con Edison attempted to standardize the regression procedure but obviously has problems doing so (Tr. 2303-2304). Con Edison used the t-statistics to determine whether or not a weather variable is included in the model (Tr. 2300-01). However, the estimated t-statistics are biased if the model exhibits serial correlation in the error term (Tr. 2308, Ln. 11-13). Using a biased estimate for the t-statistics as criteria to select weather variables will lead to mis-specified models and, consequently, biased estimates for weather impact. The Company's attempt to standardize the procedure by not correcting any serial correlation results in biased estimates for weather impact on actual sales volume.

Another problem is that Con Edison understates its forecast for normal weather. As discussed on the issue of the sales volume forecast, the Company's calculation for normal weather is inconsistent with the actual 30-year average number of cooling degree days. As such, there will always be “above normal” sales volume for some months and days that give the Company extra revenue.

Con Edison realized the various problems with its proposal after Staff’s review and later suggested it is willing to do the weather normalization only for the summer months from June through September, instead of the entire year as originally proposed (Tr. 1604-05).

Staff strongly opposes the Company’s proposals for the same reasons discussed above, particularly in view of the fact that most of the higher than normal weather related revenues occurred in the summer months.

B. Revenue Per Customer

Staff opposes the company’s per-customer RDM model and instead recommends that total delivery revenues be trued-up on a class-specific basis. Staff believes that there exists a strong potential for gaming the estimated number customers with a per-customer RDM model. Under Staff’s proposal, the incentive for gaming is eliminated and the entire procedure is simplified.

Staff notes the drawback of Company’s proposal that the average revenue for will be trued-up for each customer different from the forecast, regardless of how large or small that customer actually is. Staff is also concerned that multiple metered customers could be encouraged to convert to individually metered customers, thus to increase the actual number of customers and get extra revenue that would not otherwise be unified under a total revenue RDM (Tr. 3973-74).

We recognize that a revenue-per-customer RDM in theory provides a better incentive for Con Edison to care about customer growth and retention than a total revenue RDM. However, those customers that are mostly likely subject to attraction or retention under direct influence of the Company will be excluded from the RDM. In addition, NYPA also has power for job programs implemented in the Con Edison service area. These programs are designed to retain or attract customers for the purpose of economic development. Therefore, we strongly believe that under a per-customer RDM the potential harm to customers resulting from possible gaming on the estimated number of customers would outweigh the benefit of potential customer growth or retention.

VIII. SERVICE RELIABILITY PERFORMANCE MEASURES

The electric service reliability performance mechanism (“RPM”) has evolved to its present state through various Commission Orders as the electric industry and customer expectations have changed in New York State. The

Commission’s actions have promoted the continuing provision of reliable service to customers of New York’s regulated utilties. More specifically, the Commission’s Orders in Cases 90-E-1119, 94-E-0952, 96-E-0897, 00-M-0095, and 04-E-0572 have directly impacted Con Edison’s RPM.

In Case 90-E-1119, the Commission adopted the use of frequency and duration interruption index and the exclusion of major storms.[53] In Case 94-E-0952 (Opinion No. 95-7) the Commission’s expressed its strong preference for performance-based regulation wherever a monopoly remains.[54] Based on the Commission’s stated preference, the parties to Cases 96-E-0897, 00-M-0095, and 04-E-0572 excuted joint proposals embodying such a performance based mechanisms that evolved into the RPM under the current rate plan.[55]

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[53] Case 90-E-1119, Proceeding on Motion of the Commission to Consider Establishing Standards on Reliability and Quality of Electric Service, Order Adopting Standards on Quality and Reliability of Electric Service (Issued July 2, 1991). As defined in 16 NYCRR Part 97, a major storm consist of at least 10% of the customers interrupted within an operating area or customers out of service for at least 24 hours.

[54] Case 94-E-0952, In the Matter of Competitive Opportunities Regarding Electric Service, Opinion and Order Adopting Principles to Guide the Transition to Competition at 8 (Issued June 7, 1995) (Opinion No. 95-7).

[55] Although the RPM in the previous Con Edison rate cases all resulted from their inclusion in a joint proposal, there is no impediment to the Commission continuing such a mechanism in this case, notwithstanding the absence of Con

For this rate case, Staff has reviewed the Company's current RPM to ensure that it continues to promote reliable service and to fullfill DPS recommendation 83 from the Long Island City outage investigation where it states "the reliability performance mechanism should be re-examined in the next rate case to determine if changes are needed to make it more effective for a network event similar to what happened in the Long Island City network."[56]

Edison agreement to such mechanism in a joint proposal. Under New York Public service law section 65, the Commission is statutorily responsible for ensuring that the Company maintain safe and adequate service. Clearly, the metrics and standards included in the RPM help define what the Commission considers to be acceptable levels of service. Moreover, the incentives, expressed in negative rate adjustments for not meeting those performance metrics, not only provide appropriate motivation to the Company to take reasonable measures to provide such service absent the ability of customers to choose an alternative transmission and distribution provider, but such adjustments also reflect the Commission's well-reasoned judgment about what constitutes just and reasonable rates for the provision of electric service based upon the possible levels of adequacy of service. Should the Company provide service that fails to fall within acceptable standards, then the Commission's negative rate adjustment reflects the idea that, in the Commission's expert judgment, the just and reasonable charge to the customer is something less than such charge would be under circumstances where the Company's service falls above those parameters prescribing adequate service.

[56] Case 06-E-0894, Proceeding on Motion of the Commission to Investigate the Electric Power Outage of Consolidated Edison Company of New York, Inc.'s Long Island City Electric Network, DPS Staff Final Report on its Investigation of the July 2006 Equipment Failures and Power Outages in Con Edison's Long Island City Network in Queens, NY (Issued February 9, 2007).

The RPM Should Continue

In its rebuttal, the Company testifies that the current rate plan under the 2005 joint proposal provides that all existing penalty mechanisms not be renewed and that no replacement or new mechanisms be instituted. (Tr. 1892, Lns. 7-9) Con Edison asserts that pre-determined financial exposure is not necessary for the Company to fulfill its obligations to provide safe and adequate service. (Tr. 1892, Lns. 12-18) The Company maintains that the RPM simply promotes negative rate adjustments despite Company intentions to perform at or above the established standards. (Tr. 1892, Ln. 19 to Tr. 1893, Ln. 2) Despite the ability of the Company to seek relief from a negative rate adjustment imposed by the RPM, the Company maintains that such process is not adequate and that the Commission should instead eliminate any rate adjustments based on sub-standard performance. (Tr. 1893, Lns. 7-11)

Staff recommends that the RPM, including the provisions for negative rate adjustments, remain in place in accordance with the Commission’s expressed preference in Opinion No. 95-7 for performance-based regulation wherever a monopoly remains. So long as the Company's delivery service remains a monopoly, Staff believes that there needs to be clearly defined consequences to the Company for failing to provide adequate delivery service. The Company has control over their performance under the reliability mechanism as proposed by Staff, especially when the exclusions from service failures from major storm outages are considered. (Tr. 4046, Ln. 22 to Tr. 4047, Ln. 20)

Company witness Lewis and the Infrastructure Panel, in their respective rebuttal testimony, do not propose eliminating the threshold standards as part of an RPM, but do propose eliminating the rate adjustments with the substitution of an annual corrective action plan. (Tr. 1605, Lns. 2-6; Tr. 1993, Ln. 16 to Tr. 1994, Ln. 6) According to the Company, such a plan would describe actions the Company should take to address any performance result that does not meet the minimum standards of the RPM. (Tr. 1993, Ln. 16 to Tr. 1994, Ln. 6) The Company also recommends that if the Commission deems negative rate adjustment incentives appropriate, a separate phase of this proceeding should develop financial incentives and disincentives. (Tr. 1605, Lns. 7-11; Tr. 1997, Lns. 3-8)

The Company’s proposal for a corrective action plan to replace negative rate adjustments should not be followed. The recommendation to implement such plans is redundant. An assessment of areas where the Company finds its system needs improvement is required as part of the Reliability and Power Quality reporting requirement,[57] and is also performed separately in preparation for the summer peak period.

In light of the foregoing, Staff finds that there is no factual basis for this corrective action plan recommendation. Indeed Company witness Lewis, when asked how the corrective action plan would benefit rate payers, was unable to provide any proof of added benefit. In addition, Lewis makes the statement that the Commission should be interested in the reasons why the Company is not meeting the thresholds, implying, incorrectly, that the Commission is not also interested in such information. (TR 1675, line 13 to TR 1676, line 4).

