STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Case 08-E-0539 – Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Consolidated Edison Company of New York, Inc. for Electric Service.

Direct Testimony of a Panel Consisting of John Chamberlin, Don Bennett, and Brian Hedman

On Behalf of New York Power Authority

September 8, 2008

NYPA PANEL

I. INTRODUCTION AND PURPOSE OF TESTIMONY

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

A. [John Chamberlin] My name is John Chamberlin. My business address is The Cadmus Group, 28 E. Main Street, Suite A, Reedsburg, Reedsburg, Wisconsin 53959.

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

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

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

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

I joined PG&E Energy Services following the 1997 sale of the consulting company I co-founded: Barakat and Chamberlin, Inc. (“BCI”). This 150-person firm was a national leader in utility consulting for more than ten years. At BCI, I led the electric utility consulting practice, and personally managed numerous rate, cost of service and related assignments

for utilities throughout North America. I have appeared in numerous regulatory proceedings during the past 20 years, and have testified in several civil proceedings, and before several state legislative bodies. I am the author of four books, numerous published articles and hundreds of presentations on utility rate, cost of service and related issues. I hold a B.A. in Economics from California State University at Chico, as well as an M.A. and a Ph.D. in Economics from Washington State University. My resume is attached as part of Exhibit __ (NYPA-1).

[Don Bennett] I am an independent management consultant, providing financial and strategic management consulting services to the energy utilities industry and other infrastructure businesses. I have served the energy industry for 37 years, first as a financial executive and, for the last 15 years, as a consultant. I was a partner at Arthur Andersen, serving as the head of its National Utility Consulting Group before departing in 1997. Prior to entering consulting, I served in various financial management positions with The Southern Company, the electric holding company in Atlanta, Georgia. I have appeared as a witness before this Commission as well as the Federal Energy Regulatory Commission. I also have testified in several litigation proceedings, both in court and before arbitration panels. I have a Bachelor of Science degree in Industrial Management from the Georgia Institute of Technology (Atlanta, Georgia) and an M.B.A. from the University of North Carolina at Chapel Hill. My resume is attached as part of Exhibit __ (NYPA-1).

[Brian Hedman] I am a principal with The Cadmus Group, where I am responsible for utility rates, cost of service, and other regulatory services. Prior to joining The Cadmus Group in February 2001 (then Quantec, LLC), I was Manager of Regulation for PacifiCorp. I was responsible for the development of revenue requirements and demand side regulatory

policy. I have testified before the Federal Energy Regulatory Commission and the regulatory commissions in New York, Wyoming, Utah, Idaho, Montana, Oregon and Washington. I received a B.A. in Accounting from the University of Washington and an M.S. in Economics from Portland State University. My resume is attached as part of Exhibit __ (NYPA-1).

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

Q. What is the purpose of your testimony?

A. On behalf of the New York Power Authority ("NYPA"), the purpose of our testimony is to present the findings of our review and analysis of the rate case filing made by Consolidated Edison of New York, Inc. ("Con Edison" or "the Company") which gave rise to this proceeding before the New York Public Service Commission (the "Commission" or "NYPSC").

Q. Please summarize your recommendations for the Commission.

A. As described in detail below we recommend that the Commission:

1) Reject Con Edison's imputation of an unsubstantiated additional $15.1 million in alleged NYPA revenue deficiency
2) Require that Con Edison prepare a contemporaneous cost-of-service study or in lieu of that, allocate the final revenue requirement increase on an equal percentage basis across all customer classes
3) Assign NYPA its $17.1 million proportionate share of excess TCC revenues
4) Reduce projected expenditures on rate base by 20%
5) Authorize no higher than 9.1% return on equity
6) Reduce working capital by $54.2 million

7) Eliminate the EBCAP adjustment, reducing rate base by $201 million

Exhibit __ (NYPA-2) summarizes the revenue requirement impact of these recommendations. In total, our recommendations would reduce the Company's proposed revenue requirement increase by $211 million.

Q. Please describe the organization of your testimony.

A. First, we describe the proposal's highly inequitable cost apportionment on the NYPA and Economic Development Delivery Service ("EDDS") classes resulting from Con Edison's unorthodox two-step revenue allocation process (which relies on an outdated 2005 cost-of-service study) and recommend that the unsubstantiated NYPA revenue deficiency be eliminated. Second, we address the inequitable treatment proposed for NYPA and EDDS with respect to Transmission Congestion revenues and recommend to the Commission an equitable solution. Third, we summarize our analysis of the revenue requirement portion of the filing and present specific recommendations to the Commission.

Q. Please explain why you structured your testimony in this way.

A. While traditionally we would address the revenue requirement aspect of the rate filing first, we believe that the inequities we discovered in our analysis, stemming from the Company's proposed treatment of the NYPA and EDDS classes, on the issues of cost of service and TCC revenues, are particularly detrimental to NYPA and its customers and merit a heightened priority.

II. COST-OF-SERVICE MODEL AND REVENUE INCREASE ALLOCATION

Q. Do you agree with Con Edison's reliance upon a 2005 cost-of-service model to determine a revenue deficiency for the current proceeding?

A. No. Utility rates are set to recover the expected costs to provide the utility service. The rate year in the current proceeding is 2010. It is unlikely that the costs incurred in 2005 will bear any resemblance to the costs that will be incurred during the rate year. Similarly, the revenues used to develop the purported deficiency in the 2005 study are neither the current revenues, nor are they the revenues proposed for the rate year.

Q. Please explain why a cost-of-service study is needed.

A. There is little debate that the cost of providing electric service is the primary criterion for the reasonableness of rates. It is the regulator's role to establish the cost of providing service to each customer class and to set rates that allow the utility a fair opportunity to cover its costs and earn a return on its shareholders' investment based on the costs and revenues that are expected to be received during the period that the rates are in effect.

Q. Are you aware of any sources that lend support to these principles that you've outlined?

A. Yes. On page 389 of their 1988 book "Principles of Public Utility Rates" authors Bonbright, Danielsen and Kamerschen state "Without a doubt the most widely accepted measure of reasonable public utility rates and rate relationships is cost of service." On page 12 of the 1992 "Electric Utility Cost Allocation Manual of the National Association of Regulatory Utility Commissioners" ("NARUC Manual" or the "Manual") indicates that cost studies are used by regulators for the following purposes:

- To attribute costs to different categories of customers based on how those customers cause costs to be incurred.
- To determine how costs will be recovered from customers within each customer class.

- To calculate costs of individual types of service based on the costs each service requires the utility to expend.
- To determine the revenue requirement for the monopoly services offered by a utility operating in both monopoly and competitive markets.
- To separate costs between different regulatory jurisdictions.

Q. **Does the NARUC Manual describe the cost allocation procedure?**

A. Yes, the Manual devotes several chapters to describe the specific methodologies commonly used for both embedded cost studies and marginal cost studies. The Manual summarizes the process as:

> The total revenue requirement of the utility is attributed to the various classes of customers in a fashion that reflects the cost of providing utility services to each class. The cost allocation process consists of three major steps: functionalization of costs, classification of costs, and allocation of costs among customer classes.

Q. **How are total revenue requirements determined?**

A. NARUC defines total revenue requirements as the sum of the costs (including a fair return on investment) to serve all of the utilities various classes of customers.

Q. **Does the New York Codes, Rules and Regulations ("NYCRR") address cost of service?**

A. Yes, we think so. Section 16 NYCRR 61.3(a) states (in relevant part):

> (a) The utility whose rates, rules and regulations are being considered shall establish by competent testimony;
>
> (1) the annual revenues under the existing rates, rules and regulations that are being considered and under those which said utility proposes to charge;
>
> (2) number of units of service rendered (e.g., kilowatt-hours, M cubic feet, car miles and

car hours or telephone calls) **for each service classification involved**, actual and proposed; (emphasis added).

