STATE OF NEW YORK

PUBLIC SERVICE COMMISSION

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.	Case 07-E-0523

INITIAL BRIEF

OF THE

NEW YORK STATE CONSUMER PROTECTION BOARD

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Dated: November 30, 2007
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Table of Contents

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This proceeding was initiated by the New York Public Service Commission ("PSC" or "Commission") in response to a May 4, 2007, filing by Consolidated Edison Company of New York, Inc. ("Con Edison" or "Company") in which the Company requested a rate increase of $1.225 billion (34% of electric delivery revenues) for the twelve months beginning April 1, 2008. The Company also proposed a multi-year rate plan that provides for electric delivery rate increases of an additional $334.5 million and $389.8 million in the years ending March 31, 2010, and March 31, 2011, respectively. (Exhibit 164, Summary) In updated testimony, Con Edison revised its proposed rate increase to $1.201 billion (33% of electric delivery revenues) for the first year, $323.1 million for the second year and $381.0 million for the third year. (Exhibit 165, Summary) Overall, the Company now proposes to increase its electric delivery revenues by $4.632 billion in the three-year period beginning April 1, 2008. Con Edison also proposed other changes including a new program to promote energy efficiency, a revenue decoupling mechanism ("RDM") intended to protect the Company from conservation-induced loss of revenue, and rate design changes.

The Consumer Protection Board ("CPB") filed testimony given by three witnesses demonstrating that Con Edison substantially overstates the amount of rate relief which it should be provided and does not properly address several important policy issues. Testimony in opposition to the Company's request was also filed by other parties including Staff of the Department of Public Service ("DPS Staff"); the City of New York ("NY City"); the County of Westchester ("COW"); Utility Workers Union of America, AFL-CIO, Local 1-2; New York Energy Consumers Council; New York State Energy Research and Development Authority ("NYSERDA"); New York Power Authority and jointly by Natural Resources Defense Council ("NRDC") and Pace Energy Project. Hearings were held before Administrative Law Judges ("ALJ") William Bouteiller, Michelle L. Phillips and Rudy Stegemoeller over 11 days concluding October 31, 2007. The CPB participated fully in those hearings.

The CPB has the following primary recommendations:

<u>Capital Expenditures</u>

- Con Edison's proposal to reflect $1.906 billion of capital expenditures on transmission and distribution ("T&D") projects in 2008 in delivery rates, should be reduced by approximately 20%.

- Costs of the proposed Advanced Metering Initiative ("AMI") should not be recovered from customers at this time.

- The Commission should immediately commence an audit of Con Edison, with particular focus on its construction program planning. The results of that investigation should be considered as part of Con Edison's next electric rate case.

- The PSC should require Con Edison to demonstrate in its future T&D capital investment proposals that demand-side management solutions ("DSM") could not have served customer needs at a lower cost.

- The Company's T&D capital spending under its current rate plan has not been reviewed in an open and transparent forum. The $1.6 billion spent in excess of the amounts reflected in rates should be carefully scrutinized as part of the audit we recommend and subject to comment by interested parties.

Profit Rate

- Con Edison's cost of equity is 9.0%, reducing its revenue requirement by $246 million. There is no basis in this case to deviate from long-standing PSC-approved methodologies to determine the Company's cost of equity.

Adjustments to Projected Expenses

- Site Investigation and Remediation ("SIR") costs of approximately $135 million have not been properly reviewed. They should be scrutinized as part of the audit we recommend and subject to comment by interested parties.

- Costs incurred by the Company related to recovery from the attack on the World Trade Center of approximately $100 million should not be recovered from customers at this time, since there continues to be substantial uncertainty regarding amounts to be obtained from the federal government and insurance carriers.

- The Company's projection of labor expenses should be reduced by $26.9 million to reflect, among other things, a $10.8 million reduction in projected compensatory and overtime costs and the elimination of $11.2 million of ratepayer funding for the variable pay program.

- Con Edison's projections of employee welfare expense should be reduced by $6.1 million and its forecasts of insurance expense should be reduced by $10.8 million. The latter recommendation includes elimination of ratepayer funding of Director's and Officer's Liability Insurance.

- Reductions are required to Con Edison's projections of costs for System and Transmission operations and maintenance ("O&M") expense of $3.6 million and Electric Operations O&M expense of $49.9 million. The latter includes adjustments to the Company's extremely large projected increases in spending for underground structure inspection, stray voltage testing, distribution line clearance and double wood programs.

- Con Edison's forecast of facilities expense should be reduced by $13.4 million and its projection of customer operations expense should be reduced by $2.7 million.

- Reductions in the Company's projected expenses are required for steam operations expense ($4.4 million), interference costs ($27.1 million), storm costs ($3.0 million) and escalation ($2.2 million).

- The Commission should emphasize that in the future, Con Edison must fully support its proposed programs in its direct case, not merely assert their importance.

Proposals to Mitigate the Rate Increase

- Significant costs including carrying costs on the excess of T&D capital expenditures over the amount used to set Con Edison's current rates, SIR costs and WTC-related costs, should be amortized and recovered over a longer period of time than proposed by the Company. This would reduce the amount of the rate increase in this proceeding by more than $100 million.

- Con Edison's proposals to decrease service lives, reduce net salvage rates and recover a projected depreciation reserve deficiency should be rejected, reducing projected depreciation expense by $87 million.

Policy Issues

- A collaborate proceeding regarding an interim DSM and a revenue decoupling mechanism ("RDM") should commence on a schedule to permit PSC approval in March 2008. The DSM program should be based on the existing system-wide program conducted pursuant to the Company's current rate plan. Another collaborative proceeding to establish a long-term DSM program should commence after the PSC's resolves certain issues in the generic energy efficiency proceeding.

Miscellaneous

- The Outage Notification Incentive Mechanism should be revised to include new criteria regarding the accuracy of the Company's outage estimates and a requirement for holding conference calls to brief public officials. In addition, the financial consequences for failure to achieve acceptable results should be increased by a factor of ten.

- Con Edison's proposal to increase the customer charge for residential customers should be rejected. Current customer charges for residential customers should be maintained.

This brief consists of 6 sections. Point I discusses the CPB's concerns and recommendations regarding capital expenditures for T&D, including projected spending of $1.906 billion in 2008 and approximately $1.6 billion of spending for the period ending March 31, 2008, in excess of what was reflected in the Company's current rates. In Point II, we address our recommendation that the Company's cost of equity be set at 9.0%. Point III focuses on the need for numerous adjustments to Con Edison's projected expenses. In Point IV, we provide several recommendations intended to mitigate the delivery rate increase beginning April 1, 2008. Policy issues regarding energy efficiency and revenue decoupling are addressed in Point V. In Point VI, we discuss remaining issues including rate design, and an incentive mechanism to help ensure that the Company provides its customers proper information on the expected extent and duration of electric outages. The absence of discussion in this brief of any particular item should not be construed as support for, or opposition to, the Company's position. Rather, the CPB reserves the right to comment further in our reply brief on the positions articulated by the parties in their initial briefs.

I. THE CONSUMER PROTECTION BOARD'S INFRASTRUCTURE PROPOSALS SHOULD BE ADOPTED.

One of the main causes of Con Edison's extremely large rate increase request is its proposal regarding capital spending on its T&D network. The Company plans $1.906 billion of T&D capital expenditures in 2008 and $1.829 billion in 2009. (Exhibit 129, p.6)

It also requests permission to recover from ratepayers, the amount by which actual T&D capital expenditures during its current rate plan exceeded what was provided in current rates, an estimated difference of $1.616 billion. (TR 1454)

The CPB testified that substantial increases are required in Con Edison's capital spending to provide for growth of the Company's system and to help ensure safe and reliable service. (TR 4680) The record, however, shows that the Company's proposed infrastructure spending is extraordinary (TR 4680) and far exceeds spending levels proposed in the last rate case that the Commission characterized as "extremely large."[1] The proposed level of capital spending in calendar year 2008 is $479 million (34%) higher than in calendar year 2007, and 80% higher than the average in the five-year period ending 2007.[2] Further, the Company anticipates spending "approximately two billion dollars annually over the next several years" on T&D capital projects. (TR 2425)

The amount by which Con Edison's actual capital spending during the period of its current rate plan exceeds the levels reflected in rates, approximately $1.6 billion, is also extraordinary. The Company's actual expenditures in this three-year period are expected to exceed what it requested in its last rate case by more than $1 billion. (TR 2479-81)

The CPB fully recognizes that consumers benefit from prudent and cost effective capital spending. We are concerned, however, that Con Edison has the incentive and the opportunity to undertake capital expenditures that are not required and to implement infrastructure projects in a manner that is not cost effective. Indeed, utilities have a

1 Case 04-E-0572, Order Adopting Three-Year Rate Plan, March 24, 2005, p. 38.

2 Calculated from Exhibit 129. p. 6.

powerful incentive to make expenditures on capital projects since it increases their rate base, as both the CPB and Con Edison witnesses testified. (TR 4680, 2753) Given this incentive, careful scrutiny of Con Edison's capital spending proposal is required.

The CPB testified that the PSC's oversight and regulation of Con Edison's infrastructure spending in the last decade has not been satisfactory and has not ensured that capital improvements are made in a cost effective manner or meet the needs of Con Edison's customers. (TR 4680) Accordingly, the procedures used by the PSC to review Con Edison's construction program activities should be overhauled. In the meantime, the CPB recommends that the Commission establish rates in this proceeding to reflect projected T&D capital expenditures that are approximately 20% less than proposed by the Company for the rate year. We also urge the Commission to scrutinize the Company's actual T&D expenditures during the current rate plan, and ensure that the amount recovered from ratepayers is subject to reconciliation based on the results of that investigation.

A. Projected Capital Expenditures

For several reasons, the Company's projected T&D capital expenditures of $1.906 billion for 2008 are excessive and should be reduced. In addition, several changes are required to the procedures used by the PSC to review those projects.

1. Automated Meter Initiative

The capital and operations and maintenance ("O&M") costs associated with Con Edison's proposed AMI should be removed from the revenue requirement projections used to establish rates, since that proposal is under consideration by the PSC in a separate case. This would reduce projected rate year capital expenditures by $59 million and O&M costs by $10.331 million. (TR 4684, Exhibit 47)

Con Edison proposed to implement AMI throughout its service territory, following completion of three pilot projects that are expected to commence in 2007. It would install advanced meters throughout its service territory over a seven-year schedule. (TR 767–8)

The CPB testified that AMI has the potential to reduce costs for customers and provide for environmental benefits. In particular, it can help reduce the costs of meter reading; increase meter accuracy; reduce the number of estimated bills, thereby lessen customer confusion and the need to contact the Company with billing inquiries; provide customers more detailed information regarding their usage; facilitate customer participation in demand-side management programs; and enhance Con Edison's ability to identify the extent of an outage and more effectively dispatch service crews to restore service. (TR 4684)

The PSC is examining the appropriateness of AMI and the conditions under which utilities should deploy it, in a separate proceeding. In an order issued August 1, 2006, the Commission stated that it will "establish and manage the development of [AMI]," and it directed Con Edison and other utilities to file a comprehensive plan for development and deployment of advanced metering.[3] Those proposals are required to include an analysis of cost savings associated with AMI as well as deployment

[3] Case 04-E-0952, et al., Order Relating to Electric and Gas Metering Services, pp. 13-14.

schedules and outreach and education proposals. Con Edison submitted its proposal on March 28, 2007.

The Commission has not yet issued an order regarding Con Edison's proposal. On October 10, 2007, the PSC requested further information to use in evaluating that filing,[4] in particular, information regarding the features and functions of AMI systems that should be included in an AMI standard.[5] The Commission also reiterated the importance of conducting a thorough review of the AMI proposals, stating that these efforts "should not be undertaken lightly or without due deliberation."[6]

As the CPB testified, the Company's AMI proposal in this proceeding would prejudge the outcome of that comprehensive review. It would also prejudge evaluation of the pilot programs, which are intended, among other things, to provide actual data on the reasonableness of the cost and performance assumptions underlying the Company's March 28, 2007 filing. (TR 4685) Accordingly, the CPB recommends that Con Edison's proposal in this proceeding be rejected at this time, and its projected capital and O&M costs for this project be removed from the revenue requirement projections used to establish rates in this proceeding. The Company, however, should be permitted to recover the prudent costs of its AMI-related pilot programs. (TR 4685) DPS Staff made a similar recommendation. (TR 3944-46)

In its rebuttal testimony, Con Edison argues that the AMI issue should be decided in this proceeding, so as not to "unduly prejudice the Company" in pursuing its

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4 Case 04-E-0952, et al., Notice Seeking Comments, October 10, 2007, pp. 1-3.

5 Id., p. 2.

6 Id.

AMI efforts. (TR 818) As a threshold matter, the Commission is expected to decide this rate case in March 2008, and may very well issue an order in the AMI proceeding before that time. In that circumstance, the PSC's determination in this case can reflect any decision rendered in the AMI case. If its AMI decision is made after its determination in this proceeding, the Commission is fully capable of addressing AMI funding issues either in that generic case, or in a subsequent proceeding. Regardless of the timing of the Commission's order in the generic proceeding, neither Con Edison nor consumers will be disadvantaged if the CPB's recommendation is adopted, because the ongoing comprehensive evaluation of this issue will not be prejudged.

The Company's recommendation, by contrast, would unduly prejudice consumers, who would be required to fund AMI before it has been reviewed. There is no rational basis to approve the Company's proposal in this proceeding, since the record does not even contain a complete description or evaluation of the proposal and includes no mention of a cost/benefit analysis. In addition, although the Company contends that the main benefit of AMI is the avoidance of meter reading costs, it is not apparent that such cost savings are reflected in the Company's filing. Further, the record is bereft of any explanation of the results of the on-going pre-deployment demonstrations, or pilot programs.

In contrast, in its own March 27, 2007 filing in Case 94-E-0952 et al, the Company advocates the need to analyze, and base decisions regarding the next steps of the AMI project upon, the results of those pilot programs, which are being considered in the generic case. It states that the Company plans to conduct four "pre-deployment demonstrations" to "evaluate the performance of selected technologies, the integration of meter data derived from AMI into their 'back-office' systems, and customer response to additional information about their utility usage."[7] The Company explained that it would propose to proceed with AMI deployment "provided the results of these demonstrations support the Companies' assumptions," and it can recover all associated costs.[8] It also highlighted a concern about the AMI technology to be used in its underground system, saying that "many AMI systems have not been adequately tested in network distribution systems like Con Edison's, which have characteristics that can adversely affect the performance and functionality of offerings that use the electrical network as a communication medium."[9] The Company also explained that it will need to design yet another pilot project that will use a common-carrier wireless data path for wide-area communication "when it is available."[10] Con Edison also asserted that its estimated costs of the AMI project are uncertain, and were "developed from non-binding estimates provided by vendors for their respective components based on their limited evaluation and/or assumptions and without time to conduct proper propagation studies."[11]

Despite these explicit concerns, Con Edison is now apparently eager to implement its full AMI proposal regardless of the results of the pre-deployment demonstrations, and without the benefit of the Commission's comprehensive review in

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[7] Case 94-E-0952, et al, Plan for Development and Deployment of Advanced Electric and Gas Metering Infrastructure by Consolidated Edison Company of New York, Inc. and Orange and Rockland Utilities, March 28, 2007, p.2.

[8] Id.

[9] Id., p. 7.

[10] Id., p. 8.

[11] Id., p. 21.

the generic case. Although AMI may ultimately be shown to be in consumers' interest, Con Edison's proposal should be rejected at this time, and the projected capital and O&M expenses should be removed from the calculations to establish the Company's rates.

2. Inadequate Consideration of Demand Side Management Efforts

The record shows that the Company's capital expenditure projections do not reflect the Governor's target of reducing electricity consumption by 15% of forecast levels by 2015, or any of the DSM programs proposed by parties in this proceeding. (TR 2191) The Company testified that new DSM programs will be included only in future load forecasts and capital expenditures. (TR 5422-3) Omitting the impact of DSM programs that will be implemented in the near future overstates the need for capital expenditures.

Moreover, the record shows that as a conceptual matter, the Commission's oversight and regulation of Con Edison's infrastructure currently does not properly consider DSM alternatives to T&D capital expenditures. (TR 4682) Utilities have little, if any, incentive to consider or implement DSM alternatives to T&D investment, since such solutions do not augment rate base. Therefore, it is incumbent upon the PSC to ensure that utility capital expenditure projections are carefully reviewed to determine whether DSM alternatives have been properly considered. The record in this case, however, includes little, if any, evidence of such a review. For example, when asked whether any of the Company's proposed capital expenditures can be deferred in consideration of DSM efforts, DPS Staff answered only that the Company asserted that its load forecast reflects a reduction resulting from one DSM project that commenced in

2005. (Exhibit 221, response to CPB IR 2d) This is simply inadequate. Since there has not been proper scrutiny of Con Edison's capital expenditure projections despite the fact that it is well known that the Company's investment incentives are not aligned with those of ratepayers, it is reasonable to conclude that the Company's projected capital expenditure needs are overstated. In future proceedings, the Company should be required to demonstrate, to the satisfaction of the Commission, that customer needs could not be met, at a lower cost, by DSM solutions.

