BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of

Consolidated Edison Company of New York, Inc.

Case 07-S-1315

February 2008

Prepared Testimony of:
Accounting Panel

Kristee Adkins
Public Utilities Auditor 2

Tim Canty
Public Utilities Auditor 3

Claude Daniel
Public Utilities Auditor 2

Kevin J. Higgins
Public Utilities Auditor 3

Jane Wang
Public Utilities Auditor 2

Office of Accounting, Finance
and Economics
State of New York
Department of Public Service
Three Empire State Plaza
Albany, New York 12223-1350

90 Church Street
New York, New York 10007-2919

Q. Please state your names, employer, and business addresses.

A. We are Kristee Adkins, Tim Canty, Claude Daniel, Kevin Higgins and Jane Wang. We are employed by the New York State Department of Public Service (Department). Our business addresses are Three Empire State Plaza, Albany, New York 12223 and 90 Church Street, New York, New York 10007.

Q. Ms. Adkins, what is your position at the Department?

A. I am employed as a Public Utilities Auditor 2 in the Office of Accounting, Finance and Economics.

Q. Please describe your educational background and professional experience.

A. I graduated from the State University of New York Institute of Technology in Marcy, New York in 2002 with a Bachelor of Science degree in Accounting and Finance. I have been employed by the Department since June 2005. In the course of my employment, I examine accounts, records, documentation, policies and procedures of regulated utilities. I have also worked on asset transfer filings for Consolidated Edison Company of New York, Inc. (Con Edison or the

Company) in Cases 06-M-0407, 99-E-1146, and 07-E-0106 and for Adrian's Acres West Water Company, Inc in Case 06-W-1187. I have participated in the rate proceedings in Case 07-E-0523, <u>Con Edison – Electric Rates</u>; Case 06-G-1332, <u>Con Edison – Gas Rates</u>; Case 05-W-0802, <u>Adrian's Acres West Water Company, Inc.</u>; and in Case 05-G-1494, <u>Orange and Rockland Utilities, Inc</u>. (Orange and Rockland).

Q. Ms. Adkins, have you previously testified before the New York State Public Service Commission (the Commission)?

A. Yes, I have submitted testimony on revenue requirement, various other operating revenues such as late payment charges (LPC) and operation and maintenance (O&M) expense forecasts in Case 05-G-1494, <u>Orange and Rockland – Gas Rates</u>; in Case 06-G-1332, <u>Con Edison – Gas Rates</u>; and in Case 07-E-0523, <u>Con Edison – Electric Rates</u>. I testified in Case 07-E-0523, <u>Con Edison – Electric Rates</u>.

Q. Mr. Canty, what is your position at the Department?

A. I am employed as a Public Utility Auditor 3 in the Office of Accounting, Finance and Economics.

Q. Please describe your educational background and professional experience.

A. I graduated from St. Bonaventure University, in St. Bonaventure, New York in 1988 and have a B.B.A. degree with an Accounting major. I have been employed by the Department since 1988.

Q. Please briefly describe your responsibilities with the Department.

A. My responsibilities include examination of accounts, records, documentation, policies and procedures of regulated utilities. I have been involved in numerous rate and accounting examinations.

Q. Mr. Canty, have you previously testified before the Commission?

A. Yes, I have testified before the Commission proceedings on a variety of accounting and regulatory issues.

Q. Mr. Daniel, what is your position at the Department?

A. I am employed as a Public Utilities Auditor 2 in the Office of Accounting, Finance and Economics.

Q. Please describe your educational background and professional experience.

A. I graduated from Hunter College of the City University of New York with a Bachelor degree in Accounting and joined the Department in 1986.

Q. Please describe your responsibilities with the Department.

A. I routinely examine accounts, records, documentation, policies, and procedures of regulated utilities. I have also reviewed numerous petitions filed by Con Edison seeking authority for asset transfers, deferrals and reconciliations.

Q. Mr. Daniel, have you previously testified before the Commission?

A. Yes, I have prepared cost of service exhibits and offered testimony on various O&M expense, other taxes and rate base adjustments in previous Con Edison Electric, Gas and Steam Rate Cases including Cases 04-E-0572, 05-S-1576, 06-G-1332, and 07-E-0523. I also testified on rate base items in Case 90-C-0191, New York Telephone Company - Rates.

Q. Mr. Higgins, what is your position at the Department?

A. I am employed as a Public Utilities Auditor 3 in the Office of Accounting, Finance and Economics.

Q. Please describe your educational background and professional experience.

A. I am a graduate of the State University College of New York at Oneonta with a Bachelor of Arts degree in Business Economics. I have also earned an Associates degree in Accounting from Morrisville State College. I joined the Department in June 1987.

Q. Please describe your responsibilities with the Department.

A. My work as a Public Utility Auditor has included the examination of accounts, records, documentation, policies and procedures of regulated utilities so as to develop issues for electric, gas, telecommunications and water rate proceedings, financing, rate of return studies and other general accounting matters.

Q. Mr. Higgins, have you previously testified before the Commission?

A. Yes, on numerous occasions.

Q. Ms. Wang, what is your position at the Department?

A. I am employed as a Public Utilities Auditor 2 in the Office of Accounting, Finance and Economics.

Q. Please describe your educational background and professional experience.

A. I graduated from Tsinghua University, Beijing, China in 1985 with a Bachelor of Science degree in Electric Power Engineering. I also received a Master's degree in Electric Power Engineering from Tsinghua University in 1988. I received a Master's in Business Administration from Union College, Schenectady, New York in 1997. I have experience working as a cost engineer with General Electric and a Staff Accountant with Time Warner Cable. I have been employed by the Department since April 2005.

Q. Please briefly describe your responsibilities with the Department.

A. My responsibilities include examination of accounts, records, documentation, policies and procedures of regulated utilities. I have worked on Case 05-E-0553, <u>Village of Bath Electric Rates</u>; Case 05-S-1376, <u>Con Edison – Steam Rates</u>; Case 06-G-1332, <u>Con Edison – Gas Rates;</u> and Case 07-E-0523, <u>Con Edison – Electric</u>

Rates. I worked on revenue requirement models and accounting examinations in these cases.

Q. Ms. Wang, have you previously testified before the Commission?

A. Yes, I have submitted testimony in rate proceedings in Case 05-S-1376, Con Edison – Steam Rates, Case 06-G-1332, Con Edison – Gas Rates, and Case 07-E-0523, Con Edison – Electric Rates. I testified before the Commission in Con Edison electric rate proceeding in Case 07-E-0523.

Q. Panel, what is the purpose of your testimony?

A. Our testimony addresses accounting aspects of Con Edison's steam rate filing. We will discuss and recommend adjustments in the following areas:

- Other Operating Revenues
  - Interdepartmental Rents – ERRP
  - Fuel Management Program
  - Late Payment Charge Revenues
  - Deferred Interference Expense – 2006 Rate Plan
  - Asset Depreciation Range Deferred Tax Benefits

- Operation & Maintenance Expenses
    - Fuel Oil Storage & Handling
    - Administrative & General Expense Capitalized
    - Asbestos Removal & Abatement
    - Boiler Cleaning
    - Company Labor
    - Consultant Expense
    - Corrective Maintenance Expense
    - Site Investigation and Remediation Program Costs
    - Employee Pensions and OPEBs Expense
    - Employee Welfare Expenses
    - Financial Services
    - Insurance Expense
    - Interference Expense
    - Regulatory Commission Expense
    - Shared Services
    - Water Treatment
    - Other Operation and Maintenance Expense
    - Steam Incident – O&M Expense Effects
- Taxes Other Than Income Taxes
    - Property Tax Expense

- Payroll Taxes
- Rate Base
  - Earnings Base Capitalization
  - Change of Accounting Section 263A
  - WTC Deferral Recovery
  - Accumulated Deferred Income Tax ADR/ACRS/MACRS Depreciation Differences
  - Unbilled Revenues
- Income Taxes
  - New York State and Federal Income Tax Expense
  - Cost of Removal Tax Deduction

We also summarize Staff's overall revenue requirement position.

