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

DIRECT TESTIMONY AND EXHIBIT

OF

DOUGLAS W. ELFNER

Dated: September 7, 2007
Albany, New York

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Q. Please state your name and title.

A. My name is Douglas W. Elfner. I am the Director of Utility Intervention for the New York State Consumer Protection Board ("CPB").

Q. Dr. Elfner, please summarize your education and employment experience.

A. I received a B.A. with honors and distinction in economics and mathematics from the University of Delaware in 1976, and a Ph.D. in Economics from the University of Michigan in 1982. From 1982 through 1984 I was an Assistant Professor of Economics at the University of Vermont, where I taught courses in econometrics and microeconomics. I was employed from December 1984 to January 1989 by AT&T in Bedminster, New Jersey, where I held positions of increasing responsibility as an Economist in the Market Analysis and Forecasting organization. My responsibilities included developing revenue and quantity forecasts for existing services; analyzing opportunities for new services and the effects of changing the price and rate structures of existing services; and producing forecasts and market analyses for regulatory purposes.

Since January 1989, I have been employed by the New York State Consumer Protection Board. As Director of Utility Intervention, I am responsible for all aspects of analysis, policy development, and advocacy on behalf of New Yorkers regarding the regulation of utilities.

I am a member of Phi Beta Kappa, the American Economic Association and the National Association of Business Economists. I have presented original papers at conferences sponsored by the American Economic Association and the Econometrics Society.

Q. Have you previously testified before the Commission?

A. Yes. I have testified in numerous cases before the New York State Public Service Commission.

Q. What is the purpose of your testimony?

A. I provide an overview of the CPB's positions and recommendations in this proceeding and briefly summarize the topics covered by other CPB witnesses. I also address several issues directly affecting Con Edison's revenue requirement including infrastructure investment, depreciation expense and amortization recovery periods. In addition, I discuss a number of policy issues including demand side management, revenue decoupling and the outage notification incentive mechanism.

Q. Are there any Exhibits associated with your testimony?

A. Yes. Exhibit___(DWE) contains a copy of the response to information requests that I reference in this testimony.

Summary of Position

Q. Please summarize briefly the CPB's position on the rate filing by Consolidated Edison Company of New York, Inc. ("Con Edison" or the "Company").

A. On May 4, 2007, Con Edison filed tariffs and testimony supporting its request for a delivery rate increase of $1.225 billion, representing 34% of current delivery revenues. (Calculated from Exhibit___(AP-9), Schedule 1) The testimony of CPB witnesses addresses some, but not all, of the revenue requirement and policy issues raised by Con Edison's filing. Numerous significant adjustments are required to be made to that filing to reflect reasonable projections and proper ratemaking practices. Overall, the Company's proposal substantially overstates its revenue requirement and does not properly address several important policy issues.

Q. Please identify the other witnesses testifying on behalf of the CPB in this proceeding and the topics they address.

A. The CPB is sponsoring the testimony of two witnesses or panels in addition to this testimony. Mr. Helmuth W. Schultz, III, CPA, and Ms. Donna M. DeRonne, CPA, of Larkin & Associates, PLLC, a Certified Public Accounting and Regulatory Consulting Firm, demonstrate that the Company has substantially overstated its revenue requirement, particularly in the areas of labor expense, interference and operations and maintenance programs, and that numerous significant adjustments to the Company's projections are required.

Mr. Tariq N. Niazi, the CPB's Chief Economist, is submitting testimony addressing the rate of return on equity that should be authorized for Con Edison, as well as a rate design issue. Mr. Niazi demonstrates that the Company has significantly overstated its required return on equity and that changes to its proposed rate design are required.

