STATE OF NEW YORK
DEPARTMENT OF PUBLIC SERVICE

CASE 07-E-0949 - Proceeding as to the Rates, Charges, Rules and Regulations of Orange and Rockland Utilities, Inc. for Electric Service.

STATEMENT OF THE DEPARTMENT OF PUBLIC SERVICE STAFF IN SUPPORT OF JOINT PROPOSAL

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BACKGROUND

On August 10, 2007, Orange and Rockland Utilities, Inc. ("Orange and Rockland" or "Company") filed tariff leaf revisions designed, inter alia, to increase its electric revenues by approximately $47.8 million for the Rate Year July 1, 2008 through June 30, 2009 (Rate Year 1).[1] The Company projected the impact of the increase on the more than 200,000 customers that it serves in Orange and Rockland Counties would be approximately 25.5% on delivery rates, with a bill impact of about 7.8%. As part of its rate filing, Orange and Rockland included an alternative three-year rate plan recommending increases of $10.0 million, 1.6% bill impact (5.3% delivery rate increase) for the Rate Year July 1, 2009 through June 30, 2010 (Rate Year 2) and $5.1 million, 0.8% bill impact (2.7% delivery rate increase) for the Rate Year July 1, 2010 through June 30, 2011 (Rate Year 3).[2] The primary rate drivers cited by Orange and Rockland in support of the proposed $47.8 million Rate Year increase, relate to costs associated

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1 By orders of the Commission, operation of the tariff amendments designed to effectuate the rate increase was suspended through July 6, 2008. Case 07-E-0949, Order Suspending Major Rate Filing (issued August 27, 2007) and Further Suspension of Major Rate Filing (issued December 20, 2007).

2 The Company noted that it would not waive its right to file for new rates if the Commission adopts a three-year rate plan providing for rates that Orange and Rockland deems unreasonable.

with new plant, labor, pensions and other post employment benefits (OPEB), manufactured gas plant (MGP) remediation, research and development (R&D) and recovery of deferred expenses.

Staff of the Department of Public Service ("Staff") conducted extensive informal and formal discovery of the Company's rate proposal. Staff also had technical meetings with Company staff to review specific programs and projects proposed. Staff's investigation and issuance of discovery requests began at the inception of this proceeding and continued throughout the period of negotiations.

As a result of the prehearing conference held in this case on October 11, 2007, a litigation schedule was adopted which provided for, inter alia, the filing of Staff and intervener testimony and exhibits on December 15, 2007, the filing of Company rebuttal testimony and exhibits on January 11, 2008, evidentiary hearings and public statement hearings February 4-6, 2008, Initial Briefs to be filed February 29, 2008, and, Reply Briefs to be filed March 12, 2008.[3] In a November 29, 2007 email, Administrative Law Judge Lynch clarified that the filing date for Staff and intervener testimony and exhibits was December 19, 2007, rather than December 15, 2007. In accordance with the Judge Lynch's directive, on December 19, 2007, Staff filed testimony and exhibits with the Commission's Secretary in response to Orange and Rockland's rate filing for Rate Year 1; service was also made to the parties on the Commission's Active Parties list. Staff recommended a one-year case allowing the Company a revenue increase of $17.497 million. No other parties submitted testimony or exhibits in this case. By letter dated December 20, 2007, Staff disclosed the individuals designated to serve as Trial Staff for this case (16 NYCRR §4.3(d)).

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[3] Case 07-E-0949, Ruling Adopting Litigation Schedule and Memorializing Other Procedural Requirements (issued November 15, 2007) ("November 15th Ruling").

On January 11, 2008, the Company filed rebuttal testimony and exhibits, reducing its revenue requirement increase to $43.7 million to reflect, in part, the impact of the Commission's October 2007 rate order,[4] updated sales and revenue figures, operation and maintenance (O&M) adjustments (including recommendations for additional employee positions), rate base changes and updates (capital expenditures due to the Mirant Lovett Generating Station closure and capital projects in-service dates), depreciation and tax updates.

Evidentiary hearings on the rate filing took place on February 5th and 6th.[5] Active parties entering appearances at the hearings included the Company, Staff, the Consumer Protection Board (CPB), County of Rockland and Rockland County Attorney, and, the Small Customer Marketer Coalition (SCMC) and Retail Energy Supply Association (RESA) and the Town of Ramapo. The testimony and exhibits of Company and Staff witnesses were presented for cross-examination and admission into the record.

Following exploratory discussions among the parties, pursuant to the Commission's Rules and Regulations (16 NYCRR §3.9), Orange and Rockland filed a notice of impending negotiations (notice) with the Commission's Secretary on February 13, 2008 and served a copy on each of the parties on the Active Parties List. In accordance with the notice, settlement negotiations began on February 21, 2008 and continued on several dates thereafter. All negotiation sessions were held in Albany at the Department of Public Service offices; parties were permitted to participate in person or by telephone. Participants at all or some of the negotiation sessions included the Company; Staff; CPB; County of Rockland and Rockland

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[4] Cases 06-E-1433 and 06- E-1547, Orange and Rockland Utilities, Inc., Order Setting Permanent Rates, Reconciling Overpayments During Temporary Rate Period, And Establishing Disposition of Property Tax Refunds (October 2007 Order).

[5] Case 07-E-0949, Notice Changing Initial Date of Evidentiary Hearing (issued January 29, 2008).

County Attorney; Mirant New York, Inc.; SCMC and RESA; Strategic Energy, LLC; New York State Electric & Gas Corporation and Rochester Gas & Electric Corporation. In light of the parties' periodic reports of negotiation progress and the need for additional time to conclude negotiations, an extension of the time to reach an agreement was allowed and the post-hearing briefing schedule (schedule for filing briefs in the event of no agreement) was revised. The parties used their best efforts to reach a resolution on each of the issues raised by the negotiating parties. Despite the inability to reach an agreement on a couple of relatively minor issues, Staff concluded that it was in the public interest to move forward to a final agreement on the remaining issues.

In a conference call on March 27, 2008, the parties informed Judge Lynch that an agreement was reached concerning a multi-year rate plan for Orange and Rockland's electric operations. The schedule for the remainder of the case was established at that time, the schedule providing for the filing of: an executed Joint Proposal by April 18, 2008; Company testimony and exhibit updates for the second and third rate years, and, statements in support or opposition of the Joint Proposal by April 25, 2008; reply statements of the parties by May 2, 2008; Staff and intervenor testimony and exhibits in response to Orange and Rockland's second and third rate year revenue requirements on May 9, 2008. Hearings on the updates and Joint Proposal were planned for the week of May 22, 2008. At the request of Staff, the date for filing of the statements in support or opposition was extended to April 30, 2008; the date for reply statements was moved to May 7, 2008.

On April 18, 2008, the Joint Proposal executed by the Company and Staff was filed with the Commission's Secretary.

OVERVIEW OF JOINT PROPOSAL

As discussed in greater detail below, and in the various sections of this Statement in Support, the Joint Proposal contains a number of provisions designed to protect and benefit ratepayers, maintain and improve Orange and Rockland's system reliability and ensure its economic viability, and, to the extent feasible and appropriate, provide a resolution to other issues raised by interveners. One of the key provisions of the Joint Proposal (Section III.1) is the recommended three-year term of the rate plan (Rate Plan), covering the 12-month periods ending June 30, 2009 (Rate Year 1), June 30, 2010 (Rate Year 2) and June 30, 2011 (Rate Year 3), respectively. To mitigate the impact of the revenue increases, $23.2 million for Rate Year 1; $9.5 million for Rate Year 2 and $4.0 million for Rate Year 3, the parties agreed that a levelization of the increases to approximately $15.6 million per year would be appropriate.[6] The levelization of the rate increases, without the Energy Efficiency surcharge, will result in average bill increases in each Rate Year of about 2.5%.[7]

The rates set for Orange and Rockland's electric operations for the three rate years are based on an allowed return on equity (ROE) of 9.4% and a 48% common equity ratio (Joint Proposal, Appendix A, p. 3). Rate payers will share 50% of any earnings above a 10.2% ROE and 75% of any earnings in excess of an 11.2% ROE. A provision has been incorporated in the Joint Proposal to direct disposition of the customers' share of the excess earnings to offset

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6 To ensure that rates at the end of the Rate Plan are not higher than they would be absent levelization of the rate increases, the $15.6 million for Rate Year 3 is composed of two parts ($5.7 million base rate increase and a surcharge of $9.9 million to be recovered through the Energy Cost Adjustment (ECA).

7 The proposed $4 million surcharge is outlined in Joint Proposal, Section III.21. The surcharge offers the benefit of establishing initial or "start up" funding for the programs the Commission may adopt in Case 07-M-0548, Proceeding on Motion of the Commission Regarding an Energy Efficiency Portfolio Standard.

certain expense deferrals, pension and OPEB, energy efficiency program costs, etc.) (Joint Proposal, Section III.11). Section III.12 of the Joint Proposal delineates the agreed to reconciliations, which are consistent with the Commission's policy. Property taxes are reconciled (actual to forecast) with the Company recovering 100% of the increase over forecast due to tax rate changes and 86% of the increase over forecast due to assessment changes (Joint Proposal, Section III.12.C).