Section 16 NYCRR 61.3(b) states (in relevant part):

(b) Such utility shall establish by competent testimony:

(1) **the detailed cost of rendering the service to which such rates, rules and regulations are applicable**;

(2) the cost per unit of service rendered as defined in the preceding paragraph; (emphasis added).

Section 16 NYCRR 61.3(c) states (in relevant part):

(c) Such revenues and costs shall be:

(1) for each of the three years immediately preceding the initiation of the case (emphasis added)

These rules clearly indicate that there is a need to be able to compare the detailed cost of service for each service class to the revenues for those classes for each of the three years prior to the case.

Q. **Does Con Edison's revenue increase allocation methodology follow the Bonbright measure of reasonable rates, the NARUC Manual or the NYCRR?**

A. While we are not making a legal interpretation of the NYCRR, a layman's reading of the rule would seem that Con Edison has not done so and indeed has not even updated the cost-of-service study it prepared for the prior rate case, 07-E-0523. The rules appear to require that the proposed revenues be based on costs and that those costs be more contemporaneous than Con Edison is proposing. Con Edison's allocation of the proposed revenue increase is inconsistent with the NARUC guidelines and Bonbright principles in that they 1) allocate the

revenue increase on the basis of forecasted revenues rather than costs and 2) rely on an outdated cost-of-service study.

Q. **Please explain why you believe that forecasted revenues are not an appropriate basis for allocating the revenue requirement increase.**

A. Allocating the revenue requirement increase on forecasted revenues implicitly assumes that the costs that will be incurred by Con Edison during the rate period will be incurred by the customer classes in the same proportion as the costs that underlie the rates used to forecast the revenues.

Q. **For ratemaking purposes, is it proper to assume that future costs will be incurred in the same proportion as they were in the past?**

A. No. Such an assumption would be valid only when all customer classes are growing at the same rate and when all investment is proportional to existing rate base. It is highly unlikely that either condition is true very often or for any length of time. Consequently, it is vital that cost-of-service studies be updated frequently and that they match the period during which the rates will be in effect.

Q. **Please describe Con Edison's revenue requirement increase allocation process in more detail.**

A. Con Edison employs a two step revenue requirement allocation. In the first step Con Edison conducts a cost-of-service study based on an historic test period. The various components of rate base and operating expenses are functionalized and allocated to the customer classes using allocation factors that are based on cost drivers, such as kWh, kW and numbers of customers. In the current case, a cost-of-service study (developed for the prior case, 07-E-0523) was based on 2005 costs. in the first step, the cost-of-service study compares the allocated costs to revenues based on current rates applied to the billing

determinants of the historic period. This comparison indicates whether each customer class's revenues would have fallen short of or exceeded their costs had the current rates been in effect during the historic period.

A revenue deficiency or surplus is indicated when the calculated return on rate base exceeds a tolerance band around the return that would have been earned by the Company had the current rates been in effect during the historic period. The calculation of this revenue deficiency or surplus is the first step in the two step process.

Q. Why is a tolerance band employed?

A. Cost-of-service studies are developed based on assumptions about the underlying cost drivers such as the demand a customer or customer class places on the system during the time that the system peaks or the total energy that a customer purchases through the system. The use of a tolerance band reflects the realization that both the impacts that these drivers actual have on the system and the measurement of the drivers themselves cannot be determined precisely.

Q. The 2005 cost-of-service study employed a 10% tolerance band. Is that a reasonable band to assume in this case?

A. No. The rate year in this case is 2010, five years distant from the period of the cost-of-service study. Such a time difference suggests that precision with which the cost-of-service study reflects the actual costs that will be incurred during the rate period is greatly diminished. We suggest that it is improper to base rates upon a 2005 cost-of-service study, however, if the study is used the tolerance band should be expanded to reflect this additional uncertainty.

Q. **Has the New York Commission previously relied upon a cost-of-service model developed for a prior case to determine rates in a current case?**

A. We have found no evidence that the Commission has ever relied on a re-used cost-of-service model. Con Edison also indicates that they are not aware of any such occasion. See Exhibit __ (NYPA-3).

Q. **Please describe the second step in the revenue requirement allocation process?**

A. The second step is the actual allocation of the revenue requirement increase. Con Edison does not allocate the revenue requirement increase based on the projected costs of each customer class; rather, the Company allocates the increase based on the forecasted revenues for each class adjusted by the revenue deficiency or surplus identified in the first step. Con Edison forecasts each customer class energy and demand for the rate year. The Company then applies the rates currently in effect to those forecasted demand and energy values to forecast the revenues for each customer class. The revenue deficiency or surplus identified in the first step is then added to the forecasted revenues to create the total revenues by class. The proportion of these total class revenues to the total system revenues is then used to allocate the revenue requirement increase to each customer class.

Q. **Does that complete the two-step process?**

A. Not quite. After the revenue requirement increase is allocated to each customer class the revenue deficiency or surplus (from the first step) is added to the allocated revenue requirement increase to form the total increase proposed for each customer class. Consequently, the identification of a revenue deficiency in step one has a multiplicative impact on the overall increase proposed for that class. It has a direct impact in that it is added to any allocation of the proposed revenue requirement increase and it has an indirect impact in that it is added to the revenues used to create the allocation percentage.

Q. **Is this method of allocating revenue requirements commonly accepted in the industry?**

A. No, in fact we are unaware of any other utility in the nation that uses such a method.

Q. What is the total revenue deficiency that Con Edison has incorporated into the proposed allocation of revenues to NYPA?

A. The total "deficiency" that Con Edison seeks from NYPA is $30.2 million. This is comprised of two parts:

a. a deficiency of $15.1 million is built into the revenues shares for NYPA from the immediately prior rate case. This deficiency will continue (under the Con Edison proposal) into the current case.

b. Con Edison proposes to add an additional $15.1 million. This second $15.1 million is the portion of the alleged deficiency in the last case that was denied by the NYPSC in the final order. Somehow, Con Edison believes it is entitled to recover this additional amount, even though the Company does not even make an attempt to show that NYPA is producing a current revenue deficiency, nor does the Company make an attempt to show that NYPA will produce a deficiency during the period that the rates will be in effect. See Exhibit __ (NYPA-4). We will discuss each of these sources of "deficiency" in turn.

Q. **So then how does Con Edison justify the inclusion of a $15.1 million revenue deficiency in addition to the $15.1 million embedded in current rates?**

A. While they reiterate that they have not conducted a more recent cost-of-service study, the Company indicates that it is their belief "that the 2005 Embedded Cost of Service ("ECOS") study indicates that there is a remaining NYPA deficiency for the rate year beginning April 1, 2009". See Exhibit __ (NYPA-5).

Q. **Did you prepare an updated cost-of-service study for the NYPA class?**

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A. Yes. We developed an updated cost-of-service study that included updated allocators and cost-of-service data from the FERC Form 1. The cost-of-service study is based on allocators updated for NYPA load research and as such reflects only NYPA's updated cost.

Q. **Please describe the cost-of-service allocators that you updated.**

A. NYPA conducts an on-going study of its loads and provides the information to Con Edison for use in Con Edison's class demand study. We used NYPA's data along with Con Edison's system peak data to calculate a revised transmission demand allocator. The D03 allocator declined from 13.71% in Con Edison's 2005 cost-of-service study to 12.59% in 2007.

Q. **Was this decline expected?**

A. Yes. The D03 allocator measures the class contribution to Con Edison's peak demand hours. Con Edison has indicated that one of the primary drivers of its demand growth is residential room air conditioning, see Exhibit __ (NYPA-6). The increased use of air conditioning shifts additional demand into the summer months, where Con Edison's peak occurs. The increased air conditioning load tends to decrease NYPA's relative contribution to the summer peak.