Regarding the Company's recommendation to have a separate proceeding to establish financial incentives and disincentives, Staff finds the Company's position to be disingenuous in light of Company testimony that its statutory obligations are sufficient to ensure reliable and adequate service, absent financial incentives. Moreover, as demonstrated in Opinion No. 95-7, the Commission has rejected such a notion and expressed its preference for

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[57] Case 02-E-1240, Proceeding on Motion of the Commission to Examine Electric Service Standards and Methodologies, Order Adopting Changes to Standards on Reliability of Electric Service (Issued October 12, 2004).

preformance-based relaibility mechanisms where a monopoly, such as Con Edison’s delivery service, remains. Accordingly, the Commission should not only keep the negative rate adjustment, but should increase the amount of exposure to provide for greater financial incentive to the Company to meet its statutory obligation for furnishing adequate and reliable service.

Current threshold standards should not be altered

Staff’s review of the RPM threshold standards, found that the targets are appropriate. These targets were set at a level indicative of long-term trends, which is Staff’s primary focus. (Id.).

In his testimony, the Company’s consultant Lewis argued explicitly against keeping the duration and frequency threshold standards at their respective current values. (Tr. 1604, ln. 12 to Tr. 1605, ln. 2). Instead Lewis recommends less stringent duration and frequency threshold standards based on the Company’s implementation of its Outage Management System (OMS) called System Trouble Analysis and Response (STAR); recommends that distinct threshold standards for the Company's network and radial systems be combined into a standard for the entire system; recommends the threshold standards be based on the

Company's most recent historical performance, excluding anomalies; and recommends the threshold performance standards take into consideration the natural variability of reliability results caused by weather and other random events. (Id.). Staff believes that Lewis' recommendations are baseless and should not be adopted.

According to his first recommendation, Lewis postulates that the Company's use of STAR will increase duration and frequency threshold standards based on his experience in the industry. (Tr. 1641 Lns. 13 - 20). To support his contention, he offers the results of recent outage reporting based on using STAR in its simulation mode.

As an initial matter, Lewis' testimonial foundation is shattered by the Company's own position regarding the reliability of the STAR simulation mode. (Exh. 159).[58]

[58] In Exhibit 159, Con Edison unequivocally states that "The Company does not believe that the numbers produced by this simulation should be relied upon. To begin, the STAR production system has a two-way interface with ECS, while the test system used to produce the results cannot replicate this interface. Although we also ran a test script to simulate STAR's receipt of ECS tickets during this period and ECS's completion of these tickets, transactions that may normally have been processed on these tickets, such as the grouping of duplicate tickets or partial restorations, are not reflected in these results. Therefore, expected decreases in customer outages as they are restored do not appear to be reflected in the results." Additionally, the Company states "since the [STAR]

Moreover, his basis for stating that STAR will increase duration and frequency value is from decisions made by only four regulators in jurisdictions that are not similar to New York and with utilities that are not similar to Con Edison. (Tr. 1607, Lns. 1 - 7). In fact, on cross-examination, Lewis admits that no two utility systems are exactly comparable. (Tr. 1634, Lns. 18 - 19).

Another problem that Lewis faces is that the assumptions underlying his study are invalid, which in turn, invalidates his study results. Lewis testifies that he did not include Westchester in his study because the Company was already using STAR in that area during the entirety of the study. (Exh. 116, p. 10, see Tr. 1651, Lns. 2 – 22). He then states that he did use all other areas of Con Edison's service territory including Bronx and Manhattan. However, according to an IR produced by Staff, the Company was also using STAR in the Bronx for that same entire study period and in Manhattan for at least part of the study period. (Exh. 157). Thus, any decision based on

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simulation does not include the interaction that would take place in production between STAR and ECS as jobs are being analyzed, grouped and partially restored, there are far more jobs and customers out . . . there would have been in production, and the earlier daily numbers are also inflated."

his study results would be irrational and not supported by substantial evidence.

Notwithstanding the foregoing, Lewis also states that OMS should be able to predict devices that are out of service. (Tr. 1643, Lns. 19 - 20). Such a prediction is based on the design of the system. If the utility system design is unique, as Lewis testified, (Tr. 1634, Lns. 20 - 23) and OMS system is based on electric system design, then it cannot be reasonable to compare Con Edison’s OMS system to other OMS systems in the industry. Therefore, it is inconsistent to maintain Con Edison’s OMS system will produce increased duration and frequency of outages simply because that effect was measured in other jurisdictions bearing no resemblance to Con Edison.

Lewis’ second recommendation is to combine network and radial duration and frequency index to improve reliability and for the benefit of ratepayers. (Tr. 1623, Lns. 5 - 24). However, Lewis could not provide any justification for why this recommendation should be adopted. (Tr. 1666, Lns. 12 - 18). Not combining the indexes does not invite “sub-optimal allocation of resources that could hinder Con Edison's ability to achieve its goal of maximizing overall system reliability for all customers” (Tr. 1623, Lns. 6 - 8) because Con Edison’s resources for its network system is substantially different from resources used for the radial system. It requires different crews, system design, computerized monitoring, restoration and emergency procedures, operating procedures, system analysis, contractors, and equipment.

Lewis' third recommendation is that the Company's threshold standards should be based on the most recent historical data rather than using data going back to 1985 as he suggest was done by Staff. (Tr. 1617, Lns. 5 – 18). His reference to Staff usage of data is misrepresented. The current RPM values are a result of various inputs such as a review of current SAIFI and CAIDI values, and decisions made during recent joint proposals that are confidential. In addition, as noted above, such a recommendation actual would work against the Company to the extent that the Company achieves superior performance in any short-term historic period. Thus, this recommendation likewise should not be adopted.

Lewis' fourth recommendation is for the duration and frequency standards to take into consideration the natural variability of equipment failures and external events, such as weather by implementing a two standard deviation above and below Lewis' recommended frequency and duration standards. (Tr. 1618, ln. 15 to Tr 1619, ln. 12). When pressed on cross-examination to explain how this recommendation would ensure reliability, Lewis again could not provide any proof and only state that it is his belief. (Tr. 1675, Lns. 6 – 12). Because the purpose of the RPM is to ensure reliability, setting the targets at two standard deviations only provides the Company more leeway. In the past, such an outcome would have resulted, for example, in the Company not being held responsible for the East River Substation transformer fire, which caused electric service to be out of service for 63,500 customers for over seven hours.

A Restoration and the Remote Monitoring System mechanism should be added.

Recommendation 83 from the Long Island City outage investigation states “the reliability performance mechanism should be re-examined in the next rate case to determine if changes are needed to make it more effective for a network event similar to what happened in the Long Island City network.”[59] Staff recommends adding two new provisions to

[59] Case 06-E-0894, Proceeding on Motion of the Commission to Investigate the Electric Power Outage of Consolidated Edison Company of New York, Inc.'s Long Island City Electric Network, DPS Staff Final Report on its Investigation of the July 2006 Equipment Failures and Power Outages in Con Edison's Long Island City Network in Queens, NY (Issued February 9, 2007).

the RPM, the Restoration mechanism and the Remote Monitoring System (RMS) mechanism. (Tr. 4050, Lns. 17 - 23; Tr. 4053, Lns. 9 -14). The Restoration mechanism uses Restoration time as a means to measure the Company's performance. The restoration targets are set based on location and storm category. Under the Remote Monitoring System mechanism 95% of the Remote Monitoring System should be reporting in each network.

Restoration

For each outage event, an estimated restoration time should be derived by the Company. (Tr. 4051, Lns. 1 - 20). Such information is the basis for determining the number of resources needed to complete a job, gauges the performance of the Company, and provides customers with an expectation of when electric service will be restored. (Id.). In Con Edison's recent history, there have been many cases where restorations times were not met; and the Company has failed to provide, adhere to, and inform customers of restorations times during the recovery period of an emergency event. Restoration time is critical information to both the Company and its customers. (Id.).

Con Edison’s position is that the adoption of Restoration performance targets based upon the number of customers without service does not properly represent the reasonable estimated restoration time required for an event. (Tr. 1999, Lns. 15 - 18).