Q. What is the effect of Staff's adjustments on the Company's rate of return?

A. The adjustments, as shown on Exhibit__(AP-2), Schedule 1, increase the steam rate of return before any proposed rates from 3.20% to 4.72%.

Q. What is the rate of return recommended by the Financial Panel?

A. The Financial Panel recommends a 7.35% rate of return based on a 9.1% return on equity. As a result, the indicated rate change in steam rates is a $60 million increase for the rate year ending September 30, 2009.

Q. What are the major areas where Staff is proposing adjustments?

A. The adjustments fall into eight major categories: sales revenue, other operating revenues, fuel expense, depreciation expense, operation and maintenance (O&M) expenses, taxes other than income taxes, state and federal income taxes and rate base.

Q. Please highlight the major adjustments by category proposed by Staff.

A. Staff witness Barney has proposed 540 MMlb of additional steam sales, which equates to approximately $5.6 million of additional net revenue.

Staff is proposing adjustments totaling approximately $24 million to O&M expenses. Staff’s major adjustments are to Company Labor, Interference, Corrective Maintenance, Facilities Maintenance and Water Treatment Expense.

Staff is also proposing to decrease the

Company’s projected rate year rate base by about $39 million, which decreases the revenue requirement by approximately $4 million. Staff is proposing adjustments to Plant In Service, Working Capital, Accumulated Deferred Income Taxes, the Earnings Base Capitalization (EB/Cap) adjustment.

Staff’s adjustments impact the calculation of state and federal income tax expense, primarily due to lower income resulting from its recommended return on equity. Finally, as noted above the Finance Panel recommends a lower rate of return (7.35%) than the Company’s request (8.58%).

Q. Will the Panel refer to, or otherwise rely upon, any information produced during the discovery phase of this proceeding?

A. Yes, the Panel will refer to, and has relied upon, numerous responses to Staff Information Requests (IR) and various Company supplied workpapers. The IRs and workpapers are collectively designated as Exhibit__(AP-1).

Q. Is the Panel sponsoring any other Exhibits?

A. Yes, the Panel is sponsoring Exhibit__(AP-2), which is Staff’s cost of service presentation. In addition, we sponsor Exhibit__(AP-3), which is Staff’s computation of the labor growth rate factor.

Q. Please describe Exhibit __(AP-2).

A. Exhibit__(AP-2) contains eight schedules. Schedule 1 is Staff’s projection of steam operating income, rate base and rate of return for the rate year ending September 30, 2009, and includes Staff’s proposed revenue requirement. Schedule 1 is supported by Schedules 2 through 8.

Q. Please describe the format of Schedule 1.

A. Column 1 of Schedule 1 contains the income statement, rate base and rate of return figures as filed by the Company for the rate year, before a revenue increase. Column 2 contains references to the supporting schedules that present Staff’s adjustments set forth in Column 3. Column 4 presents Staff’s projected rate year figures before a revenue increase. Column 5 contains Staff’s proposed changes in revenues, and Column 6 is Staff’s recommended rate year income, rate base and rate of return after the proposed revenue increase.

Q. What information is shown on Schedules 2 and 3?

A. Schedule 2 reflects Operation and Maintenance expense by element of cost for the rate year. Schedule 3 reflects taxes other than income taxes.

Q. What information is shown on the remaining schedules?

A. Schedules 4 and 5 calculate New York State and federal income tax expenses, respectively. The adjustments in these schedules correspond primarily to adjustments set forth in other schedules. Schedule 6 projects the rate base for the rate year. Schedule 7 projects an allowance for working capital, which is a component of rate base. Schedule 8 lists Staff’s adjustments with reference to the supporting witnesses.

Proposed Three-Year Rate Plan

Q. Con Edison sponsored a three-year rate proposal in its filing. Will the Panel address this proposal?

A. No. Witness Rasmussen states in his pre-filed testimony at page 11, lines 3 though 8 that while Con Edison proposes a three-year rate plan, the Company does not waive its rights to file for new rates immediately after the conclusion of this case should it determine that the rates set by the Commission in its rate order for the first rate year are inadequate or if the Company determines that the terms set by the Commission for the other two rate years are unreasonable. Given the Company's position, our testimony will only address the issues necessary for the Commission to determine rates effective October 1, 2008, or until the Company files its next rate case and the Commission makes a determination on that request.

Other Operating Revenues

Interdepartmental Rents: East River Repowering Project (ERRP)

Q. Please describe the interdepartmental rent associated with East River Units 1 and 2 (East River Repowering Project or ERRP).

A. The ERRP is a combined steam and electric plant producing both steam and electricity. The entire cost of the project was charged to steam operations. The Steam department charges electric operations a rent equal to approximately 66% of the carrying costs of the investment. The rents are reflected in the Company’s revenue requirement presentation as Other Operating Revenue.

Q. Is Staff proposing to adjust the rate year forecast of interdepartmental rent revenue for ERRP?

A. Yes. Staff proposes an adjustment to decrease the Company’s rate year forecast of $75,401 million by $4,834,929, reflecting Staff’s 10.25% pre-tax rate of return and by $92,000 to reflect an updated ERRP property tax expense forecast.

Q. Please explain.

A. The interdepartmental rent includes a return on investment, depreciation, property taxes and income taxes. The Company’s original rate year forecast was developed using the Company’s proposed 12.27% pre-tax rate of return and existing depreciation rates. We also discovered an error in the Company’s rate year forecast of ERRP property taxes. In response to Staff IR

DPS-208, the Company updated its filing to reflect proposed depreciation rate changes and to correct ERRP property tax expense forecast for the rate year. We will address our adjustments to rate year Property Tax Expense later in greater detail. The Staff Financial Panel addresses its proposal for a 10.25% pre-tax rate of return.

Fuel Management Program Revenues

Q. Please describe Con Edison’s Fuel Management Program.

A. Con Edison’s Fuel Management Program produces revenues for services performed by the Company such as storage tank subleasing, fuel oil exchanges, and barge subleasing. The Company also is reimbursed for costs associated with heating the sublet storage and for fees associated with fuel storage and exchanges.

Q. Please explain the Company’s forecast of Fuel Management Program revenues.

A. As set forth on the Company’s Exhibit__(AP-6), Schedule 1, page 2, the rate year forecast is $356,000. In its response to Staff IR DPS-146, the Company states that it inadvertently entered

$356,000 as the rate year Fuel Management Program revenue in its initial filing. It indicates that the rate year forecast should be increased to $671,332, or approximately one-half the actual revenues for the months of July 2006 through July 2007. The Company claims that its Fuel Management Program revenues will be lower in the rate year than the 12 months ending July 2007 because fuel oil prices have been higher than natural gas prices on average for the last few months which has led to higher natural gas burns over fuel oil burns in plants with dual fuel capability. Con Edison expects this trend to continue during the rate year. Accordingly, the Company forecasts that less fuel oil storage capacity will be sublet and lower quantities of fuel oil will be exchanged during the rate year.

Q. Does the Panel agree with this update?

A. We agree that the level of Fuel Management Program revenues should be increased. However, we have concerns regarding the proposed rate year level of Fuel Management Program Revenues.

Q. What comments does the Panel have on the Company’s proposal to update its rate year forecast?

A. There can be no presumption that the Company’s new estimate is reasonable merely because it claims that it expects a certain short-term trend to continue. Lacking appropriate support, another basis for the rate year forecast must be found, and our proposed approach is a reasonable basis.