Q. **Did you update the other allocation factors?**

A. Yes. The revenue allocator (R01) and kWh allocator (K01) were updated based on the Company's response to New York City's interrogatory request ("IR") 24, see Exhibit __ (NYPA-7). The Company declined to provide the detailed meter data required to determine the high tension (D04) and low tension (D09) allocators, see Exhibit __ (NYPA-8), consequently the D04 and D09 allocators were estimated based on their historical relationship to the demand allocator (D03).

Q. **Did you also update the underlying cost data?**

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A. Yes. We used the FERC Form 1 to update the 2005 cost-of-service data for 2006 and 2007. The FERC data is not functionalized in the manner of the 2005 cost-of-service study nor does it have the ratemaking and tax adjustments. Consequently, we functionalized the FERC data on the same basis as the 2005 study. This approach implicitly assumes that the investments that Con Edison is making going forward mirror those made historically. We assumed the same ratemaking and tax adjustments as used in the 2005 study.

Q. **What did you assume for revenues?**

A. We used the actual 2006 and 2007 revenues provided by Con Edison in response to New York City IR 24 for the sales revenue, see Exhibit __ (NYPA-7). We assumed the 2005 level for miscellaneous revenues.

Q. **Do these revenues reflect the rate increase ordered in Case 07-E-0523?**

A. No, they do not. These are the actual revenues paid to Con Edison during 2006 and 2007.

Q. **Do the 2006 and 2007 studies indicate that NYPA continues to exhibit a revenue deficiency?**

A. No, they do not. Both studies indicate that NYPA's rate of return is within a 10% tolerance band around Con Edison's earned return. In 2006 NYPA's rate of return is 97% of Con Edison's while in 2007 NYPA's return is 96% of Con Edison's, see Exhibit __ (NYPA-9).

Q. **Do your revenue assumptions include the higher expected revenues from the elimination of NYPA's share of the net transmission congestion revenues or the assignment of $15.1 million in revenue deficiency both of which were ordered in Case 07-E-0523?**

A. No, they do not. NYPA's revenues would be expected to increase by more than $8.5 million due to the elimination of the TCC credit and by more than $17.4 million due to the

assignment of the $15.1 million revenue deficiency if the revenues were updated to reflect the rates ordered in Case 07-E-0523. See Exhibit __ (NYPA-10).

Q. **If the revenues were adjusted to reflect current rates would NYPA produce a revenue deficiency?**

A. Not at all. As we noted above, the updated cost-of-service models indicate that even under the old rates NYPA does not have a deficiency in 2006 or 2007 due to the declining allocation factors and the shift in investment towards distribution plant. If the revenues were adjusted to the current rates NYPA would show a surplus of $8 million in both 2006 and 2007. It is worth repeating that Con Edison has produced no evidence in this case indicating that NYPA produced a deficiency in 2006 or 2007. They rely solely upon the outdated 2005 ECOS.

Q. **What would be the effect of incorporating the Company's proposed additional $15.1 million revenue deficiency on NYPA?**

A. It would further increase NYPA's surplus.

Q. **What do you conclude about the use of a 2005 cost-of-service study to determine rates in this case?**

A. Our analysis clearly demonstrates the need for a more contemporaneous cost-of-service study to support the current filing. Con Edison's reliance on a 2005 cost-of-service study means that the costs occasioned by the customer classes during the 2009-2010 rate year will be 5 years removed from the costs used to determine NYPA's alleged revenue deficiency. The load and investment data clearly indicate that NYPA's share of the total system costs are declining while NYPA's rates have been increased proportionately more than the system in each of the last two rate cases. The updated cost-of-service studies indicate that NYPA's revenue deficiency no longer exists. Imputing an additional $15.1

million based on an antiquated cost-of-service study would swing the pendulum past parity and result in a significant revenue surplus. Such a result meets neither the standard of fair nor reasonable rates.

Q. **In light of these conclusions, do you have any recommendations for the Commission?**

A. Yes. First, the Commission should reject Con Edison's proposal to impute an additional $15.1 million alleged revenue deficiency on NYPA. Second, the Commission should require that Con Edison follow the NYCRR and produce a cost-of-service study for the three years prior to the initiation of this case. Finally, in the absence of an updated cost-of-service study the Commission should apportion any rate increase equally across all classes.

III. TRANSMISSION CONGESTION REVENUES

Q. Do you have concerns with the Company's proposed rate treatment of auction proceeds from Transmission Congestion Contracts (TCCs)?

A. Yes, our analysis shows that the proposed treatment results in an unfair allocation of revenue requirement to the NYPA and EDDS classes.

Q. The Company has said in its testimony that its TCC proposal is consistent with the Commission's Order in the immediately previous rate case (07-E-0523) and, accordingly, the current rate plan. In that order, and the NYPSC's subsequent order denying NYPA's request for rehearing, the Commission concluded that there was "no good reason" to allow NYPA to share in TCC auction proceeds. With respect to the current proposal, do you agree?

A. With all due respect to the Commission, we do not agree. This issue was raised late in the last case (on briefs), and there was no opportunity to develop testimony, nor to cross examine witnesses on this critical topic. Our testimony in this case will show that the evidence is clear that NYPA and EDDS pay their proportionate share of the costs of the entire Con Edison transmission system, and are therefore entitled to a proportionate share of the excess transmission congestion revenues that accrue to that system. Our proposed treatment of NYPA and EDDS is exactly the same as that proposed for the Con Edison Native Load customers.

Q. How does Con Edison propose to incorporate revenue from the sale of Transmission Congestion Contracts?

A. The Accounting Panel explains in their testimony that the revenue requirement assumes $150 million in projected auction proceeds from the sale of TCCs. This value reflects a credit to the revenue requirement. Any difference between the projected value and actual proceeds will then be reconciled through the Company's Monthly Adjustment Clause ("MAC").

Q. Does NYPA benefit from these proceeds?

A. No. The Final Order in Case 07-E-0523 specifically excluded NYPA participation in TCC auction proceeds. The NYPSC, reversing the recommendation in the RD, accepted Con Edison's arguments that the transmission system used to serve NYPA is "not related to" the transmission system used to serve Con Edison Native Load customers, and that since NYPA was compensated for its congestion costs (as a result of a May 11, 2000 Agreement), any further participation in TCC auction proceeds would be unfair to Native Load Customers.

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Q. In order to better understand the basis for the allocation of TCC revenues, please provide a brief overview regarding TCCs. What is a TCC?

A. A TCC represents the right to collect, or the obligation to pay, the Day-Ahead Market (DAM) congestion rents associated with 1 MW of transmission between a specified Point of Injection and a specified Point of Withdrawal.

Q. How does Con Edison acquire TCCs?

A. In three ways. First, when the NYISO was formed, Con Edison was granted a set of TCCs that were thought to be sufficient to hedge the congestion costs of its Native Load customers. These are referred to as Existing Transmission Capability for Native Load ("ETCNL" or "Native Load TCCs"). Second, the NYISO also assigned Con Edison (and other New York Transmission Owners) a set of Residual TCCs. Third, in 2000, NYPA assigned to Con Edison NYPA's original TCCs (within Con Edison's service territory) that were allocated to it by the NYISO. Con Edison may also purchase TCCs on its own account, but NYPA does not pay for, nor have an interest in this last category, and we ignore it in the remainder of this discussion.

Q. **How does a transmission owner receive revenue from these TCCs?**

A. In two basic ways:

1. The transmission owner can sell TCCs in the NYISO market, and receive "auction proceeds" from the sale.

2. The transmission owner receives "congestion rent" for any TCCs that it retains (from users of those portions of the transmission system).