Staff's proposal for the Resotration mechanism does not set targets based on the number of customers out of service. Rather, Staff's proposed Restoration mechanism is in line with the current framework set forth in the Company's own emergency plan. (Tr. 4091, Lns. 12 - 15). Furthermore, Staff's proposed mechanism does not restrict the Company from ensuring proper ICS training of involved emergency responders, notification to critical care customers and Life Sustaining Equipment customers, periodic media releases, daily municipal conference calls where applicable and the establishment and communication of a Global ERT. Indeed, these recommendations were made by Staff in previous outage investigations and have minimal, if any, interference with the Company's ability to get its system out of emergency status.[60] As with the other

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[60] Case 99-E-0930, Proceeding on Motion of the Commission to Investigate the July 6, 1999 Power Outage of Consolidated Edison Company of New York, Inc.'s Washington Heights Network, Order Concerning Staff Report and Directing Company to Show Cause (Issued March 15, 2000).

Case 00-E-0811, Proceeding on Motion of the Commission to Review Electric Utility Procedures for Special Needs and Life Support Equipment Customers During Service Interruptions, Order on Electric Service To Life Support Equipment And Special Needs Customers (Issued October 5, 2000).

sections of the RPM, exclusions will be granted for actions completely out of the control of the Company.

Remote Monitoring System (RMS)

Staff recommends an RMS based on findings from the Long Island City event investigation. There, Staff found that Con Edison's electric operating procedure required that at minimum, 95% of the Remote Monitoring System should be reporting in each network, which did not occur during the LIC outage. (Tr. 4053, Lns. 11 - 14). The 95% target enables the Company's control room operators to gain sufficient information about the status of the network system. The Company has continually operated below this reporting target rate, which has resulted in Con Edison running its system with an unacceptable level of uncertainty. In fact, this very shortfall was first identified by the Company via internal recommendations following the 1999 Washington Heights outage and then again

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Case 06-E-0894, Proceeding on Motion of the Commission to Investigate the Electric Power Outage of Consolidated Edison Company of New York, Inc.'s Long Island City Electric Network, DPS Staff Final Report on its Investigation of the July 2006 Equipment Failures and Power Outages in Con Edison's Long Island City Network in Queens, NY (Issued February 9, 2007).

in 2006 following the Long Island City Network outage.[61] The Company continues to blame both the first and second generations of RMS devices on its inability to maintain the 95% reporting rate required by the Company's own procedures. (Tr. 2022, ln. 20 to Tr. 2023, ln. 6). However, following the Long Island City event, the Company was able to bring the RMS reporting rate within the Long Island City network up from approximately 80% to the required 95% within two months following the event.[62] Additionally, after the Long Island City event, the Company made a revision to its procedures manual from a "minimum 95%"

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[61] Case 99-E-0930, Proceeding on Motion of the Commission to Investigate the July 6, 1999 Power Outage of Consolidated Edison Company of New York, Inc.'s Washington Heights Network, Order Concerning Staff Report and Directing Company to Show Cause (Issued March 15, 2000).

Case 06-E-0894, Proceeding on Motion of the Commission to Investigate the Electric Power Outage of Consolidated Edison Company of New York, Inc.'s Long Island City Electric Network, DPS Staff Final Report on its Investigation of the July 2006 Equipment Failures and Power Outages in Con Edison's Long Island City Network in Queens, NY (Issued February 9, 2007).

[62] Case 06-E-0894, Proceeding on Motion of the Commission to Investigate the Electric Power Outage of Consolidated Edison Company of New York, Inc.'s Long Island City Electric Network, DPS Staff Final Report on its Investigation of the July 2006 Equipment Failures and Power Outages in Con Edison's Long Island City Network in Queens, NY (Issued February 9, 2007).

reporting rate to "a goal of achieving 95%".[63] The network system is very complex and exists only below ground, making it more difficult to monitor than an overhead system. Accordingly, it is critical that Con Edison achieve the standards it previously set for its operations, and not simply change the wording of its standards to make it easier to operate their system.

There are many specifications and manuals that reference RMS or data derived from RMS with regards to network performance. The Commission has provided funding to the Company to improve the reporting rate of RMS in each network.[64] Staff has recommended after the Long Island City event for the Company to have 95% reporting rate in each network by December 31, 2007 as per Con Edison’s specification.[65] Although the Company has apparently been

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[63] Specification EO-10110, Inspection and Maintenance of Network Type Distribution Equipment.

[64] Case 04-E-0572, 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, Consolidated Edison Company of New York, Inc., Order Adopting Three-Year Electric Rate Plan (Issued on March 24, 2005).

[65] Case 06-E-0894, Proceeding on Motion of the Commission to Investigate the Electric Power Outage of Consolidated Edison Company of New York, Inc.'s Long Island City Electric Network, DPS Staff Final Report on its Investigation of the July 2006 Equipment Failures and Power Outages in Con Edison's Long Island City Network in Queens,

working towards improving the RMS, Staff’s concern is not abated and continues to recommend the RMS in thios case.

Increased financial exposure is warranted

For the proposed RPM, Staff has recommended an increase in financial exposure for failure to meet the network and radial duration targets from $4 million to $5 million each, for a total exposure of $10 million for duration; increase "No Current Street Lights and Traffic Signals" exposure from $2 million to $3 million; include $5 million per event for the Restoration mechanism with unlimited exposure; and include $10 million per network for the Remote Monitoring System mechanism also with unlimited exposure. (Tr. 4050, Lns. 1 – 14; Tr. 4053, Lns. 1 – 8; Tr. 4052, Lns. 1 – 3; Tr. 4054, Lns. 10 – 14).

The increase in the adjustment for failure to attain the duration target is to ensure that both frequency and duration failures provide the same financial level of incentive. The Company should not be given a financial incentive that appears to favor compliance with one target over another. The increase in revenue adjustment for "No Current Street Lights and Traffic Signals" was deemed necessary to have an exposure equivalent to other special

NY (Issued February 9, 2007). This information was provided as a follow-up to recommendation 51.

projects. The rate adjustment for the proposed restoration mechanism is $5 million per event with unlimited exposure and came about because of repeated concerns expressed and recommendations made by Staff during outage investigations related to Con Edison's failure to provide, adhere, and inform customers of restorations times during the recovery period of an emergency event. The $10 million adjustment for each network not at a 95% reporting rate with unlimited exposure is based on the critical role that RMS has towards network system performance and concerns expressed in two major outage investigations, Washington Heights and Long Island City.[66]

IX. ENERGY EFFICIENCY

The Company's DSM Proposal

[66] The following documents give reference to RMS: Specification EO-6612, EO-10110, EO-4095, EO-4097, EO-2072, and EO-2133.

Case 99-E-0930, Proceeding on Motion of the Commission to Investigate the July 6, 1999 Power Outage of Consolidated Edison Company of New York, Inc.'s Washington Heights Network, Order Concerning Staff Report and Directing Company to Show Cause (Issued March 15, 2000).

Case 06-E-0894, Proceeding on Motion of the Commission to Investigate the Electric Power Outage of Consolidated Edison Company of New York, Inc.'s Long Island City Electric Network, DPS Staff Final Report on its Investigation of the July 2006 Equipment Failures and Power Outages in Con Edison's Long Island City Network in Queens, NY (Issued February 9, 2007).

Con Edison proposed to administer a new Demand Side Management (DSM) Program to achieve at least 500 MW of permanent demand reduction by 2016. This program is premised on the Company receiving approximately 150 MW of energy savings from a continuation of its current program, which is designed to target energy efficiency initiatives in order to provide load relief in certain transmission and distribution load areas (Targeted Program). The Company asserts that the remaining 350 MW will come from unidentified energy programs to be offered by Con Edison throughout its service territory (territory wide program) (Tr. 2944, Lns. 4-21).

Increasing energy efficiency is a major goal of New York State’s energy and environmental policy. In early 2007, Governor Spitzer proposed to dramatically reduce New York’s energy consumption. In May 2007, the Commission instituted a proceeding, Case 07-M-0548, Proceeding on Motion of the Commission Regarding an Energy Efficiency Portfolio Standard, to establish an Energy Efficiency Portfolio Standard (EPS), that calls for a 15 percent reduction in electricity usage below the 2015 forecasted level (Tr. 4220, Lns. 2-11).

The Company has not linked the program’s 500 MW goal to an analysis of meeting the goals of the EPS Proceeding, but rather to the New York Independent System Operator's (NYISO) 2007 Reliability Needs Assessment. The Company indicates that its analysis of statewide reliability needs shows that they could be partially addressed with 1,000 MW of new supply in the New York City area by 2016. Con Edison's position is that half of the 1,000 MW should be met through DSM and the remaining half through "new clean and efficient supply" (Tr. 2993, Lns. 12-22, Tr. 2994, Lns. 1-2). It appears, however, that 500 MW would only be a small percentage of the MW needed from the Con Edison service territory to meet the EPS goals (Tr. 4223, Lns. 1-4).