Q. Please explain the Panel’s adjustment.

A. Based on a three-year historic average (June 30, 2005, 2006 and 2007) of actual fuel management program revenues, we are proposing to increase the rate year forecast to $1,483,000, which is an additional increase of $812,000,

Q. Why should a three-year historic average of actual Fuel Management Program revenues be used to forecast the rate year level?

A. Use of a historic three-year average to forecast the rate year Fuel Management Program revenues will mitigate anomalies and fluctuations evident in any single year. Therefore, the Company’s updated rate year level of $671,000 should be increased by $812,000 to a rate year level of $1,483,000.

Late Payment Charge (LPC) Revenues

Q. Please explain the Company's methodology used to forecast late payment charge (LPC) revenues.

A. The Company's Accounting Panel developed a three-year average of LPC to revenue ratio of .1638%. The Company applies the ratio to its sales forecast, which results in the LPC revenue forecast of $1,094,000.

Q. Does the Panel agree with the Company's methodology?

A. Yes, the Panel agrees with the methodology; however, Staff Rate Panel has adjusted the sales forecast, which requires a tracking adjustment of the LPC revenues in the rate year.

Q. What is the tracking adjustment?

A. Staff's rate year forecast of LPC revenues is $1,111,000; an increase of $18,000 to the Company's forecast.

Deferred Interference Expense – 2006 Rate Plan

Q. Please explain your issue with deferred interference expenses related to the 2006 rate plan.

A. The Company’s current rate plan for the period October 1, 2006, through September 30, 2008, is governed by the Commission Order in Case 05-S-1376. The Order permits the Company to reconcile actual interference expenses (excluding Company Labor) with the level provided in rates. According to the Order, the Company can defer 90% of the variance between actual non-Company-Labor interference expenses and the rate allowance in any rate year to recover from or refund to customers. However, the actual deferred interference expenses to date and estimated amount through September 2008 were not reflected anywhere in the Company’s revenue requirement presentation.

Q. How much is the estimated deferred interference expense at the end of the current rate plan?

A. According to response to Staff IR DPS-183, the Company booked a customer credit of $197,000 for the first rate year ended September 2007. The Company also estimates that it will book an additional $306,000 through September 30, 2008, the end of its second rate year under the current rate plan.

Q. How will the deferred interference expense affect the revenue requirement?

A. The Company proposes to amortize deferred regulatory assets and liabilities over a three-year period. The amortization of deferred interference over collection will increase other operating revenue by $167,667, if the Company's three-year amortization period is adopted, and the unamortized balance will decrease the rate base by $253,114. However, the Commission has the authority to determine a longer or shorter amortization period.

Asset Depreciation Range Deferred Tax Benefits

Q. Please explain the Panel's adjustment to the Company's rate year forecast of Asset Depreciation Range (ADR) tax amortization.

A. In its response to Staff IR DPS-129, the Company acknowledges that its rate year forecast was not totally consistent with the Commission Order in Case 06-E-0990, Consolidated Edison Company of New York, Inc. for disposition of 2000 and later Asset Depreciation Range Deferred Tax Benefits not properly accounted for by the Company issued on September 4, 2007. The Commission Order included an additional $14,000 of interest associated with the ADR tax deferral that should be passed back to steam customers. Consequently, we increased the rate year forecast of ADR tax amortization by $5,000. A concomitant adjustment is also required reducing the rate year rate base by $7,000 to reflect the additional unamortized interest associated with the ADR tax deferral.

Operation and Maintenance Expenses

Fuel Oil Storage and Handling

Q. What are fuel oil storage and handling costs?

A. Generally speaking, they are the costs for storing fuel oil and moving the fuel oil from the storage areas as needed.

Q. How are fuel oil storage and handling costs recovered?

A. The Company recovers fuel oil storage and handling costs through its monthly fuel adjustment clause (FAC).

Q. How did the Company forecast its rate year fuel oil storage and handling costs?

A. In his testimony, Company witness Catuogno indicates that the costs were determined based on historical applicable charges made against each account and consider known, upcoming major or non-normal planned work, such as dredging and storage tank repairs. He also notes that the forecast is based on the allocation methodology between electric and steam approved by the Commission in Cases 99-S-1621 (i.e. split 12.42% to Electric and 87.58% to Steam).

Q. How much did the Company forecast for fuel storage and handling costs in the rate year?

A. It estimated fuel oil storage and handling costs of $13,199,000.

Q. Did you review the reasonableness of the costs the Company's proposes to recover through its FAC in the rate year?

A. Yes. We reviewed the costs and are particularly concerned with a number of costs included in the Company's estimate.

Q. Please explain your first concern.

A. The Company's forecast shows $5,500,000 being spent in 2008 ($1,375,000 for the rate year) associated with dredging the bottom of the Hudson River in the vicinity of the 59th Street Generating Station Dock. We are primarily concerned about the permissibility of these costs through the Company's FAC because these costs appear to be outside the traditional costs associated with storing fuel oil and moving it from storage.

We are also concerned that the Company would simply propose to flow through its FAC this significant project cost as opposed to reflecting it in base rates.

Q. What are you proposing?

A. We are proposing that no costs related to this dredging project, or any other dredging work, be recovered through the FAC until the Company can sufficiently support the permissibility of recovery of these costs through its FAC. In the event the Company is unable to support recovery of dredging costs through its FAC, we propose that, in its rebuttal filing, the Company propose an acceptable alternative method of base rate recovery.

Q. Please explain your next concern.

A. The Company's forecast includes labor costs associated with planned work at the 59th Street Generating Station. Con Edison's estimated labor costs are recovered through base rates. Consequently, we propose removing $409,000 from the storage and handling forecast because no labor costs should be recovered through the FAC, otherwise the Company would be collecting for the same labor cost twice.

Q. Does the Panel have any additional concerns?

A. Yes. In its forecast the Company shows spending of roughly $3,000,000 in the rate year associated with dock work at 59th Street Generating Station. In its response to Staff IR DPS-79, the Company states that the costs are to maintain the fuel oil dock as well as known structural repairs that must be made to the dock.

Here again we are concerned about the permissibility of recovery of structural repair costs through the Company’s FAC as they appear to be outside of conventional fuel oil storage and handling costs. Moreover, we are concerned that these costs appear to be of a longer-term nature and as such should be capitalized.

Q. What are you proposing?

A. We are proposing that no costs associated for any structural repair work flow through the FAC until the Company can sufficiently support the permissibility of recovery through the FAC. In the event the Company is unable to support recovery through its FAC, we propose that the Company, in its rebuttal filing, propose an acceptable alternative method of base rate recovery.

Administrative and General Expenses Capitalized

Q. Please explain the Company's forecast methodology for the rate year level of administrative and general (A&G) expenses capitalized.

A. The Company applies a general inflation factor of 5.1 percent to its historic year level of $2,279,000 for A&G expenses capitalized. This application projects an increase of $117,000 which results in the rate year level of $2,396,000 as illustrated in Exhibit__(AP-6), Schedule 9.

Q. Does the Panel agree with Con Edison's forecast methodology for A&G expenses capitalized?

A. No, we do not. The Company's forecast methodology will understate the rate year level of A&G expenses capitalized.

Q. Please explain.

A. Some components of capitalized A&G expenses are projected by the Company to grow at rates in excess of the general inflation rate of 5.1 percent. In addition, as a follow-up to its response to Staff IR DPS-34, the Company has provided through an informal channel its 2008 Administrative & Supervisory Expenditures Applicable to Plant Construction Costs Authority Letter and its 2008 Labor Capitalization Rate Authority Letter. Based on these facts, we conclude that the rate year A&G expenses capitalized, will increase at a rate greater than the general inflation rate.