Since these are two related sources of revenue (i.e., from TCC auction proceeds, as well as congestion rents associated with TCCs retained by the transmission owner), it is appropriate to refer to these collectively as "congestion revenues". In the case of Con Edison, its

congestion revenues are derived from the proceeds Native Load TCC and Residual TCC auctions as well as congestion rents from the NYPA grandfathered TCCs that it retains.

Q. **Prior to Case 07-E-0523, did NYPA share in any of the TCC auction proceeds?**

A. Yes, prior to this most recent decision, NYPA received a share of the first $60 million in TCC revenues. The share was 14.22%; or the proportion of NYPA load to the total system load. This share is also the basis for the allocation of the system transmission cost to NYPA.

Q. **In Case 07-E-0523, Con Edison argued that the transmission system used to serve NYPA was "not related to" the transmission system used to serve Con Edison's Native Load, and that NYPA was therefore only entitled to reimbursement of its congestion costs, and not to any transmission revenues associated with the "Native Load system". If the Company were to repeat this argument in the current case, would you agree?**

A. No, there is no factual basis for this argument. Con Edison provided no support at all for the assertion, and it is in fact wrong. Con Edison's system is integrated. The statement that the transmission facilities used to serve NYPA are "not related to" transmission facilities used to serve Native Load is a fiction. The facts are that NYPA agreed to give Con Edison a set of TCCs (totaling 1680 MWs) that were provided to NYPA when the NYISO was formed. These "grandfathered TCCs" were intended to approximate the pre-existing network service agreements between NYPA and Con Edison. Since TCCs are all "point to point" rights, there could not be an exact match between the previous network agreements, and the TCCs. When it became clear that NYPA received TCCs that were worth more than the pre-existing network agreements, NYPA agreed to turn the TCCs over to Con Edison, in return for being reimbursed for its actual congestion costs. NYPA did not, however, give up any right to receive a share of the surplus in revenues accruing to the transmission system. In

fact, if the "NYPA system" was separate and distinct, the appropriate cost allocation would be a direct assignment of the costs of that system, rather than an allocation of a share of the costs of the total system. It is the latter approach, of course, that Con Edison employs. That is, NYPA pays for the cost of the **entire** transmission system in proportion to its use of the **entire** transmission system. Con Edison itself agrees that the transmission system used to serve NYPA is not an electrically separate system, see Exhibit __ (NYPA-11).

Q. **Does Con Edison use any part of the "NYPA" transmission "system" that is represented by the NYPA grandfathered TCCs?**

A. Of course it does. The best evidence for this is that the congestion rents collected by Con Edison from the grandfathered NYPA TCCs are substantially larger than the congestion rents incurred by NYPA. Exhibit __ (NYPA-12) shows that, in 2005, for example, Con Edison collected $174.5 million in congestion rents from various users of the grandfathered NYPA TCCs, while it reimbursed NYPA for $112.5 million in NYPA congestion costs.

Q. **Does Con Edison continue with the exclusion of NYPA from participation in congestion revenues in this case?**

A. Yes, Con Edison does not update the 2005 ECOS. The Company uses the "revenue shares" calculated from the final order in Case 07-E-0523. These revenue shares exclude NYPA from any participation in TCC revenues. Since NYPA does not pay the MAC, it cannot benefit from any flow through additional TCC auction revenues, nor congestion rents, via the MAC.

Q. **Do users of the transmission system also incur congestion costs?**

A. Yes, both NYPA and Con Edison incur congestion costs. NYPA's congestion costs are fully hedged, since Con Edison reimburses NYPA for its congestion. Con Edison's Native Load congestion costs are also fully hedged, to the extent that TCC auction proceeds and

congestion rents exceed those congestion costs. The excess of TCC auction proceeds and congestion rents, under the current proposal, will flow entirely to Con Edison Native Load Customers. NYPA will not share in this at all.

Q. **Please quantify the transmission congestion revenues in this case.**

First, Con Edison sells its Native Load TCCs in the NYISO market. Under the NYISO tariff, Con Edison is required to sell all its Native Load TCCs in the auction. This resulted in $105 million in revenue in 2006. See Exhibit __ (NYPA-13).

Second, Con Edison also receives income from congestion rents associated with grandfathered TCCs assigned by the NYISO to NYPA at the creation of the NYISO. In accordance with the 2000 Agreement, Con Edison reimburses NYPA for its congestion costs within its service area associated with its governmental load in New York City and its business customer load in the City and keeps the remainder (which in turn is flowed through the MAC). In 2006, Con Edison received $83 million in TCC rents from which it reimbursed NYPA for $56.5 million in congestion costs. See Exhibit __ (NYPA-12).

Third, Con Edison receives revenues from the sale of Residual TCCs by the NYISO in the NYISO auction market. This resulted in approximately $44 million in revenue to Con Edison in 2006. See Exhibit __ (NYPA-13).

Q. **Is NYPA entitled to any part of these congestion revenues?**

A. Yes, NYPA is entitled to its share of the ***excess*** of congestion revenues over congestion costs.

Q. **Please explain.**

A. Congestion revenues are an offset to the revenue requirement associated with the transmission system, and should be credited to the parties that pay for the system. NYPA

pays for the transmission system in proportion to its use; it should be treated exactly like the Native Load Customers in both the allocation of the transmission system costs, as well as the transmission system revenues. To afford NYPA any less is unfair, and confiscatory.

Q. **But, isn't NYPA fully compensated for its congestion costs when Con Edison reimburses NYPA all of its congestion costs?**

A. Yes, but it is not fully compensated in comparison with Native Load Customers. While it is true that, under the terms of the 2000 Agreement, Con Edison reimburses NYPA for all of its congestion costs associated with the "grandfathered TCCs," retaining all of the congestion revenues for the benefit of Native Load customers produces a significant "surplus" (ie., congestion revenues exceed congestion costs) for the Native Load customers, while NYPA is afforded exactly zero benefit. NYPA is seeking is to be treated exactly like Native Load customers: to share in the congestion "surplus" in proportion to the allocation of the transmission cost. To see the fairness of this one might also suggest that Con Edison's Native Load customers are fully compensated when they receive the benefit of auction revenues equal to the Native Load congestion costs (similar to Con Edison's reimbursement to NYPA for NYPA's congestion costs), and therefore any further benefit to Native Load customers is somehow "double counting." In fact, both NYPA, and Native Load customers pay for the system in proportion to their use, and both should share in excess congestion revenues in proportion to how they pay for the system.

Q. **How is the proposed treatment of congestion revenues unfair to NYPA?**

A. Exhibit __ (NYPA-12) shows the various components of the "congestion surplus" for 2005 and 2006. Line 1 shows that the TCC auction proceeds associated with Native Load was $169 million (2005) and $105 million (2006). Con Edison also received $37 million and $44 million (in 2005 and 2006) from the sale of residual TCCs. Congestion costs associated

with Native Load was $116.5 million (2005) and $51 million (2006). Thus, there is a congestion surplus (or "excess congestion revenues") of $89.5 million (2005), and $98 million (2006).

Q. **Does NYPA share in any of this surplus?**

A. No, it is entirely retained by Native Load customers. The TCC revenues are an offset to revenue requirement for Native Load Customers, while the congestion costs are flowed through the MAC.

Q. **Does Con Edison have any Native Load customers who purchase power from an entity other than Con Edison?**

A. Yes, approximately 61% of Con Edison's Native Load is represented by customers, who like NYPA, pay Con Edison for the use of its transmission and distribution system, but purchase power from some other entity. See Exhibit __ (NYPA-14) which provides raw data upon which this percentage is based.