3. Absence of Audits Required by the Public Service Law

The Public Service Law ("PSL") explicitly provides the Commission authority to conduct an independent audit of Con Edison, with a focus on the Company's T&D capital expenditures, and in fact, requires the PSC to do so at least once every five years. These audits must include, but are not limited to, "an investigation of the company's construction program planning in relation to the needs of its customers for reliable service and an evaluation of the efficiency of the company's operations."[12] The law also requires that the Commission review a utility's compliance with the directions given and recommendations made as a result of previous audits and incorporate that review in its order regarding a major change in rates for that company. As explained by the New York State Legislature in enacting the law:

> The legislature further finds and declares that there is at present and will continue to be a pressing need to review critically the construction programs of gas and electric utilities which are important to the reliability of service, the level of utility rates and the companies' need to raise capital. While it is recognized that gas and electric utilities must plan,

[12] PSL §66(19).

> build and maintain sufficient facilities if they are to continue to provide reliable service, they should not build more facilities than are necessary to achieve that goal.[13]

Notwithstanding this legislative intent, the PSC has not conducted such an audit of Con Edison in at least 15 years and it has taken no action that would reasonably substitute for an audit's in-depth, independent review of the Company's capital spending and the extent to which it serves the needs of customers. (TR 4683) The CPB has repeatedly urged the Commission to adhere to this provision of the PSL.[14] Formal action has yet to be been taken on those requests.[15]

In this case, however, the parties and the Commission do not have the benefit of a recent independent assessment of Con Edison's construction program planning in relation to the needs of its customers for reliable service, or any reasonable substitute for such an investigation. This is of particular concern given the magnitude of the Company's proposed capital spending and its reliability problems in recent years. To address this issue, the CPB recommends that the PSC resume its audits of utilities, beginning with Con Edison, and complete that audit in time for the results to be considered as part of a review of rates for Con Edison's electric operations for the year beginning April 1, 2009. In the meantime, given Con Edison's incentives and the general absence of proper oversight of its capital expenditures, it is reasonable to conclude that Con Edison's projected T&D capital spending is overstated.

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13 Laws 1976, ch 556 §1.

14 Case 06-E-0894, Initial Comments of the New York State Consumer Protection Board, March 2, 2007, pp. 18 – 20; Case 06-E-0894, et al, Petition for Rehearing and Clarification of the New York State Consumer Protection Board, August 20, 2007.

15 We understand from recent reports in the media that the PSC finally intends to resume conducting audits of utilities.

4. Uncertainty Regarding the Network of the Future

The CPB testified that subsequent network upgrades such as the much publicized planned installation of superconducting cables and the “3G architecture,” may obviate the need for some of the capital expenditures proposed by the Company, or may render such spending worthless shortly after it has been made. (TR 4681) Further, the Company’s capital expenditure proposals do not clearly and completely reflect the impact of this new technology. Indeed, in response to a request from an ALJ on whether it would be more cost effective for the Company to implement the 3G architecture before or after it proceeds with certain capital projects it has proposed in this case, particularly those regarding substations, the Company said it is “wrestling” with that question. (TR 2203-4)

Con Edison’s capital expenditure forecast may be overstated because it does not fully reflect the impact of new technology for delivering electricity, nor does it properly consider the most cost effective way to transition to that new architecture. Accordingly, there is a considerable risk that projects proposed by the Company, if approved by the PSC, will result in worthless investment that will then be charged to customers. Until there is more certainty regarding these issues, the Commission should recognize that Con Edison’s capital expenditure forecasts may be unreasonably high, and it should not explicitly approve long term capital projects that may be substantially affected by future decisions regarding the 3G architecture.

5. Doubts About the Ability of the Company to Complete its Proposed Projects in a Timely and Cost-Effective Manner

There is substantial doubt over whether Con Edison can in fact complete all of its proposed T&D capital projects on the schedule it identifies, as well as implement the projects in a low-cost manner. (TR 4686) For example, the Company's projected increase in capital spending far exceeds its proposed increase in workforce. Exhibit 129 shows that Con Edison is proposing to increase its T&D capital expenditures by $479 million (34%) from calendar year 2007 to calendar year 2008. In comparison, the Company proposes an increase of 395 employees for capital-related projects for 2006-2008 (Exhibit 3), representing less than 3% of Con Edison's total workforce of 13,500. The record also shows that Con Edison is losing between 800 – 900 experienced employees each year (TR 1498) and replacing them with employees with little or no experience. This would tend to decrease the productivity of Company workers on capital projects, reducing the likelihood that Con Edison's proposed capital projects will all be completed on time.

Con Edison is expected to assert that it could use outside contractors to complete its proposed T&D capital projects. However, as the CPB testified, this may not be reasonable, since the Company does not even track the cost of internal versus contractor labor to help determine which is more cost effective. (TR 4726)

Overall, there is substantial uncertainty as to whether Con Edison could complete all of its proposed T&D capital projects in a cost effective manner. Therefore, it is likely that the Company's T&D capital projections are exaggerated.

6. The Budget Presented to the Board of Directors

In January 2007, Con Edison's Board of Directors ("Board") reviewed a five-year capital plan for the years 2007 – 2011 and approved a capital budget for 2007. Those projections were based on the most recent and accurate information available and the expertise of the Company's most knowledgeable employees including executives in the engineering and finance departments. (TR 5363-79, 5406-7) The T&D capital expenditure budget presented to the Board for 2008 was $1.325 billion. (Exhibit 294)

Less than four months later, however, the Company filed a request to increase rates that includes a T&D capital expenditure projection of $1.906 billion for 2008, an increase of $581 million (44%) over the projection provided to the Company's Board. Over the three year period 2008 – 2010, the Company's rate increase request reflects a proposed $1.474 billion in additional T&D capital spending beyond what the Company presented to its Board. (Id.) Curiously, Company witnesses were not even aware of Con Edison's attempt to reconcile these two forecasts.[16] (TR 5409-11) The increase in proposed T&D of this magnitude, in only four months, is extremely difficult to rationalize, and strongly suggests that the Company's rate request reflects a wish list of projects that are not necessary to serve consumers' needs.

7. Inadequacy of DPS Staff Review and Proposals in this Case

To assess the reasonableness of Con Edison's T&D capital expenditure projections, DPS Staff reviewed each major program proposed by the Company. In numerous instances, it recommended adjustments to the Company's proposals. The

[16] It is noteworthy that those same witnesses testified, albeit in a different context, "what's a couple billion among friends?" (TR 5374)

CPB recognizes the difficulty of the task performed by DPS Staff and commends its contribution to the record in this proceeding.

It is noteworthy, however, that one of the main tools it used to evaluate the Company's proposal was a comparison of the Company's actual historical spending on a particular project with the budget in the historical period. Indeed, the vast majority of DPS Staff's proposed adjustments are based on use of the ratio of actual spending to the budget in the historical period, to adjust the Company's projected spending in the future.[17] While a useful indicator, this approach has several shortcomings. It may not be appropriate for large projects that occur infrequently, since it would produce a projection that is too high if the historical data included large projects that will not be repeated in the forecast period. In addition, it does not assess whether the spending in the historical period was actually necessary and conducted in a highly cost effective manner. Further, even where actual spending was found to be close to budget in historical periods, it cannot be concluded that spending on that project should continue, or increase, as the Company and DPS Staff often propose. Overall, while useful in some respects, the DPS Staff approach falls short of the comprehensive review of the Company's "construction program planning in relation to the needs of its customers for reliable service" that is required by the PSL and that should serve as the basis for the PSC's decision on this critical issue.[18]

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[17] E.g., transmission and switching substations (TR 4005-6); obsolete transformer replacement program (TR 4011-2); category alarms program (TR 4013-4); remote terminal unit replacement program (TR 4014); substation loss contingency program (Id.); enhancing substation reliability program (TR 4015); security enhancements (TR 4026); environmental projects such as pumping plant improvement program and environmental risk program (TR 4027); and several projects in the category of storm hardening and response (TR 4030-1).

[18] PSL §66(19).

Regarding future oversight of Con Edison's capital expenditures, DPS Staff emphasizes the importance of holding the Company "accountable for its rate allowance for electric infrastructure improvements." (TR 3994) To address that concern, it proposes to increase the frequency of reports filed by the Company from annual to quarterly. (TR 3994) It does not explain how it would analyze the information, what it would do with those reports, or state if there would be any increased scrutiny of the Company's capital expenditures in the future. (TR 4105-6; Response to CPB IR 2c)

Accordingly, this DPS Staff recommendation is wholly insufficient. As explained in Point I(B) infra, DPS Staff has met with Con Edison 25 times since 2005 to discuss the annual reports filed by the Company as well as other issues regarding its capital expenditures (TR 4107), yet there is no evidence of any PSC action, DPS Staff recommendation or even a summary document stemming from such reports and discussions. Based on the experience of the last three years, it is apparent that the solution to the current concerns regarding the level of oversight of Con Edison's capital spending must go far beyond additional reports and more two-party, closed-door meetings.

8. CPB Proposal

For the reasons identified above, the PSC must substantially revise its procedures for reviewing Con Edison's proposed T&D capital expenditures. The centerpiece of a new approach to oversight of the Company's infrastructure spending should be the audits required by the PSL. The results of such audits should be available for review by interested parties and for consideration in rate proceedings. In addition, the Commission should require that Con Edison demonstrate as part of its filings in rate proceedings, that as an alternative to proposed T&D capital projects, DSM solutions could not meet customer needs at a lower cost.

In this proceeding, the PSC is faced with the consequences of more than a decade of inadequate oversight of Con Edison's capital expenditures, coupled with severe reliability problems in the Company's network in recent years, a request to recover $1.6 billion of overspending on capital projects in the last three years, and requests to spend approximately $2 billion per year on capital projects for the foreseeable future. In this predicament, for purposes of establishing rates for the year beginning April 1, 2008, the Commission should establish rates based on a forecast of T&D infrastructure spending that is lower than Con Edison's, primarily in recognition of the overwhelming record evidence that the Company's capital expenditure projection is exaggerated.

First, it should remove the AMI program.[19] It should also ensure that the Company has the revenue necessary to implement the directives in the Commission's July 20, 2007 order in Case 06-E-0894 concerning reliability-related improvements needed to address concerns identified in the review of the Long Island City and other outages, as well as to achieve other PSC mandates. (TR 4687) Then, the Commission should reduce Con Edison's T&D capital spending proposal by approximately 20%, which as explained below, is reasonable. The Company would be responsible for prioritizing investment projects to meet the needs of its customers within that budget.[20]

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[19] See Section I(A)(1).

[20] The record includes documents which identify Con Edison's prioritization of its proposed T&D capital projects. (TR 5379-81)

While there is a need for additional infrastructure investment, not all projects proposed by Con Edison may be necessary at this time and the Company may not be able to implement all proposed projects efficiently.

To protect ratepayers, the Commission should also adopt safeguards to ensure that funds designated for capital projects are used for that purpose. If the Company's prudent capital expenditures are less than the electric T&D capital spending included in rates, the revenue requirement equivalent of the difference should be deferred and used for the benefit of customers. The PSC has adopted similar mechanisms in other proceedings.[21]

Con Edison opposes such a mechanism. (TR 2420) Under its proposal, rates would reflect extraordinary increases in projected capital spending, but Con Edison would not be held accountable for spending the funds on infrastructure. Instead, it could simply retain them as additional profit. This is not fiscally responsible. The CPB's proposal would eliminate the possibility of such a result.

The PSC should have full confidence that the 20% adjustment to Con Edison's T&D capital spending projection that we propose in these circumstances is reasonable and provides ample funding for the Company.[22] Con Edison would still have the largest T&D capital expenditures budget in its history, approximately 90% above the level only

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[21] E.g., Case 01-E-0359, Petition of New York State Electric & Gas Corporation for Approval of its Electric Price Protection Plan and Case 01-M-0404, Joint Petition of Energy East Corporation, RGS Energy Group, Inc., New York State Electric & Gas Corporations, Rochester Gas and Electric Corporation and Eagle Merger Corp. for Approval of Merger and Stock Acquisition, Joint Proposal, Section VI(E); Case 05-E-0934, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Central Hudson Gas & Electric Corporation for Electric Service, Case 05-G-0935, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Central Hudson Gas & Electric Corporation for Gas Service, Joint Proposal, April 17, 2006, Section VII(A).

[22] We note that the effect of the DPS Staff proposal is to reduce Con Edison's projection of T&D expenditures by 12% (TR 4120). Our concerns regarding the limited scope of the DPS Staff's investigation that resulted in this recommendation, are explained in Section I(A)(7), infra.

four years ago, and 12% greater than the amount presented to its Board of Directors in January 2007. (TR 4732) Coupled with proper PSC oversight, this recommendation fairly balances short and long-term interests of consumers and the utility and should be adopted.

B. T&D Capital Expenditure Carryover

As stated above, Con Edison's actual T&D plant in service at the end of its current rate plan is expected to exceed the level reflected in rates by $1.616 billion. This is contrary to the results generally expected by the parties and Commission, as evidenced by the Commission's references to "the extremely large capital investment planned over the coming three years and the previously discussed doubts about the Company's ability to proceed with all construction on the pace the latter originally envisioned."[23] In this proceeding, the Company seeks authorization to recover that excess spending from its customers. The record shows, however, that Con Edison does not have an appropriate incentive to conduct such spending in a cost effective manner, and there has not been a satisfactory review of the excess T&D capital expenditures. Therefore, the Commission should direct that the Company's T&D capital spending during the term of the current rate plan be carefully scrutinized in an open and transparent process.

[23] Case 04-E-0572, Order, p. 38.

1. Level of Review Required by the Current Rate Plan

The Joint Proposal includes provisions requiring reconciliation of actual costs in certain categories, to the levels reflected in rates, including property taxes, pensions and T&D capital expenditures. It states that:

> The reconciliations in each of RY1, RY2, and RY3 will be deferred and recovered from customers or credited to customers after expiration of this Electric Rate Plan, in a manner to be determined by the Commission. However, at the end of each Rate Year, and <u>subject to audit and prudence review</u>, the Company may apply any available credits, except credits associated with TCC's to offset the deferred balance.[24]

The need for review in this proceeding, of the excess of T&D capital expenditures above the level reflected in rates, was also addressed by the New York State Assembly Standing Committee in its "Public Hearing on Consolidated Edison's Proposed Rate Plan," held on May 23, 2007. In sworn testimony before that Committee, Mr. Charles Dickson, the Director of the Office of Accounting, Finance and Economics of the Department of Public Service, testified that DPS Staff would "have to evaluate those expenditures retroactively" in this rate proceeding "as part of its overall review of infrastructure investments and the forward-looking component."[25]

Moreover, as a matter of public policy, utility requests to recover extremely large costs that were not anticipated, such as the $1.616 billion at issue here, must be analyzed, particularly when the utility does not have a proper incentive to control those costs. The public interest and public confidence in the regulatory process requires that those costs be properly reviewed in an open and transparent manner.

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24 <u>Id</u>., Section D, emphasis added.

25 Transcript of Public Hearing on Consolidated Edison's Proposed Rate Plan, p. 122. The cover page and relevant pages of that testimony are included as an Attachment to this Brief.

2. Level of Review Conducted

The record demonstrates that neither DPS Staff, nor any other party in this proceeding, conducted an effective evaluation, audit or prudence review of the T&D capital expenditures made during the current rate plan. Further, in apparent conflict with the provision of the current rate plan cited above, the Company applied available credits in rate years one and two of the current rate plan, to offset the carrying costs of T&D capital expenditures that exceeded levels in rates, although there is no evidence of any "audit or prudence review" of the appropriateness of doing so. (TR 2519-20)

Instead, we expect that Con Edison and DPS Staff will argue that three reports filed by the Company, identified as Exhibits 141 - 143, and a series of meetings between DPS Staff and the Company, obviate the need for any further scrutiny of the Company's request to have customers fully fund the T&D capital expenditures at issue. Such claims are without merit. Those reports, which are required by the current rate plan, were intended "for informational purposes," and identify completed projects and their cost, the status of ongoing projects, explanations of the reasons for any deviation of expenditures of 15% or more from estimates, and describe any new projects.[26] Con Edison and DPS Staff may contend that these reports were reviewed by DPS Staff, discussed at approximately six meetings of these parties, and obviate the need for any further scrutiny of the $1.616 billion at issue. However, the CPB strongly disagrees with such claims. The assertions by Con Edison and DPS Staff that these expenditures were properly scrutinized are not credible in light of the absence of <u>any</u> proposed adjustment to the Company's proposal to recover the entire amount from ratepayers

[26] Case 04-E-0572, Joint Proposal, Section D(3).