<u>Infrastructure Investment</u>

Q. Please summarize the Company's proposal regarding infrastructure investment.

A. One of the main determinants of Con Edison's proposed $1.225 billion rate increase is its projected increase in capital spending and operations and maintenance ("O&M") expense for upgrading, reinforcing and replacing its infrastructure. As explained by its witness Mr. Edward J. Rasmussen, the Company "plans to spend approximately two billion dollars annually over the next several years" in this effort. The depreciation and carrying cost on the additional investment proposed for the rate year make up $235 million of the requested rate increase (approximately 20%). The Company's proposal to increase O&M expenses "related primarily to programs to support, upgrade and maintain its infrastructure," constitutes another $280 million, or 23%, of the requested rate increase. (Direct Testimony of Mr. Rasmussen, p. 8)

Q. What is your reaction to this proposal?

A. Substantial increases are required in Con Edison's capital spending as well as associated O&M to provide for growth of the Company's system and to help ensure safe and reliable service. Nevertheless, the Company's proposed infrastructure spending is extraordinary. The proposed level of capital spending in calendar year 2008 is 75.7% higher than the average in the five-year period ending 2007. (Calculated from Exhibit___(IIP-1), p. 6) It far exceeds spending levels proposed in the last rate case that the Commission characterized as "extremely large." (Case 04-E-0572, Order Adopting Three-Year Rate Plan, March 24, 2005, p. 38)

Q. Before presenting your specific recommendations, do you have any other general observations regarding this proposal?

A. Yes. Utilities have a powerful incentive to undertake capital expenditures since it increases their rate base. Their authorized profits are the product of the dollar value of rate base and the rate of return approved by the regulator. Careful scrutiny of Con Edison's request is required to ensure that proposed capital expenditures are necessary.

Generally speaking, the PSC's oversight and regulation of Con Edison's infrastructure spending in the last decade has not been adequate to protect consumers. Currently, for example, the PSC permits Con Edison to recover from ratepayers capital spending that exceeds the levels on which rates are based, apparently without an examination to ensure that the investment is necessary and/or funds are spent in an efficient manner. Although the Company's infrastructure spending has increased substantially, particularly since 2002, it has not always resulted in the reliable service that customers expect. In general, I share the view expressed by DPS Staff in their report regarding the Long Island City outage, that "the benefits and gains from the spending, albeit resulting in many equipment upgrades and system improvements, have fallen short of … expectations." (Case 06-E-0894, DPS Staff Report, February 2007, p. 129) While the current regulatory mechanism facilitates investment that the Company believes is necessary to provide safe and reliable service, neither that approach, nor PSC oversight, has ensured that capital improvements are made in a cost effective manner or that they meet the needs of Con Edison's customers.

A comprehensive new approach to the Commission's oversight and regulation of Con Edison's electric infrastructure is required to achieve these objectives, particularly given the Company's plans to spend $10 billion in the next 5 years. Subsequent network upgrades such as the much publicized planned installation of superconducting cables, may obviate the need for some of that planned investment, or may render it worthless shortly after it has been made.

Q. What changes in the Commission's oversight and regulation of Con Edison's infrastructure do you propose?

A. I recommend two main changes. First, in proposing transmission and distribution ("T&D") infrastructure investment, 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 a demand side management solution(s). Utilities currently have little, if any, incentive to consider or implement demand side alternatives to T&D investment, since such solutions do not augment rate base. Therefore, the Commission must ensure that utility submissions on this issue are carefully reviewed.

Second, the PSC must immediately commence a comprehensive independent audit of Con Edison, with a focus on the Company's capital investment in relation to the needs of its customers. The Public Service Law ("PSL") explicitly provides the Commission authority to use this critically important tool, and in fact, requires the PSC to do so at least once every five years. It states that 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." (PSL §66(19)) 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, 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.
>
> (Laws 1976, ch 556 §1)

Despite this, the PSC has not conducted such an audit of Con Edison in at least 15 years. Moreover, 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. The CPB urged the Commission to comply with this provision of the PSL in Case 06-E-0894. (Initial Comments of the New York State Consumer Protection Board, March 2, 2007, pp. 18 – 20) No action on that recommendation has yet been taken. The CPB recently filed a Petition in that case in which we renewed that recommendation. (Case 06-E-0894, et al, Petition for Rehearing and Clarification of the New York State Consumer Protection Board, August 20, 2007)

Q. Do you have any recommendations regarding specific projects proposed by the Company?

A. I have not analyzed each of the Company's proposed infrastructure and O&M projects. As explained below, I have concluded that one large proposed project should not be approved at this time, and several other recommended adjustments are made by CPB witnesses Mr. Schultz and Ms. DeRonne.