Q. **Are these customers excluded from sharing in the "congestion surplus"?**

A. No, they receive their allocated share of the surplus through the MAC. Only NYPA is excluded from the surplus.

Q. **You mentioned earlier that Con Edison receives revenue, in the form of congestion rent, from the NYPA grandfathered TCCs. Does this revenue exceed the congestion costs that Con Edison is required to reimburse NYPA?**

A. Yes, the congestion rents exceed NYPA's congestion costs. Exhibit _(NYPA-12) shows that Con Edison received $62 million (2005) and $26.5 million (2006) more in congestion rents than it reimbursed NYPA for congestion costs.

Q. **How does Con Edison propose to treat this excess or surplus revenue?**

A. The surplus flows through the MAC to the benefit of Native Load customers. NYPA would not receive a share of it at all.

Q. **But doesn't the 2000 Agreement require that Con Edison retain the surplus?**

A. The agreement states that NYPA is to be reimbursed for its congestion costs, and that Con Edison therefore retains any surplus. However, the agreement is silent on the ratemaking treatment of the surplus Con Edison retains. It certainly does not state that the surplus is to be retained solely for the benefit of Native Load customers.

Q. **Do you believe that NYPA is entitled to a share in the surplus of this congestion rent?**

A. NYPA is entitled to share in this surplus in exactly the same manner as Native Load customers; that is, it is entitled to a share in proportion to the manner in which the cost of the system is allocated.

Q. **Since NYPA is reimbursed for its congestion costs, why should it have any right to participate in either the Native Load congestion "surplus", or the NYPA congestion "surplus"?**

A. For the same reason that Native Load customers have a right to these revenues: Con Edison generates these revenues with the transmission facilities that both groups pay for. The question might be turned around and asked: why should Native Load customers have a right to share in the congestion surplus, instead of their right being limited to a recovery of incurred congestion costs? Both NYPA, and Native Load customers should be treated in an identical manner, and both should share in the congestion surplus in proportion to their assignment of the cost of the transmission system.

Q. How should actual congestion revenues be allocated if they are greater than, or less than the $150 million built into the Company's current proposal?

A. Under the Company's proposal, any difference is passed through the MAC, in which NYPA does not participate. We recognize that this may create an unfair situation. It would be unfair to NYPA, if the actual value is greater than $150 million, and unfair to customers who pay the MAC if it is less. We therefore would agree to an adjustment mechanism for NYPA that would apply a pro rata share of the difference between the actual congestion surplus and $150 million. This mechanism could also include an adjustment to recover Native Load congestion costs in the extremely unlikely event that Native Load congestion costs were greater than congestion revenues – to ensure that both NYPA and Native Load congestion costs were fully hedged. However, if there are Native Load customers who also do not pay the MAC, such a true up should be applied to them as well.

Q. **Please summarize the appropriate treatment of congestion revenues.**

A. Congestion revenues include both congestion rents, and TCC auction proceeds. These represent offsets to the cost of the transmission system. They should be allocated to all customers in proportion to the costs paid for the transmission system. This allocation must reflect the congestion costs paid by customers as well. The "surplus" (i.e., the congestion revenues minus congestion costs) should be allocated to all customers in proportion to their allocation of the costs of the system.

Exhibit __ (NYPA-12) shows that the total surplus for Con Edison was $151.5 million in 2005, and $124.5 million in 2006. Since the test year is 2006, NYPA should receive an amount equal to its ECOS transmission allocator (D03), times $124.5 million, or a total amount equal to $17.1 million. Note that the D03 allocator in the 2005 ECOS was 13.713% (i.e., not 14.22%).

Con Edison's proposal, and our proposed alternative can be summarized in Figure 1 below:

NYPA PANEL

Figure 1

Proposed Con Edison Rate Plan:

Native Load:	Congestion Costs recovered through TCC proceeds Excess TCC proceeds returned to NL via the MAC Excess NYPA congestion rents distributed via the MAC
NYPA:	Congestion Costs recovered through 2000 Agreement Excess congestion rents flow to Native Load via MAC Excess TCC process flow to Native Load via MAC

NYPA Proposal:

Native Load:	Congestion Costs recovered through TCC proceeds Proportionate share of excess returned to NL via the MAC Proportionate share of excess NYPA rents distributed via MAC
NYPA:	Congestion Costs recoverd through 2000 Agreement Proportionate share of excess TCC proceeds Proportionate share of excess NYPA congestion rents

Q. **Does your recommendation allow NYPA (and/EDDS) to receive any "double benefit" from transmission revenues?**

A. No, it does not. It would ensure that NYPA (and EDDS) and Native Load customers are treated exactly equally, and thus fairly. On the contrary, the current proposal allows Native Load customers to enjoy the benefit of having their congestion costs fully reimbursed, and to benefit additionally from the surplus congestion revenues. Under the current proposal NYPA/EDDS would be reimbursed for congestion costs, but would receive no benefit at all from surplus congestion revenues. Our proposal would restore equity. Since both Native Load and NYPA/EDDS pay their proportionate share of the entire transmission system that produces these revenues, both should share in the surplus in the same proportion.

IV. REVENUE REQUIREMENT

Q. Do you have some overall thoughts on the Con Edison rate request before we get into some of the specifics of the proposed revenue requirement?

A. A few weeks after placing a $425 million increase in its delivery service rates, Con Ed has returned to the NYPSC with a request for another 15.4% overall increase in the first rate year, and indicates the need for over 40% overall over a three-year period.

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

A. Overall electric rates in New York are among the highest in the country, a fact that is well known and was not challenged in the 2007 case. We will identify several components that should be reduced including the company's exceptionally large and expensive capital expansion plan.

Q. Does Con Edison justify its rates with demonstrations of cost increases?

A. Yes, and many of those costs are demonstrably accurate, and the company should recover such costs. However, it's the totality of the rates, and the price charged to the customers, that concern us. Rather than focus purely on the opportunity to raise rates because of cost increases, we would like to see the company placing similar efforts on lowering costs, finding ways to meet customer service requirements for less cost.

Q. Based on your analysis, how reliable is the Con Edison system?

The Company's statistics suggest that the company is 80 times more reliable (or less unreliable) than other companies in the industry. Indeed, in reviewing Con Edison's presentation at the Technical Conference on June 18, 2008, and looking specifically at slide 22, Exhibit __ (NYPA-15), we see a company operating at the very peak levels of reliability,

within an industry that generally is considered to be quite reliable. This is an impressive performance.

Q. Is there other evidence of Con Edison's high reliability?

A. Yes. In IR NYPA 52, we asked the Company to elaborate on its reliability record. In response, the Company shared a series of graphs developed by PA Consulting, identifying Con Ed as the clear leader among a number of large and well-known utilities. See Exhibit __ (NYPA-16). We have every reason to agree that Con Edison is the most reliable distribution utility in the United States, consistent with its own claims.

Q. But the Company seems to justify at least part of its rate increase request on the need to maintain or even improve the level of reliability, doesn't it?

A. Yes, it does. And we question how a company at the very peak of reliability levels must spend at this level to continue to improve that reliability. The amount of money being spent by the company, together with small gains in reliability, suggests very strongly that the company has surpassed the optimum point of spending.

Q. What do you mean by the "optimum point"?

A. In many engineering or management decisions, there are tradeoffs between service reliability or other measures of quality, and cost. In many situations, a company has the opportunity to spend more money to enhance quality or reliability. But, inevitably, a point of diminishing return is reached wherein the quality gains are not commensurate with the cost of achieving those gains. Ideally, management would seek to find that ideal "point of diminishing return," where reliability has reached a point where additional expenditures provide increasingly fewer improvements in reliability that do not justify their cost.