Q. Please describe the components included in A&G expenses capitalized.

A. A&G expenses capitalized include the administrative and supervisory (A&S) expenditures applicable to plant construction costs. The A&S costs include payroll and related functions such as human resource and labor relations, injuries and damages, and employee welfare expenses. The A&S expense to be capitalized is determined by the Company’s labor capitalization rate. The A&S costs also include functions, such as corporate accounting, property records, purchasing, information resources, and electronic information administration, which are based on time studies.

Q. Please continue.

A. If the Company experiences an increase in capital construction activities during a period of time, the labor capitalization rate will increase and cause the level of A&G expenses capitalized to increase.

Q. Please explain the change in the Company’s labor capitalization rate since the historic year.

A. The Company has provided the approved Authority Letter, effective January 2008, with a labor capitalization rate of 35.5 percent. The labor capitalization rate is the percentage of total Company payroll expected to be capitalized as part of construction projects during a calendar year. The historic 2005, 2006, and 2007 labor capitalization rates have been 33.0 percent, 34.25 percent and 34.5 percent, respectively.

Q. Please explain the change in the A&G expenses from the historic year (12 months ending June 30, 2007) to the rate year (12 months ending September 30, 2009).

A. On pages 1 and 2 of Exhibit__(AP-6), Schedule 4, the Company projects the rate year level of A&G expenses, excluding A&G expenses capitalized, net employee pension and OPEB expenses, net employee welfare expenses and shared services, at $35,992,000. The result is an increase of $7,291,000 (or 25.4 percent increase) over the historic year level of $28,701,000. The Company also projected the rate year level of A&G labor at $7,643,000; an increase of $991,000 (or 14.9 percent increase) over the historic year of $6,652,000. These projected growth rates are substantially higher than the Company's general inflation rate of 5.1 percent.

Q. Please explain the Panel's rate year forecast of A&G expenses capitalized.

A. We start with the approved 2008 A&S estimated expenditures to be transferred to construction and apply general inflation to this estimated level to forecast the annual 2009 A&S transferred levels. Then, we use a weighted average of 2008 and 2009 annual transfer levels to develop a rate year level of A&G expenses capitalized at $50,726,350 for the total Company. We have a concomitant adjustment relating to the Engineering Panel's proposed adjustments to the steam capital projects. We then apply the Company's steam allocation factor of 5.65 percent which results in $2,861,000 for the steam operations. This produces an increase of $465,000 over the Company's rate year forecast.

<u>Asbestos Removal and Abatement</u>

Q. Does the Panel have any concerns with the Company's projected rate year expense for asbestos removal and abatement?

A. Yes. Con Edison's rate year forecast of $1,732,000 for asbestos removal and abatement expense is almost nine times its actual spending of $197,000 in the test year. We have concern whether the Company will complete all of the planned work in the rate year as proposed.

Q. Please explain.

A. The current rate plan provides the Company an annual rate allowance of $920,000 for the first rate year ended September 30, 2007. However, the Company only spent $197,000 in the test period ended June 30, 2007, about one-fifth of the rate allowance. Staff recognizes that there was a three-month timing difference between the rate allowance for 12 months ended September 30, 2007 and the historic period ended June 30, 2007. Therefore, we further reviewed the Company's actual spending on asbestos removal and abatement in the historic years ended June 30, 2003 through 2007, and compared the actual spending levels with rate allowances provided for the same period of time. The comparison indicates that the Company did not spend up to the annual rate allowance in any single year during the period. Moreover, the aggregate rate allowances for the period from October 1, 2002 through September 30, 2007 was $7.64 million, but the Company's aggregate spending for the five-year period from July 1, 2002 through June 30, 2007 was only $2.9 million based on information provided by the Company in response to Staff IR DPS-1. As a result, the Company has over-collected $4.74 million in rates on this expense item. Though there is the three-month timing difference in the comparison, the timing difference would not contribute to a $4.74 million variance, because the Company only spent 2.9 million in the five-year period.

Q. Are the proposed asbestos removal and abatement programs necessary for the safety of the Company's employees and the public, as well as for plant reliability?

A. Yes. Staff is not questioning the legitimacy of the proposed programs to remove and abate asbestos. Rather, based on the Company's historic experience, we have concern with the Company's intent and ability to complete the work as planned.

Q. How does Staff propose to adjust the Company's rate year forecast on asbestos removal and abatement?

A. Given the Company's actual performance in the historic periods, Staff is proposing to use the three-year average of actual spending (periods ended June 30, 2005 to 2007), adjusted for general inflation, as the rate year estimate for asbestos removal and abatement expense. Staff's approach reduces the Company's rate year forecast by $1.218 million.

Boiler Cleaning Expense

Q. How much did the Company request for a rate allowance for boiler cleaning expense?

A. As set forth on the Company's pre-filed Exhibit__(AP-6) Schedule 1, page 3, the rate year forecast of boiler cleaning expense is $2,058,000. This is $1,121,000, or 119%, more than the expense of $937,000 actually incurred in the historic test year.

Q. What is causing the substantial increase?

A. In its testimony, the Company's Steam Operations Panel indicates that "the increase in the boiler external wash program is primarily due to the addition of the initial external pressure washes for the East River Units 1 and 2 since the units commenced operations. The program also includes internal chemical cleanings for Boiler 114 at 59th Street and Boiler 121 at 74th Street".

Q. Please explain how Con Edison projected its rate year boiler cleaning expense.

A. The Company started out with the actual historic test year (HTY) expense of $937,000, and then increased that amount for program changes amounting to $1,020,000, then escalated those amounts by $101,000 for inflation.

Q. What are the program changes comprised of?

A. The workpapers to the Steam Operations Panel Exhibit__(SOP-3) indicate a request for $300,000 for boiler washing at East River 1 and 2; $320,000 for boiler chemical cleaning at 59th Street; and $400,000 for boiler chemical cleaning at 74th Street.

Q. What is the nature of this activity?

A. Staff understands that this activity is of a recurring nature that the Company routinely and periodically performs in order to maintain the system reliability, avoid overheating and increase efficiency of the system. Costs for such activity have always been provided for in the revenue requirement. Therefore, being that they recur, and being that these costs are already reflected in the historical year, it is normally only necessary to apply the general escalation factor to forecast the rate year allowance for this item.

Q. In what manner has the Company presented this element of expense as a program change?

A. Per the Company's workpapers to the Exhibit__(SOP-3), the program change includes CO2 boiler washing for the East River 1 & 2, and High Pressure Boiler Chemical Cleanings for the 59th and 74th St.

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

A. Not entirely. The boiler washing for the East River 1 & 2 is related to the "addition of the initial washes since the East River commenced operations in April 2005" and therefore, is a legitimate program change. However, we believe that the cleanings of the other boilers fall in the category of recurring activities and should not be afforded program change recognition beyond the general escalation.

Q. What is the effect of the Staff recommendation to the Boiler Cleaning expense?

A. Staff's adjustment decreases the Company's forecast of rate year expense from $2,058,000 to $1,301,000, or by $757,000.

Company Labor

Q. Do you propose any adjustments to Company Labor

Expense?

A. Yes. We propose several adjustments to Company Labor Expense. The adjustments relate to incentive compensation (Stock Based Compensation and Variable Pay), Wage Progression increases, Shared Service Administration Group costs, and labor related program changes. There are also a few tracking changes that are affected by adjustments to labor expense.

<u>Incentive Compensation Plans</u>

Q. Could you describe the Company's incentive compensations plans?

A. Yes. The Company has two broad incentive based compensation plans -- a Variable Pay Plan for management employees and a Stock Based Compensation Plan comprised of a Stock Option Plan and a Long Term Incentive Plan for employees and directors.