(TR 4755), and the fact that the alleged investigation did not result in <u>any</u> recommendation to the Commission in this case or Case 04-E-0572 (TR 4136; 4755), <u>any</u> recommendation to the Judges in this case (TR 4756), nor even <u>any</u> public document produced by DPS Staff. (TR 4135) When asked by the ALJs for regularly kept records at the time those meetings were being held, DPS Staff was not able to produce <u>any</u> (TR 4753), and the Company was able to produce only scattered e-mails regarding six of those meetings. (Exhibits 350-5)[27] Further, these meetings were attended by only Con Edison and DPS Staff – other parties were not even invited.

The CPB does not dispute that the reports identified as Exhibits 141-3, satisfy the requirements of the Joint Proposal in Case 04-E-0572. However, as our witness testified, those reports are a necessary first step to such an investigation, but are not a substitute for it. (TR 4769) Moreover, it is the obligation of DPS Staff, not other parties such as the CPB, to conduct such an investigation. This obligation was explicitly recognized by the proponents of the Joint Proposal in Case 04-E-0572. As DPS Staff and the Company stated in their response to a question by ALJ Lynch on this matter:

> [Exhibits 141 - 143] would normally be submitted only to [DPS] Staff. There is no obligation or requirement that this information be provided to all interested parties, and the signatory parties identified no reason to accord opponents of the Joint Proposal, or non-signatories, the same privileges as signatory parties. Further, neither Rule 4.3(c) nor the Commission's practice with respect to participation in administrative proceedings, are relevant to this matter because no party will be prevented from participating in administrative review of the information, if any. Granted, non-signatories will have to take affirmative steps to obtain the information, but they will not be denied access to the information. It should be noted that this information will be

[27] The availability of information regarding only six of the meetings raises serious doubts about the content of the remaining meetings that were alleged to have occurred.

> filed with the Secretary, and will be publicly available through the Department's Central Files.[28]

The Commission decided to require the Company to provide a copy of the reports designated as Exhibits 141 - 143, to all parties who expressed an interest.[29] However, in reference to the potential administrative review cited above, the PSC did not establish any administrative proceeding, or permit other parties to participate in meetings held between DPS Staff and Company meetings. Thus, the Commission and all parties anticipated that participation by parties other than Con Edison and DPS Staff in any review of Exhibits 141 - 143, would be precluded unless and or until an administrative proceeding was convened. This is the first administrative proceeding in which this information is subject to review and the record contains no rational basis for a Commission determination that ratepayers should fund these capital expenditures.

3. CPB Proposal

As explained above, unusual circumstances have led to the Company's request to recover $1.6 billion in capital expenditures that were not previously approved by the Commission or reviewed by any party other than DPS Staff. Attempts by the Company and DPS Staff to treat this issue as "business as usual," are disappointing and wholly inappropriate. Rather than the PSC continuing to defend its past mistakes, the CPB strongly urges it to move forward by recognizing that unique circumstances have created this request to recover $1.6 billion, and a unique solution is required to protect

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[28] Case 04-E-0572, Responses to Data Requests from Judge Lynch, #59, referenced at TR 4764 and cited in full in November 14, 2007, letter from CPB to Con Edison re: cross examination of CPB Witness Elfner.

[29] Case 04-E-0572, Order, p. 105.

consumers. We recommend that Con Edison's infrastructure spending during its current rate plan be reviewed as part of the independent audit proposed by the CPB. The results should be presented to the parties for comment, preferably in a proceeding to consider Con Edison's electric delivery rates for the period beginning April 1, 2009. This proposal, in which independent experts would conduct an investigation subject to review and comment by all parties in an open and transparent process, is a reasonable and balanced approach which should be adopted by the Commission.

II. CONSOLIDATED EDISON'S COST OF EQUITY IS 9.0%.

The CPB recommends a cost of equity for Con Edison's electric operations of 9.0% based on the methodology set forth in the Recommended Decision in the Generic Finance Case and consistently relied upon by the Commission for over a decade.[30] DPS Staff, applying a methodology very similar to that followed by CPB, produced a recommendation of 8.9%.[31] After adopting the ten basis point adjustment for an RDM proposed by DPS Staff, which the CPB supports, the CPB's and DPS Staff's recommendations are identical. By contrast, Con Edison's estimate that its cost of equity is 11.2% was derived in a manner inconsistent with well-established Commission principles. It is clearly excessive, and should be rejected. If adopted, the CPB's recommendation would reduce Con Edison's revenue requirement by $246 million. (TR 4790)

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[30] Case 91-M-0509, Proceeding on Motion of the Commission to Consider Financial Regulatory Policies for New York State Utilities ("Generic Finance").

[31] Staff's calculated ROE was 8.85% (Exhibit 255, p. 3) which was rounded to 8.9%. (TR 3727)

A. CPB's Proposal

The CPB calculated Con Edison's cost of equity by applying the two-stage Discounted Cash Flow ("DCF") model and the Capital Asset Pricing Model ("CAPM") to a proxy group of electric and combination electric and gas companies with investment grade ratings from Moody's and Standard & Poor's. (TR 4777) The DCF approach resulted in a median equity return of 8.28% while the average of the two CAPM methods resulted in return of 10.17%. (Id.) Applying a 2/3 DCF and 1/3 CAPM weighting in accordance with both the recommended decision in the Generic Finance Case and the instructions given by the Commission in its most recent Order directly addressing the issue,[32] resulted in an initial equity cost estimate of 8.91%. The CPB then applied a downward adjustment for credit quality of 12 basis points, and an upward adjustment of 21 basis points for anticipated issuance costs during the rate year. This produced our final ROE recommendation of 9.0% for Con Edison's electric operations. (TR 4788-4789)

1. Proxy Group Selection

The CPB's objective in selecting the proxy group was to define a pool of companies having the business characteristics of a financially sound regulated electric utility that was large enough to assure that the analysis would not be biased by any one entity. To do this, a list of 60 companies listed in The Value Line Investment Survey as electric utilities operating electric or electric and gas distribution systems were identified.

[32] Case 06-E-1433, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Orange and Rockland Utilities, Inc. for Electric Service, "Order Setting Permanent Rates, Reconciling Overpayments During Temporary Rate Period, and Establishing Disposition of Property Tax Refunds," issued October 17, 2007 ("O&R Order"), p. 14.

Companies that did not have an investment grade credit rating from Standard & Poor's and Moody's, and any that did not derive at least 70% of their total annual revenues from regulated utility operations, were removed. Finally, two companies were eliminated due to special circumstances, one because it is being acquired by another company, and one because it is currently not paying dividends. The result of this process was a proxy group of 29 companies having average credit ratings of Baa2 from Moody's and BBB+ from Standard & Poor's. (TR 4778-4779)

2. DCF Analysis

The CPB applied a two-stage DCF growth model to the proxy group to arrive at a median return of 8.28% as shown in Exhibit 315, Schedule 1, page 3. The DCF model used is the one that was developed in the Generic Finance Proceeding and adopted by the ALJs in their recommended decision. For the six-month average prices in the proxy group, the CPB used the average of monthly high and low closing prices of each stock for the period February 1 through July 31, 2007. All other data, including dividends per share, earnings per share, book value per share and shares of common stock, were taken from the Value Line Investment Survey as agreed upon in the Generic Finance case. (TR 4784)

3. Capital Asset Pricing Model

In developing a CAPM estimate of Con Edison's equity return, the CPB once again relied on the Generic Finance case. The average of the two CAPM methods recommended by the Judges in that proceeding was used. First, as shown in Exhibit 315, Schedule 2, the CPB determined the risk-free rate by using the six-month average ending July 31, 2007, of 30-year and 10-Year Treasury Bond Yields as reported by the Federal Reserve Board. That average was 4.87%. (TR 4786)

The beta of 0.86 used to adjust the market risk-premium was derived from the same electric and combination electric and gas proxy group companies used for the DCF analysis. It is the average of the individual company betas as reported by Value Line. (TR 4787)

The market return of 10.9% used in the CAPM method is based on the August 10, 2007, issue of Merrill Lynch Quantitative Profiles – Monthly Insights for Equity Management. The estimate is the implied return for a portfolio of 1,168 companies. (Id.)

Finally, the risk premium of 6.03% was derived by subtracting the 4.87% risk-free rate from the 10.9% market return. (Id.) After incorporating these variables in the two CAPM formulas, the traditional CAPM produced an equity return of 10.06% while the zero-beta CAPM approach produced an equity return of 10.27%. The average of the two methods was an equity return estimate of 10.17%. (Id.)

4. Weighted Result

The CPB used the 2/3 DCF and 1/3 CAPM weighting advocated by the ALJs in the Recommended Decision in the Generic Finance case. This generated an equity return estimate prior to adjustment of 8.91%. (TR 4788)

5. Credit Quality Adjustment

The CPB used a proxy group rated Baa2 by Moody's and BBB+ by Standard & Poor's, the middle and upper ranges of the B level, respectively. Con Edison is rated at the middle of the A level by both companies. (Id.) Since Con Edison is rated somewhat higher than the proxy group, the CPB adjusted the equity return to reflect the difference between A-rated and Baa/BBB-rated long term public utility bond yields. Over the six-month period from February 2007 to July 2007, A-rated utility bond yields averaged 6.05%, while Baa/BBB-rated utility bonds were 6.23%. (Id.) Because the average proxy group rating was slightly higher than the reference bond he used (Baa/BBB+ vs. Baa/BBB), the CPB made a credit adjustment of only 12 basis points rather than the full 18 point difference. Subtracting this adjustment from the weighted result of the DCF/CAPM analysis gave a credit-adjusted ROE estimate of 8.79%. (TR 4789)

6. Issuance Cost Adjustment

The record shows that the Company intends to issue $600 million of equity during the rate year. (Id.) Assuming issuance costs of 3%, consistent with those incurred for recent Company equity financings, the CPB projected an equity return adjustment of 21 basis points, equal to the $18 million cost of the proposed issuance divided by the average common equity balance of $8.6 billion. (Id.) Adding this adjustment to the credit-adjusted ROE estimate of 8.79% yields the CPB's overall ROE recommendation of 9.0%

7. Comparison with DPS Staff

The CPB's conclusions corroborate those arrived at by DPS Staff, which also calculated the cost of equity for Con Edison by following the methodology recommended in the Generic Finance case. As would be expected, this produced a calculated result very close to that derived by CPB -- 8.85% compared with CPB's

9.0%. DPS Staff selected the same proxy group of 29 companies that was used by CPB (TR 3728-3730), applied the same DCF and CAPM methodologies to the companies in the group, and made adjustments for both credit quality and issuance costs. The slight differences among the DCF and CAPM numbers calculated by DPS Staff and CPB are attributable to different time periods for the data input, six months ending June 2007 for DPS Staff versus six months ending July 2007 for CPB. (TR 3733) Ultimately, these differences are irrelevant given the Commission's policy of updating ROE calculations when it issues its rate order.

Most of the 15 basis point overall difference between CPB's estimate and that of DPS Staff results from a ten basis point deduction applied by DPS to reflect a reduction in business risk that will result from the adoption of an RDM for Con Edison. (TR 3751) The CPB fully agrees with Staff's proposed adjustment. The potential impact of an RDM was not considered, explicitly or implicitly, in the CPB's analysis. Applying the RDM adjustment to CPB's figures would yield an 8.9% ROE recommendation, identical to that of DPS Staff.

B. Response to Con Edison's Rebuttal

In its rebuttal testimony, the Company's witness levels a series of criticisms at the analyses of CPB and DPS Staff. However, for the reasons that follow, none has merit. First, he contends that the recommended returns are unreasonably low. That is simply not true. The recommendations are well in line with the most recent equity return authorized by the PSC for a New York electric utility. In its Order issued just last month, the Commission approved an ROE of 9.1% for Orange & Rockland's electric operations.[33]

Con Edison's primary evidentiary support for its contention that the recommendations of CPB and DPS Staff are "outside the mainstream" was a table of allowed returns for 29 U.S. utilities. (TR 2666A-12) On cross-examination, however, the Company's witness acknowledged that he did not know whether the returns shown were used for ratemaking purposes or as earnings sharing thresholds; whether they were the result of litigation or multi-year settlements; or even whether they were recently approved. (TR 2669-2674) He admitted that for one company of which he did have knowledge, ALLETE, the current ROE was authorized in 1994. (TR 2669) He also acknowledged DPS Staff's evidence that the ROE for another of the companies on his list, NSTAR, was the result of a seven-year rate plan settlement. (TR 2674)

In defense of his obviously stale data, Con Edison's witness contends that if the authorized rates of return currently in effect for these companies were excessive, they would have been the subject of show cause orders. (TR 2672). This is absurd. Equity return, although important, is only one element of a utility's overall cost structure, and it is generally dwarfed by capital and operating expenses. For a company such as ALLETE to stay out of a rate case for 13 years, it would have had to find ways to cope with inflationary cost increases that would have amounted to over 45% even at a modest 3% annual rate. It is extremely unlikely that a public utility commission would seek to reduce an excess return of two and a half percent in the face of substantial

[33] O&R Order, p. 9.

upward cost pressure, given the likelihood that the net effect of its review would be a rate increase.

Second, the Company next attacks the DCF model used by CPB and DPS Staff. All of its points in this regard were clearly addressed by the Commission in its O&R Order. The Company argues for use of the quarterly version of the DCF model rather than the annual version, and says that the use of an average six-month stock price "mismatches stock price and expected growth." (TR 2666A-5) The Commission has recently concluded just the opposite, finding that it "[c]ontinues to endorse the annual DCF model" and "to support the use of six months' worth of stock prices as the input to the DCF calculation."[34]

Third, the Company contends that there is a logical inconsistency, or circularity, in the long-term growth component of the two-stage DCF model and that investors are expecting higher growth rates than CPB and DPS Staff use. (TR 2666A-5) In its O&R Order, the Commission concluded that "the circularity of Staff's sustainable growth calculation is overstated" because the forecasts of expected future earnings "reflect investor expectations about how a wide variety of other factors, unrelated to the <u>allowed</u> cost of equity, will affect the overall earnings."[35] It approved the DPS Staff DCF analysis as "superior and reliable."[36]

Finally, the Company's witness asserts that the market risk premium based on Merril-Lynch data is not representative of investors' consensus forecast. (TR 2666A-27)

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[34] <u>Id</u>., p. 11.

[35] <u>Id</u>., p. 10, emphasis in original.

[36] <u>Id</u>., p. 11.

He advocates the use of a historically-derived premium based on data from Ibbotson's Stocks, Bonds, Bills, and Inflation 2007 Yearbook. (Id.) The CPB's expert points out that Con Edison's recommended risk premium implies a market return that is 100 basis points higher than the average return of all 1,168 firms included in Merril-Lynch's Quantitative Profiles – Monthly Insight for Equity Management. (TR 4799) It is precisely this discrepancy which caused the Commission in the recent O&R decision to describe the methodology used by the Company in this case as "unreliable," and to continue instead its endorsement of the method used by CPB and DPS Staff.[37]

In the O&R Case, the Commission revalidated all of the critical elements of the DCF and CAPM models employed by the CPB and DPS Staff. It also confirmed the weighting of the results of the two models, saying that it would "continue to accord two-thirds weight to the DCF result and one-third to the CAPM."[38] Consequently, in the absence of any showing that calculation errors were made by CPB or DOS Staff witnesses, it must be assumed that their recommendations are fully in agreement with current Commission policy. No such errors have been shown, and the close correlation between the CPB and DPS Staff results belies their existence.

By contrast, analysis by the Company's witness incorporates arbitrary, self-serving assumptions and relies on sources and methods that have been expressly and repeatedly rejected by the Commission, most recently in Case 06-E-1433. His recommended equity return of 11.2% is unreliable, and should be rejected.

First, the Company's selection of proxy groups is evidently result-oriented. Although its witness does establish criteria for his selection of proxy companies, namely

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[37] Id., p. 13.

[38] Id., p. 14.

an investment-grade bond rating and coverage by Value Line (TR 2626), he ignores the result of these screens. He excludes 39 companies from his proxy group based on businesses designated as electric or combination electric and gas utilities by S&P, and 34 companies from his group drawn from the Moody's Electric Utility Index, even though all met his selection criteria. (TR 4793) It flies in the face of common sense to assume that these exclusions are random. In response to DPS Staff criticism that his proxy group is excessively risky, Dr. Morin notes that the average beta of his group is .91, lightly lower than the .93 beta of DPS Staff's proxy group. (TR 2666A-34) This is, however, precisely what would be expected from a group carefully selected to produce a pre-determined result.

The Company's witness employs three separate methodologies to derive ROE estimates for Con Edison: the DCF and CAPM models and a Risk Premium analysis. His recommendations concerning the DCF and CAPM are essentially the converse of his criticisms of the CPB and DPS Staff methodologies. As shown above, those criticisms, and therefore, the Company's recommendations, have been firmly rejected by the Commission.

The same is true of his risk Premium Analysis. As noted by the CPB, the Commission has repeatedly rejected the use of the Risk Premium approach. It did so in 2006 in a New York Gas & Electric Corporation rate case, saying that the Company had shown no justification for departing from the methodology developed in the Generic Finance Case.[39] It did so again in the Orange & Rockland case, concluding that "the

[39] Case 05-E-1222, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of New York State Electric & Gas Corporation for Electric Service, "Order Adopting Recommended Decision with Modifications," issued August 23, 2006, p. 95.

hazards of comparing apples and oranges make the Company's risk premium analysis too unreliable to use."[40] Con Edison has presented nothing new or different that would justify a different conclusion in this case.