Section III.12.A of the Joint Proposal addresses the Company's transmission and distribution system plans and expenditures during the three years of the Rate Plan. This provision allows Orange and Rockland the ability to modify its project plans as needed, but gives the parties the option to monitor project progress and related expenditures. The provision also captures, for the benefit of the ratepayers, any shortfall in net plant balances or expenditures from the cumulative targets at the end of the Rate Plan.

In anticipation of the Commission's adoption of energy efficiency programs in the EEPS Proceeding, the Joint Proposal (Section III.21) recommends implementation of a $4 million annual surcharge to provide "start up" funding for such programs.

Section III.26 of the Joint Proposal reflects the agreement that Orange and Rockland will withdraw the two pending lawsuits it filed challenging the Commission's setting of temporary and permanent rates in Case 06-E-1433.[8] The Joint Proposal also resolves an equally contentious issue in Case 06-E-1433, the Revenue Decoupling Mechanism (RDM). Section III.10 of the Joint Proposal reflects the parties' agreement for Orange and Rockland to implement an RDM based on total revenues by customer class.

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[8] Matter of Orange and Rockland Utilities, Inc. v. Public Service Commission of the State of New York, Index No. 5067-07, RJI #01-07-ST7846 and Matter of Orange and Rockland Utilities, Inc. v. Public Service Commission of the State of New York, Index No. 1264-08.

Other significant provisions of the Joint Proposal include a change to remove the credit and collections charge from the Merchant Function Charge and include it in Purchase of Receivables (Joint Proposal, Section III.3.E). Consistent with the Commission's Unbundling Order,[9] Orange and Rockland will implement rate design and unbundling changes applicable to the Merchant Function Charge (MFC) and billing and payment processing (Joint Proposal, Section III.7 and Appendix D).

Finally, the parties agreed to modifications to the reliability performance mechanisms (CAIDI and SAIFI), increasing the negative revenue adjustment applicable to each target (Joint Proposal, Section III.19 and Appendix M). The Joint Proposal contains additional provisions that are self explanatory and need not be discussed herein.

STANDARD OF REVIEW

For the terms of a settlement agreement to satisfy the Commission's standards of review and be adopted, they must be just and reasonable and in the public interest.[10] Determining whether the public interest is satisfied requires consideration of the following: whether the settlement strikes a fair balance among the interest of the ratepayers and investors and the long-term soundness in the utility; whether the settlement compares favorably with the reasonable range of results that a fully litigated case might yield; the settlement's consistency with law and the regulatory, economic, social and environmental policies of the Commission and the State; and whether there exists a rational basis for the settlement. Additional weight is given

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[9] Case 00-M-0504, Proceeding on Motion of the Commission, Statement of Policy on Unbundling and Order Directing Tariff Filings (issued August 25, 2004).

[10] Cases 90-M-0225 and 92-M-0138, Opinion, Order and Resolution Adopting Settlement Procedures and Guidelines, Opinion No. 92-2 (Settlement Guidelines) (issued March 24, 1992).

to settlements that are entered into by normally adversarial parties. Finally, a review of the agreement includes an assessment of the completeness of the record.[11]

The Joint Proposal entered into in resolution of this proceeding fully satisfies the Commission's Settlement Guidelines and provides substantial benefits and protections to both ratepayers and the Company. It was the product of extensive negotiations among parties with different or diverging interests. Overall, the Joint Proposal creates a long-term Rate Plan that minimizes the impact of needed rate relief and provides customers with rate certainty during a time of increasing economic uncertainty. The Rate Plan assures the Company of a sufficient revenue stream to manage daily business operations and make substantial system improvements that will assist in maintaining and improving its electric system's reliability. The various reconciliation provisions in the Joint Proposal were crafted, consistent with Commission practice, to limit ratepayer exposure to the actual and reasonable level of expenditures that should be recognized for recovery. As a result, the Joint Proposal clearly balances the interests of ratepayers, the Company and its investors.

Staff also believes that the evidentiary record of this case provides a solid foundation for the Commission's adoption of the Joint Proposal's three-year Rate Plan, limiting the need for record augmentation to only a few issues at most. As discussed below and indicated on the Attachment hereto (page 1 of 2), the stipulated $23.29 million revenue requirement for Rate Year 1 (before levelization) closely approximates the level that could be expected from a fully litigated case. The first year revenue requirement comports with Staff's prefiled position ($17.5 million) as adjusted, at the February evidentiary hearings (to $19.33 million) for corrections and known changes and thereafter adjusted to factor in the revenue requirement

[11] Id. at 30.

impact resulting, for the most part, from: the agreed 9.4% ROE; the 2008 pension/OPEB Actuary Update; the Bonus Depreciation provision in the Federal Economic Stimulus Act of 2008;[12] a recent change in special franchise taxes; employee staffing levels; and, a carrying charge adjustment (Middletown Tap). The Rate Year 2 and 3 revenue requirements are, with limited exceptions, for expenses associated with inflation, limited to additional staffing and a recognition of expected capital program expenditures offset by sales growth. Thus, although the Company and Staff will be augmenting the record on Rate Years 2 and 3, a rational basis already exists for the Joint Proposal programs, expenses and revenue requirements for each of the rate years.

JOINT PROPOSAL PROVISIONS

Rate Plan Term and Revenue Increases

As noted previously, the Joint Proposal establishes a three-year Rate Plan covering the 12 months ending June 30, 2009 (Rate Year 1), June 30, 2010 (Rate Year 2), and June 30, 2011 (Rate Year 3). In essence, the Joint Proposal adopts revenue increases of $23.287 million in Rate Year 1 (Appendix A, p. 1), $9.526 million in Rate Year 2 (Appendix A, p. 4) and $4.057 million in Rate Year 3 (Appendix A, p. 5). However, in order to mitigate the ratepayer impact associated with the increase in Rate Year 1, the revenue increase is phased over the three-year term of the Rate Plan, resulting in recommended increases of $15.591 million in each of the three rate years. The revenue increase in Rate Year 3 bills will include a $9.903 million surcharge to be recovered through the Energy Cost Adjustment. The $5.668 million base rate increase and overall bill impact of the increases equates, on average, to approximately 2.5% per rate year.

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12 Public Law No. 110-185.

The revenue requirement contemplated by the Joint Proposal compares favorably with a litigated outcome for the rate year ending June 30, 2009 (Rate Year 1). As shown on the Attachment to this Statement in Support of the Joint Proposal, Staff's filed case of $17.497 million (Exhibit 23, Schedule 1), adjusted for corrections and updates accepted at hearings, contemplated a rate change for Rate Year 1 of $19.333 million.[13] The $3.954 million increase in the first year revenue requirement from Staff's $19.333 million hearing recommendation to a rate change of $23.287 million, is comprised of a limited number of elements. Principal drivers behind the Joint Proposal's Rate Year 1 increase amount, as compared to the level in Staff's litigated case, are the increase in ROE from 8.9% to 9.4%, the adjustment to Pension and OPEBs costs to reflect the impact of the January 2008 updated actuary studies, adjustments to reflect the federal tax benefits (bonus depreciation) associated with the Economic Stimulus Act and increased property taxes related to the State Board of Real Property Services special franchise assessment changes that are largely offsetting to the bonus depreciation benefits. Other minor adjustments include changes to the Middletown Tap Revenues to reflect the Company's Energy Cost Adjustment filing effective May 1, 2008 and modifications to Staff's recommended employee level.

The Joint Proposal, in essence, adopts revenue increases of $9.526 million in Rate Year 2 and $4.057 million in Rate Year 3. The operating results for Rate Year 2 and Rate Year 3 were developed using Rate Year 1 as the base for the projections. The sales forecast for Rate Year 2 and Rate Year 3 contemplate a growth rate of 1.7%. The sales volumes are set forth in

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[13] Staff's filed case incorporated a recommendation (Exhibit 54, p. 5) to remove two new requested positions in the energy services/retail access department as premature, updating health care costs for 2008 premium costs (Tr. 421), adjusting expense to reflect a three year average of sundry uncollectible net write-offs (Tr. 421) and an update to prepaid property taxes included in rate base (Tr. 427).

Appendix B of the Joint Proposal. The total number of customers is forecast to grow at an average annual rate of 0.8%. Generally, operating and maintenance expenses for Rate Year 1 were escalated by the GDP deflator of 2.1% per year. As set forth in Appendix L of the Joint Proposal, Orange and Rockland is allowed a Direct Labor increase for seven additional employees in Rate Year 2 and two additional employees in Rate Year 3, as well as a wage growth rate of 2.50% per year inclusive of a 1% productivity adjustment. Property Taxes were escalated using the Company's historical average growth rate of 1.27%. The average rate base for each rate year was increased to reflect the Company's construction budget net of accrued depreciation as projects were closed to plant in service.