The Variable Pay Plan is additional compensation for non-officer management employees based on achieving certain targets related to the Company's net income, operating budgets, operating objectives and the individual employee obtaining at least a "satisfactory" performance rating during the review period. This is a compensation plan designed to incent employees to achieve Company goals and objectives, and should be considered incentive compensation.

The second type of incentive compensation the Company offers is Stock Based Compensation Plans which are described in Note M of the Company’s Stockholder Report. It reads, “Note M – Stock-Based Compensation - The Companies may compensate employees and directors with, among other things, stock options, restricted stock units and contributions to a discount stock purchase plan. The Stock Option Plan (the 1996 Plan) provided for awards of stock options to officers and employees for up to 10 million shares of Con Edison common stock. The Long Term Incentive Plan (LTIP) among other things, provides for awards of restricted stock units, stock options and, to Con Edison’s non-officer directors, deferred stock units for up to 10 million shares of common stock (of which not more than four million shares may be restricted stock or stock units).” Employees are rewarded through the Stock Based Compensation plans if the stock price appreciates.

Q. Does the Commission have a long-standing policy concerning incentive compensation?

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

Furthermore, the issue of incentive compensation has been addressed by the Commission for other jurisdictional utilities. Incentive compensation was reviewed in the 1991 National Fuel Gas Distribution Corporation rate Order Case 90-G-0734, et al., Opinion 91—16 (issued July 19, 1991). In the Order, the Commission states, "Since, in this case, the goals are related to financial parameters, it is only reasonable to expect that, if those goals are met, there will be cost savings, which have not been reflected in the revenue requirement.

In that case, the savings would offset the costs of the plan, and the plan would be self-supporting. Failure to reflect those savings would provide the Company a windfall at the ratepayer expense."

The long-standing precedents regarding incentive compensation are reasonable and logical. Incentive plans should be self-supporting and must be matched with associated efficiency gains. Consistent with Commission practice, the incentive compensation amounts should be offset with associated productivity.

Q. Has the Company proposed any efficiency or productivity offsets related to the incentive plans in its filing?

A. No, it has not.

Q. What adjustments are necessary to remove incentive compensation from the Company's rate filing?

A. Stock based compensation was included as "Deferred Compensation Expense" under "Other O&M". We propose an adjustment to remove the entire $318,000.

For the Variable Pay incentive plan we

adjusted the historic test year labor to eliminate variable pay by multiplying the 2007 budgeted amount for variable pay of $24 million times the 5.1% steam allocation factor, which amounts to a $1.23 million adjustment.

Q. Are there any other adjustments related to Variable Pay?

A. Yes. In the Company's Computation of the Labor Growth Factor, Company Exhibit__(AP-6), Schedule 2, page 2, it mistakenly added the 6% variable wage increase to calculate the rate year wages. The effect of including the variable wage increase in the rate year, but not the test year, has the effect of making it an incremental change between the test year and rate year. The labor growth factor developed, is then multiplied by the steam only labor expense, which already includes variable pay wages. In effect, it is a double-count of variable wages.

Q. What is the amount of this adjustment?

A. Eliminating the variable pay from the Labor Factor Computation reduces the Labor Factor from 6.77% to 4.40%, which amounts to a $1.346 million adjustment to Company Labor. The adjustments to the Labor Factor Computation are included in Exhibit__(AP-3).

<u>Wage Progression Increases</u>

Q. Do you have any other adjustments to the labor escalation calculation?

A. Yes. Our adjustment to the labor escalation rate is related to the elimination of the Wage Progression increases.

Q. Please describe the Company’s Wage Progression Plans?

A. The Company’s Wage Progression Plans apply only to Union employees, and are part of the collective bargaining contracts. They are designed to assist employee progress from the minimum to the maximum rate of pay for his/her job title. In the latest labor contracts the increments are increases of slightly over 50 cents per-hour and they are awarded bi-annually. The employees continue to receive these stepped-increases until they reach the maximum rate of pay for their respective job title.

Q. Are you proposing to eliminate these stepped increases from the labor escalation rate?

A. Yes. The stepped increases are not an incremental cost to the Company. The stepped increases are included in the historic test year and over time should not incrementally cost the Company anything.

Q. Please explain.

A. Con Edison has a large turnover in employees each year. When employees leave the Company, for retirement or other reasons, they are replaced by new hires or newly promoted employees. The Company's Accounting Panel testified that: "Approximately 35 percent of our employees have more than 25 years of experience, and the Company will need to hire new employees to replace these employees as they leave." Logically, the employees who leave are almost always higher along the progression plan than the employees who replace them, who generally start at the bottom of the pay grade and begin working their way up one step at a time. There is an actual net savings to the Company when employees leave and are replaced by employees lower on the progression plan.

Q. Are you proposing a negative adjustment related to the wage progression plan?

A. No. Over time, with the natural turnover of employees, the progressive steps are averaged into any given year. In years when there is a large turnover the costs would be less than an average year. In years when turnover is low, the progressive increments may cost more than in an average year. Over time they should equal out.

Q. What is the effect of your proposed adjustment on the labor escalation rate?

A. The adjustment decreases the labor escalation rate by .97, which equates to a $551,000 revenue requirement adjustment, which and can be seen in Exhibit__(AP-3).

Labor Program Changes

Q. Does the large increase in the labor force concern you?

A. Yes it does. The hiring of new employees should be entered into with the idea of a long-term commitment. Con Edison is a very large company with over 13,700 employees. In calendar year 2007 alone, the Company hired approximately 1,100 new employees, approximately 850 employees left the Company and it ended the year with approximately 13,700 employees. A full eight-percent of Con Edison's workforce was hired in 2007 and they had net gain of 250 employees. From 2005 through 2007, the employee count increased by 1,100 employees from 12,600 to 13,700, or almost a 9% increase. If the Company is to keep its overall costs under control, the growth in the number of employees needs to be monitored.

Q. Would you describe the $886,000 in program changes related to labor proposed by the Company?

A. Yes. The biggest single item is a $541,000 program change for the implementation of operational initiatives that the Company anticipates it will undertake in response to the July 18, 2007 steam incident at 41st Street. We will discuss this program change under the "Steam Incident" section of its testimony.

Q. Would you briefly describe the remaining $345,000 in labor program changes?

A. Yes. The $36,000 is related to hiring engineers and planners. The $200,000 is for programmers for the growing information technology demands.

$63,000 is for 12 additional employees for the Finance Department. The remaining $46,000 is for various new hires for the Law, Human Resources and Security Departments.

Q. Are you proposing adjustments related to these labor related program changes?

A. Yes. We are proposing to remove all of the additional labor costs associated with these program changes in the Company’s revenue requirement.

Q. Please explain why you are proposing this adjustment.

A. At a company as large and complex as Con Edison, management’s priorities and emphasis are constantly changing. With the large and growing workforce, and the large turnover in employees, the Company should have more than enough flexibility to meet the needs that these new programs may require.

It makes little sense to implement a 1% productivity adjustment to reflect the fact that technology allows companies to operate more efficiently, and then allow that adjustment to be watered-down by hiring new employees on a project-by-project basis. The nature of the new programs do not seem so extraordinary or unique that they could not be met by shifting current employees, or hiring new employees with reprioritized skill sets within the normal employee turnover.

Shared Services Administration Group

Q. Please describe the Company’s Shared Services Administration Group.

A. Con Edison’s Accounting Panel describes the Shared Services Group as: “the concentration of Company resources performing like activities in order to service multiple internal customers with higher service levels. The benefits of a shared service structure include increased efficiency, better utilization of personnel, improving and integrating systems, leverage technology, and improved effectiveness through standardization of processes and the sharing of expertise and best practices across organizations and companies.” The group is comprised of 13 management personnel, of which 12 are in place.