Next, the Company's witness contends that credit quality adjustments made by CPB and DPS Staff are unwarranted. He argues that the adjustments fail to take into account the fact that Con Edison's credit ratings are "teetering on the edge" of a downgrade and that given the Company's pending capital expenditures program, this is "no time to apply a return decrement and reduce the Company's return relative to its industry peers." (TR 2605) The latter argument is backwards. The purpose of the adjustment is to bring the Company's return in line with those of its peers in the industry that have similar credit ratings. The fact that the Company's current credit status could change in the future does not negate the fact that the rating agencies consider it to be deserving of the rating it has now and, presumably, so do investors. Therefore, there is a current difference in expectations between the Company and the average member of the model proxy groups. This needs to be taken into account. An adjustment for credit rating differences is appropriate and both DPS Staff and the CPB have put forth reasonable estimates of the magnitude of that adjustment.

III. THE CPB'S OPERATIONS AND MAINTENANCE EXPENSE ADJUSTMENTS ARE SOUNDLY BASED AND SHOULD BE ADOPTED.

In many respects, Con Edison's forecast of rate year O&M expense is overstated and unsupported. The CPB submitted pre-filed testimony in which we recommended that the Company's expense projections be reduced by approximately $220 million. In this section, we explain those proposals and respond to opposition raised in rebuttal

[40] O&R Order, p. 14.

testimony and at the hearings. The CPB also supports many of the proposed O&M expense adjustments made by DPS Staff and other parties, although we do not address each one herein.

A. Inadequacy of Supporting Documentation

Con Edison did not provide adequate information to support many of its proposals to increase O&M expense. As a result, it has not satisfied the requirements of the PSL or the New York State Code of Rules and Regulations ("NYCRR"), which place the burden of proof upon the utility. The relevant portion of PSL §66 (12) (i) reads:

> At any hearing involving a rate, the burden of proof to show that the change or proposed change if proposed by the utility, or that existing rate, if it is proposed to reduce the rate, is just and reasonable shall be upon the utility.

Similarly, the NYCRR states:

> The burden of proof is upon the utility whose rates and rules and regulations relating thereto, charged or proposed to be charged, are being considered. (16 NYCRR §61.1).

In the absence of adequate supporting information, the CPB developed reasonable and balanced recommendations, which should be approved.

1. Requests for Five Years of Data

The CPB sought five years of historical expense data to help assess the reasonableness of the Company's forecasts regarding projects including the distribution line clearance program (TR 3258), steam operations (TR 3276) and storm costs (TR

3283). However, the Company consistently refused to provide that information and supplied data only for three years.

The CPB's expert testified that five years of data for programs such as these is required to help ensure that rate year projections are not unduly influenced by anomalous events. (TR 3283) The Company's expert agreed with this point as shown in the following colloquy:

> Q: Do you think that using a five-year average is a reasonable means to estimate a cost similar to this on the overhead inspection?
>
> A. For things that are high-volume, repetitive-type tasks, yes, I do, especially when there is a defined cycle time, five-year period. (TR 2058)

Nevertheless, the Company refused to provide the CPB with five years of cost data for programs involving a defined cycle time such as line clearance. For such projects, including the three programs identified above, the CPB used available information to develop a balanced recommendation.

We urge the Commission to require the Company, in the future, to provide five years of historical data, at a minimum, for projects that are performed on a defined cycle, as well as storm costs, which are often subject to anomalous events.

2. Alleged Difficulty of Providing Additional Information

The Company often alleged that providing the information sought by the CPB would have been impractical or unmanageable. For example, in response to the CPB's concerns about the general absence of supporting information regarding the Company's general education and outreach request of $10.15 million, the Company responded that providing the information sought by the CPB "would not have been practicable." (TR 848) Similarly, in responding to the CPB's concerns about the absence of details concerning proposals in the category "substation operations O&M programs," the Company stated:

> given the hundreds of projects covered by the billions of dollars at issue, providing details for each project in the Company's filing, rather than in response to interrogatories, would make the Company's filing unmanageable. (TR 1977)

The Company failed to acknowledge that the CPB did in fact submit specific information requests seeking more information on these issues. Its responses to those requests were inadequate. (TR 3235)

The Company's attempt to blame the CPB for, in essence, asking for too much information, is baseless. The CPB asked for information to determine whether ratepayers should be required to fund specific programs, but too often, the Company either did not have it, or chose not to provide it.

3. Attempt to Shift Burden of Proof

In response to the CPB's findings that Con Edison often did not provide information to support its request,[41] thereby affecting our analysis and recommendations, the Company often attempted to dismiss our concerns by shifting the burden of proof. A common response by the Company to our concerns about the absence of necessary information, was that the CPB should have taken further action to obtain the information it sought. For example, the Company contends that if the requested information was not included in its filing or workpapers, and was not provided

[41] Specific instances in which information was not provided in direct testimony, workpapers and/or in response to explicit information requests, are detailed throughout Section III of this brief.

in response to an explicit information request, the CPB should have filed additional information requests.

The following dialog regarding the adequacy of the Company's response to a CPB information request is illustrative. The information request stated: "Provide any document that describes to employees what variable pay is and how it is determined." (Exhibit 215, CPB IR 1(h)) The response contained no document(s), only a brief description of the objective of the program. Upon being asked whether the Company's expert considered this response to be complete, the witness stated:

> MR. REYES: When I read this question, it was my understanding that CPB was looking for an explanation of the variable pay program and my response includes an explanation of that program.
>
> JUDGE BOUTEILLER: So, the way you read the question, the only document that would have been required to provide an adequate response to the CPB is the explanation that you provided here; so that's your satisfaction of their request for a document?
>
> MR. REYES: Yes, because we never received any other request for a particular document.
>
> JUDGE BOUTEILLER: You received this request –
>
> MR. REYES: After this was submitted, I received no further request.
>
> JUDGE BOUTEILLER: Let's just stay with this one item here. We're trying to figure out what you were trying to accomplish when you responded to the question. The question asked you for a document. Did you appreciate that at the time?
>
> MR. REYES: Yes.
>
> JUDGE BOUTEILLER: And then you prepared this response?

> MR. REYES: Yes, I did.
>
> JUDGE BOUTEILLER: And did you intend by this response to satisfy the request for a document?
>
> MR. REYES: Yes, I did.

The Company is apparently under the mistaken impression that its responses to information requests are considered complete unless parties submit two or more specific requests asking for the same information.

Similarly, Con Edison repeatedly asserts that the CPB should have taken further action to compel the production of information it required, such as by filing formal motions with the ALJs. For example, the Company stated:

> Whether or not CPB's claims have merit, it is inappropriate for CPB to wait until its responsive testimony to raise such complaints and it is inappropriate for CPB to recommend that projects that may be necessary for reliability not be funded because CPB does not approve of the Company's presentation. Had CPB been interested in investigating the Company's proposed expenditures, it could have pressed the Company for additional details, or filed a Motion to Compel the Company to provide whatever data or details CPB deemed necessary for its review. (TR 1390)

Similar assertions are found at TR 3335, 3345 and 3354.

By this approach, Con Edison seeks to stand well-established regulatory practice on its head. The consequences of its incomplete and/or ambiguous responses to information requests are for the Company to bear, not parties such as the CPB. The Company has a duty to supplement any response they later determine to be incomplete or incorrect. However, in the vast majority of cases, it did not do so. The CPB properly accepted the Company’s responses at face value and proceeded with our investigation based on the available information. Where the record demonstrates that necessary supporting information has not been provided, the Commission should find that the Company has not met its burden of proof.

B. Site Investigation and Remediation Expenditures[42]

Con Edison's current electric delivery rates include $8.433 million for the recovery of costs associated with SIR programs, particularly involving former manufactured gas plants and Superfund projects. (Exhibit 164, Schedule 4, p. 3) In its original filing in this proceeding, the Company projected total SIR costs of $189.8 million for the period April 2007 – March 2009, approximately $150 million of which is allocable to electric operations. It proposed to amortize those costs over three years. (Id.) In its update/rebuttal testimony, Con Edison revised its cost projection for this two-year period to $170.9 million for total Company operations (TR 517-18), or $134.5 million for electric operations using the historic allocator of 78.7%. (Exhibit 164, Schedule 4, p. 3) If amortized over three years, approximately $45 million of SIR costs would be included in rates established in this case.

The CPB fully supports the need to investigate and remediate sites in accordance with directives of the New York State Department of Environmental Conservation ("DEC"). We do not question the action plans approved by the DEC or other agreements between the DEC and the Company. Our sole concern is whether Con Edison implements those plans in the most cost effective manner possible. Under established PSC ratemaking policies, 100% of prudent SIR costs incurred by utilities are

[42] This section addresses only the CPB's recommendation regarding the reasonableness of the Company's request to commence recovery of projected SIR costs for the period April 2007 – March 2009. Our proposal that MGP/Superfund costs be amortized and recovered over a longer period of time than proposed by the Company (TR 4694), is addressed in Section IV(B), infra.

recoverable from ratepayers. Thus, the only incentive that utilities have to implement approved SIR projects in the most cost effective manner is the risk that the Commission may question or disallow recovery of certain costs from customers. This is unlike the vast majority of other categories of costs, including operations and maintenance expenses, which the Company has an incentive to control during a multi-year rate plan. The public interest therefore requires that SIR costs for which the Company is seeking recovery, be scrutinized, particularly in view of the magnitude of the costs at issue and their rate of growth. The Company's request in this proceeding totals $134.5 million for the period ending March 2009, and if recovered over three years as it recommends, represents an increase of approximately 430% over the SIR costs in current rates. The remarkable rate of growth of these costs is also evidenced by the fact that projected total Company SIR costs for the year ending March 2009 are approximately 95% above the estimate presented by the Company earlier this year in its gas rate case. (TR 3231)

The CPB attempted to scrutinize this significant projected increase to determine if ratepayers should pay the requested amount. We planned to assess the reasonableness of the Company's cost estimates, examine its assessment of its potential liability for specific sites, evaluate its procedures for bidding for site remediation work as well as the competitiveness of the bidding process. Additionally, we also intended on reviewing the extent to which the Company manages SIR projects in a manner that minimizes overall costs such as by bundling or unbundling projects for bidding and coordinating projects to take advantage of excavation being done by site developers.

However, we were unable to do so because of the lack of supporting information provided by the Company. Such information did not accompany the Company's original filing. As a first step in our review, the CPB explicitly asked Con Edison to:

> provide all supporting work papers and documentation for the calculation of the MGP/Superfund amount and the allocation for the rate year. Supporting documentation should also include any cost estimates received for $189.8 million in projected spending. (Exhibit 23)

The response referred to the Company work papers provided with the filing. (Exhibit 215, response to CPB IR 22(f)) However, as the CPB's witness testified, the workpapers included "no documents showing and/or explaining how the $189 million estimate was derived," and the only information provided "could best be characterized as 'some numbers on a page.'" (TR 3230) For that reason, the CPB testified that the Company has failed to provide sufficient justification for its proposal and recommended that the entire amount be removed from the Company's filing. (TR 3233)

The Company rebutted the CPB's conclusions and recommendation. Its witness claimed that the CPB's information request cited above was addressed to the wrong Company witness, and that the CPB admitted that fact in testimony. (TR 526) Both assertions are inaccurate and disingenuous, as a plain reading of the information request (Exhibit 23, quoted above) and the CPB's testimony (TR 3230) demonstrates. The information request identified the relevant "witness/subject" to be "programs (sic) changes," and did not direct the request to a particular witness. The CPB's testimony reiterated those facts. The Company also claimed that it provided information supporting its $189 million request in response to several discovery requests submitted by DPS Staff (TR 527), which its witness attached as an exhibit to his rebuttal testimony. (Exhibit 22) As a threshold matter, in responding to the CPB's information request on July 31, 2007, the Company should have at least referenced the supporting information that it had previously provided to DPS Staff and included in Exhibit 22. Its failure to do so thwarted the CPB's review and analysis of these issues.

The information eventually provided by the Company includes a project-level quantification of SIR costs incurred in recent years, projections for the year ending March 31, 2009, and anticipated start and completion dates. Although a useful first step, this information is not completely responsive to the CPB's initial information request, and it falls far short of the information that CPB intended to review as part of this case. (TR 3315) Particularly striking is Con Edison's testimony that it possesses much of the information that the CPB requested and intended to review, including invoices (TR 538), bids for each project (TR 538), the reasons why cost estimates have been revised over time (TR 539), and documentation explaining why actual costs exceed projections. (TR 541) However, this information was not provided to the CPB nor is it in the record in this case.

The position taken by DPS Staff, while a step in the right direction, does not sufficiently protect ratepayers in these circumstances. DPS Staff proposed three adjustments to the Company's projected SIR expenses for the two-year period ending March 31, 2009: a reduction of projected costs in recognition of new information on the timing of proposed remediation at the Purdy Street Station manufactured gas plant site (TR 3595-96), a similar reduction because of the timing of activities at the West 45th Street Gas Works site (TR 3596-97), and a reduction in projected expenses in recognition of certain expected tax credits. (TR 3597) The CPB supports these recommendations.

However, the record contains no evidence of any examination of the following key issues: the Company's SIR cost estimates with the exception of the timing of certain projects, Con Edison's procedures for bidding for site remediation work, the competitiveness of the bidding process, and the adequacy of the Company's management of SIR projects to minimize overall costs. Company assertions that it implements approved environmental investigation and remediation projects in a cost effective manner are unavailing, in view of the absence of any financial incentive for the utility to do so.

For these reasons, the CPB recommends that the PSC direct that these issues be part of the next management audit of Con Edison's operations. Recovery from ratepayers of the approximately $135 million of SIR costs identified in this proceeding, before adjustment to reflect the recommendations of DPS Staff cited above, should commence at this time only if the Commission explicitly concludes that such recovery is subject to reconciliation based upon the results of the audit. Should the audit reveal that Con Edison did not manage approved environmental investigation and remediation projects in a cost effective manner, the Commission would have the ability to adjust the amounts to be recovered from ratepayers. Our recommendation regarding the period of time for which these costs should be recovered is addressed in Section IV(B).

C. Recovery of Deferred World Trade Center Costs

Con Edison proposes to recover the remaining costs it has incurred to restore its facilities in lower Manhattan that were damaged as a result of the September 11, 2001 attack on the World Trade Center ("WTC"), as well as associated interest. The $100.5 million of estimated expenses would be recovered over a three-year period, which would have the effect of increasing rates by $33.5 million in the rate year. (TR 2438-9; Exhibit 95, Schedule 4) Associated capital costs would be recovered over 30 years, also increasing rates. The CPB recommends that the Company's proposal be rejected at this time, since there is still considerable uncertainty regarding the nature and amount of the costs that should be recovered from ratepayers.

The Company asserts that it should be permitted to recover these costs from ratepayers now, since it will not recover them completely from other sources including the federal appropriation for reimbursing utilities. (TR 2439) The Commission has previously considered the ratemaking treatment of costs incurred by Con Edison related to the emergency response and restoration efforts following the September 11, 2001, attacks on the WTC, in Case 01-M-1958, Petition of Consolidated Edison Company of New York, Inc. for Permission to Defer Costs Related to Emergency Response and the Restoration of Service Related to the World Trade Center Disaster, filed in C 9187. In an Order issued January 30, 2004, the Commission stated:

> Consideration of WTC-related expenses is premature because of the unsettled nature of such costs. Con Edison and the State of New York continue to pursue multiple avenues for recovery of those extraordinary costs, including, but not limited to, insurance claims, federal aid and other reimbursement programs, and possible state and federal tax deductions.[43]

[43] P. 3.

The other alternatives for recovery of WTC costs including those identified by the Commission in 2004, are still open, and the nature and amount of such costs continues to be unsettled. The amount of federal aid has not yet been finalized. Indeed, Con Edison has yet to even file a claim under the federal reimbursement program for costs designated as Category 3, concerning the relocation of Company facilities. (TR 3561) In addition, the current deadline for application and submittal of documentation for such costs, December 31, 2007, may be extended. (TR 4692) Further, although the total requests for reimbursement for Category 3 costs exceeds the $60 million which is currently available for that purpose, unutilized funds from other reimbursement categories could be reallocated to Category 3. (TR 2500, 4736) The Company also has an appeal pending for certain costs for which reimbursement under the federal program was denied. (TR 2498) Moreover, Con Edison admitted that it has pending litigation seeking recovery of a portion of those costs from other entities. (TR 2463, 2499)

Finally, the record demonstrates that Con Edison's request for recovery of costs from its customers has not yet been reviewed to determine if it comports with PSC ratemaking practices. The record shows that auditors employed by the Empire State Development Corporation for purposes of determining amounts that are reimbursable from federal appropriations, have denied portions of the Company's reimbursement claims. (TR 2494) This suggests that upon review, portions of Con Edison's request may be denied by the PSC. However, such a review has not yet occurred.