The Joint Proposal seeks to minimize and balance, to the extent practicable, the need for rate relief to cover escalating expenses, the Company's increasing workload and the financial impact of the rate increases on customers.

Cost of Capital

The Joint Proposal's revenue requirement reflects a 7.69% overall cost of capital, including a 48.0% equity ratio and an authorized ROE of 9.4% (Joint Proposal, p. 3, Appendix A). The Company's testimony proposed an 8.79% rate of return based on a 48.59% common equity ratio and an 11.5% ROE for a multi-year rate plan (Exhibit 58, E-8, Schedule 1), and argued that an 11.2% ROE is reasonable for a one-year case (Tr. 675).[14] In contrast, Staff testified that a more appropriate rate of return for Orange and Rockland would be 7.45%, including a 47.93% common equity ratio and an 8.9% ROE (Tr. 760). The 7.69% cost of capital contained in the Joint Proposal is a reasonable outcome given the modest increase in the Company's business risk, the multi-year term of the rate plan, and the current interest rate

[14] No adjustments were made to the cost rates for the one-year case.

environment. The 48% equity ratio is also reasonable given the long-term nature of the rate plan and the potential impact of the sale of the parent's non-regulated generating assets and the subsequent retirement of debt on the consolidated capital structure (Tr. 550).

The Joint Proposal's recommended 9.4% multi-year Rate Plan ROE is 50 basis points higher than Staff's 8.9% ROE testimony recommendation and 210 basis points lower than the Company's pre-filed 11.5% ROE position (Tr. 760). The 9.4% ROE is fair and reasonable, particularly given the recent developments which have increased risk and the particular dynamics of the multi-year Rate Plan. To begin with, risk in the broader credit markets has been increasing since Staff's pre-filed testimony was submitted, as evidenced by the 9.1% ROE that the Commission authorized for Consolidated Edison using the same Staff ROE methodology.[15] And, Orange and Rockland's own business risk has increased; its senior unsecured debt securities have very recently been downgraded by Standard & Poor's and their outlook was revised from stable to negative by Moody's Investors Service.

One indication of the increased risk in the credit markets is the prospective cost of issuing new debt securities. While benchmark Treasury rates haven't changed significantly, the yield spreads required of corporate debt issuers has increased appreciably. For instance, Staff's testimony was predicated on the fact that the yield spread required for new 10-year "A" rated utility obligations was 153 basis points above the ten-year treasury yield, while the yield spread for new 30-year debt was 164 basis points (Tr. 784). Currently, based upon the actual cost rates incurred by similarly-rated Con Edison in its April 7, 2008 issuance of $600 million of ten-year debt securities and $600 million of thirty-year obligations, spread requirements have widened and are now 230 basis points for 10-year debt and 240 basis points for 30-year debt. This

[15] Case 07-E-0523, Consolidated Edison Company of New York, Inc. – Rates, Order Establishing Rates for Electric Service (issued March 25, 2008).

development has increased the likelihood that Orange and Rockland's actual interest costs during the Rate Plan will exceed the 6.19% weighted cost of debt forecast that Staff testified to (Tr. 789) and was agreed to by the parties in the Joint Proposal (Appendix A, p. 3).

The Joint Proposal (Section III.15) allows for the reconciliation and deferral of interest and swap costs related to its two issues of tax exempt debt. In the past this debt has consistently been among the lowest cost sources of financing for the Company. Two unrelated events, however, have called into question the ability of the Company to leave this debt outstanding. The first is the retirement of the Lovett Plant and the outstanding debt obligation financings for pollution control equipment. The second is the sub-prime mortgage crisis, which has unsettled the variable rate tax exempt debt market. Each of these may result in the retirement or refinancing of some or all of the tax exempt debt. It is, therefore, appropriate to recognize these uncertainties which are beyond the Company's control, and to allow the true up of its interest and swap costs to the levels reflected in the 6.19% weighted cost of debt determination.

Finally, with respect to the risks inherent in a multi-year plan, it is common practice to add a modest premium to the allowed ROE to account for a utility's risk that much of its non-commodity O&M expenses, such as labor costs and health care costs, will increase faster than is expected over the term of the rate plan. Such a premium is reasonable given that these risks will be borne by the Company's shareholders. Moreover, the premium in this case, which is no more than 30 basis points, is consistent with the historical stay-out premiums allowed.[16]

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[16] Only a few months ago the Commission established a ROE for Long Island Water that included a 30 basis point stay-out premium. Cases 07-W-0508 and 05-W-0339, Long Island Water Corporation, Order Determining Revenue Requirement and Rate Design (issued March 5, 2008).

Earnings Sharing

The Joint Proposal (Section III.11) provides that on an annual basis, earnings in excess of the 10.2% ROE earnings sharing threshold will be deferred. Earnings sharing between the Company and customers is calculated on a cumulative basis. At the end of the three year term, earnings between 10.2% and 11.2% will be shared equally between the Company and customers, while customers will receive 75% of any earnings in excess of 11.2%. The customer's allocated share of deferred earnings will be applied to reduce deferred pension and/or OPEB costs, and/or offset against other deferred debits on the Company's books. The equity ratio used in the earnings sharing mechanism will be the lesser of the Company's actual average common equity ratio or 50%. Officer restricted stock payments, any earned reward or penalty related to property tax refunds, or other incentive mechanisms made effective during the term of the rate plan pursuant to an Order of the Commission, will be excluded from the calculation.

The earnings sharing mechanism provided in the Joint Proposal is an important part of any multi-year plan. It provides Orange and Rockland with a strong incentive to minimize costs and improve efficiencies, while allowing the Company's customers to share in savings produced by these efforts. And, if the Company exceeds the expectations of financial performance contemplated in the Rate Plan, the sharing mechanism ensures that customers receive a fair share of the benefits associated with that performance while preventing the Company from receiving an inappropriately large return. Further, this mechanism encourages the Company to control its costs, thus increasing the likelihood of lower-than-forecasted expenses at the end of the Rate Plan and when rates are reset.

The structure of this earnings sharing provision is comparative to that adopted by the Commission for the Company's gas operations.[17] However, the size of this dead-band is tighter than that contained in the existing gas rate plan. Its allocation of benefits and risk is appropriate and, therefore, should be adopted.

Reconciliations and Deferrals

As will be discussed more fully in the next few sections of this Statement in Support, Section 12 of the Joint Proposal identifies the cost categories that will be reconciled annually and for which the Company may use deferral accounting to account for differences between actual costs and levels provided for in the Rate Plan. These costs are Transmission and Distribution Capital Expenditures, Environmental Remediation, Property Taxes, Pension/OPEB Expenses, Research and Development Costs, Low Income Program, Asbestos Workers' Compensation Reserve, Contractor Tree Trimming and 263A Deferred Taxes and Deferred Bonus Depreciation. As described below, each of these costs will be reconciled based on the levels set forth in Appendices F, G and I over the three year term on the rate plan and each of these reconciliations is consistent with Commission general practice.

Transmission and Distribution Capital Expenditure

The Joint Proposal balances parties' interests by establishing a method to reconcile capital expenditures up to those contemplated by the Company's filing (Section 12.A), while addressing Staff's concern that the Company may not in fact realize its forecasted capital expenditures and associated net plant additions. Simply stated, Orange and Rockland will defer the revenue requirement of any shortfall on the amount by which the Company's actual

[17] Case 05-G-1494, Orange and Rockland Utilities, Inc. – Gas Rates, Order Establishing Rates and Terms of Three-Year Rate Plan (issued October 20, 2006).

expenditures for capital programs, over the term of the rate plan, results in an average net plant that is less than the average plant included in rate base up to the average plant targets, presented in Appendix F.

As discussed in more detail below, the Joint Proposal (Appendix H) adds reporting requirements that will allow Staff and other interested parties to review aggregate actual capital expenditures compared to the capital program targets.

Environmental Remediation

Orange and Rockland and its predecessor companies manufactured coal gas and water gas for local use prior to the introduction of natural gas in the 1940's. The Company has identified seven sites at which it or its predecessors operated MGP facilities and pursuant to two Consent Orders entered into with the New York State Department of Environmental Conservation, Orange and Rockland has been actively investigating these sites (Tr. 282). Orange and Rockland's West Nyack Operating Center also remains listed on the New York State Inactive Hazardous Site Registry (Tr. 283). The Company is currently allowed reconciliation or deferral accounting for MGP site investigation and remediation costs.

The Joint Proposal (Section III.12.B) continues deferral accounting for the treatment and recovery of environmental remediation costs and provides that if the level of actual expenditures varies in any rate year from the levels provided for in rates, and set forth in Appendix I of the Joint Proposal, such variations will be deferred and recovered from or credited to customers. Deferred environmental remediation balances varying from the level reflected in rate base will accrue a carrying charge cost at the pre-tax rate of return. Deferred balances will be reduced by accruals, insurance recoveries, associated reserves and deferred taxes, and will continue to be allocated between the Company's electric and gas operations on a 70.75%/29.25% basis.