Q. What large proposed project should not be implemented at this time?

A. The Company has proposed to implement an Advanced Metering Initiative ("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. Con Edison includes in its revenue requirement projection, $59 million in capital and $10.331 million in O&M costs associated with this project. (Testimony of Customer Operations Panel, pp. 6-10; Exhibit___(CO-1))

AMI can help reduce the costs of meter reading; increase meter accuracy; reduce the number of estimated bills, thereby reducing 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. Overall, it has the potential to reduce costs for customers and enable environmental benefits.

The PSC has issued an order stating that it will "establish and manage the development of [advanced metering infrastructure]," and it directed Con Edison and other utilities to file a comprehensive plan for development and deployment of advanced metering. Those proposals are required to include an analysis of cost savings as well as deployment schedules and outreach and education proposals. (Case 04-E-0952, et al, Order Relating to Electric and Gas Metering Services, August 1, 2006, pp. 13-14) Con Edison submitted its proposal on March 28, 2007.

Although I am not aware of any PSC action on Con Edison's proposal in that proceeding, the Commission has established a procedure for its review, and has apparently been assessing it for more than five months. The Company's AMI proposal in this proceeding would prejudge the outcome of that 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. Accordingly, Con Edison's proposal in this proceeding should be rejected at this time, and its projected capital and O&M costs for this project should be removed from the revenue requirement projections used to establish rates in this proceeding. The Company should, however, be permitted to recover the costs of its AMI-related pilot programs.

Q. Apart from your recommendation regarding AMI, and the proposals by CPB witnesses Mr. Schultz and Ms. DeRonne, do you have any other recommendations regarding Con Edison's proposal infrastructure investment?

A. Yes. There is substantial doubt that all spending proposed by the Company is necessary in the rate year. If projects proposed by the Company are necessary to provide safe and reliable service, why were they not undertaken to some degree?

Moreover, it is not obvious that Con Edison could in fact complete all of its proposed projects on the schedule it identifies, to say nothing of completing the projects in an efficient manner. The Company is not increasing its workforce commensurate with the projected increase in capital spending. Further, funds provided for capital projects should be used for that purpose. This is of particular concern given the Company's proposal that the T&D true-up mechanism included as part of its current rate plan, be discontinued. (Testimony of Mr. Rasmussen, p. 3) Under that mechanism, if the actual level of T&D investment falls short of projected amounts, the difference would be credited for the benefit of customers. (Case 04-E-0572, Joint Proposal, December 2, 2004, Section D.3) Under the Company's proposal, rates would reflect extraordinary increases in projected capital spending, but Con Edison would not be accountable for spending the funds on infrastructure. It could simply retain them as additional profit.

I recommend that for purposes of establishing rates for the rate year, the Commission adjust the Company's proposed level of infrastructure spending. As a starting point, the Commission should adopt the CPB's infrastructure-related recommendations including removal of the AMI program. 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 certain outages. Issues concerning the prudence of Company actions, and the extent to which ratepayers should fund the costs of complying with those directives in the Long Island City network, are the subject of Case 06-E-0894.

Overall, I recommend that the PSC establish rates to reflect an increase in infrastructure investment beyond the Company's budget for the year ending March 31, 2008, but at a level that is approximately 20% less than proposed by the Company for the rate year. Con Edison would be responsible for prioritizing investment projects to meet the needs of its customers within that budget. To protect ratepayers, I also recommend that 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 returned to ratepayers in the next rate year. The intent of this proposal is to recognize that 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 in a cost-effective manner.

The Commission should also take action to ensure that the procedures it uses to assess Con Edison's construction program activities are overhauled, as discussed above. That effort should be completed in time for the results of the audit to be considered in the summer of 2008, as part of a review of rates for Con Edison's electric operations for the rate year beginning April 1, 2009.

Depreciation Expense

Q. What is the Company's proposal regarding depreciation expense?

A. The Company proposes to increase the provision for depreciation expense for its electric plant from $349.467 million under existing depreciation rates, to $394.615 million under proposed rates, an increase of $45.15 million (13%). (Exhibit ___CH-1, p 3) Two main factors causing the projected increase are new service lives and net salvage factors.