Given these issues, the CPB recommends that the Commission not change its current practice, which is to permit Con Edison to defer WTC-related costs while the Company aggressively pursues recovery from insurance carriers, the federal government and other parties. The record shows that until all these avenues have been fully explored, funding from the federal government has been fully encumbered and appeals by Con Edison or on its behalf have been denied, it would be premature for the Commission to increase the amount of recovery currently provided in rates. (TR 4692-93)

D. Labor Expense

Con Edison projects an increase in labor expense of $84.3 million (17.1%) beyond the level in the test year, reflecting additional employees, pay raises, increased overtime and a generous compensation program for non-union employees. (TR 3213) The record demonstrates that revisions are required to the Company's normalization adjustment ($2.46 million), the amount requested for program changes ($2.45 million), projected compensatory and overtime pay ($10.803 million) and anticipated variable pay ($11.205 million). Overall, the CPB recommends reducing Con Edison's proposed labor expense by $26.918 million.

1. Normalization Adjustment

To develop its forecast of labor expense, the Company began with actual labor expense in the test year and made a normalization adjustment of $3.372 million to reflect positions filled during the year for which a full year of compensation is not included in the historical data, as well as compensation for positions that were vacant at the end of the test year. (TR 3214) The Company did not sufficiently justify this adjustment, either in its testimony or supporting workpapers. Its proposed adjustment is strictly one-sided, since it did not remove funding for employees that left during the test year or for vacancies that will occur in the rate year. (TR 3214-5)

In rebuttal and cross examination, the Company's witness indicated that Con Edison's forecast properly addresses these concerns since it "reflects a vacancy factor." (TR 1407; 1533) However, he could not identify the duration of vacancies encompassed in that factor, nor did the Company explain how this factor addresses our concern that ratepayers would be required to fund positions that are unfilled for an extended period of time and/or positions that are unfilled at the commencement of the rate year. Accordingly, the CPB recommends that the Commission disallow the full amount of the normalization adjustment, with the exception of 75% of the requested normalization adjustment for shared services and finance. This would reduce the Company's projection by $2.46 million. (TR 3215)

2. Program Changes

The Company proposes $49.0 million in "program changes" to reflect the addition of numerous employees to accommodate many of its proposed initiatives. However, it has not clearly identified how many employees it proposes to hire. This information was sought by the CPB in two separate information requests, but the answers provided were not complete, and simply referenced the workpapers. Moreover, the workpapers were not organized and lacked any index or summary. When eventually located, the documents simply presented amounts, without the detail requested by CPB.[44] (TR 3215-7)

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[44] An example illustrating our concern is provided in Exhibit 214, Schedule 3.

In view of the general absence of support for this Company proposal, the CPB would normally have recommended that, at most, only one-half of the proposal be approved. However, because several of our other recommendations also adjust labor expense, we limit our recommended adjustment to 5% of this request, or $2.45 million. (TR 3215-7) The Company's rebuttal to this recommendation (TR 1408-9) is based on the contention that its request is fully supported. The CPB disagrees and we address this issue in more detail in Section III(A).

3. Compensatory Time and Overtime

Compensatory time is authorized overtime for non-union personnel including management. It includes planned overtime, emergency overtime, holiday overtime, as well as other payments to certain management personnel. The Company's rate year proposal is based on actual compensatory pay in 2006, which was $33.2 million, an increase of 42.5% over the level just two years before. (TR 3215-7) The CPB recommends that this projection be reduced by $10.8 million.

Con Edison has not satisfactorily supported this substantial increase, and does not even maintain data identifying compensatory time for its electric operations. (TR 1409) The absence of this information prevents the parties and the Commission from assessing whether the proposed compensatory time is justifiable, attributable to non-recurring events and whether it should be paid by electric ratepayers. (TR 3218)

A similar problem exists with the Company's rate year proposal for union overtime, which has increased 38.6% from 2004 to 2006. The record shows that the Company does not maintain data identifying the amount of overtime allocated to electric operations. Therefore, it is essentially unable to know the cause and effect of any event on its labor costs. The absence of such information is inconsistent with effective management. (TR 3219)

The lack of such basic information could justify full disallowance of the compensatory pay and overtime proposed by the Company. The CPB, however, made two modest proposals to adjust the Company's projections of these costs. First, we recommend removing Con Edison's proposed 6.39% escalation of these costs beyond their level in 2006. This adjustment is necessary because overtime in 2006 is excessive in comparison to levels in the historical period, and a further increase would be unexpected and unwarranted. This would reduce payroll expense by $4.212 million. Second, the CPB proposes to reduce the projected compensatory time and overtime by 10%, or $6.591 million, to reflect the fact that significant additions to the Company's work force are projected and that some of the overtime that occurred in 2006 was attributable to unusual storms that are not expected to recur. (TR 3220-1)

In rebuttal, the Company asserts that its projection of compensatory time and overtime is based on data that removed the effect of the unusual storms in 2006. (TR 1410) This does not explain the large increase in these costs in 2006, nor does it address the CPB's observation that overtime and compensatory time may be reduced in the future as a result of significant additions to the Company's workforce.

4. Variable Pay

The Company's "management variable pay plan" allows for payment of additional compensation to non-officer management employees on the presumption that it enhances corporate results. The Company forecasts $11.205 million of variable pay expense in the rate year. For the following reasons, the CPB recommends that the entire amount be disallowed.

Con Edison did not provide information requested by the CPB to support this program. In response to a specific request for "any document that explains to employees what variable pay is and how it is determined," the Company provided a very general response and produced no document.[45] (TR 3222) In addition, Con Edison has not demonstrated that the beneficiaries of variable pay are ratepayers, instead of shareholders. The absence of this basic information casts doubt upon Company assertions that ratepayers should fund this expense. (Id.)

Further, ratepayer funding of this program as currently structured, is not in the best interest of Con Edison's customers. As the CPB's expert testified, variable pay, or bonus pay, should be only awarded for performance that is over and above that which is expected of an employee and which results in increased benefits to shareholders and ratepayers. (Id.) The Company's variable pay program, however, provides awards to management employees with satisfactory performance, as the CPB testified and Con Edison's witness admitted on cross-examination. (TR 3222; 1156)

For these reasons, the CPB recommends that the Company's entire unsupported variable pay proposal of $11.205 million be rejected.

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45 The inadequacy of the Company's specific response is discussed further in Section III(A).

E. Employee Welfare Expense

The CPB recommends two reductions to the proposed employee welfare expense, which total $6.1 million.

1. Group Life Insurance

Con Edison projects an increase in rate year expense for group life insurance of 22.6%. (TR 3224) The CPB testified that this projection is unusual, excessive and appears to ignore a dividend from the insurance provider. Adjusting the Company's projection to reflect the expected dividend would reduce costs to Con Edison's electric operations by $730,440.

The record shows that the Company typically receives a dividend for its group life insurance and that the annual dividend has averaged $929,487 in the last five years, $730,440 of which is attributable to electric operations. However, Con Edison's projection of this expense for the rate year did not account for the dividend, did not include a placeholder for an anticipated dividend and instead, "estimated the cost based on gross premiums paid." (Exhibit 215, Response to CPB IR 39)

In its rebuttal testimony, the Company asserts that the CPB's adjustment to correct for the absence of a dividend in Con Edison's projection is not warranted since there is no guarantee that a dividend will be received, as demonstrated by the absence of a dividend in 2004. (TR 1148) This argument ignores the fact that a dividend has been received four of the last five years and there is no record evidence demonstrating that the Company will not receive a dividend this year. In these circumstances, the

CPB's recommendation reflecting a dividend of the average received in the last five years, is reasonable and should be adopted.

2. Overall Benefit Costs

Con Edison's projected cost of employee benefits should be adjusted for consistency with the CPB's projection of payroll costs. (TR 3225) Using the 17.25% ratio of welfare benefit expense to payroll expense, the CPB recommends that Con Edison's projected benefit expense in the rate year be reduced by $5.373 million. Although Con Edison opposes the CPB's proposed labor adjustment, it is incontrovertible that its projection of employee benefit costs should be revised commensurate with any adjustment to labor costs adopted by the PSC.

F. Insurance Expense

The CPB proposes two adjustments to Con Edison's insurance expense which would reduce the Company's revenue requirement by $10.79 million.

1. Overall Insurance Expense

The CPB testified that Con Edison's proposed insurance expense is not consistent with historical trends and should be adjusted. To correct this deficiency, we recommend that the Company's projection for the rate year be reduced by $5.354 million. (TR 3226-7)

Con Edison's insurance expense for the years 2004-2006 was $27.2 million, $24.9 million and $24.1 million, respectively, indicating a declining trend. It proposes, however, an increase of $5.354 million, representing 22% of its insurance expense in the historic year total. (TR 3584) Con Edison has not adequately justified this projection and did not provide supporting documentation to verify its projections, even when the CPB explicitly asked to show "how insurance premium expense was forecasted." (Exhibit 215, response to CPB IR 24) In its rebuttal testimony, the Company updates its projection to reflect known premiums for 2007 and the latest forecast for 2008. This update reduces the Company's previous projection by $1.2 million. (TR 1435) However, Con Edison did not provide any information supporting its latest forecast for 2008.

In view of the absence of record support for the Company's forecast of insurance expense, a trend that clearly indicates that insurance expense is declining, and the Company's update which indicates that its insurance expense forecasting methodology overstates actual expense, the CPB recommends that the Commission disallow the proposed "program change" of $5.354 million.

2. Director's and Officer's Liability Insurance

The CPB recommends that cost of Director's and Officer's Liability ("D&O") Insurance be funded by shareholders instead of ratepayers since this program provides no direct benefit to customers. We propose excluding the $5.44 million cost of this program from the calculation of Con Edison's electric delivery rates. (TR 3227-9)

D&O insurance is designed to protect directors and officers from inappropriate activities they may have participated in and/or decisions they have made. It protects shareholders from their decision to appoint directors who are in turn responsible for hiring the officers of the Company. Generally, it is shareholders who will make a claim against the directors and/or officers, and shareholders who would receive the proceeds if liability is found. Ratepayers do not decide who is to serve as officers and directors of the company and they would receive nothing from any finding of liability. Further, the profit or return on equity allowed shareholders under conventional ratemaking incorporates a risk factor, including the risk that management is competent. The cost of insurance to secure that competence is part of that risk, and should be funded by shareholders. (TR 3227-9)

The CPB testified that directors and officers receive fair compensation including generous stock options funded by ratepayers. They are paid for their expertise and competence, so it is unreasonable for ratepayers to pay again, to insulate these individuals from their personal responsibility for inappropriate decisions. (Id.) The Company attempts to counter this argument by declaring that D&O coverage is not only for the Directors and Officers but also for the corporation itself under the "corporate reimbursement" section of the policy, and further, that "most claims of a D&O nature are covered under this section of the D&O policy." (TR 1434) It does not, however, provide any support for those assertions.

Con Edison also asserts that it "would not be able to retain any qualified individual to act as an officer or director if it did not provide this insurance." Noticeably lacking from this assertion, however, are any supporting statistics, studies or analysis. Indeed, during cross-examination, the Company admitted that it has never studied the issue. (TR 1514-5) Further, this claim ignores the fact that Con Edison's shareholders could pay for this insurance, rather than the directors and officers themselves. (TR 3327-8)

For these reasons, the CPB recommends that the Commission exclude the $5.44 million cost of this program from its calculation of electric delivery rates. If the PSC does not adopt this recommendation, we urge it to disallow a portion of those expenses. The cost of D&O insurance has increased significantly in recent years and now represents 22.6% of the total insurance expense of Con Edison's electric operations. Some neighboring jurisdictions have disallowed a portion of this cost. (TR 3228) In response, the Company contends that this cost increase is not "any fault of Con Edison's management." (TR 1434) That assertion is unsupported, and potentially inconsistent with the considerable criticism of the Company's management following prolonged power outages in 2006, the resulting lawsuits and the PSC's on-going prudence review of the appropriateness of the utility's actions. The recent large increase in Con Edison's D&O expense may be attributable, at least in part, to the potential for findings of liability against its directors and officers associated with those outages. Therefore, to the extent the Commission does not eliminate ratepayer funding of the entire program, it should at least ensure that Con Edison's customers are not required to pay higher D&O insurance premiums attributable to the actions and inactions of Company officers associated with those outages. To achieve this objective, the Commission should establish rates based on a level of D&O insurance expense that is no greater than before the prolonged outages of 2006.

G. Substation Operations

The Company requested an $11.028 million (31%) increase for substation operations O&M from the test year. (Exhibit 122) Of this request, approximately $6.7

million is for the associated labor costs and approximately $4.3 million for "other" costs. The CPB, in its direct testimony, proposed adjustments to this request to remove $592,000 of program change labor costs and $3,145,000 of unsupported other costs. (TR 3236) We recommended these adjustments since the Company did not properly support its request in testimony or in its response to information requests. (TR 3234 – 6; referring to Exhibit 215, response to CPB IRs 8, 10)

In its rebuttal testimony, the Con Edison asserts that the CPB had incorrectly characterized the size of this proposed expense increase. (TR 1975) The Company states that it projects an increase of 12.4% over the test year, not 31% as the CPB calculated. The calculation in the CPB's testimony was based on data on O&M projects related to substations included in the Company's own exhibit (Exhibit 122). This further supports the CPB's often-repeated concern that the Company's filing is confusing and does not lend itself to an easy analysis. Notwithstanding this correction, the projected 12.4% increase is still significant.

The Company's rebuttal testimony also describes, for the first time, the substation operations programs at issue, including dynamic feeder rating, advanced control group, facilities betterment telecommunications and cable cooling system maintenance. (TR 1978–81) Although this information appears to demonstrate that the projects are necessary, it does not change the fact, however, that they were not adequately supported. Nevertheless, because of the apparent importance of these projects, the CPB withdraws its objection to ratepayer funding for these projects, but we urge the Commission to emphasize that in the future, Con Edison must fully support its proposed programs in its direct case, not merely assert their importance.

H. System And Transmission O&M

The Company requests an increase in test year system and transmission O&M expense of $7.375 million (76%), comprised of $2.557 million for labor costs and $4.818 million for other costs (Exhibit 125). In our direct testimony, the CPB recommended that this projection be reduced by $3.798 million, due to an absence of supporting information. (TR 3236-40) Based on information in the Company's rebuttal testimony regarding manhole refurbishment, we now recommend a reduction to the Company's original proposal of $3.643 million.

Again, the Company did not adequately support its request in testimony, workpapers or in response to our information requests. Instead, it essentially provided summary information without cost support or justification. (TR 3236-7) Due to the absence of supporting information, the CPB recommended that the proposed program changes for several system and transmission operations O&M programs be adjusted or eliminated, including for projects identified as "AECC equipment support and maintenance," "new EMS system license," "telecommunications costs," "manhole reburbishment," "bird discouragers," and "improve OH restoration capability." (Exhibit 214, Schedule 5, page 2)

Based on the information provided in cross examination, the CPB now supports ratepayer funding of the "AECC equipment support and maintenance" program and the "telecommunications costs" program. We understand that the Company filed rebuttal testimony on only two of the remaining projects. Due to the continued absence of information supporting the “new EMS system license” and “improve OH restoration capability” programs, we continue to oppose ratepayer funding of those proposals.

1. Bird Discourager

The CPB recommends that costs of the bird discourager program be removed from Con Edison’s expense projections and capitalized. This is a new program, with no expenditures in the test year. The Company suggested during cross examination that the genesis of the program was two outages on overhead transmission lines in late 2006 or early 2007 as well as some video which “we believe attributed it to birds.” (TR 2056-2057) Although we are concerned that the program was not adequately supported, our opposition is limited to the Company’s proposed accounting.

We recommend that the costs of this program be capitalized and not considered O&M expense. (TR 3238) Expensing the costs of equipment that is expected to provide customer benefits for a long period of time instead of capitalizing it, permits the Company to artificially accelerate recovery of the costs of that equipment. Permitting the Company to account for these costs in this manner encourages it to defer implementation during a rate plan of equipment such as bird discouragers that would normally be capitalized, so that the costs may be expensed in a rate proceeding such as this one, thus allowing for accelerated recovery. This is not in the best interest of ratepayers.

The Company stated that its accounting procedures and guidelines require that the costs of these devices be capitalized when they are installed at the same time as the tower, and otherwise, they are to be expensed. (Exhibit 215, Company response to

CPB 11 (d); TR 1982) As support for its assertion, Con Edison cited Part 168, paragraph 168.10(c) of the PSC's Uniform System of Accounts. However, that section of the PSC's rules and regulations has been repealed.