Staff is encouraged that Con Edison has demonstrated a serious commitment to DSM, but concerned that the Company's proposal is flawed, especially in two critical areas.

First, the Company failed to put forth any concrete program plans or proposals for the territory wide program. In order to analyze the effectiveness of the proposal, Staff must have an understanding of the programs the Company plans to implement. The Company's proposal lacks sufficient detail, such as specific program descriptions, budget priorities, estimated energy and demand savings and a cost benefit analysis to allow a meaningful assessment of the proposal's value to the ratepayers and role in responding to the challenge of the ambitious goals of the EPS (Tr. 4229, Lns. 4-17).

Second, the Targeted Program lacks a sufficient track record to justify significant future investments without an independent program evaluation. The program is an ongoing effort by Con Edison to defer specific transmission and distribution (T&D) load relief projects by implementing permanent energy efficiency measures (Tr. 2990, Lns. 6-11). The program was initiated by the Commission under the current Rate Plan and, to date, has resulted in 86 MW of permanent targeted demand reduction (pursuant to contract) and the Company is anticipating identifying additional energy reductions by the end of 2007 (Tr. 2997, Lns. 1-3). The Company expects to reach the goal established in the current rate plan of 150 MW by March 2008 (Tr. 3449, Lns. 2-4). If the goal is achieved, the cost of the Targeted Program could reach as high as $112 million, not including administration and evaluation fees and the present value of the construction revenue requirement reductions achieved by the deferral of the planned T&D reinforcements (Tr. 4230, Lns. 20-22, Tr.4231, Lns. 1-4).

The current average cost of Targeted Program measures has been approximately $1000/kw (Tr. 3026, Lns. 1-3). To date, 3.2 MW of measures have been installed and verified.

The installation schedule is coordinated with the need date for relief for the relevant networks. The Company expects that about 11 MW will be installed by November 1, 2008 and the balance, 75 MW, by 2011 (Tr. 3013, Lns. 17-22, Tr. 3014, Lns. 1-4). Con Edison reports that most of the measures constitute lighting upgrades, air conditioning and motor replacement (Tr. 3055, Lns. 23-24).

Staff sees merit in the concept of the Targeted Program’s ability to target system relief to the areas with the highest needs. While the program has demonstrated some success in securing project commitments, there is insufficient evidence that the program is the most cost effective use of ratepayer funds and is being effectively administered by the Company. Despite expenditures likely to exceed $100 million, the program has not undergone formal program evaluation to quantify program performance. Staff will not endorse extension of the Targeted Program, originally proposed by the Company as a three year program at $55.8 million, without an independent evaluation to document the levels of energy and demand savings attributable to the program, and an assessment of the program’s design, delivery and implementation, including identifying opportunities for program improvement.

Con Edison maintains that there is “no clear justification” for an evaluation of the Targeted Program because it was developed as part of a collaborative process, subject to cost effectiveness guidelines, and the Company provides occasional briefing to Staff (Tr. 3037, Lns. 16-21, Tr. 3038, Lns. 1-2).

Staff finds this argument weak. While it is true that the Targeted Program was created with feedback from a collaborative process, the collaborative does not create an exemption from evaluation of the actual performance of the Targeted Program.

Moreover, occasional meetings with Staff are not an adequate substitute for a comprehensive independent evaluation. For example, the Company admitted that measurement and verification reports for the program are not shared with the interested parties. Even if the reports were so shared, they lack analysis of critical evaluation data including estimates of free ridership (energy savings that would have occurred absent the program) (Tr. 3120, Lns. 4-24, Tr. 3125, Lns. 16-24, Tr. 3126, Lns. 1-14).

The Company’s objection to conducting an evaluation is puzzling when considering its stance regarding evaluation of the NYSERDA administered, Con Edison funded, System wide program. For this program, NYSERDA provides to Staff, the Company and other interested parties, periodic, detailed progress reports, and in 2007, a program evaluation report conducted by an independent contractor (Tr. 5192, Lns. 15-19, Tr. 5193, Lns. 1-3). Like the Targeted Program, the System wide program was the result of a collaborative process and NYSERDA periodically meets with Staff to provide progress updates. The Company, not only did not argue that NYSERDA's evaluation effort was unjustified, but aggressively pursued NYSERDA for more program evaluation data (Tr.3113, Lns. 7-23).

Charging NYPA Customers for Con Edison DSM Initiatives

Con Edison asserts that New York Power Authority (NYPA) customers should be eligible to participate in Con Edison's DSM programs in order to maximize DSM gains (Tr. 3002, Lns. 19-22) and that it be permitted to recover DSM program costs from all NYPA customers, although the Company has provided inadequate detail regarding how and to what extent these costs would be assessed. The NYPA Panel states that the NYPA customers should be exempt because its customers are already paying for and have access to NYPA's DSM programs (Tr. 4651, Lns. 9-10).

Staff witness Saxonis states that it is critical that NYPA and the Company work cooperatively to encourage energy efficiency, and Staff supports efforts to enhance their working relationship; however, the Company appears able to offer only limited insights into the business arrangements, the financial impacts, and the degree of additional energy savings opportunities that will result from expanding its programs' reach to NYPA customers (Tr. 4225, Lns. 10-15).

The information needed to adequately assess the Company's proposal to provide DSM services to, and collect fees from, NYPA customers has not been provided by the Company. Because the Company has offered little detail on the programs for NYPA customers and associated fees, the Commission should reject this proposal.

DSM Coordination Board

NYC witness Chernick proposes that energy-efficiency programs in New York City should be planned, coordinated and directed by a DSM Coordination Board consisting of Con Edison, KeySpan, NYSERDA, the City, NYPA and Staff; and ultimately, by a New York City governmental body proposed in PlaNYC called the New York City Energy Efficiency Authority (Tr. 3942 Lns. 19-22). According to Mr. Chernick, the Coordination Board will provide the expertise necessary to optimize the Con Edison DSM programs, including the important coordination effort (Tr. 4946, Lns. 9-10).

Con Edison states that such a Board would add an additional layer of bureaucracy that could only serve to delay the delivery of DSM programs. (Tr. 3019, Lns. 18-20). Staff opposes the establishment of such a board, because the injection of additional governing boards and authorities will likely serve to make planning, coordination and administration more complex and thus more challenging (Tr. 4265, Lns. 15-19).

For the reasons provided by both Staff and Con Edison, the Commission should reject the proposal to create a DSM Coordination Board.

Staff's DSM Program Proposal

As a result of the ongoing EPS Proceeding, Staff maintains that it is premature to recommend a specific DSM program portfolio for the Con Edison service territory. There are no guarantees that programs recommended by Staff or other interested parties would effectively synchronize with the guidance that will result from future Commission EPS rulings (Tr. 4237, Lns. 5-10).

There is a legitimate concern that if a specific DSM program is not approved in this rate case, and the EPS Proceeding is not concluded by early 2008, there will be a period of uncertainty during which the Company would have no role in the implementation of new DSM initiatives. Considering the importance of DSM to State policy objectives and the aggressive EPS goals, this scenario is not desirable (Tr. 4238, Lns. 7-16).

Staff recommends that a collaborative be established to explore options for a “bridge program” to continue the momentum for improving energy efficiency in the Company’s service territory. A similar concept was used in Case 06-G-1332, Con Edison-Gas Rates (Tr. 4238, Lns.19-22, Tr. 4239, Lns. 1-2).

The role of the collaborative would be limited to making recommendations for a bridge program based on one or a combination of four options. These options include: 1.) Implementation of programs selected from the fast track energy efficiency programs as summarized in EPS Staff Proposal. These programs are based on programs with a proven ability to produce cost effective energy savings and can be implemented quickly or can target under-served markets; 2.) The continuation of the Con Edison System wide Program for a period of time beyond the conclusion of the current rate plan on March 31, 2008. This energy program is funded by Con Edison through the MAC and administered by NYSERDA; 3.) The continuation of the existing Con Edison Targeted Program for a period of time beyond the conclusion of the current rate plan on March 31, 2008; 4.) Enhancing the Company's efforts at marketing energy efficiency in general, and energy efficiency programs in particular (Tr. 4239, Lns. 5-22, Tr. 4240, Lns. 1-12).