Q. Please explain the Company's proposed new service lives.

A. Company witness Mr. Charles D. Hutcheson proposes to change the service lives of 12 of the Company's primary plant accounts or sub-accounts, which would increase annual expense by approximately $8.0 million. (Testimony of Mr. Hutcheson, p. 8) Proposed changes to

Underground Transformers and Station Equipment generate $7.1 million of that $8.0 million.

Q. Please explain the Company's proposal to change estimates of net salvage.

A. As electric plant is retired, the Company obtains the salvage value of that plant, but must pay costs to remove it. The net of these two items is referred to as net salvage. Company witness Mr. Hutcheson proposes to revise estimates of net salvage for many plant accounts, increasing overall depreciation expense by $37.2 million. (Testimony of Mr. Hutcheson, p. 15)

Q. Should those changes be approved by the Commission?

A. No, they should not. In this case, the Company is proposing an increase in its delivery rates of approximately 34%. In view of the extremely large proposed rate increase, the Company's proposed methodological and procedural changes should only be approved upon a finding that current service lives and net salvage estimates are inadequate to provide for the Company's recovery of its capital costs. There is no evidence of a capital recovery crisis that would justify augmenting an already steep rate increase proposal.

Q. Is it your testimony that the methods and procedures for calculating depreciation expense that are currently in place for Con Edison are superior to those proposed by Mr. Hutcheson?

A. No. I am not expressing an opinion as to whether any particular methodology is theoretically preferable to any other. The question I have addressed is whether the Company's need for depreciation-related changes proposed in this case is sufficient to justify the resulting rate increase for consumers. In my judgment, the answer is no. Accordingly, I recommend that the Commission reject Con Edison's proposed changes to service lives and net salvage, thereby reducing the Company's projection of depreciation expense by $45.2 million.

Q. Do you have any other recommendations regarding depreciation expense?

A. Yes. The Company has proposed to recover a projected $626.7 million accumulated depreciation deficiency over 15 years, further increasing annual depreciation expense by approximately $41.8 million. (Testimony of Mr. Hutcheson, p. 28) This projected deficiency is based on the Company's proposed changes to average service lives and net salvage percentages. However, as explained above, use of such assumptions is unwarranted at this time. Using current average service lives, net salvage percentages and life tables, the accumulated depreciation reserve deficiency is approximately $275.7 million. (Exhibit___(CH-1), p. 3) This is less than 8% of the total reserve for depreciation, and thus is within a 10% band that is considered reasonable as a test of adequacy of the accumulated provision for depreciation. There is no need at this time to recover that deficiency. Therefore, I recommend that the Company's proposal to recover the accumulated deficiency in current rates be rejected, thereby reducing depreciation expense by another $41.8 million. Overall, my recommendations reduce projected depreciation expense by $87.0 million.

Recovery of Deferred Costs

Q. Please summarize Con Edison's proposals to recover certain deferred costs over time.

A. The Company proposes to recover three categories of costs it has incurred or will incur in the rate year: those related to the attack on the World Trade Center, carrying charges on transmission and distribution investment, and environmental remediation costs. It proposes to recover these over a three-year period, thereby increasing rate year revenue requirement by approximately $37.27 million, $52.62 million, and $50.00 million, respectively.

Q. Please explain the Company's proposal regarding World Trade Center-related costs.

A. The Company asserts that it will not recover all of the costs it has incurred to restore its facilities in lower Manhattan that were damaged as a result of the attack on the World Trade Center, either from the federal appropriation for reimbursing utilities or from insurance carriers. It proposes to recover the remaining expenditures and carrying charges incurred through March 31, 2008, over a three-year period, which would have the effect of increasing rates by $37.27 million in the rate year. (Rasmussen, pp. 21 - 22; Accounting Panel, p. 92; Exhibit___(AP-9), Schedule 4)

Q. What is your position on this proposal?

A. The Commission should carefully consider whether these costs should be recovered from ratepayers at this time. We understand that the Company continues to have an opportunity to seek recovery of these costs from funds made available by the federal government. In particular, the deadline for application and submittal of cost documental for costs designated as Category 3, concerning the relocation of Company facilities, is December 31, 2007, and “may be extended if redevelopment efforts remain unresolved at that time and if program funds are still available to address costs under this category.” (Lower Manhattan Development Corporation, Partial Action Plan S-2 for Utility Restoration and Infrastructure Rebuilding, p. 12) Until all such funds have been fully encumbered and appeals by Con Edison or on its behalf have been denied, it would be premature for the Commission to commit to having ratepayers fund those costs. In the meantime, they can continue to be deferred by the Company.