Q. Were you able identify Con Edison's "optimum point" and whether it has surpassed it?

A. We could not. However, NYPA asked the Company questions regarding the optimizing of its capital expenditure program in IRs 53 and 54. It is troubling to us that the responses suggest that Con Edison does not seek an optimum level of reliability, but instead relies on overall measures and equipment-specific loading levels. One could conclude that Con Edison will keep spending at ever increasing levels until the Commission says "enough." These questions and Con Edison's responses are entered as Exhibit __ (NYPA-17)(also containing supporting Con Edison responses).

Q. Does Con Edison's proposal consider its customers' willingness and ability to pay for increased reliability?

A. We asked the Company in IRs NYPA 55-57 how they take customer preferences for reliability versus cost into account. According to the answers, shown on Exhibit __ (NYPA-18), the Company does not. Con Edison does incorporate economic tests into their capital spending decisions, as evidenced in their capital budgeting guidelines and in their budgeting procedures, but those seem to be mostly to select least-cost alternatives among programs that they are committed to do. But we could not find any evidence anywhere that they make economic tradeoffs between customers' preferences for reliability versus their preferences for lower rates.

Q. Do they not have cost-related goals?

A. In IRs NYPA 110 and NYPA 111, we asked to see the performance measurements applied to their executives – those measures that drive the incentive pay program. In our experience, these measures are strongly indicative of the pressures placed on individual managers and executives to achieve certain business results. The Company responded with copies of the performance indicators and weightings for each of its vice presidents, shown here as Exhibit __ (NYPA-19).

Q. Did you review this performance system?

A. Yes, and Con Edison evidently has a fairly robust performance management system, much to its credit. The most noteworthy thing we observed, though, is the conspicuous absence of measurements related to the cost of its T&D service. Each executive has a goal related to his or her own O&M budget, as many companies do. And each also has a stake in corporate ROE, again a very common measurement. But the only mention of the customer in these measurements was a Customer Satisfaction Survey, which has a weighting in most of the Con Edison cases of about three percent. Other measures related to the customers had to do with quality of service measures, but it seems evident that no one's performance is based on the ultimate price of the service to the customer, and the tradeoff between service quality and price.

Q. Can the dramatic proposed capital expenditures be justified by high load growth that must be served?

A. Here, there seems to be a discrepancy between the rhetoric that we hear and the facts – including facts that are presented in this case. The rhetoric suggests a company that is struggling to meet rapid load growth, as we see in the aforementioned Technical Presentation, with dramatic pictures of new customer installations (slides 5-9 of Exhibit __ NYPA-15). But, we also see in calculations derived from the information provided by the Company's Forecasting Panel on its Exhibit (Con Edison FP-7) that projected load growth is near zero (0.4% from 2007 through the rate year ended March 31, 2014) with DSM projections taken into account. Any new load must be met with service, of course, but Con Edison's near-zero load growth effectively means that they cannot attribute heavy capital spending to new loads.

Q. So what can you conclude from your analysis of Con Edison's growth?

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A. We contend that Con Edison's load growth is quite low to non-existent, and provides little justification for the level of construction envisioned. So if we combine the two main reasons for building new infrastructure plant – reliability and new load – we see a company with the highest reliability in the country and very little load growth seeking to build at a rate of growth that is among the highest in the country. It just doesn't compute.

Q. Do you have a recommendation for the Commission? If so, please explain in detail.

A. We have seen responses to hundreds of interrogatories seeking to understand Con Edison's construction program and to understand its justifications. We have not examined the Company's specific requirements sufficiently to challenge specific expenditures – in fact, we believe that Con Edison itself is in the best position by far to make these judgments.[1]

We prefer, instead, that the Commission determine a cap based in part on the customer's value of reliability and impose that on Con Edison. If the Company finds that it simply can't live with the cap, then its alternatives would be to live with lower income, to offset the costs elsewhere (like in O&M expense) or to come back to the Commission with further justification. The additional justification the Company should be required to provide should include an analysis of the Company's overall level of reliability, as well as an economic justification that links additional capital investment expenditures to Customer valuations of the associated additional reliability.

Q. What do you think the Company would do in the face of such a cap?

A. Evidence from Con Edison's response to NYPA IR 70, Exhibit __ (NYPA-20), both the text response as well as in the budget guideline letters provided as attachments, all suggests

[1] Of course, we fully support DPS Staff's abilities to review the Con Ed program, but believe that Con Ed has access to more data and to more analytical and engineering resources than anyone else involved in this case.

that the Company would find a way to reduce its spending to conform with amounts consistent with its rate allowances. By its refusal to modify overall spending to reduce rate pressures, the Company seems to be putting itself in the posture of asking the Commission to tell it where to cut. We believe that burden belongs on the Company, not the Commission, but if the Company insists on spending at this level in the face of this evidence, then we believe the Commission has little choice but to allow a lesser amount of the expenditures in the rate base.

Q. How much less?

A. In the last case, the Commission disallowed approximately 8% based on a careful parsing of the expenditures program by DPS Staff. Unfortunately, the 8% cut in one year's spending only results in a reduction of about $25 million annually when fully reflected in rates. We think a more meaningful cut on the order of 20% would be in order, and would still give the Company a very high level of spending proportionate to its size. A cut of 20%, or about $360 million for 2009, would lower annual revenue requirements by more than $65 million.[2] Of course, a lowering of the annual capital expenditure program over time produces much greater savings in annual revenue requirements. If the Company believes that a reduction of this level would result in system reliability below that which Customers are willing to pay for, they should make that demonstration to the Commission.

Q. Con Edison's testimony suggests that the Company is facing significant financial distress as a result of the current rate plan which increased its annual revenue by $425 million. From a financial standpoint how does Con Edison support this position?

[2] The exact calculation of revenue requirement reduction depends on several factors, notably the in-service dates and depreciable lives of cancelled equipment, as well as the property tax treatment.

A. Con Edison cites a number of Wall Street investment bankers who seem to be "disappointed" in the rate result. If you look at it from the investment banker's point of view, it is always disappointing to get less revenue and, therefore, less earnings. But we believe that Con Edison is actually in very sound financial condition, should acknowledge this, and accept the fact that its earnings don't have to be at or even near the top of the industry to provide a sound financial return to its investors.

Q. Please explain why Con Edison's focus is incorrect.

A. The analysis of Con Edison's financial condition, in our opinion, focuses on poor comparisons. If one looks at the relative handful of purely distribution utilities, with little or no generation and little or no non-regulated businesses, then the returns aren't nearly as high, and the financial ratios, including those related to stock price, aren't nearly as robust. See Exhibit __ (NYPA-21). These companies, as a general rule, have one key factor in common with Consolidated Edison – very low risk from a segment of the business that is heavily regulated as to price, and is completely protected from the wild swings that are common in energy commodity prices. Many of these companies have very little business interest outside of the distribution of energy to end users.

Q. One reason the Company is proposing to raise rates is to increase its stock price. Do you think the current market price of its stock reflects a financial instability that would hinder investment in the Company?

A. No. For a company that is regulated on the basis of the book value of its investments, keeping the stock price close to book value would seem to suggest that regulation is working – that the Company is allowed to earn a return that justifies a market price that is consistent with the accounting value of the assets placed into utility service. At a market-to-book ratio of 1.13 as of mid-August, the market is saying, in our opinion, that the expected

return on Con Edison's common stock is enough to justify the full value, plus a premium, of the book value of its assets. We're not sure why regulation should provide for more than that, especially with a company whose earnings are low-risk as this one is.

Q. Please explain how investment in Con Edison presents a "low risk" to investors and how it can be financially advantageous.