Consistent with the Commission's order in the Company's last case,[18] Staff acknowledged the continuation of deferral accounting for these costs (Tr. 406). Considering the potential size of the rate increase, Staff's one-year case recommended that the $4.111 million ($6.852 million minus $2.741 million) Manufacturing Gas Plant site remediation rate allowance reflect a five-year amortization of the June 30, 2006 deferred balance plus the projected spending from July 1, 2006 through June 30, 2009 (Tr. 393-394). Appendix I of the Joint Proposal reflects Staff's recommended rate allowance for the first rate year. The signatory parties have agreed that the allowance increase for Rate Years 2 and 3 are sufficient to provide a five year amortization of expenditures expected to be incurred in each of those years. The deferral and recovery of MGP expenses is consistent with Commission policy. And, the amortization of these expenditures over five years mitigates the economic impact on ratepayers.

The Joint Proposal also requires that the Company, within 90 days, file a status report for each MGP site as of July 1, 2008, outline the projected expenditures at each site that are reflected in the revenue requirement for each rate year and, summarize the activities to be conducted at each site during the following calendar year. In addition, after the end of each calendar year, the Company will provide a report that describes the investigation and remediation activities and itemize actual expenses recorded, that occurred at each site during the previous calendar year and summarizes the activities to be conducted at each site during the following year. This provision of the Joint Proposal will allow interested parties to monitor remediation

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[18] Case 03-E-0797, Orange and Rockland Utilities, Inc. – Electric Rates, Order Adopting the Terms of a Joint Proposal (issued October 23, 2003).

progress and expenditures to ensure that the remedial activities are performed and appropriate expenditures are made.

The Joint Proposal's treatment of MGP remediation activities and cost recovery are reasonable and should be adopted by the Commission.

Property Taxes

The Joint Proposal (Section 12.C) includes a reconciliation mechanism for property taxes. The reconciliations for property taxes are limited to variances in any rate year from the levels provided for in rates and set forth in Appendix G. Variations due to tax rate changes will be deferred and fully recovered from or credited to customers, while 86% of any variation due to assessment changes will be deferred and recovered from or credited to customers.[19]

Orange and Rockland forecasted its updated electric property taxes to be $18.359 million for Rate Year 1 and proposed full deferral of the variation between actual and allowed property taxes. Its forecast methodology started with the development of an average escalation factor to apply to the latest known tax information and apportioned it over the appropriate tax year to determine the projected property tax expense in the rate year (Exhibit 27, pp. 20-21, Exhibit 43, p. 9). The Company then made certain normalizing adjustments which included assessment tax changes in connection with certain construction. The forecast was further updated to reflect the Company's 75% portion of property taxes relating to the Autobank Transformer at the Bowline Station (Tr. 307-309). Because its filing related only to a one year

[19] The Company advocated a sharing mechanism for property tax refunds and assessment reductions that would establish an 86%/14% customer/Company sharing of benefits (Tr. 290). Since Staff's filed case was limited to one year, no property tax sharing recommendation was made.

case, Staff rejected the need for a reconciliation mechanism. Staff agrees that the estimated taxes of $194,000 on this transformer equipment for the rate year are proper and should be adopted.

Staff accepted the Company's escalation factor but disagreed with the Company's normalizing adjustments for additional taxes of $358,000 related to assessment tax changes in connection with certain construction.

The Joint Proposal (Appendix G) reflects the Staff's testimony for establishing the level of property taxes in rates and takes into account an additional update to reflect the Office of Real Property Services' (ORPS) increase to special franchise taxes ($598,000), producing a target Rate Year I expense level of $18.599 million. The amounts for RY2 and RY3 escalate at 1.27% annually to account for likely increases in taxes. The limited reconciliation of property taxes for rate changes provides the Company with an incentive to minimize property tax expense in the area (assessment level) in which it has some control.

The Joint Proposal also provides that any property tax refunds resulting from the Company's efforts will be shared 86%/14% between customers and shareholders. Incremental costs incurred by Orange and Rockland to achieve the refunds will be deducted from the refunds before the sharing is applied. The deferral, recovery and retention of property tax refunds, subject to a showing of Company efforts, is reasonable and provides the Company with a further incentive to contest high assessments. A similar sharing mechanism was adopted by the Commission in Orange and Rockland's last gas rate plan.[20]

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[20] Case 05-G-1494, supra.

Pensions/OPEBs

Orange and Rockland will continue to adhere to the Pension Policy Statement,[21] including deferring any differences between actual pension and OPEB expenses and the level allowed in rates (Joint Proposal, Section 12.D). The level of pension and OPEB expenses allowed in rates, set forth in Appendix G, is based on the updated January 2008 actuarial studies. The Joint Proposal also reflects Staff's 60-month recovery period, for the projected deferred Pension and OPEBs balances at the start of Rate Year 1, and reflects Staff's offset for the pass-back of deferred Medicare tax benefits over 36 months (Appendix I) to help mitigate the overall rate increases in the Joint Proposal (Tr. 386). In addition, the amortization period for the deferred OPEB Transitional Obligation balance maintains the existing amortization period which extends through to December 31, 2012, a result that neither the Company nor Staff proposed to modify (Tr. 386-389). Thus, the treatment of pension and OPEBs provision in the Joint Proposal is just and reasonable and has a record basis for adoption.

Research and Development Costs

The Company is currently allowed reconciliation or deferral accounting for research and development costs. Under the Joint Proposal (Section 12.E) and pursuant to the Commission's 1978 Technical Release, the Company will continue to reconcile its actual research and development expenses to the level allowed in rates as set forth in Appendix G.

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[21] Case 91-M-0890, Commission Proceeding – Accounting and Ratemaking Treatment for Pension and OPEBs, Statement of Policy and Order Concerning the Accounting and Ratemaking Treatment for Pensions and Postretirement Benefits Other than Pension (issued September 7, 1993).

Low-Income Program

As noted in Section 20 of the Joint Proposal, Orange and Rockland has a low income program that was recently authorized by the Commission in its October 2007 Order.[22] Section 12.F of the Joint Proposal continues the existing accounting for this program which allows the Company to reconcile actual payments to low income customers to the level allowed in rates as set forth in Appendix G.

Asbestos Workers' Compensation Reserve

The Commission October 2007 Order approved the use of reserve accounting for asbestos claims paid by the Company to former power plant employees in order to protect the interests of both the Company and ratepayers.[23] Consistent with that accounting provision, Section 12.G of the Joint Proposal states that if the actual asbestos claim payments to the Company's former employees varies on a cumulative basis over the term of the Rate Plan from the levels provided in rates (set forth in Appendix G), such variation will be deferred and recovered from or credited to customers. The amount of deferred asbestos claims being amortized over the term of the agreement is set forth in Appendix I. The level of claim payments and amortization of deferred balances provided in rates, set forth in Appendices G and I, and the continued use of reserve accounting, are consistent with the Staff testimony. This proposal continues to protect the interests of both the Company and ratepayer.

Contractor Tree Trimming

In Case 06-E-1433, the Company proposed an expansion to its transmission and distribution danger tree programs. The Commission, in its October 2007 Order, adopted the

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[22] Cases 06-E-1433 and 06-E-1547, supra.

[23] Id., pp. 20-21.

Company's budgeted amount for contractor tree trimming and directed that any shortfalls would be deferred for customer benefit.[24]

Orange and Rockland advocated for an expansion of its Vegetation Management Initiatives program by targeting danger trees both on the distribution and transmission system historically shown to be the cause of many of the Companies electric outages (Tr. 119-121). The Company proposed additional expenditures to cover the more stringent New York State transmission line vegetation management requirements.[25] In total, the Company's projected annual incremental costs for this program of $1.125 million (in addition to the historical spending amount of approximately $4.7 million) (Tr. 121).

Staff supported the additional funding requested by the Company to address the tree issues that continue to cause electric outages in Orange and Rockland's service territory (Tr. 208-209). However, because the program is new and has not fully ramped up, Staff recommended – consistent with the Commission's October 2007 Order - continuation of the deferral of any spending shortfall (Tr. 209).

Section 12.H of the Joint Proposal notes that the Company will defer for the benefit of customers any cumulative shortfall, over the term of the Rate Plan, between actual expenditures and the level provided for in rates (which are set forth in Appendix G) for the Company's transmission and distribution tree trimming program. This includes shortfalls in the danger tree program, and the levels provided in rates and set forth in Appendix G.

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24 October 2007 Order, p. 20.

25 Case 04-E-0852, Utility Transmission Right-Of-Way Management Practices, Order Requiring Enhanced Transmission Right-of-Way Management Practices By Electric Utilities (issued June 20, 2005).