Q. Has the Company quantified any benefits associated with this organization?

A. Yes. The Company reflected 25 percent of the group's labor cost as a proxy for productivity savings, or $17,000, in the rate year.

Q. Do you believe that the 25% productivity to the group’s labor cost provides enough benefits to ratepayers?

A. No. In its testimony, the Company’s Accounting Panel identified increased efficiency and improved effectiveness through standardization as justification for creating the Shared Services Administration. However, in the rate year, the Company will allocate $68,453 of Shared Services Administration labor to steam operations, while proposing only $17,000 of productivity savings. In addition, the Company made a $25,000 normalization adjustment, ($19,000 labor, $6,000 other expenses) to account for hiring the 13th person for the group. In effect, the Company’s Shared Services Administration will increase rate year steam labor costs by $70,453 and other expenses by $6,000. The Company expects the program to be self-funding through achieved savings within five years. By the end of the rate year, the "five-year" period referenced by the Company will be almost two-thirds complete. Staff expects that as of the rate year, the Company should be able to achieve significant program savings in an amount equal to at least the ongoing costs of operating the Shared Services Administration. As a result, we recommend the elimination of the entire Shared Services Administration Labor Expense net of imputed productivity, or an adjustment of $70,453 to labor and a $6,000 adjustment to other expenses.

<u>Labor Escalation</u>

Q. Do you have any other adjustments to Labor Expense that track adjustments made by Staff?

A. Yes. Tracking Staff's adjustments to Labor Expense, we made an adjustment to reduce the Labor escalation by $140,000.

<u>Consultant Expense</u>

Q. Do you propose any adjustments to Consultant Expense?

A. Yes. Included within the test year is $252,000 cost for the "Brattle Group – Customer price Response Model". This consulting group assisted

Con Edison with its price elasticity model and customer pricing models for the steam rate filing. The costs were fully allocated to the steam business. We do not expect this to be a recurring expense in the rate year and should therefore be normalized out of the rate year. We propose to reduce rate year consulting expenses by $252,000.

Q. Do you have any other adjustments to this item?

A. Yes. It appears that the Company fully forecasted rate year audit fees within the program changes and then escalated those fees for inflation, which is a double-count. In response to Staff IR DPS-131 the Company agreed to eliminate any unnecessary escalation. To eliminate the double count we recommend subjecting only $290,000 to the GDP escalation rate. The $290,000 represents the $706,000 total consulting fees, less the Brattle Group and Price Waterhouse Coopers audit fees. This results in a $24,000 adjustment to Consultant Expense.

Corrective Maintenance Expense

Q. What is corrective maintenance?

A. According to testimony filed by the Con Edison Steam Operations Panel, it is maintenance performed to restore a system or component to a state of repair where it is capable of performing its intended design function.

Q. How much did the Company request for a rate allowance for corrective maintenance?

A. As set forth on the Company's pre-filed Exhibit__(AP-6), Schedule 1, Page 3 of 4, the rate year forecast of corrective maintenance expense is $13,561,000. This is $6,464,000, or approximately 91%, more than the expense of $7,097,000 actually incurred in the historic test year.

Q. What is causing the substantial increase?

A. Two scheduled program changes, specifically: (1) East River Units 1 and 2 NOX/CO Catalyst Replacement, with a projected cost of $4,800,000; and (2) East River Units 1 and 2 HRSG Leak Repairs, with a projected cost of $1,000,000.

Q. Please explain how Con Edison projected its rate year corrective maintenance expense.

A. The Company started out with the actual HTY expense of $7,097,000, then increased that amount for the two scheduled program changes amounting to $5,800,000, and then increased those amounts by $664,000 for inflation.

Q. Are you proposing to adjust Con Edison's rate year forecast of corrective maintenance expense?

A. Yes. In its response to Staff IR DPS-73, the Company reveals that subsequent to its filing the program change request for East River Units 1 and 2 NOX/CO Catalyst Replacement was determined to be a capital project and not an expense item. Consequently, we are reducing the Con Edison's rate year corrective maintenance expense forecast by $5,047,000 to remove the program change request and associated inflation.

Q. Are you also adjusting the Company's filing to reflect the capitalization rather than expensing of the program change request?

A. No. In its response to Staff IR DPS-185, the Company indicates that this capital project will not begin before 2010 which is outside the rate year in this proceeding.

<u>Site Investigation and Remediation Program Costs</u>

Q. Would you please describe the Company's Site

Investigation and Remediation (SIR) Program?

A. In his testimony, Company witness Price indicates that Con Edison has an on-going program for managing and ensuring required remedial measures are performed for sites that have been contaminated by past releases of petroleum products, hazardous wastes and hazardous substances from the Company’s and its predecessors’ facilities and / or operations. The program encompasses, Manufactured Gas Plant (MGP) Sites; Superfund Sites; Spill sites subject to the investigation and cleanup requirements of Appendix B of a 1994 Consent Order (as modified by a December 2006 Order) between the Company and the Department of Environment and Conservation (DEC); and the areas of the Astoria Site subject to the Resource Conservation and Recovery Act (RCRA) corrective action requirements imposed under the DEC’s hazardous waste management facility permit for the Company’s PCB waste storage facility at that site.

Q. How much did the Company request for a rate allowance for SIR costs?

A. As set forth on the Company’s pre-filed Exhibit___(AP-6), Schedule 1, Page 3 of 4, the forecast of rate year SIR program costs is $3,313,000.

Q. How did the Con Edison forecast its rate year SIR program costs?

A. The Company projects company-wide SIR program costs of $199,500,000 for the period between July 1, 2007, and September 30, 2009, of which it allocated $10,175,000, or 5.1%, to the steam department, then reduces that amount by $1,880,000 to reflect the Commission provided rate allowances for SIR costs in steam rates through September 2008, and then increases that amount by $1,644,000 to reflect its estimate of steam deferred SIR costs as of June 30, 2007. The Company proposes to recovery the balance of $9,939,000 ($10,175,000 - $1,880,000 + $1,644,000) over a three-year period, or $3,313,000 a year.

Q. Are you proposing to adjust the Con Edison’s forecast of rate year SIR program costs?

A. Yes. We are proposing to remove one-third of the Company’s request, or $1,104,000, from the rate year forecast because of problems associated with the Company’s responses to a number of questions we asked concerning its SIR program.

Q. Please explain.

A. In its responses to Staff IR DPS-180.5, 180.6, 180.7, 180.8, and 180.11, Con Edison objected to providing responses primarily because they determined the questions to be unduly broad, vague and burdensome, but they did not even attempt to provide Staff with any responsive material notwithstanding their objections.

Q. Do you agree?

A. No. We believe questions are straightforward and relevant, as well as necessary to ascertain the reasonableness of the Company’s rate request.

Q. What do recommend?

A. Because the Company provided Staff with nothing responsive to allow us to properly evaluate its rate request, we recommend that in its rebuttal filing, the Company provide comprehensive and sufficient responses to our five information requests in order for us to determine the reasonableness of the rate request related to its SIR program in this proceeding before we can make any further determination on whether any other adjustment might be warranted.

Facilities Maintenance

Q. What is facilities maintenance?

A. The Con Edison Steam Operations Panel testifies that facilities maintenance is that which is performed on facility structures, structural components and infrastructure that keep the facility in an acceptable state of repair. In particular it includes repair and maintenance performed to comply with New York City Local Law 11 (Local Law 11).

Q. What is Local Law 11?

A. Con Edison's Steam Operations Panel testifies that Local Law 11 mandates the periodic inspection of the exterior walls and appurtenances of building greater than six stories in height for public safety. They state that these examinations are completed on a five-year cycle, with a two-year window for report filing to establish the repairs required to comply with this mandate.