A. Two reasons – the past and the future. The past clearly shows that Con Edison stands out among its peers in one very important aspect of financial performance, and that is earnings stability. Value Line, the respected investment analysis service, scores Con Edison's financial stability at a perfect 100. Even more compellingly, even after the last "disappointing" rate case result, Value Line rates Con Edison's financial strength[3] as A++, and there is no other utility rated at that level; only three are rated as high as A+. Value Line, incidentally, also used the term "disappointing" in reference to the last rate result, but still rated New York regulation as "average" and accorded the aforementioned highest possible ratings to Con Edison's financial stability and financial strength. This does not sound to us like a definition of a utility that is in dire financial straits.

Q. Can you conclude that the Company will continue its remarkable earnings stability into the future?

A. One could say that the Value Line assessment of the top level of financial strength and stability is predictive, but we can go further. We know of no U.S. electric utility that has the earnings protections built into its rate and regulatory structure that Con Edison does.

[3] Value Line describes its own ratings as follows: "Our Financial Strength ratings take into account a lot of the same information used by the major rating agencies. Our analysis focuses on net income, cash flow, the amount of debt outstanding, and the outlook for profits. Other factors also enter into the equation. For example, a company that faces the loss of patent protection on a key product might face a downgrade. The ratings range from A++ (highest) to C (lowest) in nine steps, based on the judgment of our senior staff members."

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Q. Please explain the relationship between risk, earnings stability and the Con Edison rate structure.

A. In our opinion, the most important factor in assessing risk from the standpoint of investors is volatility of earnings. Consistently high earnings tend to command a relatively high stock price, and consistently lower earnings will merit a lower stock price. But inconsistent earnings, especially a record of negative surprises, are especially damaging to securities valuations. The predictability of return is the reason that fixed income securities (mostly debt, like first mortgage bonds) requires so much lower return to the investor than does common stock. And the safer the debt (higher the debt rating) the greater the probability of receipt of interest and ultimately the return of principle, the lower the required interest rate, and thus the realized return, to the investor. Therefore, in view of Con Edison's exceptionally stable financial condition and the built-in regulatory assurances that it will continue to earn its allowed return, the Company's allowed return should, in fact, be lower than the many companies with greater risk of earnings volatility.

Q. Can you speak to the allowed return in the 2007 case and to the Department of Public Service Staff's ("DPS Staff'") position on that issue?

A. We certainly supported DPS Staff's position and approach in the last case. We believe that the rate of return granted by the Commission is properly reflective of the very low risk profile that Con Edison enjoys, and that is reflected when proper cost-of-capital studies are conducted.

Q. How does Con Edison have earnings stability built into its rate structure?

A. Con Edison has several huge advantages in its rate structure. Probably the biggest advantage is its fully forward-looking test year. This is an inherently sensible ratemaking idea – to review and determine rates based on the time period in which they are actually

going to be in effect, and we support the concept.[4] By being able to use a fully forward-looking test year, the Company is able to project its costs two years forward from the time of the rate filing and have overall revenue requirements determined based on that. So the Company's task is to project O&M costs and capital costs and other important factors with enough conservatism that it can in fact stay within those limits during the actual periods of operation. In our opinion, there are relatively few companies in this industry that have this advantageous a ratemaking position.

Q. Are there other mechanisms that help provide earnings stability?

A. Yes, the revenue decoupling mechanism insulates the company's earnings margins from kilowatt-hour sales volumes. In its testimony, the Company emphasizes the negative – that it does not benefit from sales growth increases. But the positive side is that the Company is insulated from the negative aspects of an economic downturn or of unusually mild weather– that if kilowatt-hour sales go down, the Company's earnings margins are not affected.

Q. Is Con Edison exposed to commodity energy prices?

A. No. The Company is able to pass through its commodity energy prices to its full-service customers. And of course, many of Con Edison's customers only buy delivery service from the Company. So unlike many more vertically integrated companies, Con Edison has essentially no exposure to commodity energy prices.

Q. So what can you conclude regarding Con Edison's earnings stability?

A. Con Edison's returns on invested capital are remarkably consistent. Comparing Con Edison's parent company (Consolidated Edison, Inc.) returns from one year to the next over the past nine years, we see a remarkable consistency, and a consistency fully aligned with

[4] As we stated earlier in our testimony, we feel very strongly that Con Ed should be as forward-looking in its rate design and cost allocation as it is about its test period.

Value Line's finding of a Financial Stability rating of 100. Exhibit __ (NYPA-21) shows the aforementioned nine distribution utilities with their annual ROE's for the past nine years, taken from the Value Line reports. We calculated the standard deviation of the ROEs for each company, and then divided the standard deviation by the mean, which is a measure of central tendency, or the degree of variance from the mean. Con Edison's ratio is 0.14, third lowest among the nine companies, and well below the average of 0.23. We note also that among the nine, only two have nine-year average ROEs above that of Con Edison.

Q. Has Con Edison met its allowed return?

A. Yes. In fact, as the Company's response to IR NYPA 42 shows, the Company has *exceeded* its allowed return in each of the last three years. Exhibit __NYPA-22.

Q. Given the Company's strong financial stability, do you have any recommendations with respect to the rate of return to be allowed by the Commission?

A. Our conclusion is that we find the award in the last case at 9.1 percent to be not unreasonable and we urge the Commission to reach a similar finding in this case.

Q. Let's move on to issues of Working Capital and Earnings Base Over Capitalization (EBCAP). What are your general thoughts on the Company's treatment of these issues.

A. We continue to have questions about these two areas that seem to receive very superficial treatment by the Company.

Q. What are your thoughts specifically on Con Edison's Working Capital Calculation?

A. Our issues are with respect to the cash component of Working Capital. There, the Company insists on using a formula that it refers to as the "FERC one-eighth formula" and basically calculates the amount of cash working capital required as one-eighth of certain annual O&M expenses.

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Q. Please describe the advantages and disadvantages of utilizing this FERC one-eighth formula.

A. The advantage that Con Edison touts is that the one-eighth formula is quick and easy to calculate. We observe that this formula substantially overstates the amount of cash required to run the business, which, presumably, Con Edison finds to be advantageous. However, the Commission's objective here should be to determine a just and reasonable estimate of the legitimate ongoing cash needs for operating a business. The one-eighth formula may have been an acceptable estimate at one time, but in this era of aggressive cash management, it simply no longer appears to hold true.

Q. Is there a more accurate method for calculating the Company's working capital requirements?

A. We believe the Company should be required to prepare a detailed study of its actual working capital requirements, rather than being allowed to rely upon a very simple approximation of their requirements. Working Capital is a significant element of rate base, and the value allowed should be equal to the actual requirements, not based upon a simple approximation. Our suggestion is that a lead-lag study should be required to support the Company's Cash Working Capital requirements.

Q. Please describe how a "lead-lag" study works and why it is more accurate than the FERC one-eighth formula.

A. A lead-lag study basically recognizes that the only reason for cash working capital is to meet the day-to-day cash needs of a company. The Company's accounting statements, as is true for virtually all public corporations, are based on the concept of accrual, wherein assets and liabilities, as well as revenues and expenses are recognized at the time of the transaction or the delivery of service. These expenses and revenues are recognized despite the fact that

cash changes hands at a time separate from the delivery of the services and materials to the company or the services to customers.

Thus, the lead-lag study presents a detailed review of the amount of time between the provision of a service and the receipt of the revenue, as well as the obtaining of a material or service by the company, and its payment. To the extent that services are rendered by the company in the form of electricity delivered to the customer, the company must wait to receive its cash, and, similarly on the other side, the company will receive a bill for various expenses and will pay that within an appropriate amount of time. These leads and lags on revenue recoveries and expense payments constitute the real reason that the company must maintain cash working capital.