The Joint Proposal contains this provision as Staff recommended. It provides a balance between increased costs and the provision of reliable services. The outcome is reasonable and should be adopted.

Deferred Income Taxes – 263A and Bonus Depreciation

As pointed out by Staff, the Company and the Internal Revenue Service have an open audit issue concerning the Section 263A tax deduction claimed by Orange and Rockland for the tax years 2002 and later (Tr. 408). The Company informed Staff that a resolution of this matter is pending for all tax years and may result in a disallowance of a portion of the tax deduction claimed by the Company (Exhibit 22, (AP-1), p. 12). The Joint Proposal simply establishes a 263A deferred tax balance that reflects the anticipated outcome of this dispute.

The Economic Stimulus Act will allow the Company to depreciate plant assets that are started and completed during the 2008 tax year using "bonus depreciation rates." The Joint Proposal captures the benefit, reflecting an estimate for the net average rate base deduction.

Section III.12.I continues the mechanism provided in Case 06-E-1433 which reconcile the actual 263A deferred tax benefit to the level reflected in rates. This section also provides a true-up of deferred taxes related to bonus depreciation in the economic stimulus package given that the Treasury Department has yet to issue guidance on the new tax break. The provision is consistent with Commission longstanding practice to encourage companies to pursue the lowest level of permissible taxes.

Additional Reconciliation/Deferral Provisions

The Joint Proposal (Section 12.J) continues other specific reconciliations and /or deferral accounting provisions that the Commission recently adopted in Case 06-E-1433; but, acknowledges that they may be modified or discontinued by the Commission. Treatment of any differences between actual revenues and authorized revenues as determined by the Company's RDM, as discussed in Section 10 of the Joint Proposal is also authorized. In addition, the Company will defer carrying costs for projects approved or required by the Commission that are incremental to the Company's capital additions. The use of reconciliation provisions is standard accounting practice for utilities.

Limitations on Deferrals

The Joint Proposal (Section 12.K) limits Orange and Rockland's ability to defer expenses as its earnings increase. Specifically, if the ROE is above 10.2%, the Company will apply up to 50% of its share of any such earnings to reduce net expenses deferred for later recovery. The application of excess earnings to reduce deferred expense balances constitutes a fair balancing of customers' interests and the incentive for the Company to cut costs. Similar limitations on deferrals have been approved for Orange and Rockland and Consolidated Edison in the past.[26]

Major Storm Costs

Orange and Rockland has a longstanding practice of reconciling actual major storm costs through reserve accounting. In the past the reserve was funded from available customer credits. In this proceeding the Company's revenue requirements provide funding for incremental storm costs of $6.7 million over the rate plan. As provided in Section 13 of the Joint Proposal, to the extent that, over the term of the rate plan, the Company incurs cumulative incremental storm damage costs in excess of $7.2 million, the Company will be permitted to defer the excess costs. To the extent that over the term of the rate plan, the Company incurs

[26] Case 05-G-1494, supra, and Cases 03-G-1671 and 03-S-1672, Consolidated Edison Company of New York, Inc. – Rates, Order Adopting the Terms of a Joint Proposal (issued September 27, 2004).

cumulative storm damage costs of less than $6.2 million, the Company will defer any variation less the $6.2 million for the benefit of customers. The provision is reasonable because it balances cost control and requirements for safe and adequate service.

Inflation Adjustment

Section III.14 of the Joint Proposal, under a limited number of circumstances, allows the Company to defer inflationary increases above a 4% inflation threshold to expenses set forth in Appendix J. It is essentially a three-part test. The deferral will be triggered on a cumulative basis over the three year term of the Electric Rate Plan, if inflation exceeds 12% over the three year period; actual expenses for the "pooled" items is greater than the inflation level; and, the Company is earning less than its allowed ROE. The deferral will also be based on the lower of inflationary increases above the inflation threshold or actual costs incurred by the Company for the expenses contained in the Inflation Pool. This provision of the Joint Proposal balances concerns over cost control incentives while providing the Company a measure of protection if the economy experiences "hyper" inflation during the term of the Rate Plan.

Direct Labor/Wages

Section 17 and Appendix L identifies and provides justification for additional new employees phased in over the three year rate plan.

Staff removed 21 new additional employees proposed for the rate year ending June 30, 2009 (Rate Year 1). Staff recommended that one meter system specialist be removed from the rate case and revisited in the context of the existing Advanced Metering Initiative (AMI) proceeding[27] (Tr. 206). The Joint Proposal adopts Staff's recommendation.

[27] Cases 94-E-0952, Competitive Opportunities Regarding Electric Service, 00-E-0165, Competitive Metering, and 02-M-0514, Competitive Metering for Natural Gas Service.

Two energy services/retail access department positions were removed as premature, because the energy efficiency programs for Orange and Rockland were not determined (Exhibit 54, p. 5). The Joint Proposal reflects an allowance for only one of the two positions requested, i.e. a customer program analyst (Appendix L, p. 7). Staff also removed two of three additional overhead linemen - sought by the Company related to its linemen attrition program. This was based on actual staffing levels for the twelve months ending August 31, 2007 (Tr. 372). The Joint Proposal provides an additional lineman, or a total of 2 positions, based upon updated staffing levels for the twelve months ending March 31, 2008 (Appendix L, p. 1). Staff further recommended deferring the implementation of the Company's Electrical Engineer Career Development Program (Tr. 418-419). The Joint Proposal defers two of the three positions sought for Rate Year 1, ending June 30, 2009.

The Staff filed case also removed thirteen positions sought in the Company's November 15, 2007 updated filing (Tr. 374). The positions include the following:

- Design / Drafting Department – 3 positions
- Line Technical Services – 2 positions
- Mobile Workforce Initiatives – 4 positions
- System Operations Services – 2 positions
- Labor Relations Administrator – 1 position
- Training Specialist – 1 position

There was no testimony supporting these positions. Staff, accordingly, determined that because no back-up information or justification for these positions was provided by Orange and Rockland at that time, Staff could not support these positions (Tr. 374).

For the rate year ending June 30, 2009, the Joint Proposal provides for only one of the thirteen new additional positions sought, a drafting technician, deferring other hires to Rate Years 2 and 3. Although allowance of the drafting technician position is arguably in contravention to the Commission's policy on test periods,[28] Staff believes that given the increased capital program budget in Rate Year 1, the new drafting position is justified and a waiver of the Policy Statement, to the extent necessary, should be granted.

Staff followed up on the Company's testimony, with additional detailed information requests, and held discussions with the Company personnel regarding the need for the positions. As a result, Staff determined that additional positions are justified. With the additional capital construction workload and new reliability programs occurring within the Orange and Rockland territory, additional resources are needed to support these efforts. And, with the attrition issue that continues to effect many departments within the organization, these positions are warranted. As a result, Staff determined that an additional nine new employee positions are warranted.

The Joint Proposal recommends an additional seven positions for Rate Year 2. Justification for the additional drafting technician and service layout estimator positions are provided for and addressed on Joint Proposal, Appendix L, p. 2. Page 8 of Appendix L explains the need for an additional labor relations administrator. Support for an additional mobile workforce administrator is included on page 10 of Appendix L. The need for two additional system specialists is addressed on pages 11 and 12; and, a supervisor position is supported on page 12. Finally, for Rate Year 3, the Joint Proposal provides for a training specialist and for a mobile workforce administrator, pages 9 and 10 of Appendix L, respectively. Given the

[28] Statement of Policy on Test Periods in Major Rate Proceedings, 17 NY PSC 25-R (issued November 23, 1977) (Policy Statement).

magnitude of the rate increase and the number of new positions granted, Staff believes that the Joint Proposal fairly addresses both the increasing work load and the need to mitigate rate impacts.

Rate Design & Unbundling

Delivery Rate Changes

In Exhibit 35, the Company's Embedded Cost-of-Service Study (ECOS), Orange and Rockland classified the total costs of line transformers as demand–related costs. In filed testimony, Staff proposed that a portion of line transformer costs should be classified as customer-related (Exhibit 98, pp. 9-10). Based on the historic book cost data provided by the Company, Staff determined, using the minimum–size method and 25 kVA transformers and smaller, that costs should be split 80% customer / 20% demand for overhead transformers and 72% customer / 28% demand for underground transformers (Exhibit 98, p. 11).

In its rebuttal testimony, the Company did not address Staff's proposed split for the underground transformer costs and recommended developing the minimum-size calculation for overhead line transformers using transformer sizes up to and including 15 kVA (Exhibit 36, p. 2). The Joint Proposal (Section II.3.D) uses the alternative methodology that the Company presented in its rebuttal testimony. Staff believes that the methodology is reasonable and a likely outcome of a litigated proceeding decision. Accordingly, it should be adopted.