Should the Commission determine, however, that recovery of those costs should commence, I recommend that they be recovered over a much longer period of time than the three years proposed by the Company. Recovering these costs over ten years would help mitigate the impact on customers of the large rate increase proposed in this proceeding.

Q. Please summarize Con Edison's proposal regarding recovery of certain Transmission and Distribution costs.

A. Under Con Edison's current rate plan, the Company is permitted to incur capital costs in excess of amounts provided for when rates were established, and to defer those amounts for future recovery from ratepayers. The Company calculates that it has accrued $157.69 million of carrying charges on those expenditures, and proposes to recover that amount over three years. That proposal would increase rates by $52.623 million in the rate year. (Testimony of Accounting Panel, p. 92; Exhibit___(AP-9), Schedule 4)

Q. What is your position on this proposal?

A. I recommend that these costs be recovered over a period of 10 years, to help mitigate the impact on customers of the large rate increase proposed in this proceeding.

Q. Please summarize your proposal regarding the recovery of MGP/Superfund costs.

A. Con Edison asserts that it will incur approximately $190 million in environmental remediation costs from March 31, 2007 through the end of the rate year, $149 million of which is the responsibility of the Company's electric operations. (Testimony of Mr. Rasmussen, p. 20) As explained in the testimony of CPB Witnesses Mr. Schultz and Ms. DeRonne, the Company has not provided adequate support for that estimate, and accordingly, recovery of those projected costs from customers should not commence.

Alternatively, if the Commission is convinced that the support for all or a portion of the Company's estimate of MGP/Superfund costs is adequate, it could establish a mechanism to begin to recover the documented costs attributable to electric operations, subject to the conditions described in the testimony of Mr. Schultz and Ms. DeRonne. However, to help mitigate the impact on customers of the large rate increase proposed in this proceeding, those costs should be recovered over a period of 10 years, instead of three years as proposed by Con Edison.

Q. What is the total impact of your recommendations regarding the Company's proposals to recover deferred costs?

A. These recommendations would reduce the Company's rate year revenue requirement by approximately $109 million.

Demand Side Management

Q. Please summarize the Company's recommendations regarding demand side management.

A. Con Edison witness Ms. Rebecca Craft explains the Company's demand side management ("DSM") proposals, which encompass energy efficiency and demand response programs. The Company proposes a new DSM program, to be administered by the utility, to achieve installed permanent demand reductions of at least 500 MW by 2016.

In the next three years, Con Edison proposes to contract for at least 250 MW of permanent DSM. 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.

Q. What is your position on these recommendations?

A. The CPB commends Con Edison for embracing New York State's electricity demand reduction goals and making a constructive proposal to achieve those objectives. It is critically important that additional efforts to achieve those goals commence as soon as possible.

However, I have several concerns with Con Edison's proposal, including the size of the program, the specific program elements, and the proposed incentive. For the reasons explained below, I recommend that the Company's DSM proposal not be adopted at this time. Instead, I outline a DSM program that should be in place before the end of the current rate year, and a procedure for establishing a long-term program.

Q. Please elaborate on your concern regarding the size of the DSM program.

A. 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. (Testimony of Ms. Craft, p. 6)

The 500 MW proposal, which would be funded entirely by ratepayers, was apparently developed without any consideration of ways in which DSM goals may be achieved without ratepayer funding, at least of the magnitude proposed by the Company. For example, current investment in energy efficiency falls short of optimal levels because of informational and financial barriers faced by consumers. Consumers do not have access to complete and accurate information regarding the costs and benefits of energy efficiency investment. Additional efforts to provide that information to consumers on a consistent basis, such as calculations of savings achieved by consumers residing in similar housing stock, would likely encourage additional private sector investment in energy efficiency. Similarly, consumers' reluctance and inability to invest in cost-effective energy efficiency because of the initial investment required might be addressed through new creative financing approaches, such as those which allow consumers to repay loans from their energy bill savings. A portion of DSM goals could also be achieved by changing the energy efficiency aspects of building codes as well as adopting new, stronger energy efficiency standards for appliances and equipment.