It is critical that the bridge program focus on program efforts that have the ability to be implemented quickly and cost effectively. The program must also be consistent with the goals, objectives, and guidance emanating from the EPS Proceeding. Care must be taken to ensure that any new energy efficiency programs that are initiated through a Con Edison specific bridge program collaborative process do not complicate the ultimate transition to the anticipated approval of an EPS state-wide energy efficiency program portfolio and create confusion in the marketplace among customers and service providers.

Incentives

Con Edison proposed that it be eligible to earn payments, through three separate incentive schemes, for achieving the goals associated with its DSM programs and programs operated by other organizations including NYSERDA and the NYISO. The Company stressed the importance of incentives to effective utility administration of DSM programs (Tr. 3006, Lns. 3-7). Staff concluded that the incentives proposed by the Company were excessive. While the exact cost to the ratepayers of the proposed incentive program will depend on factors such as the quantity of achieved energy savings, the value of the avoided use of resources and the emergence of a greenhouse gas reduction market, preliminary estimates of just one of the three components of the proposed incentives would exceed 90 percent of the Company's proposed DSM program budget (Tr. 4242, Lns. 3-15).

Overview of the Company's Incentive Proposals

Incentive One - Shared net resource benefits

The Company proposed that it be allowed to receive 20 percent of net resource benefits associated with the demand reduction achieved under its DSM program, up to its annual energy savings goal. For savings exceeding the annual goal, the Company would receive 30 percent of net resource benefits (Tr. 3004, Lns. 19-22, Tr. 3005, Lns. 1-6). Net resource benefits reflect the present value of the estimated avoided costs, including energy and capacity, over the service lives of DSM measures installed each year as result of the Company's programs, minus DSM program costs.

Based on data provided by the Company in response to New York City IR-244, this incentive, for only one of three proposed by the Company, could equal approximately $92 million, or about 90 percent of the three-year program budget, of approximately $92 million. Staff noted that the estimate could prove low if Con Edison installs measures with a measure life longer than the 12-year estimate used in its calculation of energy price increases (Tr.4243, Lns. 3-22, Tr. 4244, Lns.1-4). Staff is opposed to this incentive proposal for three key reasons.

First, while the Company argued, in some detail, that from a conceptual standpoint, incentives are good policy, the Company failed to provide sufficient justification for the specific terms of its incentive proposal, which it describes as “appropriate” (Tr. 3006, Ln. 4). For example, why did the Company select 20 percent of net resource benefits for meeting 90 percent of its goal? Why not 15 percent of the benefits for achieving 95 percent of the goal? Why not 25 percent for achieving 88 percent of the goal?

Staff maintains that developing a sound incentive policy is a challenging undertaking that requires careful consideration of a number of complex factors to balance the need for the incentive to be a stimulant for the utility with the need to be fair to ratepayers. Staff’s testimony offered seven guidelines for developing a viable incentive policy (Tr. 4251, Lns. 13-22, Tr. 4252, Lns.1-5). A

Company witness suggested the need for a well thought out incentive policy noting that it is not sufficient to simply offer an incentive program, but critical that the incentives be strong enough to encourage the utility to meet or exceed its program goals. If incentives are not strong enough it would represent "bad public policy" (Tr. 2730, Lns. 4-5, and 16-21). Reflecting upon a recent rule making process of the California Public Utilities Commission (CPUC) that resulted in a 227 page order outlining utility incentive policies, the Company witness Zielinski expressed concern that some elements of the Order were not based on "economic reason" (Tr. 2727, Lns. 11-17).

The Company conceded that it did not perform an economic analysis of its incentive levels. The most rigorous analysis and justification offered by the Company was that the incentive levels fell within the range of credits used for property tax adjustments (Tr. 3060, Lns. 7-24, Tr. 3061, Ln. 10). Considering the potential cost of these incentives and the complexities involved in developing an effective incentive strategy, Staff needs more evidence that the Company's plan is justified and economically sound.

Second, Staff is concerned about the potential size of the incentive payments. The Company's justification when questioned about this overly generous incentive, which could easily exceed 90 percent of the program budget, was that the incentive is simply a sharing of a benefit and the ratepayers will still keep the majority of benefit (Tr. 2756, Lns. 23-24, Tr. 2757, Lns.1-90. Staff believes, however, that if Con Edison did not receive an incentive of this magnitude, the Company would be able to increase its program budget by over ninety percent and provide substantially more DSM programs and services (Tr. 4401, Lns. 12-25, Tr. 4402, Lns. 1-4).

In order to further place the magnitude of the incentive in context, Staff referenced a report issued in October 2006 by the American Council for an Energy-Efficient Economy (ACEEE), titled "Aligning Utility Interests with Energy Efficiency Objectives: A Review of Recent Efforts at Decoupling and Performance Incentives" that surveyed recent performance incentive programs in several states. The report found that, while details varied, the performance incentives generally ranged from about 5 to 10 percent of the program budgets. Moreover, many of the states with incentive programs lack revenue decoupling (RDM) and lost revenue recovery mechanisms

(LRRM). In this case, however, Con Edison has proposed an RDM (Tr. 4248, Lns. 12-22, Tr. 4249, Lns. 1-16).

Third the proposal does not provide for any negative consequences for failure to perform, even if the Company falls far short of achieving its DSM goals. For example, if the Company achieves only one MW of its 500 MW goal, it would receive 20% of the net resource benefit of the one MW. Customers would be placed in a position of providing an incentive despite the Company's significant underperformance (Tr. 4244, Lns. 5-15).

<u>Incentive Two - Fee per MW for encouraging enrollment in DSM programs</u>

The Company requests a continuation of the incentive for its role in encouraging enrollment in demand response programs administered by itself, NYSERDA, and the NYISO. Specifically, the Company proposes compensation to itself of $22,500 per MW (adjusted upward for inflation) for incremental enrollment in these programs during the rate case period.

Staff maintains that this incentive must be reconsidered. The EPS Proceeding is likely to significantly increase awareness and activity surrounding energy efficiency programs, with utilities possibly playing a bigger role as marketers of energy efficiency concepts and programs. As a result, any marketing-related incentive should be considered in the context of the EPS Proceeding (Tr. 4244, Lns. 18-22, Tr. 4245, Lns. 1-22, Tr. 4246, Lns. 1-7).

Incentive Three – Greenhouse gas reduction market credits

The Company proposes that it be eligible for greenhouse gas reduction market credits as result of implementing DSM programs. If the energy saving documented by the Company results in a greenhouse gas reduction, the Company maintains it should be allowed to retain the value of the associated credits.

Staff views this incentive proposal as premature. Currently an active market for greenhouse gas reduction market credits does not exist. If a greenhouse gas reduction market develops, the Company could then develop a specific proposal, including a discussion of the financial impacts, for Commission consideration (Tr. 4247, Lns. 9-22, Tr. 4248, Lns. 1-9).

Staff Incentive Policy

Staff agrees that incentives can play a role in encouraging better programs, but has cautioned that incentives must be carefully designed to balance offering incentives that are sufficient to encourage high performance, but not so high as to burden ratepayers with unnecessary expenses. The incentive structure must also be easy to understand, administer and monitor. Without knowing the specifics of the Company's proposed energy efficiency program portfolio, it is impossible to properly design and propose a detailed incentive plan. Moreover, the EPS Staff Proposal has raised incentives as a possible strategy to encourage energy efficiency programs. Like energy program design, implementation, and budget priorities, incentive strategies would be more appropriately addressed in the EPS Proceeding. Incentives could be considered as part of the bridge program collaborative, but only as they relate to the bridge program initiatives.

X. CONSUMER SERVICES RELATED ISSUES

Call Center Enhancements

In this proceeding, Con Edison is proposing a substantial rate increase that is largely driven by the Company's need to make critical and unavoidable investments in its aging infrastructure. Given the rate impacts of these necessary infrastructure investments, this is not the time for the Company to be making improvements to areas of its operations unrelated to its ability to render safe and adequate service. With respect to the Company’s proposal to increase its call center staffing, as Staff testimony indicates: recent Staff outage investigations have found that with its current equipment and personnel levels, the Company was able to respond well to outage situations (TR 3830) and that the infrastructure improvements the Company will be undertaking will further lessen the need for extra staffing to handle emergencies in the call center. Staff, therefore proposes to eliminate the Company’s increased staffing proposal and its remote agent technology proposal.