Orange and Rockland proposed to realign delivery revenues at the current rate levels for each SC to reflect the entire deficiency and surplus indications from the Company's ECOS (Tr. 9). It would then allocate the net delivery revenue increase among the SCs in proportion to the relative contribution made by each SC to the realigned total delivery revenues. A mitigation adjustment was then made, on an overall revenue neutral basis, to limit the delivery increase percentage to any customer class to not more than 1.5 times or less than 0.5 times the overall delivery increase percentage for all classes (Tr. 46-47). In its testimony, Staff agreed with the Company's revenue allocation methodology (Exhibit 93, pp. 11-12).

The Joint Proposal contains the provision to reflect one-third of the deficiency and surplus indications in each of the three years of the Rate Plan. Staff considers this approach reasonable because it balances the need to fairly recover costs from each service class while limiting the potential negative impact that could result if the entire surplus or deficiency was reflected in one year.

In testimony, Orange and Rockland proposed to apply the overall revenue increase applicable to each service class to each of the class' charges (i.e., the customer, demand and usage charges, as applicable) (Tr. 15). Staff accepted the Company's rate design for the lighting classes SC 4, 5, 16 and the Company's proposed customer charge for SC 2 un-metered service (Exhibit 98, p. 16). Staff further proposed no increase to the customer charges for SC 2 metered service and the SC 20 customer class (Exhibit 98, p. 16). Lastly, Staff proposed an alternative rate design for SC Nos. 1, 19, 3, 9, 21 and 22 by which the customer charges would be increased by twice the overall percentage increase that would otherwise be applicable to that class (Exhibit 98, p. 15). The resulting customer charges better reflect the level of customer related costs as identified in the ECOS.

The Joint Proposal contains Staff's rate design. This rate design is reasonable because, in moving toward the ECOS Study recommendations, it will ensure that a greater level of fixed costs are recovered from fixed rate components, such as customer charges, and that volumetric usage charges better reflect primarily variable cost recoveries.

Merchant Function Charge (MFC) and Purchase of Receivables (POR) Discount

Orange and Rockland's current MFC is bifurcated, one MFC (which includes commodity procurement, information resources, education and outreach, uncollectibles, and credit and collections costs associated with commodity) that is paid by all full service customers, and another that is a credit and collections MFC paid only by retail access customers (Exhibit 44, p. 5). As noted in Staff's prefiled testimony, since the credit and collections recovery through the MFC applies solely to retail access customers, when the Company calculates the discount taken from its payments to Energy Service Companies (ESCOs) under its POR program it excludes the credit and collections portion of supply-related costs from that calculation (Exhibit 44, p. 6). In its testimony, the Company proposed to continue its bifurcated MFC (Exhibit 34, p. 7) and POR discount calculation methodology (Exhibit 34, p. 6, Tr. 42-43).

Staff proposed that Orange and Rockland establish a single MFC that would only apply to the bills of Orange and Rockland's full service customers, and that the Company's POR discount be increased to cover these costs (Exhibit 44, pp. 6-8). If the MFC on the full service bill remains the same, with no MFC applying to a retail access consolidated bill, the commodity portion of the bill (including commodity and MFC components) would reflect the true retail price of the commodity supply and all customers could use this value in comparing offers from competitors. ESCOs using the Company's consolidated billing would pay the Company for performing the credit and collections function for their customers and those ESCOs billing customers directly would handle their own credit and collections. Comparisons for consumers and explanations to them would be easier, since commodity supply and delivery service would be clearly delineated and not smeared and blurred together as they are now.

Sections III (3)(A) and III (3)(E) and Appendix D of the Joint Proposal memorialize the adoption of Staff's recommendations, where the bill formats showing the new MFC are shown. For the reasons stated above, customers are better off under the provisions of the Joint Proposal. Segregating out some commodity supply-related costs from the rest only makes sense when an itemization provides additional useful information to the customer. Separating some of these costs (credit and collections) and charging them to all customers, even when Orange and Rockland doesn't provide the commodity supply treats these costs in the same manner as delivery costs. This is contrary to logic and is confusing to customers trying to figure out what they pay for commodity supply and for delivery services. It also inhibits the ability of ESCOs to cast their services in the same light as each other and the utility. As well, utility customer service representatives must be able to explain why all commodity supply-related costs are not treated identically. Therefore, the proposed change to the MFC will be beneficial to customers, ESCOs, and the utility alike.

Similarly, in the POR process, the ESCO is subcontracting with the utility to perform certain functions that otherwise would be performed by ESCO back office personnel, including uncollectible bills, procurement costs, credit and collections activities. Therefore, the POR discount should be calculated to reflect all the commodity-related activities that the utility will be performing on behalf of the ESCO. This is designed to fully reimburse the utility for the costs that would otherwise be borne by the ESCO to do these functions for themselves. Putting the credit and collections costs in the POR and the single MFC would be consistent. In fact, once the credit and collections costs are no longer collected from customers in a separate MFC applicable solely to ESCO customers, Orange and Rockland must recover these costs from the

ESCOs in some manner and through the POR discount is consistent with recovery of similar costs in the MFC, such as uncollectibles.

All other utilities in the State with MFCs and PORs currently handle credit and collections in the way proposed in the Joint Proposal. The Commission addressed this issue in Consolidated Edison's last gas rate proceeding.[29] On page 9 of the Order it stated: "[t]he Company will also make changes to its competitive rates, specifically the gas Merchant Function Charge (which will now includes credit and collections/theft)…." In the recent proceeding, the Commission also adopted a change to make Consolidated Edison's electric MFC consistent with the one adopted for its natural gas business.[30]

By reflecting Commission policy and precedent, as well as improving customer understanding and reducing the confusion that would otherwise need to be addressed by utility customer service representatives, this portion of the Joint Proposal provides benefits to all stakeholders.

Bill Issuance and Payment Processing (BIPP)

The Joint Proposal adopts the creation of a single BIPP charge at the bill level. This change was proposed by both the Company (Tr. 12) and Staff (Exhibit 44, pp. 11-14) to be consistent with Orange and Rockland's last natural gas case.[31] Under the Joint Proposal (Section III.3.B and Appendix D) a customer would only pay Orange and Rockland for BIPP service when receiving both commodity and delivery from the utility for all commodity services taken.

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29 Case 06-G-1332, Consolidated Edison Company of New York, Inc. – Gas Rates, Order Adopting In Part the Terms and Conditions of the Parties' Joint Proposal (issued September 25, 2007).

30 Case 07-E-0523, supra, Order Establishing Rates for Electric Service, p. 180. The Order incorporated the Recommended Decision position (see, Case 07-E-0523, Recommended Decision (issued January 8, 2008), p. 200).

31 Case 05-G-1494, supra.

When the customer receives a consolidated bill from the company (a bill that includes ESCO charges for one or more commodities), the customer would not be charged by the utility for billing services. In this circumstance, the utility should collect a billing fee equal to the amount of the BIPP charge from the ESCO or ESCOs. Where there are two ESCOs serving the customer, one for electricity and one for natural gas, the ESCOs would each pay half of the BIPP fee.

There was no opposition to the recommendation to combine the BIPP charge into a single account or bill level charge that would appear solely on full service customers' bills. Treating the BIPP charge as a single charge related to the bill itself, rather than any particular commodity service, will result in less customer confusion than having two separate charges. Staff notes that the Commission has addressed this issue twice, once in regard to billing credits in the Billing Proceeding in an order issued in Cases 98-M-1343 and 99-M-0631[32] and again in the Competitive Opportunities Case.[33] In both proceedings the Commission ruled that the customer should only pay a utility for BIPP service when receiving both commodity and delivery from the utility for all commodity services taken. Further, in the last Consolidated Edison gas rate case, the Commission reaffirmed its position that the BIPP charge should be an account level charge, not a commodity level charge. Specifically, the Commission stated that "the Company will also make changes to its competitive rates, specifically ... and the account level billing and payment processing charge."[34]

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[32] Case 99-M-0631, Customer Billing Arrangements, and Case 98-M-1343, Retail Access Business Practices, Order Establishing Uniform Retail Access Billing and Payment Processing Practices (issued May 18, 2001).

[33] Case 00-M-0504, Provider of Last Resort, Retail Competitive Opportunities – Unbundling Track, Order Directing Submission of Unbundled Bill Formats (issued February 18, 2005).

[34] Case 06-G-1332, supra.

The BIPP provision of the Joint Proposal is consistent with provisions adopted for other utilities; benefits the utility, ESCOs, and customers because it eliminates confusion regarding how the BIPP charge is applied, reduces customer service efforts related to explaining the BIPP charge, provides a single price for comparison, and creates consistency between commodities for Orange and Rockland.

Market Supply Charge

In testimony, the Company proposed the continuation of the current MSC mechanism (Tr. 28). In its one-year case, Staff did not recommend any changes to the current MSC mechanism. However, in order to not preclude the potential modification of the MSC during the term of the three-year rate plan, Section III.9 of the Joint Proposal requires the Company to submit a study to Staff, within 90 days of the date of the Commission's order adopting the terms of the Proposal, that evaluates the advantages and disadvantages of revising its MSC so that it reflects the actual New York Independent System Operator (NYISO) day-ahead market prices that were in effect during each customer's billing period ("Revised MSC"). This provision allows the parties to recommend to the Commission any appropriate changes to the MSC during the term of the Rate Plan. This provision of the Joint Proposal is reasonable and should be adopted.