The appropriate size of utility DSM programs is being addressed generically in Case 07-M-0548: Proceeding on Motion of the Commission Regarding an Energy Efficiency Portfolio Standard. The CPB, Con Edison and other parties are participating in that proceeding, and a decision on the appropriate size of Con Edison's DSM program should await a PSC determination in that case.

Q. Please further explain your concern regarding the details of Con Edison's DSM proposal.

A. The Company proposes an overall budget for 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 contained in one and one-half pages of the testimony of Ms. Craft. (pp. 14 – 15) She identifies several types of programs, which the Company characterizes as being "similar" to the programs it implemented from 1988 – 1998, under its "Enlightened Energy" initiative. 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.

The information provided by Con Edison is not of sufficient detail to warrant support. A decision on the specific DSM initiatives that should be conducted by Con Edison, should await the PSC's determination in Case 07-M-0548.

Q. What is the Company's proposed incentive for achieving DSM goals?

A. Con Edison proposes a three-part incentive. First, it would receive an incentive based on "net resource benefits," which is the present value of the estimated avoided costs, including energy and capacity costs, associated with the DSM measures installed each year, reduced by the program costs associated with installation of those measures. The Company proposes to retain 20% of the net resource benefits associated with demand reductions it achieves up to its annual goal, and 30% of those from demand reductions exceeding that goal.

Second, the Company wants to continue the incentive it receives under its current rate plan, a flat payment for demand reduction achieved of $22,500 per MW, adjusted for inflation. Third, Con Edison proposes to retain the value that any greenhouse gas reductions would have in a market. The Company does not propose any financial penalty should it fail to achieve its goals.

Overall, 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. 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.

Q. Please explain why you consider such an incentive to be grossly excessive.

A. If, over the first three years of its program, Con Edison achieved the demand reduction goals it identified, it would claim an incentive of $91.4 million under the net resource benefits segment of its proposal (NYC 244), and $3.1 million under the per MW incentive (calculated from Exhibit___RC-1), for a total of $94.4 million. I have not calculated the value of the third proposed incentive.

Over the same period, the Company estimates total DSM program funding of $103 million. (Exhibit___(RC-2) On that basis, the first two components of the proposed incentive alone represents 92% of total program funding. When administrative funding and labor costs included in revenue requirement are added to what the Company refers to as "program funding," the two elements of the proposed incentive equate to

77% of aggregate program costs. An incentive in this range is patently excessive.

Q. What is your position regarding incentives for DSM?

A. As a general matter, public utilities should operate in the public interest and are not entitled to positive financial incentives to achieve public policy objectives. However, the CPB recognizes that such incentives may be appropriate in certain circumstances, such as to achieve superior performance. In no event, however, should incentives be so large that they jeopardize the long-term sustainability of public policy programs.

By those standards, an incentive of up to 10% of total program costs for achieving aggressive targets might be reasonable. 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. (Aligning Utility Interests with Energy Efficiency Objectives: A Review of Recent Efforts at Decoupling and Performance Incentives, American Council for an Energy-Efficient Economy, Report Number U061, October 2006)

The appropriate level of incentives, however, 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. The PSC is expected to establish a framework for incentives applicable to utility DSM programs as part of Case 07-M-0548.

Q. What is your overall recommendation regarding DSM for Con Edison's electric customers?

A. Additional programs to help achieve the State's DSM goals should be in place by April 1, 2008, the beginning of the rate year. Current programs pursuant to Con Edison's rate plan may expire at that time. It is of critical importance that there be no gap in the availability of DSM programs to Con Edison's customers and that progress in achieving the State's energy goals continues. However, it appears that the PSC's generic proceeding on these issues may not be completed until the Spring of 2008, making it impossible to have in place a long-term DSM program that is consistent with that determination, until at least next summer.

Accordingly, I recommend that an interim DSM program for Con Edison's electric operations be developed through a collaborative proceeding, on a schedule that would permit PSC approval in March 2008. 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.

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.