Con Edison’s response to Staff’s arguments is to suggest that the need for more call center personnel is actually driven not by emergency situations but by ongoing training needs and the high turn-over among its customer service representatives (CSRs). However, aside from stating that the constant training of CSRs results in a de facto deficit of 36 CSRs, the Company provides no evidence that its current staffing levels are insufficient to meet its customers’ needs. Further, the Company admits it has been able to meet the call answer rate found in its service incentive requirement (Tr. 0859).

Like its arguments in support of increasing its CSRs, Con Edison arguments in support of its remote agent technology do not demonstrate a high priority need for the technology. Similarly, while investing in an enhancement of its voice recognition software might be appropriate at some , it is not appropriate where, as is the case here, there is no demonstration by the Company that it has explored lower costs alternatives. In fact, Con Edison acknowledges that the requested funding would be used to enhance a system that is nearing the end of its useful life (Tr. 0836).

Con Edison proposes to increase its outbound lines from 24 to 72. The Company argues that a tripling of the number of outbound lines is necessary for it “to prepare for a worst case scenario, such as a system-wide event…” (Tr. p 0837). Staff acknowledges that an increase in outbound lines is warranted but maintains that a tripling of the number of lines is excessive under the circumstances. Staff therefore proposes that the Company double the number of outbound lines by increasing them to 48.

Low Income Program

As Staff discussed in greater detail in its testimony, increases in energy costs place a much greater burden on low income families than they do on the rest of the Company’s customers. As a result the Commission and the

Company have long recognized the need to establish programs to assists low income customers with their energy burden. There is no escaping the fact that that the inevitable rate increases resulting from this proceeding will have its most severe financial impacts on low income customers and there should be a reasonable augmentation of Con Edison's existing low income programs to help offset some of the increased burden on low income customers (Tr. 3836-3837).

Given the above, as stated in its testimony, Staff recommends increasing funding for the Company's low income program to $24.9 million by freezing the monthly customer charge at $6.50 (Tr. 3838).

Con Edison contests Staff's proposed freezing of the customer charge and proposes instead to continue to provide the same monthly customer charge discount it provides currently. The Company supports its position by arguing that that Staff's proposal is arbitrary and would place an unreasonable additional subsidy on the Company's other customers (Tr. 0838).

As Staff discussed in its testimony, the Commission has long recognized that utility low income programs are necessitated by a number of factors including: the disproportionate burdens energy costs place on low income families; the increased risks that low income families will simply be unable to pay their bills; and the savings the Company can derive from the decreased credit and other bill collection costs as low income customers' bills are made more affordable (Tr. 3836). Given the size of the inevitable rate increase in this proceeding, failing to upwardly adjust the assistance provided under the Company's low income program would be inimical to the very purposes that underlie the program. Moreover, Staff believes that its proposed freezing of the customer charge for low income customers strikes the appropriate balance between the need to ensure that service remains affordable for these customers and the need to minimize the subsidies other customers pay. As Staff noted in its testimony, if spread over all electric sales, the proposed freezing of the customer charge would result in a rate impact of approximately $0.0004 per kwh (Tr. 3839).

Field Operations

The Company proposes to add 15 customer field representatives (CFRs) to address demand meter reading and investigate meter advances on inactive accounts at an O&M cost of $390,000 in the rate year. Staff recommends that the proposal be rejected because the additional staff will be self-funded through the additional revenues collected (Tr. 3840).

In its rebuttal testimony Con Edison denies that its staffing request is mostly in the service of investigating usage shown by meters where consumption is reported on inactive accounts (Tr. 0839) and maintains that the possibility of increased revenues from hiring additional CFRs is speculative and therefore should not be considered (Tr. 840). On cross examination; however, the Company's Customer Operations Panel admitted that its own exhibit demonstrated that the majority of workload for the new CFRs would involve the investigation of usage shown by meters on inactive accounts (Tr. 0870).

If the hiring of additional CFRs to investigate meter advances on inactive accounts will have any beneficial effect for the Company, it will certainly be to speed up the rate at which the Company identifies and investigates these accounts and places a new customer on record for the account. The Public Service Law and Commission regulations place significant time-sensitive limitations on the ability of the Company to bill new customers for the service used in these cases. For example, under PSL §41.1 and 16 NYCRR §11.14 (a), unless the Company's failure to discover and bill for the condition earlier "was not due to the neglect of the utility or was due to the culpable conduct of the customer" the Company may not charge a new residential customer for more than the last six months of service. (16 NYCRR §13.9 contains the time limitations on the ability of utilities to bill new nonresidential customers for meter advances on inactive accounts.) The charges for service outside these time limitations, including the attendant late payment charges the Company is often able to bill, are otherwise written off by the Company as unbilled usage.

Thus, contrary to the Company's contention, the increased revenues the Company will receive from hiring additional CFRs are far from speculative; they are both very real and significant. Moreover if these revenues do not cover the rate year costs of hiring the CFR, it calls into question the very reasonableness of the decision to hire the CFRs.

Outreach and Education

The Company's outreach and education program currently operates at a budgeted level of approximately $3.5 million. The Company has proposed an enormous increase for this program, nearly tripling the cost to $10.2 million. Staff proposes that the current budget be increased by approximately $400,000 (approximately 10%) to $3.9 million. In addition Staff proposes that the Company be required to develop an outreach and education program plan and file it with the Director of the Office of Consumer Service at least 90 days before implementation.

As Staff discussed in its testimony, even at its current funding levels, the Company carries out a comprehensive outreach and education (O&E) program that is at least the equal of the programs carried out by the other major New York State utilities. The Company’s O&E program provides education to customers about their rights and responsibilities as utility customers, informs them about the programs and services that the Company offers, helps them manage their energy bills, provides information about ways they can contact the Company and about the many options they have to pay their bills. The O&E program also provides a Company presence in the community and identifies and represents customer needs to the Company and/or municipal officials during situations where emergency customer care is warranted. O&E program materials are also provided to schoolchildren to help them understand energy and energy safety. (Tr. 0801 lines 20-24, Tr. 0802 lines 1-16)

Nevertheless, the Company justifies its proposed 300% increase by stating it needs to (Tr. 0803 lines 6-9) intensify its efforts to reach customers on a number of topics and it argues that its customers need more and better information about many of the issues surrounding their electric service.

Staff agrees that a comprehensive O&E program is an essential requirement for all utilities; and we support the Company in making its O&E program an integral function of the Company's operation. Nevertheless, the Company's proposed increased in its O&E budget simply has not been justified. As previously noted, the Company already carries out a very comprehensive and effective O&E program that meets the needs of its diverse customer base and it has not explained what has changed that would require anything close to a 300% increase in funding for it to continue to meet these needs. In fact, on cross examination, Con Edison's Customer Operations Panel acknowledged that Staff's proposed electric funding level for outreach and education was proportionate, as a function of the number of customers, to the amount of gas revenues contributed for the same program (Tr. 0879-0880).

In its rebuttal testimony, the Company also questioned the need for Staff's proposed requirement that the Company develop an outreach and education program plan and file it with the Director of the Office of Consumer Service at least 90 days before implementation. As the Company notes, over the last several years it has already been working in collaboration with Staff to help ensure that the Company's O&E program is cost effective and supportive of the customer service and education goals recognized by the Public Service Commission. This collaborative effort has included the practice of developing and sharing with the Director of the Office of Consumer services an annual public awareness outreach and education plan which sets forth the Company's O&E goals and objectives, messages, communication strategies, and evaluation methodologies. Staff merely wishes to make this existing practice permanent.

XI. MISCELLANEOUS

A. Electric Emergency Preparedness

In its rate filing, Con Edison proposes to modify its Electric Operations Emergency Management (EOEM) program. The Company's proposal is comprised of the Emergency Management Organization, Control Center Emergency Screening, Incident Command Center, and the Coastal Storm Mitigation program. The implementation of these four programs, as proposed by the Company, requires additional staffing and expanded office space. The Company asserts that these programs address equipment damage, timely recovery due to coastal storm surges, and a better process for handling emergency calls from customers. Con Edison states that the proposed programs are intended to improve the Company's storm and heat event readiness, protect equipment from coastal storm surges, better respond to customer outages, facilitate effective restoration, and improve on internal and external communications. The Company has cited $12,976,000 as the cost for these programs (Tr. 4186, Ln. 14).