Revenue Decoupling Mechanism

The issue of implementation of an RDM and the appropriate methodology has been a major contention and unresolved issue since Orange and Rockland's last case.[35] Orange and Rockland advocated in this case for a revenue per customer (RPC) RDM, the same as it proposed in Case 06-E-1433 (Tr. 41). Staff recommended that a total delivery revenue by class

[35] Cases 06-E-1433 and 06-E-1547, supra.

reconciliation mechanism be implemented for each customer service classification, with the exception of the lighting, buyback, individually negotiated contract, and standby service classifications, rather than a revenue per-customer mechanism as proposed by the Company (Exhibit 98, p. 18). Staff also discussed a modification to its total revenue approach that could be considered by the Commission, by which Orange and Rockland could retain the marginal cost to serve new customers, rather than the class average revenue (Exhibit 98, pp. 21-22). On rebuttal, the Company dismissed Staff's modification, claiming a lack of data necessary to implement Staff's alternate approach (Tr. 70-71).

The Joint Proposal (Section III.10) resolves the outstanding issues and recommends that a total delivery revenue by class reconciliation mechanism be implemented, as proposed by Staff, without the modification presented by Staff. However, in addition to excluding certain classes of customers, the RDM, as defined in the Joint Proposal will also exclude economic development customers. The RDM, as contained in the Joint Proposal, is similar to that adopted by the Commission for Consolidated Edison electric operations,[36] and would be the likely result of a litigated proceeding. It should, therefore, be considered reasonable and adopted by the Commission.

Depreciation and Amortization of Reserve Deficiency

The Company proposed to change the average service lives of 34 of its electric and common plant accounts; 12 toward shorter lives and 22 toward longer lives (Exhibit 27, p. 7). Changes were also proposed to 22 net salvage factors, 20 of those toward higher negative net salvage factors or toward lower positive net salvage factors (Exhibit 27, p. 10) Orange and Rockland's cumulative changes increased its annual depreciation expense by $457,261, as of

[36] Case 07-E-0523, supra.

December 31, 2006 (Exhibit 27, p. 13). The Company's proposed depreciation parameters resulted in a Common Plant theoretical reserve surplus of $11.4 million, which the Company proposed to amortize over 15 years at $760,000 per year (Exhibit 27, p. 17).

Staff objected to Orange and Rockland's proposed average service lives for eight accounts; and Staff proposed alternative average service lives, reducing the Company's proposed annual depreciation expense by $599,739 (Exhibit 101, p. 3). This adjustment resulted in an overall $142,478 decrease to the Company's annual provision for depreciation expense, based on the December 31, 2006 point in time (Exhibit 101, p. 3). Staff concurred with the Company's Common Plant theoretical reserve surplus of $11.4 million (Exhibit 27, p. 17). However, Staff recommended a 5-year amortization period ($2.28 million per year). (Exhibit 101, p. 14)

The Joint Proposal (Section III.22 and Appendix N) contains depreciation rates based on the average service lives and salvage factors, as proposed by Staff (Exhibit 101, p. 14). The effect of the proposed depreciation factors increase the Company's proposed Common Plant computed reserve surplus by $0.5 million, resulting in a surplus of $11.4 million and a reserve variation percentage of 20.6%. Because the resulting reserve variation is outside a plus or minus 10% bandwidth, Staff proposed that the surplus be credited to customers over a five-year period, rather than over fifteen years as proposed by the Company (Exhibit 101, p. 14) As Staff explained, using a five-year amortization lessens the overall rate impact of the Company's proposed filing and coincides with the amortization period of other (deferred) costs, such as pension and other employee benefit costs and environmental site remediation costs (Exhibit 101, p. 15). Pursuant to the terms of the Joint Proposal, the surplus would also be amortized over five years rather than fifteen as recommended by the Company (Exhibit 101, p. 3).

The amortization periods, depreciation factors and reserve surplus levels agreed to by the parties are fully supported by the hearing record in this case. Thus, the Joint Proposal result is one which could have resulted from a fully litigated case.

Capital Transmission and Distribution (T&D) Expenditures and Reporting

As explained by the Company's witness, Orange and Rockland proposes several large distribution, substation and transmission projects and programs throughout the Company's New York State service territory (Tr. 87-111), which translates into greater capital T&D expenditure levels than in any previous years (Exhibit 3, E-6, Schedule 2). The Company asserted that the projects are needed to meet system demands.

Staff conducted an in-depth evaluation in terms of cost and necessity for each of the capital T&D projects planned during the three years of this Rate Plan. The Company continues to experience above average load growth throughout its service territory, with localized areas of very high load growth (Tr. 183-184). Load growth is the main driving factor for the capital spending level ultimately agreed to in the Joint Proposal (Tr. 183-221). Staff determined, as a result of its analysis, that the projects identified are justified and needed along with the capital expenditures associated with each project to make up the total T&D budget.

As Staff testified, the proposed expenditure levels and ratepayer impact of the Company's T&D budget on rates demonstrates a need to ensure that the Company is held accountable to ratepayers for the rate allowance associated with these infrastructure improvements (Tr. 188). Toward that end, Staff recommended that the Company provide quarterly detailed reports to Staff, with justification for any variances in expenditures on a project-by-project basis (Tr. 188). Orange and Rockland agreed to implement a review process (Tr. 141). Further, Staff proposed that the Company be required to defer any expenditure amounts under the levels allowed for future return as a ratepayer credit, with interest accruing at an appropriate rate (Tr. 188).[37]

The Joint Proposal (Section III.12.A and Appendix F) sets the capital T&D budget at approximately $84 million for Rate Year 1, $72 million for Rate Year 2, and $65 million for Rate Year 3. This capital funding level gives Orange and Rockland sufficient funding for its construction program to complete the projects that will ensure the demand and requirements of its electrical system are met, along with improved reliability throughout the Orange and Rockland service territory.

The Joint Proposal also supports Staff's recommendation to require the Company to provide quarterly and annual detailed reports to Staff, with justification for any variances in expenditures on a project-by-project basis (as specified in the Joint Proposal's Appendix H), and that it defer any expenditure amounts under the levels allowed for future return as a ratepayer credit, with interest accruing at an appropriate rate. Staff believes that these reporting requirements provide an appropriate level of oversight of the utility's construction activities and assurance that the utility will be held accountable to ratepayers for the rate allowance associated with its electric infrastructure improvements.

Reliability Performance Mechanism (RPM)

As set forth in Case 06-E-1433, the Commission adopted the Company's proposed reliability performance mechanism targets of 1.36 times per year for the system average interruption frequency index (SAIFI) and 102 minutes (1.70 hours) for the customer

[37] Orange and Rockland did not address whether ratepayers should be credited for variances in construction expenditures if the Company completes less than the levels allowed in rates. However, in the Company's rebuttal testimony (pp.6-7), it proposed less rigorous construction project reporting requirements and objected to Staff's reconciliation process.

average interruption duration index (CAIDI).[38] The Commission also increased the annual negative revenue adjustments for the failure to meet either of the RPM targets from four basis points up to ten basis points per target within the 06-E-1433 Case.[39] In this case, Orange and Rockland proposed no changes to the SAIFI and CAIDI targets.

Orange and Rockland argued in the instant case for use of SAIFI as a referee for the existing reliability performance mechanism targets (SAIFI & CAIDI) and associated negative revenue adjustments (Tr. 128-131, 138-140). Staff opposed the Company's proposal to use SAIFI as a referee for the existing reliability performance mechanism targets already in place (Tr. 214-218).

The Joint Proposal (Section III.19 and Appendix M) provides for the continuation of the SAIFI and CAIDI targets of 1.36 and 102.4 minutes set in Case 06-E-1433, and does not include the SAIDI referee target. The Joint Proposal terms, however, do subject the Company to increased annual negative revenue adjustments for the failure to meet either of the RPM targets. For SAIFI, the adjustments are: 10 basis points for Rate Year 1, 15 basis points for Rate Year 2, and 20 basis points for Rate Year 3. The CAIDI adjustments are 10 basis points for Rate Year 1, 10 basis points for Rate Year 2, and 20 basis points for Rate Year 3. These increased negative revenue adjustments are reasonable considering the fact that the Rate Plan incorporates substantial funding for infrastructure projects designed, in part, to enhance reliability. Staff recommends that the stipulated reliability targets and negative revenue adjustments be adopted.

<u>Lovett Closure</u>

At the February 5, 2008 hearing, the Company requested that it be allowed to defer all costs associated with the relocation of certain facilities located at Lovett generating

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38 October 2007 Order, pp. 27-28.