Q. How much did the Con Edison request for a rate allowance for facilities maintenance expense?

A. The Company is requesting $6,304,000 of which $4,900,000 is for Local Law 11 expenses related to the 2007 through 2011 five-year cycle. According to the Steam Operations Panel, the $4,900,000 reflects the estimated repair and maintenance costs to be undertaken at the steam generations at Hudson Avenue, East River South, East 74th Street and West 59th Street as identified in the independent reports from the latest examinations of those facilities. The Panel indicates that the repairs include such items as brick pointing, replacement of cracked bricks, and lintel and parapet repairs.

Q. Does the Staff Accounting Panel oppose Con Edison's request of $4,900,000 for Local Law 11 expenditures related to the 2007 to 2011 repair and maintenance cycle?

A. No. However, we take exception with the Company's proposed recovery of the $4,900,000 in its rate year forecast of facilities maintenance expense.

Q. Please explain.

A. Staff agrees that the request of $4,900,000 is intended to cover the repair and maintenance work over a five-year period in compliance with Local Law 11 mandate, and clearly is not an annual recurring expense requirement. Accordingly, it would be unjust and unreasonable to ratepayers to build this non-recurring cost into base rates as if the expenditures are to be incurred on an annual basis.

Q. What are you proposing?

A. We are proposing that Con Edison be allowed to recover its estimate of Local Law 11 expenditures of $4,900,000 under the 2007 through 2011 cycle over a three-year period, or $1,633,333 per year. The Company would be allowed to accrue carrying charges on the remaining balance, not to exceed $3,266,667, at the Commission authorized other customer capital rate.

Q. Please explain the effect of your proposal on the Company’s rate year forecast of facilities maintenance expense.

A. We are reducing the rate year forecast by $3,434,900 to reflect the recovery of the current Local Law 11 expenditures over a three-year period.

Employee Pensions/OPEBs Expense

Q. Are you proposing to adjust the Company's forecast of rate year net pension and post-retirement benefits other than pension (OPEB) expense?

A. Yes. The Company's rate year forecast in its original filing was developed relying on a May 2007 actuarial reports from its consultant, Buck Consultants (Buck). In response to Staff IR DPS-184, the Company provided Staff an updated pension/OPEB expense estimate for the rate year based on the January 2008 actuarial reports from Buck and 2008 labor capitalization rate of 35.5%. The update increases the rate year net pension/OPEB expenses from $5,107,366 to $6,176,480, or a $1,069,114 increase. We accept the Company's update.

Q. Does the latest known actuarial information have any other impact on the Company's revenue requirement?

A. Yes. Con Edison is seeking recovery, over a three-year period, deferred under-collected net pension/OPEB costs, pursuant to the Commission’s Pension Policy Statement (Case 91-M-0890, Statement of Policy and Order Concerning the Accounting and Ratemaking for Pensions and Postretirement Benefits Other Than Pensions). The net deferral includes actual under-collections at the end of its previous rate plan on September 30, 2006, and projected under-collections through the end of the current rate plan (September 30, 2008). The update increases the projected under-recovery from $1,463,139 to $2,145,050, or an increase of $681,911. Therefore, we increase the amortization of the deferred pension/OPEB costs from $487,713 to $715,017, and the unamortized balance in rate base from $736,264 to $1,079,407, if the Commission adopts the proposed three-year amortization period.

Q. Is there any other issue related to pension/OPEB costs?

A. Yes. Staff discovered that the Company made an error in gathering data from its actuarial reports provided by Buck. Staff corrects the error with the latest Buck actuarial reports.

The correction changes the rate year steam allocation of pension/OPEB funding from $8,828,000 to $7,936,000.

Q. How does the change in pension/OPEB funding level impact the revenue requirement?

A. The Company's book operating income and related income taxes are determined by the accrued pension/OPEB expense. The current state and federal taxes are determined by cash contributions made to the pension/OPEB plans. The cash contributions made to pension/OPEB plans do not affect the income tax expenses for ratemaking purposes. However, they affect the accumulated deferred income tax (ADIT) balances in rate base. Consequently, we reduce the Company's rate year forecast of ADIT in rate base by $269,000, an increase to rate base.

<u>Pension and OPEB Reconciliation</u>

Q. How does the Panel address the Company's request to true up the pension and OPEB costs?

A. We recommend that the Company continue to reconcile its actual pension and OPEB expenses and tax benefits related to the Medicare prescription drug subsidies to the level allowed in rates, pursuant to the Pension Policy Statement.

<u>Employee Welfare Expense</u>

Q. Please explain the Company’s forecast methodology for employee welfare expenses.

A. The Company’s health insurance expenses forecast for the rate year was developed based on the 2008 contract rates and the number of participants as of September 2007. Company witness Hector Reyes states that he used three different methods for escalating employee welfare expenses. First, a labor factor of 6.77 percent was used to escalate costs that are a function of salaries and wages. Second, a non-labor factor of 5.1 percent was used to escalate costs that are unrelated to salaries and wages. Third, the projected health care cost trend rates were used to escalate health care costs including prescription drugs at 8.0 percent. The Company’s forecast of employee welfare expense is $7.365 million for the rate year.

Q. Does the Panel agree with the Company’s forecast method?

A. No. The gross domestic product (GDP) inflation indexes reflect a basket of goods and services, including health care services. On advice of counsel, the application of a separate escalation factor in forecasting health care costs, other than the general inflation factor, is inconsistent with the Commission's practice, as stated in Commission Opinion No. 84-27 issued October 12, 1984. Our adjustment reflects the 2008 health care premiums and the number of participants as of September 2007 provided by the Company plus general inflation.

Q. Please explain the Panel's adjustment to employee welfare expenses.

A. We start with the latest available information provided by the Company for its contract rates and number of participants to determine the Company's costs for the calendar year 2008. For the costs provided by the Company for the 12 months ending June 30, 2007, we escalate the 2007 costs by the general inflation factor of 3.33 percent to calculate the costs for the calendar year 2008. We then escalate the 2008 health insurance costs by the general inflation factor of 2.17 percent to calculate the costs for the calendar year 2009. Finally, we use three months of 2008 costs and nine months of 2009 costs to forecast health insurance costs for the rate year (12 months ending September 30, 2009). Our approach results in a reduction of $280,000 to the Company’s rate year level of employee welfare expenses.

Q. Does the Panel have any other adjustment to employee welfare expense?

A. Yes, the Panel has two tracking adjustments relating to the labor escalation rate adjustment and the employee level adjustment.

Q. What is the Panel’s adjustment relating to the labor escalation rate adjustment?

A. This reflects Staff’s downward adjustment from the Company’s labor escalation rate of 6.77 percent to 3.43 percent. The Company has applied the labor escalation rate to the historic levels of Thrift Savings Plan for management personnel, Group Life Insurance and Military Duty Allowance to forecast the rate year levels for these items. We applied the 3.43 percent labor escalation rate to these items resulting in a reduction of $22,000 to employee welfare expense.

Q. What is the Panel’s adjustment relating to employee levels?

A. This adjustment tracks the reductions in the rate year labor expense resulting from various Staff adjustments to the Company’s proposed employee levels. Our adjustment reduces the rate year employee welfare expense by $494,000.

Q. Please explain.

A. We expressed our adjusted forecast of employee welfare expense of $7,087,000 as a percentage of the Company’s total rate year labor expense. The result was that employee benefit expense represented 11.69 percent of rate year labor expense. We apply the 11.69 percent benefit factor to the total Staff proposed reductions to labor expense of $4,224,000. The result is a reduction of $494,000 to the rate year employee welfare expense.