Q. Are lead-lag studies used in other states?

A. Yes. While exact statistics are hard to obtain, it is obvious from a review of rate cases that many of the commissions in the country either require or encourage a lead-lag study in order to justify the inclusion of Cash Working Capital into the rate base. Among the states where lead-lag studies are commonly used are Pennsylvania, Connecticut, Vermont, California and Illinois, plus our neighbor across the river, the State of New Jersey.

Q. You mentioned New Jersey. Doesn't the Company have an affiliate there?

A. Yes, it is the Rockland Electric Company, and that company filed a lead-lag study in a recent rate case, one decided in 2007.

Q. In the absence of a fully-developed lead-lag study, is there any analysis that can approximate the results of such a study?

A. Yes. We have performed an approximation of a lead-lag study that will demonstrate why we believe Con Ed should be required to perform a lead/lag study, and we will suggest a reduction to the rate base request based on our analysis.

NYPA PANEL

Q. Please describe your analysis.

A. We obtained a copy of the Rockland Electric Company testimony and exhibits from the New Jersey Board of Public Utilities. We offer Exhibit __ (NYPA-23), a summary of the lead-lag study results for Rockland Electric. In that exhibit, we list revenue and expense items, with days of lag and lead assigned to them. The exhibit then calculates a column by multiplying days times dollars, to come up with a weighted lead and lag for each revenue or expense item.

Q. Were you able to apply the methodology contained in that exhibit to calculate Con Edison's Working Capital requirements?

A. Yes, at least as a demonstration. What we cannot be sure of is the leads and lags associated with each dollar amount. But if we assume that Rockland Electric and its business practices are at least reasonably similar to Con Edison's, then we can infer that a study of this type is indicative of the direction in which a fully-developed lead-lag study might take us.

Q. Please describe your lead-lag analysis.

A. We developed a simple schedule based on Con Edison's projections for the first rate year, the year ended March 31, 2010. To calculate the lag in revenues, we simply took an average of accounts receivable from customer sales for the past twelve months and compared that to customer revenues for the same period. Dividing average receivables by annual revenues gives us a fraction that represents the proportion of annual revenues that are held in receivables. Multiplying that result by 365 days gives us the average days of receivables outstanding for the year, in this case 30.455. This says that from the time that Con Ed recognizes the revenue until it actually receives cash is approximately 30-1/2 days. We included the Sales Tax that the Company must collect from the customers here, as well,

on the theory that it must wait to collect these revenues, but the accrual for the tax liability takes place as the service is rendered. We then multiply the 30.455 days by the annual revenue and sales tax amounts to determine a the dollar-days of lag – that is the day-weighted dollars that Con Ed must fund in the form of working capital, and it is 152.533 billion dollar-days of lag. That will be offset to some extent, however, by the lead associated with Con Edison's receipts of services and materials some days in advance of actually paying cash for them.

Q. How did you handle expenses?

A. Since we did not have access to Con Edison's accounts in sufficient detail to estimate the lag in payments, we used the lag days from the Rockland Electric schedules. The only exception is that Rockland Electric did not deal with Interest Expense. Since this is a cash expense and a definable cost of doing business, we calculated the lag in interest expense as 115 days by comparing annual interest expense to interest accrued, much as we determined the lag in revenue recovery. The assumption of the most concern and the biggest impact has to do with salaries and wages, where Rockland Electric figured a lag of 8 days. That's very low, but we used it because we had no information to contradict it. Overall, we found a total "lead" or lag in payables of 100.9 billion dollar-days, and a net lag of 51.6 billion dollar-days determined by subtracting the lead in payables from the lag in receivables. The next calculation is to divide the $51.6 billion dollar-days of net lag by 365 days to determine the average daily lag, and that is $141.38 million. See Exhibit __ (NYPA-24). This would be our recommendation for an allowance for cash working capital.

Q. Do you have a recommendation for the Commission?

A. Con Ed calculated $195.6 million based upon its use of the one-eighth of O&M expense methodology. Thus, our recommendation would be to disallow $54.2 million of rate base because of the over-estimation of cash working capital requirements.

Q. Do you also have concerns with respect to the Company's proposed EBCAP adjustment?

A. Yes.

Q. Before we go into your specific concerns, can you please describe what this adjustment is?

A. In the simplest language, utility rate base represents, or should represent, all the assets that the Company claims are needed to provide utility services. The concept of "used and useful" is well recognized in utility regulation. Looking back to a 1975 case involving Niagara Mohawk, it was determined by the Commission that the rate base (or "earnings base") was greater than the capitalization upon which the Company needed to earn a return, and that if the Company were granted a return on the entirety of rate base, then the return on capitalization, and thus the return on equity, would be above the level awarded by the Commission. Thus the Commission made a negative adjustment to rate base, to bring it down to the level of capitalization. In this case, the situation is reversed, and rate base appears to be smaller than capitalization, so Con Edison seeks an adjustment to increase rate base to equal capitalization.

Q. Do you find that this adjustment is appropriate in this case?

A. No, we do not. In the first place, EBCAP is a classic tautology. Basically, it is a regulatory theory that says that whatever rate base comes out to be – inclusive of all plant and working capital and other allowed components that comprise a "used and useful" rate base – if it is different in any respect from capitalization, that there should be an adjustment to make it

equal to capitalization. So, our question for the Commission is, "Why bother with all the discussion about Working Capital, Plant in Service, Construction, etc., if EBCAP is going to be a "plug-in" figure?" It certainly undermines any discussion of a "used and useful" doctrine of ratemaking.

Q. Are you aware of other Commissions that permit an EBCAP or similar type of adjustment?

A. We could find no other instance – none – of a public utility commission other than New York that allows such an adjustment. In a review of Public Utility Reports ("PUR") regulatory cases going back at least 10 years, we found no instance of "EBCAP" or anything that suggests an adjustment of that type. We found numerous references to "used and useful," and that certainly appears to be the prevailing doctrine for regulatory agencies in this industry.

Q. Please explain why, in the present case, the Company claims that it needs such EBCAP adjustment?

A. The Company's rationale is the basis of our concern. Con Edison does not and refuses to forecast EBCAP. In response to IR NYPA 23, the Company responded: "The Company (and other utilities in New York State) has traditionally used the historic year excess rate base over capitalization adjustment as a proxy for the rate year. Therefore, the Company has not prepared projections of these components for an EBCap adjustment for the period requested." See Exhibit __ (NYPA-25). In the 2007 case, Con Edison responded to a similar question saying, in effect, that the components of EBCAP are too hard to predict. We can't help but observe that this Company has no problem at all predicting every other component of rate base and operating expenses.

Q. What do you believe causes the EBCAP adjustment?

A. The big driver of the EBCAP adjustment is Regulatory Assets, and the big driver of that is Pension Assets and Other Post-Retirement Benefit ("OPRB") Assets. The Regulatory Assets reflect the booking of unrecognized net losses and prior service costs. Our opinion is that this is an accounting artifact that is, in fact, very difficult to forecast – mainly because it relies so heavily on pension fund performance in the financial markets. The pension and OPRB assets on the balance sheet effectively are covered, at least in part, by the $9.4 billion of pension and OPRB assets in Con Edison's managed funds. Some of those assets find their way onto the balance sheet by annual expensing (and contra-expensing) of over- and under-achievement of target returns in past years. Yet the fund assets do have, and tend to earn over time, a targeted return. We don't believe that those assets belong in a utility rate base.

A. We urge that the Commission disallow this portion of rate base, resulting in a reduction to allowed rate base of $200.8 million, which is the amount of EBCAP remaining in Con Edison's mitigated request after the $44.8 million reduction reflected in the July 25 preliminary update.

Q. Does this conclude the Panel's testimony?

A. Yes, it does.