Con Edison clearly needs to take progressive steps to improve its emergency preparedness. The Company experienced four significant outages in 2006, in Queens and Westchester County that resulted in thousands of customers without electric service for extended periods. The most onerous of these outages were in Queens where the restoration time was up to nine days. Staff believes that the four proposed programs may help improve communications, storm preparations, and emergency response. However, the proposed programs do not address a bigger and more comprehensive issue with respect to Con Edison's emergency preparedness. The Company lacks cohesion and accountability in its emergency preparedness program from the corporate level down to the crews in the field. The Company's inadequate emergency response procedures and corporate communication during the Queens and Westchester outages were pointed out by Staff in its investigation reports on those outages[67]. Recommendations for improved emergency preparedness by the Company have been made as well in the independent Audit Report developed in Case 06-M-1078.[68]

The EOEM's Business Plan makes general statements about corporate plans, yet it does not clearly define how the Business Plan (Exh. 59) should coordinate with other emergency organizations such as Corporate Emergency Planning and Security (CEPS), the electric operating regions, and the Corporate Emergency Response Center (CERC). Staff is not convinced that the strategies indicated in the Business Plan are implemented consistently throughout the Company and that there is verification that work required by the plans is being satisfactorily carried out. Staff believes that these two issues affect the

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[67] Department of Public Service, Report on Investigation of the July 2006 Equipment Failures and Power Outages in Con Edison's July 2006 Equipment Failures and Power Outages in Con Edison's Long Island City Network in Queens County, New York, dated February 2007 (Long Island City Network Report). Department of Public Service, July and September 2006 Severe Storms: A Report on Con Edison's Performance, dated February 2007 (July and September Storm Report).

[68] 06-M-1078 Proceeding on Motion of the Commission to Audit the Performance of Consolidated Edison Company of New York, Inc. in Response to Outage Emergencies, Order Instituting Proceeding and Directing Audit (Issued September 8, 2006).

Company’s various policies and plans and are among the significant reasons for the inadequate restoration of service during the Queens and Westchester outages. In order for customers to benefit from the proposed programs, the Company needs to integrate these programs into a well structured and cohesive system-wide emergency response program that ensures adequate accountability.

Con Edison stated that it has a clear structure in its emergency preparedness program (Tr. 0999, Lns. 18-20). Mr. Greenwood asserts in his testimony, that he is the Vice President of CEPS and is responsible for “responding to incidents” (Tr. 0972, Lns. 9-10). When Staff asked what he specifically meant by “responding to incidents,” Mr. Greenwood replied that his organization provides some oversight and direction for how to respond to events using a methodology called Incident Command Structure. In addition, Mr. Greenwood stated that depending on the magnitude of the event, he or his staff may personally respond to a field operation event (Tr. 1012, Lns. 11-25, Tr. 1013, Lns. 1-11). Yet, when Staff asked Mr. Greenwood whether his role involved day to day EOEM activities, coordinating restoration efforts, and developing restoration strategy between operating regions, his answer was no (Tr. 1014, Lns. 14-25 and Tr. 1015, Lns. 2-5). The role of CEPS in relations to Corporate Guidelines (CI-260-4) and its oversight of EOEM have not been clearly defined by the Company. According to CI-260-4, Mr. Greenwood is responsible for maintaining a call list and mobilization plan for a full scale incident requiring CERC mobilization. In the CERP manual, there is no reference to Mr. Greenwood or his organization with respect to when and how CERC should be mobilized.

During the early stages of the Queens outages in 2006, Staff began monitoring conditions throughout Con Edison's service territory. By the evening of July 17, the Long Island City network was in its 5th contingency[69] with a system load of 11,864 MW, a level Con Edison considered pursuant to its CERP manual to be a full scale incident[70]. According to CI-260-4 a full scale incident may be preemptively declared at the discretion of the Senior Vice President of Electric Operations and in concurrence by Mr. Greenwood, to determine whether CERC should be mobilized. Based on the full scale incident classification indicated

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[69] Long Island City Network Report, supra, pp. 12-13.

[70] CERP Rev 4/1/2006, Page 65 – Full Scale Incident Criteria – system load greater than 11,000MW, or network outage, or system load greater than 11,000MW with primary feeder overloads, or system load greater than 11,000MW with multiple secondary burnout.

in CERP, Con Edison should have made the decision to mobilize CERC on that day. It wasn't until 3 days later on July 20 that Con Edison declared CERC opened.[71] CERC was not opened earlier, apparently due to the vagueness of two different sets of procedures: the emergency plans and the corporate policies. Clearly, a well established protocol in the Company's emergency preparedness program, including a well defined and consistent set of protocols for all emergency plans across all emergency organizations, is necessary for the Company to effectively fulfill its emergency preparedness responsibilities.

An independent audit of the Company's electric emergency outage response program was conducted by Vantage Consulting, Inc. (Vantage) for the Department of Public Service in Case 06-M-1078.[72] Vantage was charged with identifying opportunities to improve Con Edison's electric emergency response programs. The findings by Vantage included Con Edison's lack of corporate over sight, insufficient coordinated strategy and emergency planning, poor restoration performance, and inadequate communication processes with customer information and call center operations. There are 159 findings and 62 recommendations

[71] Long Island City Network Report, supra, p. 14.
[72] Case 06-M-1078, supra, Order Instituting Proceeding and Directing Audit.

as a result of this audit. It is obvious from Vantage's audit that Con Edison needs to improve its emergency preparedness, not only from a departmental level, but from a corporate level as well.

In view of the importance of emergency preparedness programs, Con Edison should modify its emergency preparedness proposals in accord with Staff's testimony and the Audit recommendations that relate to the programs addressed in the Company's proposed rate plan. The Company's modified proposal should be filed and provided to Staff prior to January 1, 2008, the opportunity for comment provided, and the proposal be addressed in the Recommended Decision and in the Commission's Order in this proceeding.

Con Edison asserts that it needs more time to evaluate the independent audit's findings and recommendations, and that the January 1, 2008 deadline for modification of the Comprehensive Plan and its submission to Staff is unreasonable. The Audit was issued on October 25, 2007; notice was made of comments by Con Edison due November 6, 2007, and of comments by interested parties due November 20, 2007. Staff's proposed schedule provides sufficient time for Con Edison to reevaluate the components of its Comprehensive Plan for which funding is required.

B. <u>Research and Development (R&D)</u>

Con Edison seeks to recover $22.75 million to support its ongoing and new R&D programs. Staff witness Pause testified that the R&D programs that the Company proposed were warranted programs and were fully justified by Con Edison (Tr. 4181, Lns. 3-4). However, Mr. Pause proposed to reduce the recovery level to $19 million based on his observation that R&D expense has been less than budgeted levels the past few years (Tr. 4181, Ln. 8 – Tr. 4182, Ln. 22). Con Edison characterizes Mr. Pause's proposals as inappropriate "slippage" adjustments, explaining that the budget shortfalls that Mr. Pause observed were not the result of under-spending, but rather due to credits to the R&D accounts. Company witness Kressner indicated that the historic credits or reductions to R&D expense were simply the result of the capitalization of successful R&D products. He explained that the costs associated with the development and demonstrations of successful products are capitalized and the book expense is reduced (Tr. 147, Lns. 18-24).

Witness Kressner testified that total R&D expenditures, capital and expense combined, were at or slightly above budgeted level the past few years (Tr. 148, Lns. 1-5). Therefore, he concludes that Staff's adjustment is inconsistent with Con Edison’s actual spending patterns (Tr. 148, Lns. 9-10).

Staff’s adjustment has merit nonetheless. The unfortunate mischaracterization of Staff’s proposed adjustment has confused the issue. Staff observed that the Company’s actual R&D book expense has consistently been below R&D budget levels. Con Edison clarified the record to explain that the lower book expense was the direct result of a consistent pattern of successful R&D projects. Staff has no reason to believe that the Company will not continue to be successful in its R&D efforts. Therefore, Staff’s adjustment is appropriate as a proxy for successful R&D projects in the rate year. If Con Edison does not expect any of its R&D programs to be successful then the Commission should consider denying the entire request.

In his rebuttal testimony, Mr. Kressner suggests that Con Edison is amenable to a one-way true-up of R&D expense if the Commission allowed the Company’s full request in rates and subject to the Company’s rights to petition the Commission to defer incremental R&D expenses (Tr. 149, Ln. 19 – Tr. 150, Ln. 2). On cross-examination, Mr. Pause indicated that he would support witness Kressner’s proposal provided that the true-up was limited to the specific programs proposed by Con Edison in this case (Tr. 4184, Lns. 17-24).