2. Manhole Refurbishment Costs

Con Edison projects $1.2 million of expenses to refurbish 90 manholes in the rate year. We expressed concern about the projected cost-per-manhole of $13,333, an increase of $4,735 from the costs in 2006. We recommended that the projected costs be reduced to reflect the actual cost-per-manhole incurred in 2006. (TR 3238-9)

The Company responds that the CPB's calculation understated the number of manholes to be refurbished in the rate year, and thus overstated the cost-per-manhole. (TR 1883) It states that 108 manholes are to be refurbished in the rate year instead of the 90 used in the CPB's calculation, at an average cost of $11,111. With this revision, the increase in cost-per-manhole from the test year to the rate year is thus $2,513 (29%) instead of the larger number used by CPB. This does not change the CPB's conclusion that the projected cost-per-manhole is excessive. It is noteworthy that the Company's rebuttal testimony contains an extensive narrative of the refurbishment process, but does not provide information supporting its cost projection. (TR 1983-4) The CPB recommends, therefore, that the Company's projection be replaced in favor of one that uses the actual cost-per-manhole in 2006. This would reduce the Company's projection by $271,400, instead of the $426,000 in the CPB's direct testimony.

I. Electric Operations O&M Programs

The CPB carefully analyzed Con Edison's proposals to dramatically increase spending on electric operations O&M projects. We recognize that many of these programs are necessary and benefit consumers. However, in many cases, the projected increases in spending are unsupported and grossly inconsistent with activity in the test year. Overall, we recommend that the Company's proposals be reduced by $49.888 million.

1. Support Economic Growth

The Company projects $1.445 million in additional costs for program changes in the category "Support Economic Growth." However, it did not provide testimony to explain these costs. When asked in an information request to provide further support, it cited its workpapers (Exhibit 125, Response to CPB IR 12(e)), which contain little or no detail. (TR 3240-1) It appears that the Company did not address this issue in its rebuttal testimony.

There is no record evidence that all of the proposed program changes will occur and will provide a benefit to ratepayers. Additionally, the Company has not shown that the cost estimates are reasonable. Accordingly, the CPB recommends that 50% of the program change amount, or $722,000, be removed from Con Edison's projection.

2. Improve Reliability

The Company is requesting a $7.57 million, or 245%, increase from the test year for O&M programs in the category "Improve Reliability." (TR 3241) The vast majority of this proposed increase was not addressed in the Company's direct testimony. Other programs in this category were not supported in workpapers. In addition, the Company has apparently not addressed this issue, or the CPB's recommendations, in its rebuttal testimony. (Id.) Overall, once again, the Company has not provided information to adequately support its request.

The CPB has three recommendations regarding this issue. First, the Company's projection of costs for Unit Substation repairs and inspections of $2.325 million should be reduced. Actual costs averaged $240,000 in 2004 – 2006 and Con Edison budgeted $300,000 in 2007. Moreover, the projected costs are for special maintenance that is to be performed only once in the life of the units. Such one-time costs should not be included in their entirety in delivery rates. Accordingly, the CPB recommends that that Company's projection be replaced by the average of costs forecast for the next three years, or $1.512 million. That proposal would reduce Con Edison's estimate by $813,000. (TR 3241-2)

Expenses labeled "other costs," totaling $5.55 million, are also unsupported. Some of these costs were not even identified by the Company, and may not be incurred. (Id.) Accordingly, the CPB recommends that the projection of costs be reduced by one-half.

The amount of electric operations O&M costs in the category "improve reliability" used to establish rates, should reflect our proposed $3.588 million reduction to Con Edison's forecast. However, In recognition of the need for the Company to improve the reliability of its system, the CPB also recommends that Con Edison be permitted to spend up to its projection of $10.699 million for these projects, despite the absence of adequate support. If the Company spends less than this amount, however, the difference should be deferred and used for the benefit of ratepayers. (TR 3243)

3. Five-Year Overhead Inspection Program

The Company projects a $5.443 million increase for overhead pole inspections. Because of the absence of supporting information, the CPB recommends that this projection be reduced by one-half, or $2.721 million.

In an effort to evaluate the Company's projection, the CPB reviewed the Company's filing, workpapers and its response to information requests. Those documents revealed that no costs for overhead inspections were incurred in the test year. Instead, the Company inspected all of its overhead wood poles in 2005, and conducted no inspections in 2006 or 2007.

In its rebuttal testimony, the Company asserts that its cost projection is based on costs "incurred in the test year and is based on five years of inspections." (TR 1985) This continues the Company's confusing and contradictory statements about this issue. As cited above, the Company inconsistently claims that costs were, and were not, incurred in the test year. Additionally, the Company still has not explained how the fact that it conducted no inspections in 2006 and 2007, affects its cost projection. It is not clear whether its estimate is based on one-fifth of inspection costs for the five-year cycle, or one-third of those costs since it conducted no inspections in 2006 or 2007. It is apparent, however, that the Company was deferring inspections in those years until it could obtain explicit recovery of the associated costs through a rate case decision.

For these reasons, the CPB continues to recommend that the Company's cost projection be reduced by 50%.

4. Five-Year Underground Structure Inspection Program

The Company projects rate year costs of $35.001 million, an increase of 215% from test year costs of $11.1 million.[46] (TR 3247) This estimate is not well-supported and appears substantially overstated. The CPB recommends that it be reduced by $19.04 million.

The Company asserts that inspections of its underground equipment are conducted on a five-year cycle. Information provided by the Company shows that it spent $0, $8.5 million and $6.8 million in 2004-2006, respectively. Con Edison conducted 44,728 inspections in 2005 and 45,067 inspections in 2006. The average cost-per-inspection was $190.04 in 2005 and $246.3 in 2006. (TR 3247-8)

The Company projects that it will conduct 75,447 inspections in the rate year. (Exhibit 215, response to DPS Staff IR 329.9) This represents 27.4% of the 275,000 inspections to be conducted over five years, instead of the 20% that would be expected on a five-year cycle. Con Edison also projects an average cost-per-inspection of $463.92, which is more than double the actual cost in 2005 and 2006. (TR 3248) Both of these projections are inflated and neither has been satisfactorily explained. They appear to reflect an effort to load inspections and costs into the rate year.

In rebuttal testimony, the Company asserts that the increased cost-per-repair is due to the higher number of repairs that are directly related to the safety inspections. It

[46] The test year number was provided in Exhibit 127. However, the Company's response to CPB IR 2(d) (Exhibit 215), listed this expense as $6.8 million.

claims that in 2006, approximately 50% of inspections were completed during normal maintenance, but in the future, they will be beyond the scope of normal maintenance work, and will therefore be more costly. It asserts that 50,000 inspections must be conducted in the rate year. (TR 1972)

The CPB continues to recommend that the Company's projection be replaced. We accept the Company's representation that 50,000 inspections are required in the rate year, instead of the more than 75,000 it previously claimed. Its claims that costs-per-inspection will be higher in the rate year since more detailed inspections will be required, still does not support its $463.92 per-inspection estimate. Indeed, the Company admits that approximately 50% of the inspections conducted in 2006 were of the detailed type it will undertake in 2008. (Id.) Under the assumption that the 2005 data only reflect the "low-cost" inspections, the 30% increase in cost-per-inspection from 2005 to 2006 suggests that the cost of the more detailed inspections is approximately 60% above 2005 costs, or $319.20. This is still far less than the Company's projection.

The CPB recommends that the Company's projection be replaced by $15.96 million, the product of 50,000 inspections and $319.20 per inspection. This is $19.04 million less than projected by the Company.[47]

5. Annual Stray Voltage

The Company projects $12.522 million in rate year costs for the stray voltage testing program, a $5.722 million (84%) increase over spending in the test year. The projected spending increase has not been supported. Accordingly, the CPB

[47] Escalation for inflation of the historical average is not appropriate because the Company has already applied an escalator to the historic cost and program changes. (TR 3249)

recommends that it be removed from the forecast used to establish rates in this proceeding.

The Company spent $6.8 million on this program in 2006 and budgeted the same amount for 2007. It asserts that the projected increase is driven by anticipated rate year oversight costs which it quantifies as $3 million (TR 3251, citing response to NYC IR 81) or $2.647 million (TR 3252, citing response to DPS Staff IR 328.1). No additional support is provided for that assertion, and no explanation is supplied for that portion of the increase that is not attributable to oversight costs. It is noteworthy that the cost for testing could be reduced if the mobile stray voltage testing can be used to satisfy the testing requirement (TR 3250), a factor not considered in the Company's projection.

In its rebuttal testimony, the Company asserts that the incremental costs reflect the fact that contractor costs will rise when the contract expires, repair costs will increase as more stray voltages are found and additional oversight of contractors is required. (TR 1985) None of these assertions are further explained or accompanied by any supporting information. Additionally, the claim that more stray voltages will be found in the rate year than in the historical period is illogical.

There is simply no support for the Company's projected increase in stray voltage testing costs. The PSC should adopt the CPB's recommendation.

6. Mobile Stray Voltage

The mobile stray voltage testing program complements the traditional stray voltage program. Con Edison projects $10.883 million in costs for this program, an increase of $7.43 million over the test year. The CPB recommends that this estimate be reduced by $1.883 million.

The CPB testified to concerns regarding the amount of testing that can be performed by the testing vehicles each day and the unexplained fact that standby costs-per-detection have apparently tripled in only one year. (TR 3252-4) In addition, the Company budgeted $9 million for this program in 2007, a significant increase that reflects a larger number of testing vehicles. No justification has been provided, however, for the projected increase in cost above the 2007 budget. Moreover, as the volume of testing increases, it is reasonable to expect that the electric system will improve, thereby reducing the cost of repairs in the future. (TR 3254)

The CPB recommends that Con Edison's projection for the rate year be replaced by its 2007 budget of $9 million. This is reasonable since it represents an increase of approximately 260% over costs in the test year.

7. Network Transformer Vault Cleaning

Con Edison projects that the cost of a new network transformer vault cleaning program will be $5.488 million. The CPB recommends that the Company's forecast be reduced by $2.366 million.

As with many other programs, the Company has not provided the information necessary to support this request. The CPB's expert was unable to replicate the Company's projection using information supplied by Con Edison. The Company projected contractor costs of $3.6 million and support staff costs of $756,000, for a total of $4.357 million. The remaining costs could not be identified. In addition, the CPB testified that the ten support staff for this new, untested program, appears excessive and premature. Further, Con Edison admitted that of the nine programs included in its "public safety and environmental program" list, this program is the least important. (TR 3256) It appears that the Company did not submit rebuttal testimony on this issue.

The CPB believes that this program has the potential to benefit consumers and recommends that it be phased in. One-half of the projected contractor costs should be reflected in the rates established in this proceeding, subject to the condition that the Company maintains data in a format that would permit an evaluation of this program next year. (TR 3256-7)

8. Distribution Line Clearance and Danger Tree Removal

Con Edison projects an increase of $7.995 million in costs for distribution line clearance, to $13.755 million. Company workpapers indicate that this is due to an accelerated three-year program for its distribution system. The Company expects to spend $9.5 million on this program in 2007. Information regarding its spending in 2006 is contradictory, with its filing indicating that it spent $5.76 million (Exhibit 127) and the response to an information request indicating that it spent $10.092 million (Exhibit 215, response to CPB IR 4). The Company appears to assert that the correct number for 2006 spending is $10.092 million, although that raises a question as to why it is now requesting an increase when the 2007 budget reflects a decline in spending. (TR 3258-60)

The CPB recommends that tree trimming costs reflected in rates be based on a five-year historical average. However, the Company again provided only three years of data, which indicate that it spent an average of $8.025 million per year. Use of this average would reduce the Company's request by $5.73 million. (TR 3259-60)

The Company also recommends an increase of $632,000 for its danger tree removal program. That estimate is based on a cost of removal of $702 per tree, which far exceeds the cost used in neighboring Vermont. The CPB recommends using an estimate of $325 per tree, double the cost in Vermont. This would reduce the cost of danger tree removal by $339,500. (TR 3260)

The Company has apparently not rebutted these recommendations. Together, they would reduce Con Edison's cost projections by $6.07 million.

9. Double Wood Program

The double wood program involves the transfer of equipment from an old pole to a new pole, as required for load relief or as a result of damage. The Company requested $5.235 million (Exhibit 127) for this program, an increase of 489% over test year cost of $889,000. (TR 3261) The CPB recommends that no cost be allowed in rates for this program.

Con Edison's forecast is based on its plan to replace 2,250 poles in the rate year at a cost of $2,300 per pole, plus $60,000 to oversee contractors. It claims that it now has 6,000 double poles in its system. In 2004, the Company incurred no costs for this program, despite the high number of doubles poles that needed to be eliminated. It spent $951,000 on this program in 2005 and $889,000 in 2006, and budgeted $900,000 in 2007. (TR 3261-3)

The CPB has three main concerns with the Company's proposal. First, it appears that Con Edison is attempting to catch up on work that was limited, or not done at all, in previous years. In a 2005 survey, the Company identified approximately 6,000 double poles that required removal. However, it eliminated only a small fraction of those double poles in each year 2005-2007. The Company appears to be inappropriately using this rate case to increase its costs, by proposing to catch up on work that that it claims is urgent, but should have done previously. (TR 3262)

Second, the Company has not adequately supported the costs of this program. It asserts that rate year costs-per-pole will be $2,300 (TR 3261), but that actual costs-per-pole in 2006 were $4,445 (TR 3262; Exhibit 124, Response to CPB IR 5). It also stated, contradictorily, that it plans to complete 930 poles in the rate year (Id.) at $2,300 per pole. These inconsistencies between the number of poles to be replaced in the rate year (2,250 versus 930) and the costs per pole ($2,300 versus $4,445), cannot be reconciled and demonstrate that the Company's proposal is neither coherent nor supportable.

Third, the proposed accounting for the costs of this program may be improper. The costs of the double wood program should be categorized as capital costs and recovered over a long period of time, instead of being expensed as the Company proposes. These projects will provide improvements to Con Edison's facilities that will be used for a long period of time. (TR 3262) In its rebuttal testimony, the Company asserts that expensing these costs is in accord with "accounting instructions promulgated by the New York State Public Service Commission and the Federal Energy Regulatory Commission." (TR 945) As with the bird discourager program discussed previously, the section of the PSC's Uniform System of Accounts upon which the Company relies for its proposed accounting, was repealed more than eight years ago. The CPB continues to recommend that allowing these individually small but large in the aggregate costs to be placed into rates is inappropriate, and these costs should be capitalized and recovered over the useful life of the plant.

Overall, this program has not been a priority for the Company and the proposal in this case is not accompanied by internally consistent information. Therefore, no costs for this program should be included in rates. Should the Commission determine that ratepayers should provide funding for this program, the costs should be capitalized, not expensed.

10. Maintenance Associated with Capital Work

Con Edison requested $6.377 million for maintenance projects associated with capital work, an increase of $5.082 million over the amount spent in the test year. The Company's testimony contained no discussion of how the project costs were determined and the workpapers provided no detail on how the costs were developed. (TR 3264)

Due to the absence of support, it would be reasonable to disallow the entire request. However, since Con Edison will be conducting an expanded capital program to benefit consumers, it would reasonably be expected to incur additional maintenance costs related to that work. Accordingly, the CPB recommends that one-half of the Company's projection, or $2.541 million, be used to establish Con Edison's rates in this proceeding.

J. Facilities Expense

Con Edison projects an increase of $16.692 million for facilities expense. The CPB recommends that this projection be reduced by $13.394 million. (Exhibit 224, Schedule 6)

We have several main concerns regarding the Company's proposal. First, the Company's filing and workpapers lack a complete explanation and contain inconsistent information, making it impossible to verify the data presented by the Company or assess the reasonableness of its request. (TR 3265-6)

Second, the $11.86 million of program change costs proposed by the Company have not been supported. As a result, the electric portion of those costs, estimated at $9.623 million, should be excluded from calculation of the Company's rates.

Third, should the Commission believe that recovery of any of these costs is reasonable, the costs should be capitalized instead of expensed These are single-period costs being incurred as a result of capital projects that will provide improvements to facilities to be used over a long period of time. Con Edison's approach of dividing these costs into small components and arguing that they should be expensed, is inappropriate since in the aggregate, these costs are significant, particularly in comparison with historical spending. (TR 3266-7)

The CPB also recommends a reduction in the Company's proposed building infrastructure restoration expense. These renovation costs would be expected to benefit ratepayers in the future and should be capitalized. Expenses for this project have averaged $1.072 million annually in 2004-2006, yet the Company is projecting an additional $3.573 million for Con Edison's electric operations in the rate year. We recommend that the additional cost be recovered over five years, reducing rate year expenses by $2.858 million. (TR 3267-8)

We also recommend that the projected cost of the Company's proposed "master plan study and analysis" be excluded from the calculation of rates. The cost is not yet known and measurable, and there has been no determination that it benefits ratepayers. Our proposal would remove $912,800 from the Company's cost projections. (TR 3268)

Overall, the CPB recommends that the Company's proposed increase for facilities expense be reduced by $13.394 million.

K. Customer Operations

Con Edison proposes an additional $6.61 million for program changes associated with general education and outreach. The CPB recommends that this projection be reduced by $2.66 million.