39 <u>Id.</u>

station upon closure and demolition of Lovett (Tr. 172). Orange and Rockland's witness noted that Mirant has informed the Company and the Public Service Commission of its intention to discontinue operation of Lovett in April 2008 and subsequently demolish the Lovett facility (Tr. 143). The Lovett facility closure will require that the Company make certain capital improvements and investments in order to maintain system reliability (Tr. 143-145). The projects and improvements cited by Orange and Rockland include: installation of a new control house in the 69kV yard with a new remote terminal unit and associated protection and control systems; new telephone lines, interface and protection at the new control house; install generator backup and A/C service at the 69kV and 138kV yards; install a local water system connection; isolate a Lovett underground lead from Orange and Rockland's pressurizing plant; and, install new security fencing and substation access points (Tr. 145).

As noted on cross-examination (Tr. 240), Staff met with the Company on numerous occasions to discuss infrastructure projects, including those related to the Lovett closure and anticipated demolition. Based on Staff's review, the projects are reasonable and necessary for the Company to meet its obligation to provide safe and adequate service, including the full reestablishment of the protective system and other important services that are located within the Mirant owned portion of the Lovett facility. Accordingly, the Joint Proposal (Section III.16) recommends that Orange and Rockland be permitted to defer for future recovery capital expenditures incurred up to $1.85 million and O&M expenses incurred up to 10% ($185,000) of the capital expenditure level.

Staff recommends that the Company's proposed facility improvement program expenditure provision be accepted, and, consistent with the Joint Proposal, any recoveries or reimbursement from Mirant be applied against the cost of these projects.

Energy Efficiency

Orange and Rockland proposed to implement a cost recovery mechanism to fund energy efficiency programs beyond the implementation phase of the Energy Efficiency Plan (Plan) approved by the Commission in Case 06-E-1433[40] (Tr. 460-1). The Company recommended either diverting funds from the SBC to finance the Plan, recover the expenses for the continuation of the Plan through increases to the SBC, or initiating a new surcharge to its delivery rates to recover these expenses (Tr. 461). Staff opposed the Company's proposal to implement a new surcharge to fund energy efficiency programs (Exhibit 54, pp. 4-5). Rather, Staff recommended that the Company defer any new costs incurred for energy efficiency programs during the 2008 rate year until a more permanent recovery mechanism is established through the Energy Efficiency Portfolio Standard Proceeding (EEPS Proceeding) in Case 07-M-0458.

The Joint Proposal provides a balance between the Company and Staff positions, a compromise that should dovetail nicely with the EEPS Proceeding. Specifically, the Joint Proposal recognizes that Orange and Rockland will submit an Energy Efficiency Plan in June 2008, based on the results of the Market Potential Study currently being performed, for consideration in the EEPS Proceeding (Joint Proposal, Section III (21)). The June filing of the Energy Efficiency Plan offers the potential for the Commission to review and approve energy efficiency programs for implementation in Orange and Rockland's service territory as soon as practical, and likely much sooner than they would under the current EEPS schedule. To ensure that program funding will be in place for the upcoming rate year and avoid delays in implementation of the energy efficiency programs ultimately adopted by the Commission, the

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[40] Case 06-E-1433, supra, Order Concerning Proposed Revenue Decoupling Mechanism And Energy Efficiency Programs (issued January 16, 2008) (January 2008 Order).

Joint Proposal recommends that initial funding in the amount of $4 million per rate year be collected by the Company through a non-bypassable surcharge.[41]

Staff believes that this provision of the Joint Proposal will advance the energy efficiency goals of the Commission and State and, therefore, should be adopted.

Customer Service Performance Incentive

Orange and Rockland's customer service performance Incentive (CSPI) was recently continued by the Commission, with certain modifications.[42] Pursuant to the 2007 Order, Orange and Rockland is subject to a maximum downward revenue adjustment of up to $1.1 million under its CSPI. The Company proposed that the CSPI be discontinued, asserting that Orange and Rockland focuses on providing superior customer service, thus the CSPI is unnecessary (Exhibit 40, p. 2). Additionally, Orange and Rockland views negative revenue incentives as a poor substitution for constructive regulation (Exhibit 40, p. 2). Staff recommended continuation of Orange and Rockland's CSPI until further modified or discontinued by the Commission (Exhibit 47, pp. 6-7).

The Joint Proposal (Section III.19) contemplates continuation of the CSPI, with certain modifications directed by the Commission in the 2007 Order. Specifically, the Joint Proposal eliminates price opinion from measurement of the survey target and proposes tiered amounts at risk for the survey target.

CSPIs help to align shareholder and ratepayer interests by providing earnings consequences to shareholders for the quality of service provided to a utility's customers. As Staff noted, CSPIs are currently in effect at all of the major energy utilities that link earnings

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41 Any funding level adjustments that may be warranted can be addressed in the EEPS Proceeding.

42 Cases 06-E-1433 and 06-E-1547, supra.

directly to companies' performance on specific measures of customer service (Exhibit 47, p. 4). As long as delivery service remains a monopoly, there are virtually no consequences to a distribution utility for failing to provide good customer service. Orange and Rockland's CSPI provides direct earnings consequences to shareholders for the quality of service provided to the utility's customers. As long as customer service is maintained at current levels; however, the CSPI is not activated.

The CSPI therefore strikes a fair balance between the interests of ratepayers and the investors of Orange and Rockland, and has no deleterious effect on the long-term soundness of the company. Given that similar such CSPIs are currently in effect at all New York State energy utilities, including Orange and Rockland, continuation of the Company's modified CSPI is completely consistent with the PSL and existing Commission rules, regulations and policies, and is entirely comparable with any potential litigated result in this case.

Withdrawal of Lawsuits

As noted in the Overview section above, Orange and Rockland instituted two lawsuits challenging the Commission's temporary and permanent rate decisions in Case 06-E-1433. Joint Proposal, Section III.26 commits the Company to withdrawing the lawsuits upon the Commission's adoption of the terms of the Joint Proposal. The withdrawal of these cases will permanently settle the contentious rate issues in Case 06-E-1433. In addition, by withdrawing the lawsuits the Company will avoid the costs attendant to prosecuting these cases and can devote its resources to its core business. Withdrawal also avoids the possibility, however limited, that the Commission might be forced to reconsider its decisions in that case. If reconsideration were required, it could potentially effect an alteration of the expense allowances in the instant case. Accordingly, this provision of the Joint Proposal is reasonable and should be adopted.

Other Provisions

Other sections of the Joint Proposal contain provisions typical of the settlement agreement. Specifically, Section III.23 notes the interest (unadjusted customer deposit rate) applicable to booked credits and debits. Section III.24 recognizes that the Commission may authorize *de minimus* rate changes for new services, rate design or revenue allocation that are revenue neutral during the term of the rate plan; permit Orange and Rockland to file for rate relief if its economic viability becomes in jeopardy; or, may act to adjust the Company's rates if unforeseen circumstances cause the rates to become unjust and unreasonable. Joint Proposal, Section III.25 allows deferral for future disposition, the economic impact related to new laws, regulations or binding orders, including new interpretations of prior enactments, decisions or rulings, which were not previously contemplated in the Joint Proposal's forecasted expense levels. It also permits the Company to petition for deferral of extraordinary expenses over and above those stated in the Joint Proposal. Section IV.28 states that the programs not expressly stated to expire at the end of the rate plan will continue until changed by the Commission at the Rate Year 3 goal and target levels. Additional Joint Proposal sections deal with the non-severability of the provisions and the parties right to pursue their litigated positions if the Joint Proposal's terms are not adopted without modification (Section IV.29); the non-precedential nature of the terms (Section IV.30); the dispute resolution process (Section IV.31); and, other procedural matters.

CONCLUSION

The Joint Proposal entered into by Orange and Rockland, Staff and Intervenors clearly satisfies the Commission's Settlement Guidelines. As discussed throughout this Statement in Support, the Joint Proposal terms have a record basis and are consistent with other Commission determinations and Commission State policies. The Rate Plan offers the rate certainty attendant to a the long-term (three year) rate plan - minimizing the economic impact of the rate increases on customers during a time of economic volatility - while providing the Company with adequate revenues to maintain safe and adequate service. It continues certain mechanisms that incent Orange and Rockland to maintain and improve customer, as well as enhances some of them. The annual rate increases, expense allowances, incentives and corresponding obligations memorialized in the Joint Proposal illustrate a balancing of the interests of the ratepayers and the Company. Further, the stipulation provisions in the Joint Proposal resulted from extensive negotiations in which various concessions were made by parties to receive other benefits; thus, the Joint Proposal provisions are integral to the agreement as a whole. In sum, the Joint Proposal terms will establish a rate plan that will maintain safe and adequate service at just and reasonable rates.

For all the above reasons, Staff respectfully requests that the Commission adopt the Joint Proposal terms in their entirety.

Respectfully Submitted,

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