After a comprehensive review of the facts and circumstances in this record, Staff does not support the Company's proposal to fund R&D programs in rates at the Company's requested level subject to true-up. Staff fully supported the Company's R&D programs and funding levels, but for accounting for the Company's successes. The Company has a demonstrated track record of producing annual successes in its R&D initiatives. There is no evidence in the record that suggest that the Company will not have successful R&D initiatives in the rate year. Con Edison's rate year R&D request of $22.8 is far greater than the level the Company historically expensed. In fact, Company's rate year request is more than twice the historic year gross expenditure level of $10.8 million (Tr. 148, Lns. 6-9). The Company's proposal will require customers to fund projects that will be capitalized in rates and to then wait for refunds. Such an approach is unfair to customers. Staff's recommends that the Company be allowed $19 million to fund expected rate year net R&D expenses. In light of the substantially higher budget request, it is reasonable to expect higher levels of capitalized expenditure for successes in the rate year. Therefore, to ensure that customers do not fund more in rates for R&D than necessary, Staff recommends that the Company's proposed downward true-up be adopted. The Commission should direct the Company to report on its R&D costs and activities and defer for customers benefit unspent R&D funds in the rate year.

C. MANDATORY HOURLY PRICING

Background

Pursuant to the Commission's Order in Docket No. 03-E-0641,[73] Consolidated Edison implemented mandatory Hourly Pricing (MHP) for approximately 740 customers with a maximum demand over 1500kW (Tr. 0771). The Company proposes to expand the MHP program to customers whose maximum demand is greater than 500 kW in any month during an annual period (Tr. 0772, Lns. 5-7). The Company proposes to implement Hourly Pricing in two steps, in January 2009 for customers with demands greater than 1 MW and in January 2010 for customers with demands over 500kW (Tr. 0774-0775). The majority of customers with maximum demands between 500kW and 1500kW do not have interval

[73] Case 03-E-0641, Proceeding on Motion of the Commission Regarding Expedited Implementation of Mandatory Hourly Pricing for Commodity Service, Order Denying Petition For Rehearing and Clarification in Part and Adopting Mandatory Hourly Pricing Requirements, (Issued April 24, 2006) ("April MHP Order").

meters; interval meters must be installed for 1,360 customers (Tr. 0775, Lns. 18-22).

Outreach and Education (O&E)

The Company describes its O&E plans for the expansion of MHP saying, “Direct-mail and bill inserts will be used to communicate with customers regarding MHP and will be sent to both full service and retail access customers in the 500 kW to 1500 kW group. Efforts may also include information exchange meetings.” (Tr. 3867, Lns. 6-11) This plan differs from the previous O&E effort for customers currently on MHP only in that it includes bill inserts. As the Company explains, “Letters and information exchange meetings were used for the over 1500kW customers but not bill inserts” (Tr. 3867, Lns. 11-13). The Company’s analysis of its implementation of MHP found, “some customers still needed additional resources to assess hourly pricing.” (Tr. 3868, Lns. 9-11) Staff reviewed the suggestions resulting from the analysis of the implementation Con Edison’s MHP program and made the following recommendations regarding future O&E programs:

- Live seminars should be used to provide information on MHP to customers, consultants, and ESCOs.
- Seminars should include testimonials from customers already converted to MHP.
- Customers with demands above 1.5 MW should be

invited to a seminar for updates on the program.

- The Company should communicate with customers and vendors to determine if there are any ways to make the energy management software package more appealing and useful to customers.

In September 2006, National Grid implemented MHP for its customers with demands between 500kW and 2,000kW. Like Con Edison, National Grid filed a report on its experience with implementing hourly pricing. Staff reviewed National Grid's report, relative to implementation of MHP for customers who are similar in size to the customers Con Edison has proposed to put on MHP. As a result of its review, Staff made the following recommendations regarding future O&E programs:

- Workshops should be scheduled close to the launch of Hourly Pricing tariff.
- Web cast/video of outreach workshops should be archived and accessible on the Company's website. Training should be offered to both retail access and full service customers.
- O&E should offer expanded coverage on the topics of energy efficiency, distributed generation, and use of financial hedges.
- A monthly newsletter should be developed similar to National Grid's "Business and Energy" which provides customers with in-depth information on topics such as energy efficiency, distributed

generation, and how to use financial hedges. The newsletter should be provided electronically, as an electronic newsletter can be targeted more directly to the energy managers or building engineers than the bill inserts planned by the Company.

The Company estimates that the cost of these enhanced O&E measures would be $100,000 per year (Tr. 0830, Lns. 2-4). This is within the $300,000 increase that the Customer Service Panel has recommended for Con Edison's O&E programs.

Implementation Schedule

The Company proposes to implement Hourly Pricing in two steps, in January 2009 for customers with demands greater than 1 MW and in January 2010 for customers with demands over 500kW (Tr. 0774-0775). Staff has proposed that the implementation schedule be modified to allow customers to receive at least 6 months of hourly interval load data for customers with demand greater than 1 MW and at least one year of hourly interval load data for customers with demand between 500 kW and 1 MW. Ideally, customers should have access to a year's hourly load data before moving onto the Hourly Pricing tariff. In this way, customers would be able to see how their load is affected by season, production patterns, weather, and lighting needs in anticipation of the new Hourly Pricing tariff so they could effectively make adjustments to their load patterns. This is consistent with the MHP order and would give customers the greatest ability to prepare for the tariff implementation. In the MHP Order, the Commission stated, customers “need access to as much interval load data as possible to aid them in making informed decisions about hourly pricing” (Tr. 3862, Lns. 4-18).

The Company states that implementing the Staff proposal would delay the implementation of MHP for customers over 1MW to Fall of 2009 and customers over 500 kW delayed to the Summer of 2011 (Tr. 0827, Lns. 8-14). This concern is outweighed, however, by the increased opportunity that Staff’s proposed instructional periods would afford customers to increase their understanding of the MHP tariff and maximize the anticipated reduction in energy demand that would result.

Penalty for Denying Access to Replace the Meter

The Company proposes to amend its tariff to include a special charge of $1,000 that it would assess against the account of a customer or meter access controller in the event the Company is denied access to its meter or meters used to measure the service of an eligible customer (Tr.

0777). Staff does not support this tariff change. The Company cites its experience with residential time-of-use programs to bolster its case for a charge. As the Company explains in response to Staff IR DPS-205, in 1992, when the residential time-of-use rate was first implemented, Con Edison installed 6,100 meters and had problems accessing 5 of those meters, comprising 0.08% of meters installed. The proposed Hourly Pricing implementation involves the installation of approximately 1,600 meters. If one used Con Edison’s previous experience from 15 years ago, the prediction would indicate that one customer would refuse Con Edison access to change its meter. Con Edison’s past experience with time-of-use customers does not support its proposal to assess the special charge. One possible reason for some customers to refuse the Company access to meters may be to avoid paying hourly prices. However, customers could avoid hourly prices by simply switching to an ESCO’s service. The option of choosing an ESCO was not available in 1992. In the recent rollout of advanced meters by National Grid, which is discuss above, that company reported no problems accessing meters. Staff does not believe that adequate support for the need of such a tariff charge by Con Edison is present in the record (Tr. 3875).

Cost Recovery

The Company believes that all MHP program costs, including metering costs, should be recovered via delivery rates because MHP is deemed to benefit all customers (Tr. 0832, Lns. 6-9). The April 2006 MHP Order did authorize utilities to “recover implementation and outreach and education costs that are unrelated to meter installation and activation from all ratepayers through delivery rates” (April 2006 MHP Order at p. 31).

Staff recommends that the meter costs be recovered via a tariffed incremental meter charge in conformance with the Commission's April 2006 MHP Order. On page 31 of that Order the utilities were directed by the Commission to “recover incremental metering costs from the affected customers over time in conformance with normal amortization periods.” The Commission subsequently approved National Grid’s proposal to recover metering costs through an incremental metering charge. Con Edison has not provided sufficient evidence to support a different method of cost recovery and should therefore recover its metering costs in a similar manner to that directed by the Commission (Tr. 3876, Lns. 8-21).

XII. UPDATES

The issue of Updates has been addressed throughout the brief. We, however, reserve the right to reply to parties comments on Updates in our Reply Brief.

XIII. CONCLUSION

For the reasons stated herein, Staff’s proposals and adjustments should be adopted.

Respectfully submitted,

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