Once again, one of our main concerns is the absence of adequate supporting information for the Company's request. These concerns, detailed in the CPB's testimony (TR 3269-72), include incorrect information regarding where projected labor costs are reflected in the Company's filing (Exhibit 215, response to CPB IR 14g), the absence of any documentation for a projected $800,000 cost increase for a web-based information campaign other than reference to "verbal information provided by a vendor" (Exhibit 215, response to CPB IR 14o) and the absence of any documentation regarding a proposed $860,000 cost increase for community outreach, except a statement that the Company plans to intensify its efforts (Exhibit 215, response to CPB IR 14s).

In rebuttal testimony, the Company responded by stating that providing the information requested "would not have been practicable." (TR 848) We responded to this assertion in Section III(A). Although we recognize the importance of providing accurate and timely information to consumers, the absence of support for these proposals is striking and cannot be ignored. Accordingly, we recommend that the proposed $800,000 for web-based information campaigns and $860,000 for community outreach, be rejected.

We are also concerned about the Company's proposed increase in media spending, from $1.465 in the test year to $3.465 million in the rate year. This proposal is not adequately supported, as demonstrated by the fact that the workpapers consist of only one-half page of a very general description. In direct testimony, the CPB recommended that the proposed increase not be allowed. In rebuttal testimony, the Company attempts to justify its request by stating that it now must deliver its message to customers who speak a wide variety of languages. (TR 849) However, it still has not adequately explained the reasons for its request to increase the non-web portion of its media spending by $2 million (137%). Accordingly, the CPB recommends that the Company's request by reduced by $1 million.

Overall, we propose that the Company's projected increase for customer operations be reduced by $2.66 million. In direct testimony, we expressed concern about Con Edison's request for $2.8 million for two direct mailings on various informational topics. (TR 3271) The Company has satisfactorily explained that direct mail is the most effective way to ensure that customers obtain and read information regarding power problems, public safety issues, as well as information targeted to special needs customers. Accordingly, we no longer oppose that proposal, but urge the Company to continue to explore more cost effective ways to deliver this important information.

L. Steam Operations

Con Edison projects a net increase of $7.162 million in expenses for its steam operations. The CPB recommends that this projection be reduced by $4.392 million.

1. Absence of Supporting Information

As with many other contested issues, the Company has not sufficiently justified its proposed increase in spending on steam operations. It did not provide requested information in response to the CPB's discovery requests. We asked for five years of historical information, which the Company failed to provide. (Exhibit 215, Response to CPB IR 13) In addition, in response to inquiries seeking a comparison of historical and budgeted information, the Company often provided different test year cost levels than what is reflected in the filing. For example, of seven different categories of costs listed in the attachment to the response to CPB IR 13 (Exhibit 215), five reflected a cost different than that shown on Company Exhibit 71 for the test year. This raises questions regarding the reliability of the information that was supplied by the Company. (TR 3276-7)

2. Preventative Maintenance

The CPB testified that the combined preventative and corrective maintenance projections of $6.284 million exceeds historical spending and should be reduced to the three-year average expense. (TR 3278-9) Based on the Company's rebuttal testimony, we revise this recommendation to address only preventative maintenance.

The Company projects steam-related preventive maintenance costs of $2.234 million in the rate year, an increase of $1.173 million from the test year. (Exhibit 55) The projected increase in spending for preventative maintenance is above the three-year average of $1.358 million, and raises a concern that maintenance was either deferred in anticipation of a rate case or to minimize expenditures in the historical period despite a need for maintenance. (TR 3279) The CPB recommends that projected spending in the rate year be replaced by average spending in the last three years, thereby reducing Con Edison's projection by $876,000.

The Company's opposition to this request focuses on the fact that its preventative maintenance spending has increased in recent years. (TR 948) That fact does not obviate the need for an adjustment to the large increase it projected.

3. Gas Turbine Maintenance

Con Edison projects a $2.244 million increase from its test year expenses for gas turbine ("GT") maintenance. Under this program, the Company completes required maintenance of the GT equipment at its generation stations in a three-year cycle. The CPB's review of this issue found that Con Edison has spent an average of $431,000 a year on GT maintenance. Test year expenditures of $726,000 was the largest amount ever spent on this activity. The Company's explanation of its $2.244 million projected increase, is that it is required to bring deteriorated GT equipment into operation. (TR 3279)

The PSC should reject Con Edison's proposed $2.244 million incremental spending since it far exceeds the Company's historical spending levels. Further, the justification for the increased spending suggests that it is in the nature of capital, rather than expense, and may provide consumer benefits over a long period of time. Therefore, if the costs are allowed at all, they should be capitalized. (Id.)

In its rebuttal testimony, the Company opposes the CPB's recommendation and cites an increasing trend of historical GT maintenance spending. It asserts that the turbines are an integral part of its system to provide reliable electric service and that the CPB's proposal may negatively affect their availability. (TR 943-4) This response misses the point. The CPB does not dispute that the turbines are necessary and should be maintained, only that the projected increase in maintenance cost is unwarranted.

In response to the CPB's suggestion that these costs be capitalized, the Company reiterates its position that they should be expensed in accordance with its policy and accounting instructions promulgated by the PSC and Federal Energy Regulatory Commission. The Company's explanation that the costs must be incurred to bring deteriorated GT equipment back into operation, is inconsistent with that contention. Further, cross examination revealed that this type of maintenance would restore output of a plant that otherwise would have been lost forever. (TR 0966) This warrants capitalization of these expenditures.

4. Facilities Maintenance

Con Edison projects that it will spend $4.248 million on steam facilities maintenance, an increase of $3.2 million over the test year. The CPB recommends that this projection be reduced by $1.272 million. (TR 3278)

The proposed facilities maintenance expense far exceeds historical spending. In the years 2004-2006, the Company spent an average of $2.976 million per year for this maintenance and has budgeted just $1.487 million for these costs in 2007. (Exhibit 215, response to CPB IR 13) Now that it is time to consider new rates, the Company asserts that it is necessary to substantially increase spending on this project.

The CPB proposes to replace the Company's projection with average spending in the 2004-2006 period. (Exhibit 215, Schedule 8) In rebuttal, the Company states that historical facilities spending was relatively low because maintenance had been postponed at the Company's East River and Gas Turbines facility during certain inspections. (TR 946-7) This does not satisfactorily explain the large increase projected by the Company. Indeed, it further demonstrates that the CPB's proposal, which would permit a substantial increase over the 2007 budget, is balanced, reasonable and should be adopted.

M. Interference Costs

The Company forecasts rate year costs associated with the required relocation of Company facilities, referred to as interference, of $104.98 million. (TR 1196) The CPB recommends that that this be reduced by $27.1 million to reflect the relationship between actual and forecast interference costs in the test year.

1. CPB's Proposal

Con Edison requests that test year interference costs of $53.975 million be increased by $51 million (94.5%) to a total of $104.98 million. The Company's estimate for interference costs, excluding Lower Manhattan, is based on a formula and information regarding the City of New York's planned capital expenditures. The CPB observes that the City's projection is uncharacteristically high in comparison to historical levels and that the Company's rate year projection is significantly higher than the five-year average cost of $60.325 million. (TR 3280)

We are particularly concerned that the interference amounts are based on an estimate of costs by New York City that assumes that the City will complete a far larger number of construction projects than it has historically. In response to a request for supporting detail for the Lower Manhattan interference projects, the Company simply responded that the forecasts "are developed by preparing order of magnitude estimates for each project based on the past experience of similar projects in the lower Manhattan area." (Id.) However, the estimates and any supporting backup were not provided. Nor did Company workpapers expound upon the matter in any way. Instead, most of those documents included only broad, general explanations and some cost estimates with no detail showing how the costs were derived. In response to a further request for source documents related to interference expenses, the CPB was referred to New York City's website. (TR 3280-1) This answer does not qualify as adequate support for any rate request much less one of this magnitude.

The Company's projection of interference costs is inconsistent with historical experience. From 2002-2005, actual interference costs averaged about 3% more than budgeted. In 2006, the amount budgeted was approximately 14% higher than 2005 and approximately 22% higher than the average for 2002-2005, yet actual costs were only 74.2% of the amount budgeted. The increased budget for 2006 resulted in a significant shift from the historical actual-to-budget variance.

The rate year budget reflects a projected increase in interference costs that is even larger than was projected in 2006. The CPB recommends that the interference cost request be adjusted based on a comparison of 2006 actual-to-budget data. Using the 74.2% actual-to-budget ratio for 2006, the $104.98 million projection should be reduced $27.1 million to $77.9 million. (TR 3281)

2. Response to Con Edison's Rebuttal

The Company asserts that the CPB overstated the proposed increase in interference costs since the historical data CPB used did not include costs related to the World Trade Center. The Company has previously accounted separately for interference costs related to the World Trade Center, which it states are $17.98 million in the test year. (TR 1202) After including these costs in the historical data, the Company is requesting an increase in interference costs of $33 million (46%).[48] This is still an extremely large increase by historical standards.

The Company also criticizes the CPB's proposal to adjust the rate year projection based on 2006 actual-to-budget data, because it relies on only one-year's experience. (TR 1203) The data in question are the most recent available. Moreover, as explained above, those data are from the period of time which is most similar to the rate year, in that in both cases, a very large increase is projected. The estimate adopted in this

[48] Test year interference costs including WTC costs are $71.95 million.

proceeding should reflect the fact that when a large increase was projected, the Company's actual interference costs were far less than expected. The use of a single year's data is reasonable in these circumstances.

N. Storm Costs

The Company requests that $8 million be included in rates for storm costs. The CPB recommends that Con Edison's request be reduced by $3 million based on historical spending excluding unusual storms.

1. CPB's Proposal

The amount included in rates for storm costs should be based on actual costs incurred over a period of time, such as five years, adjusted to remove the effect of unusual or extraordinary storms. (TR 3283) The Company testified that its $8 million projection was based on the average cost of storms over 15 years. (TR 1404) It subsequently stated that this description of its forecasting methodology was incorrect, but did not provide a detailed explanation of how its estimate was developed. (TR 3282)

To test the reasonableness of the Company's projection, the CPB requested five years of historical costs. However, only three years of data were provided, and showed that costs were $.7 million, $1.5 million and $24.2 million in 2004 – 2006, respectively. The amount of storm costs in 2006 was unusual, as demonstrated by the fact that storm costs exceeded $5 million only two other times in the last 15 years: $7.3 million in 1996 and $9.2 million in 1997. Based on this information, the CPB recommends that $5 million be included in rates for storm costs. This projection is reasonable, since it would exceed the level of storm costs incurred in 12 of the last 15 years. (TR 3283-4)

2. Response to Con Edison's Rebuttal

In rebuttal testimony, the Company further explained that its $8 million storm cost projection is comprised of three elements: $4.1 million for a reserve for a "level 3" storm, $1.5 million for coverage of "level 2" storms, and $2.4 million for storm mobilization. (TR 1363-5)

The Company's projection is overstated. Regarding "level 3" storms, 12 such storms have affected the Company's service territory in the last 15 years. Approximately 60% of those storms were "level 3A" storms, and resulted in an average cost of $2.2 million. Those storms occurred on average, less than once every two years. The remaining storms, referred to as "level 3B," occurred approximately once every three years. (Id.) We note that the Company has authority to request deferral and recovery of the costs of extraordinary storms, so the cost of storms including those designated as "level 3B," need not be built into rates, particularly when there are so many other factors placing upward pressure on the Company's required revenues.

The CPB does not question the Company's justification for $1.5 million for the costs of "level 2" storms. However, the $2.4 million of projected costs for "storm mobilization" appear overstated. The Company does not provide historical data for those expenditures, but states that it has enhanced its storm mobilization efforts in order to respond more quickly to storm conditions. (TR 1364)

Review of the Company's rebuttal testimony further demonstrates the reasonableness of the CPB's recommendation. On average, the Company has experienced one “level 3A” storm every two years, at an expected annual cost of $1.1 million. Its expected annual cost of “level 2” storms is $1.5 million. Accepting, arguendo, the Con Edison’s storm mobilization cost of $2.4 million, these costs total $5 million annually, recognizing that the Company can petition for deferral and recovery of the costs of “level 3B” storms. Accordingly, the CPB’s proposal to reflect $5 million in rates for projected storm costs, thereby reducing Con Edison’s proposal by $3 million, should be adopted.

O. Escalation

Many of the Company’s cost projections include escalation to reflect projected inflation. In several cases, such escalation is unwarranted. Accordingly, Con Edison’s cost projections should be reduced by $2.237 million, in addition to its previous concession amounting to $4.776 million.

Projections of interference expense are based on costs expected in the rate year. Increasing those projections again for anticipated inflation would amount to a double count of inflation. The CPB testified that the Company’s proposal to escalate its projected interference costs should be rejected. (TR 3284-5) In its rebuttal testimony, the Company agreed with the CPB’s proposal, saying that escalation on interference costs was erroneously included in its filing. Accordingly, it removed $4.776 million of costs from its projections. (TR 1381)

The Company also proposed to escalate costs in the category labeled "Other," which includes $47.603 million of costs for program changes that were based on estimated costs in the rate year. Applying escalation to those costs would constitute a “double dip.” Removing escalation from this category would reduce expenses by $2.237 million. (Id.) In its rebuttal testimony, the Company contends that program changes are calculated without labor or general escalation, with the exception of a few elements of expense. (TR 1436-7) This claim is unsupported, and the assertion that projected costs do not reflect projected inflation, is illogical. Accordingly, the CPB continues to recommend that escalation be removed from the “Other” expense category, reducing projected costs by $2.237 million.

IV. THE CPB’S PROPOSALS TO MITIGATE THE DELIVERY RATE INCREASE SHOULD BE ADOPTED.

The Company proposes an increase in electric delivery rates of more than $1.2 billion, approximately 33% of current rates. If approved, this would be the largest rate increase in Con Edison’s history and for any energy utility in the history of New York State. Even if the vast majority of the revenue requirement recommendations identified in the previous sections and made by other parties are adopted, it is likely that the resulting delivery rate increase will be among the largest in the history of the State. At the same time, consumers are facing increasingly challenging economic conditions, including a slow-down of the economy and high energy prices.

In these circumstances, the CPB recommends that the PSC use its ample discretion to mitigate the amount of the rate increase authorized in this proceeding. Costs in several categories should be amortized and recovered from customers over a longer period of time than proposed by the Company, including the carrying charges on T&D capital costs from the current rate case, SIR costs and WTC-related costs. The CPB’s proposals for these three categories alone would reduce the amount of the rate increase by approximately $109 million. (TR 4695) Similarly, the Company's depreciation expense proposals should be rejected, thereby reducing projected expenses by $87 million. Each of these proposals is fair to consumers and the utility.

A. Transmission and Distribution Costs

As explained in Section I(B), Con Edison has incurred approximately $1.6 billion of T&D capital costs in excess of amounts provided in current rates, which it seeks to recover from ratepayers in this proceeding. It calculates that it has accrued $198.8 million of carrying charges on those expenditures, and proposes to recover that amount over three years. That proposal would increase rates by $66.3 million in the rate year. (Exhibit 95, Schedule 4)

The CPB testified and continues to recommend that those costs be recovered over a longer period of time, up to 10 years, to help mitigate the impact on customers of the large rate increase being considered in this proceeding. (TR 4693-94)

B. Site Investigation and Remediation Costs

Con Edison projects that it will incur approximately $170.9 million in environmental remediation costs from March 31, 2007 through the end of the rate year (TR 517-18), $134.5 million of which is the responsibility of the Company's electric operations. As explained in Section III(B) infra., the CPB recommends that these projections be revised to reflect recommendations of DPS Staff, that the Commission direct that these costs be scrutinized as part of the next management audit of Con Edison's operations, and that recovery of those costs commence only if it is subject to reconciliation based upon the results of the audit. The Company proposes recovery of these costs over a three-year period.

To help mitigate the impact on customers of the large rate increase proposed in this proceeding, those costs could be recovered over a longer period of time. The CPB (TR 4694) and the County of Westchester (TR 5465-66) testified that they could be recovered over ten years, and DPS Staff recommended recovery over five years. (TR 3597) A five-year amortization period was used in a negotiated settlement, approved by the Commission, which established the current rate plan for Con Edison's electric operations. (Exhibit 242)

The PSC has ample discretion to select an amortization period that is longer than the three years recommended by the Company and there is sufficient record basis for the Commission to do so. In view of the large increase in projected SIR costs and the overall magnitude of the proposed rate increase, the CPB recommends that these costs be recovered over a longer period of time than proposed by the Company.

C. Amortization of WTC-Related Costs

We explained in Section III(C) above, that Con Edison's proposal to increase rates now, to recover remaining costs it incurred to restore its facilities damaged as a result of the attack on the WTC, is premature. Should the Commission determine, however, that the expense portion of those costs, estimated at $100.5 million (Exhibit 95, Schedule 4), be recovered in rates established in this case, they need not be recovered over three years as the Company recommends. (TR 2438-39) Instead, they could be recovered over a longer period of time such as ten years, as recommended by the CPB, to help mitigate the impact on customers of the large rate increase being considered in this proceeding. (TR 4693) The amount and timing of the recovery could be revised based on a final determination regarding the availability of reimbursement from other sources including the federal government.