Revenue Decoupling

Q. Please summarize Con Edison's proposed revenue decoupling mechanism ("RDM").

A. Con Edison witness Mr. Edward J. Rasmussen describes the Company's proposed RDM, which the Company refers to as a Revenue Accounting and Rate Incentive Mechanism ("RARIM"). He asserts that the proposal is intended to remove a financial disincentive that the Company might otherwise have to promote energy efficiency and to encourage continued economic expansion.

The proposed RARIM would 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.

Q. Do you agree with the Company's proposal?

A. I generally support Con Edison's proposal, with the exceptions identified below. However, I have not reviewed the Company's proposed methodology to quantify the impact of weather on actual delivery volumes, and have no comment on that issue at this time.

Q. What is your position on the Company's overall proposal to be at risk for weather-related electric sales variations and deviations in the number of customers from forecast levels?

A. The Company is currently at risk for these factors and it should continue to be so under an RDM. A well-designed RDM should not inherently disadvantage or advantage consumers or the utility in comparison with traditional ratemaking. Regarding weather, since rates are established based on projections of normal weather, the Company's proposal to be at risk for deviations from normal weather would not inherently advantage or disadvantage either consumers or the utility. Further, in principle, I agree with the Company's contention that it should have an opportunity to retain additional revenue resulting from hot weather conditions, since it is generally responsible for additional expenses associated with providing reliable service in those conditions.

A well-designed RDM should also not jeopardize other policy objectives, such as a strong economy. 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.

Q. Do you agree with the Company's proposal regarding how deviations between actual and projected revenue-per-customer would be reconciled?

A. The Company's testimony on this point is confusing. In initial testimony, Mr. Rasmussen proposed that when actual revenues fall short of projections, the resulting shortfall would be subject to real-time recovery by the Company, but the Company would retain overcollections to offset future shortfalls. (Direct Testimony of Mr. Rasmussen, p. 30) Subsequently, the Company stated that any revenue shortfall or excess would be surcharged or refunded to customers. (Supplemental Testimony of Mr. Rasmussen, p. 8)

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.

Q. What is the relationship between an RDM and an energy efficiency program?

A. The Company asserts that a revenue decoupling mechanism be "viewed in conjunction with the implementation by Con Edison of an energy efficiency program." (Supplemental Testimony of Mr. Rasmussen, p. 2) As explained above, however, a long-term DSM program for Con Edison may not be in place for many months after the rate year has commenced. Nevertheless, the CPB recommends that an RDM be in place no later than April 1, 2008.

Q. Please explain why an RDM should be implemented by the beginning of the rate year.

A. The purpose of an RDM is to remove utilities' financial disincentive to promote DSM. 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. 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.

Q. Do you have any other concerns about the Company's proposal?

A. Yes. 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.

As explained above, the RDM should be in place by April 1, 2008. Therefore, procedures should be established to fully address all aspects of the program in time for a PSC decision no later than March 2008. To achieve this goal, the details of an RDM could be considered as part of the collaborative for an interim DSM program that we propose above.

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.

Q. Do you have any other comments on the Company's proposed RARIM?

A. The Company proposes to use the RARIM to reconcile costs including interference expense and property taxes. (Direct Testimony of Mr. Rasmussen, p. 31) 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.

Outage Notification Incentive Mechanism

Q. Please summarize the outage notification incentive mechanism ("ONIM") that is currently applicable to Con Edison.

A. The regulatory plan for Con Edison's electric operations adopted by the PSC in 2000, included a service quality incentive mechanism that assesses, among other things, the Company's performance in notifying customers of service outages. The details of that ONIM were approved by the Commission in 2002, and it has been in place since.

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.” (Case 00-M-0095, Order Approving Outage Notification Incentive Mechanism, April 23, 2002, p. 4)

Q. Has the ONIM achieved these objectives?

A. No, 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. 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. (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) Con Edison asserts that it has complied with the ONIM and that it is not liable for any payments under that mechanism. (Case 04-E-0572, Letter from Con Edison to DPS Office of Consumer Services, September 29, 2006)

Q. What do you recommend?

A. It is critically important during an outage to provide all customers timely 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 10. Further, for each subsequent failure to comply with a particular ONIM measure, the financial consequences should be doubled. 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.

Q. Does this conclude your testimony?
A. Yes.

EXHIBIT