D. Depreciation Expense

Con Edison proposes several changes which would increase projected depreciation expense for its electric plant by $87.0 million. The CPB recommends that those changes not be adopted, in view of the extremely large rate increase being considered and the absence of any compelling need for higher depreciation rates at this time.

The Company proposes new service lives for certain assets which would increase electric depreciation expense by $8.0 million. (TR 653-4) Proposed changes to the rates applicable to two categories of assets account for $7.1 million (89%) of that amount. (TR 654) It also proposes new estimates of net salvage, the difference between the salvage value of plant that is retired and the cost of removing that plant, which would increase overall depreciation expense by $37.2 million. (TR 661)

In the absence of these changes, Con Edison's accumulated depreciation reserve deficiency would be approximately $275.7 million (Exhibit 40, p. 3), less than 8% of the total reserve for depreciation. The CPB submitted unchallenged testimony that a reserve deficiency of that magnitude need not be recovered at this time since it is within a 10% band that is considered reasonable. (TR 4691) However, if the Company's proposed changes to service lives and net salvage are accepted, the accumulated depreciation deficiency would exceed 10% of the total reserve for depreciation. The Company calculates that recovery of the deficiency over 15 years would increase depreciation expense by another $41.8 million. (TR 674)

The PSC has considerable discretion regarding the calculation and timing of the recovery of utilities' depreciation expense. There is no question that Con Edison is entitled to recover the prudent costs of plant and equipment used to provide utility service, but the calculation and timing of the amount to be included in rates at any time can, and should, reflect important policy considerations. The Commission need not be a slave to particular studies or methodologies.

In this case, two fundamental facts are noteworthy. First, as explained above, the rate increase being considered in this case is extremely large and likely to have a significant impact on consumers. The Company's overall depreciation expense proposals, however, did not consider the size of the rate increase, or the order of magnitude of its proposed plant additions (TR 751), despite the fact that for at least one plant account, the Company's depreciation witness considered the need to mitigate the impact on rates for a specific significant change in technology (TR 666). Second, there is no capital recovery crisis or other compelling need at this time to increase depreciation expense. (TR 4689) In view of these real world facts, the CPB recommends that the Commission reject the Company's depreciation expense proposals regarding new service lives, new net salvage factors and recovery of the accumulated reserve deficiency, thereby reducing Con Edison's projected depreciation expense by approximately $87.0 million.

V. THE CPB'S ENERGY EFFICIENCY AND REVENUE DECOUPLING PROPOSALS SHOULD BE ADOPTED.

Additional programs to help achieve the State's DSM goals should be in place by April 1, 2008. The CPB recommends that a collaborative proceeding regarding an RDM and an interim DSM program for Con Edison's electric operations, commence on a schedule that would permit PSC approval in March 2008. The DSM program should be based on the existing system-wide program conducted pursuant to the Company's current rate plan. Another collaborative proceeding to establish a long-term DSM program should commence after issuance of the PSC's Order in the generic energy efficiency proceeding, Case 07-M-0548.

A. Energy Efficiency

Con Edison proposes a new DSM program, to be administered by the utility, to achieve installed permanent demand reductions of at least 500 MW by 2016. (TR 2993) In the next three years, Con Edison proposes to contract for at least 250 MW of permanent DSM. (TR 3000) Program costs would be recovered from customers through the Company's Monthly Adjustment Clause, except for certain labor costs that would be recovered directly in base delivery rates. In addition, Con Edison would receive a three-part incentive if it achieves demand reduction goals. (TR 3004-5) Although the CPB commends Con Edison for embracing New York State's electricity demand reduction goals and making a constructive proposal to achieve those objectives, we have several concerns regarding its proposals.

1. Con Edison's Proposed Program Size

The Company's proposed permanent demand reduction goal of 500 MW apparently represents what Con Edison understands to be one-half of the projected need for new supply in the New York City area through 2016. (TR 4696) However, it is not directly related to the Governor's objective of reducing electricity demand by 15% of forecast levels by 2015 and was developed without any consideration of ways in which DSM goals may be achieved without ratepayer funding. (Id.) Several examples of how this might be achieved were identified by the CPB's expert, including removal of informational and financial barriers faced by consumers, new building codes and new standards for appliances and equipment. (TR 4696-7)

The appropriate size of utility DSM programs is under review generically in Case 07-M-0548: Proceeding on Motion of the Commission Regarding an Energy Efficiency Portfolio Standard. That proceeding is intended to address the extent to which energy efficiency goals can be achieved without programs funded by ratepayers as well as the division of responsibility for ratepayer funded programs between utilities and NYSERDA. The CPB, Con Edison and other parties are participating in that proceeding, and a decision on the appropriate size of Con Edison's long-term DSM program should await a PSC determination in that case.

2. Con Edison's Proposed Program Elements

The Company proposes an overall budget for its DSM program's administrative costs, including labor, of $19.3 million for the first three years, or approximately 16% of aggregate program costs of $122.3 million. Its discussion of specific initiatives to achieve its DSM goals is limited to one and one-half pages of testimony, which identifies several types of programs characterized by the Company as "similar" to the programs it implemented from 1988 – 1998. (TR 3001-3) However, program details, a method for allocating funding among program elements, benefit-cost ratios, and procedures for measuring program effectiveness, are all missing from the proposal. (TR 4698)

The information provided by Con Edison lacks sufficient detail to warrant support. A decision on the specific DSM initiatives that should be conducted by Con Edison in the long-term, should await the PSC's determination in Case 07-M-0548.

3. Con Edison's Proposed Incentive

Con Edison proposes a three-part incentive, including 20% of the "net resource benefits" associated with demand reductions it achieves, a flat payment for demand reduction achieved of $22,500 per MW adjusted for inflation, and the value that any greenhouse gas reductions would have in a market. (TR 3004-5) If, over the first three years of its program, Con Edison achieved the demand reduction goals it identified, it would claim an incentive of $94.4 million for the first two components of the incentive alone. (TR 4699) The Company does not propose any financial penalty should it fail to achieve its goals.

The CPB's expert testified that the proposed incentive is grossly excessive and far beyond what is necessary or appropriate for a regulated public utility to achieve a public policy objective. (TR 4700) In particular, the first two components alone of the proposed incentive represent 92% of total program funding. When administrative funding and labor costs included in Con Edison's projected costs are added to what the

Company refers to as “program funding,” the two elements of the proposed incentive equal 77% of aggregate program costs. Incentives of the magnitude proposed by the Company threaten public acceptance of the State’s energy efficiency goals and jeopardize the long-term sustainability of energy efficiency programs. According to a study by the American Council for an Energy-Efficient Economy, financial incentives associated with DSM programs provided to utilities in other states are typically in the range of 1% – 8% of total program costs, and many states do not provide any such incentives. (TR 4700)

The appropriate level of incentives depends on a number of factors, including the degree to which the utility itself is creating and implementing the programs, the extent of competing energy efficiency programs that may make it more difficult for utility goals to be achieved, and the aggressiveness of the targets. In addition, financial penalties would also be appropriate, in the event that the Company does not achieve minimal goals. (TR 4700-1)

The PSC is expected to establish a framework for incentives applicable to utility DSM programs as part of Case 07-M-0548, and therefore determination of the financial incentives applicable to a DSM program administered by Con Edison should await the outcome of that case.

4. The CPB’s Proposal

The PSC should take action in this proceeding to ensure that an interim DSM program for Con Edison’s electric operations is developed through a collaborative proceeding, on a schedule that would permit PSC approval in March 2008. This would ensure that there is no gap in the availability of DSM programs to Con Edison's customers and that progress in achieving the State's energy goals continues. (TR 4701) This initiative should be based mainly, if not exclusively, on the existing system-wide program currently conducted pursuant to Con Edison's rate plan, as well as other NYSERDA-administered programs that have been found to be highly cost effective. It should also reflect a substantial expansion in program funding beyond current levels. Reliance on existing programs will minimize planning and start-up costs and help ensure that expanded programs are in place by April 1, 2008. (TR 4702)

Upon issuance of the PSC's Order in Case 07-M-0548, another collaborative proceeding should commence to establish a long-term DSM program. This effort should address all aspects of program size, individual program elements, incentives and measurement and evaluation of program effectiveness. The resulting program should be fully consistent with the Commission's determination in the generic proceeding, with proper recognition of utility-specific needs and circumstances, and should be in place by January 1, 2009.

Con Edison opposes this proposal, arguing that there is a need to move quickly and the collaborative proceeding would delay timely implementation of DSM programs. (TR 3019) The State's energy efficiency goals will only be achieved if consumers, who will make the decisions on whether to purchase and implement energy efficiency products and services, fully understand the available options and how they will benefit, and have confidence in the entities providing these programs. Con Edison's proposal creates the risk that consumers will be confused in the transition between today's programs, those outlined by the Company, and the long-term programs that will result from Case 07-M-0548. Such confusion would jeopardize achievement of the State's energy efficiency goals. The CPB's proposal, under which existing programs will be expanded, and then changed only after completion of the full investigation that is currently underway, offers the best opportunity to continue to raise awareness and expand energy efficiency opportunities available to consumers, while minimizing confusion. It should be approved by the PSC.

B. Revenue Decoupling

An RDM to remove the financial disincentive that the Company might otherwise have to promote energy efficiency should be in place for Con Edison's electric operations by April 1, 2008. The specific RDM proposed by the Company should be modified in several respects, and we recommend that it be considered as part of the collaborative proceeding for an interim DSM program proposed above.

1. RDM Structure

The Company proposes an RDM, which it refers to as a Revenue Accounting and Rate Incentive Mechanism ("RARIM"), to reconcile revenues on a revenue-per-customer basis. The Company would be at risk for electric sales variations resulting from weather as well as deviations in the number of customers from forecast levels.

The CPB generally supports Con Edison's proposal, with the exceptions identified below.[49] As our expert testified, a well-designed RDM should not inherently disadvantage or advantage consumers or the utility in comparison with traditional

[49] The CPB did not, however, evaluated the Company's proposed methodology to quantify the impact of weather on actual delivery volumes.

ratemaking. (TR 4703) Regarding whether the Company should be at risk for deviations from projections of normal weather, as it is currently, the CPB observed that Con Edison's proposal would not inherently advantage or disadvantage either consumers or the utility, since rates are established based on projections of normal weather. (Id.) Similarly, a well-designed RDM should not jeopardize other policy objectives, such as a strong economy. (TR 4704) Utilities should continue to have an incentive to encourage and facilitate economic development by increasing the number of customers beyond forecast levels. An RDM that reconciles revenue-per-customer, such as proposed by Con Edison, would provide that incentive, without inherently favoring customers or the utility since rates are established based on reasonable projections of the number of customers. (Id.)

The Company does not fully explain the details of its proposed RDM. Substantial care must be taken in the design of an RDM to ensure that it protects consumer interests. The data and methodology used must be readily verifiable, directly observable and not unduly impacted by anomalous events such as billing adjustments. A transparent and straight-forward methodology would enhance verification and acceptance of the RDM. (TR 4706)

The RDM must be constructed and implemented in a manner that prevents large accruals that would have a substantial impact on customer bills, thereby avoiding customer confusion and the potential loss of support for energy efficiency programs. We recommend monthly tracking of accruals, as well as immediate bill credits or surcharges if cumulative amounts equal or exceed $10 million. (TR 4704-5)

The RDM should also be carefully monitored so that any implementation concerns can be readily identified and addressed. The RDM adopted in this proceeding effective April 1, 2008, should be evaluated during the rate year as part of the long-term DSM collaborative identified above, and any recommended changes should be presented to the Commission. (TR 4706)

The Company proposes to use the RARIM to reconcile costs including interference expense and property taxes. (TR 2448) An RDM should not be used for this purpose. Those expenses are completely unrelated to energy usage and have no effect on the Company's willingness to implement DSM measures. They should be treated in accordance with applicable PSC policies. (TR 4707)

2. RDM Timing

An RDM should be in place by the beginning of the rate year. (TR 4706) Without such a mechanism in place, utilities have the incentive and opportunity to take action that is contrary to the State's energy efficiency goals. That action would diminish the value of consumer expenditures on energy efficiency, including those made by Con Edison's customers through the Company's rates and the System Benefits Charge, and may jeopardize consumers' acceptance of ratepayer funded DSM activities. (TR 4705-6) It is particularly important that an RDM be in place beginning April 1, 2008, since we propose an expansion of ratepayer funded energy efficiency programs to be effective at that time. To achieve this goal, the details of an RDM could be considered as part of the collaborative proceeding for an interim DSM program that we propose above.

VI. MISCELLANEOUS

A. Outage Notification Incentive Mechanism

Con Edison's current regulatory plan includes a service quality incentive mechanism referred to as the outage notification incentive mechanism ("ONIM") that assesses, among other things, the Company's performance in notifying customers of service outages. This mechanism measures the Company's performance in communicating with customers, the public, and other parties during electric service outages. The measured activities include updating the information reported on Con Edison's telephone broadcast message; notifying affected hospitals, nursing homes, government officials and customers that rely on life-sustaining equipment; and issuing media releases. It establishes time limits for these activities and identifies specific information that must be included in each communication.

The ONIM also includes a structure for calculation of payments for the benefit of customers, in the event of nonperformance. For each failure to complete an activity within the required time or to include required information in the communication, Con Edison is required to pay $150,000, up to a maximum of $2.0 million for each rate year.

In approving this measure, the Commission stated that it

> provides adequate assurances that the public, local and state governmental officials and sensitive customers are informed about significant outages in a timely and effective manner….While good communication cannot alleviate the physical consequences of an outage, it can assure the public that the company is aware of the problem and taking actions to reinstate service.[50]

[50] Case 00-M-0095, Order Approving Outage Notification Incentive Mechanism, April 23, 2002, p. 4.

The ONIM has not achieved these objectives. As demonstrated by the July 2006 outage in the Company's Long Island City ("LIC") Network, Con Edison failed to provide accurate and timely information to consumers and elected officials regarding the scope and expected duration of that outage. (TR 4708) The DPS Staff Report summarizing the investigation of that event concluded that Con Edison did not update its telephone broadcast message in a timely fashion, public officials were not contacted timely, and the utility's communications did not include the estimated number of customers affected. As a result, DPS Staff concluded that the Company was liable for $300,000.[51] Con Edison asserts that it has complied with the ONIM and that it is not liable for any payments under that mechanism.[52]

It is critically important during an outage to provide all customers with current and accurate information so they can make important decisions, such as whether to remain in their homes and businesses or to make alternative arrangements. It is apparent that for the LIC outage that the ONIM did not ensure that outcome. The Company's poor communications regarding that outage as well as the Washington Heights outage in 1999, justifies a substantial increase in the monetary limits applicable to this mechanism. To help ensure accountability, the CPB recommends that all such limits be increased by a factor of no less than ten.[53] Further, for each subsequent failure to comply with a particular ONIM measure, the financial consequences should be doubled.

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[51] Case 06-E-0894, DPS Staff Report on its Investigation of the July 2006 Equipment Failures and Power Outages in Con Edison's Long Island City Network in Queens County, New York, February 2007, p. 147.

[52] Case 04-E-0572, Letter from Con Edison to DPS Office of Consumer Services, September 29, 2006.

[53] DPS Staff recommends that the Company's financial exposure be doubled. (TR 3846)

In addition, new criteria regarding the accuracy of the Company's outage estimates, and a requirement for holding conference calls to brief public officials should be added to this mechanism.[54] (TR 4709-10)

In rebuttal testimony, Con Edison opposes the CPB and DPS Staff proposals for increased penalties. (TR 2038) Under the CPB's proposal, the Company would not be penalized if it provides the information that its customers require. Given the Company's unfortunate track record in the two most recent large outages affecting its system, the financial consequences for noncompliance should be increased as the CPB recommends.

B. Rate Design

Con Edison proposes to increase the customer charge for Service Classification ("SC") 1 – Residential & Religious Electric Service and SC 7 – Residential & Religious Space or Space and Water Heating Service, by approximately 29 percent. This would increase the amount the average residential customer would pay on an annual basis by approximately $41.16. (TR 4802)

The CPB's expert explained why there is no reason why the customer charge should be increased at all. The current customer charge of $11.78 per month is very close to the cost of serving the 2.6 million SC1 customers, estimated at $12.20 per month.[55] (Id.)

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[54] DPS Staff also recommends that the ONIM be revised to include the requirement that conference calls be held with public officials. (TR 3845)

[55] Although the customer cost for SC7 service is estimated to be $17.37 per month, only 16,000 customers are in this service classification. (TR 4803)

The CPB recommends that the SC1 and SC7 customer charges be maintained at their current levels, since there is only a small difference between the current charge and the cost based on the latest data. Moreover, the calculation of the cost of service is not an exact science and there is no need to set these charges precisely on the derived costs. (TR 4803) We understand that the Company did not submit rebuttal testimony on this recommendation.

CONCLUSION

For the reasons stated herein, the CPB's recommendations should be adopted.

Respectfully submitted,

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Chairperson and Executive Director

Douglas W. Elfner
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John M. Walters
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Dated: Albany, New York
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