Q. Does the Panel have any adjustment relating to other costs included in employee welfare expense?

A. Yes, the Panel proposes an adjustment to group life insurance costs to reflect the dividends that the Company has routinely received in four of the last five years from its insurer, MetLife, which the Company has confirmed in its response to Staff IR DPS-27.

Q. Please explain the Company’s forecast methodology for group life insurance relating to active employees.

A. Company witness Reyes forecast the rate year level of group life insurance at $122,000 and explains the methodology on pages 7 through 9 of his testimony. The Company provides group term life insurance equal to the base salary for management employees and escalates that amount by the labor escalation factor.

Q. Please explain the Company’s forecast methodology for group life insurance relating to union employees.

A. The Company provides $30,000 of group term life insurance for members of Local 1-2 and Local 3 in accordance with the collective bargaining agreements and escalates that amount by the 5.1 percent non-labor factor since the value of this life insurance benefit is not related to base salaries.

Q. Please continue.

A. The Company also reflects a normalizing adjustment related to the group life insurance dividends it received and used to offset the premiums during the historic year ending June 30, 2007. Thus, the projection for the rate year level of group life insurance is calculated using the basic life insurance premium rates, number of lives covered, and the appropriate use of escalation factors.

Q. Does the Panel agree with the Company's forecast method?

A. No, the Panel does not. The Company has not provided a reasonable justification for not considering routine dividends in the forecast of the rate year level. The Company confirms that the dividends that have been received for the years 2002, 2003, 2005 and 2006 were $888,201, $1,495,493, $1,121,854 and $1,140,585, respectively, in its response to Staff IR DPS-27. The dividends are material relative to the premium level.

Q. How does MetLife notify Con Edison that a dividend or payment is due?

A. In its response to Staff IR DPS-26, MetLife prepares a report that reconciles group life insurance premiums paid versus actual claims experience plus administrative expenses at the end of each calendar year and sends this report to Con Edison during the second quarter of the year. If the claims are lower than the level MetLife had forecasted and billed the Company the previous year, a dividend results which Con Edison has historically opted to receive as a credit to offset the following year's group life insurance premium. If the claims are greater than the level MetLife had forecasted and billed, a deficit results requiring Con Edison to send an additional payment for group life insurance.

Q. Please explain the Panel's adjustment to group life insurance.

A. Since Con Edison has received dividends in four of five years, Staff has developed a five-year average ratio of dividends/deficits to premiums of 46.01 percent. Staff recommends that the ratio be applied to the Company's adjusted rate year level for group life insurance of $120,000, resulting in an estimated MetLife credit for group life insurance or reduction to employee welfare expense of $55,000 in the rate year. Not reflecting this experience would routinely result in the customer paying more than is necessary.

Q. Does the Panel expect any updates from the Company relating to employee welfare expense between February and the hearings in this matter?

A. Yes, we do. However, the Company has indicated that in its response to Staff IR DPS-2 that it does not know at this time which items listed in Exhibit__(HJR-1) will be updated. Updates will be provided at the update stage of this proceeding and/or thereafter, as information becomes available. We reserve the right to review all known updates to employee welfare expense as provided by the Company.

Financial Services

Q. Could you describe the Company's backup workpapers with regard to Financial Services on line 22 of Exhibit__(AP-6), Schedule 1, page 3?

A. Yes. The back-up Financial Services workpapers go through line by line of each debt issuance and forecast the fees in the rate year. The Company develops a fully-forecasted rate year amount and subtracts the historic year costs to develop a $48,000 program change.

Q. Does the Company also apply the general escalation rate to this item and wouldn't that be a double count?

A. Yes. It applies the general escalation rate to the fully-forecasted rate year amount and that is a double count.

Q. Do you propose an adjustment to this item?

A. Yes. Since the program change has a detailed forecast of this item, we recommend allowing the program change and eliminating this item from being escalated by inflation. It is a $24,000 adjustment.

<u>Insurance Expense</u>

Q. Would you describe the Company's program change related to Insurance Expense.

A. Yes. Insurance is primarily comprised of five major categories – property, liability, bonds, insurance on employees and worker's compensation. The Company proposes a $639,000

(22% increase) program change from the level of insurance expense actually incurred in the historic test year. The proposed program change is essentially a line-by-line individual escalation of 22 different insurance policies. Because the program change is merely an escalation adjustment from the historic test year to the rate year, the Company does not propose to apply general GDP inflation escalation to this expense.

Q. Was the Company asked for the basis for their high escalation rate and for supporting workpapers and source documents supporting such a high escalation rate?

A. Yes. In its response to Staff IR DPS-84, the Company stated that the estimates of annualized premiums are made from the maturity dates using the best judgment of the Company's Insurance Manager and its brokers as to what the insurance market will look like in 2008 and the Company's historic claims experience.

Q. What has been the historical trend in insurance expense for Con Edison?

A. Con Edison's Insurance Expense for the years

2004 through 2006 was $2,561,398, $2,360,241, and $2,523,539, respectively. Clearly, indicating a flat-to-declining trend. From the year ended December 31, 2006, to the test year ended June 30, 2007, we saw an increase insurance expense from $2,523,539 to $2,867,662.

Q. Can you explain this large and sudden increase in the test year?

A. Yes. The increase is entirely associated with one insurance policy related to steam production conventional property insurance. The increase in that policy was caused by a much higher allocation by the Company to the steam business. Historically that policy was only allocated 9% to steam, in 2006 the allocation jumped to 23%. The reason for the change in Company allocation most likely had to do with ERRP coming into service. If we normalize the effect of the new allocation rate, insurance expense for the 12 months ended June 2007 would actually be slightly less than the twelve month ended 2006. So the normalized cost of insurance for the Company has actually decreased over the last three and one-half years.

Q. Has the Company justified the large escalation of insurance expense?

A. No. The Company's escalation rate of 22% for this item is excessive and, furthermore, the Company has not provided any evidence in support for this large increase. In fact, historical trends have been flat to declining and a case could be made for no escalation of this expense from the test year to the rate year.

Q. Are you proposing an adjustment to insurance expense?

A. Yes. We propose to eliminate the program changes related to this expense and to allow the historic test year expense to be escalated by the GDP deflator, similar to many other O&M expenditures.

Q. Does the Panel have any other adjustments to Insurance Expense?

A. Yes. Directors and Officers Liability Insurance is insurance payable to the directors and officers, or to the corporation itself, to cover damages or defense costs in the event they are sued by shareholders for wrongful acts while they are with that company.

We propose that Director and Officers Liability Insurance not be allowed in rates and should instead be borne by the Company's shareholders. This insurance protects the directors and officers from inappropriate activity and decisions that are adverse to shareholder interests. The insurance coverage is unrelated to ratepayers who do not select the officers and directors, and do not subject them to potential liability. The Company's directors and officers receive adequate compensation for their expertise and competence, and the customer should not pay to insulate them from personal responsibility for inappropriate decisions. We propose that the $340,000 the Company is claiming for this insurance be disallowed.

Interference Expense

Q. Is the Panel proposing any adjustments to the Company's rate year forecast of interference expense?

A. Yes, we are proposing adjustments to both steam interference expense related to New York City (NYC or City) infrastructure improvement projects and interference costs related to Lower

Manhattan reconstruction projects (WTC interference expense). Our adjustments reduce the Company's interference expense forecast by $4.168 million from $11.097 million to $6.929.

Q. Please explain Staff's adjustment to interference expense related to City infrastructure improvement projects.

A. Staff's forecast of rate year interference expense related to City infrastructure improvements is developed with a different methodology from the Company's. As a result, Staff's rate year interference expense forecast is $3.157 million lower than the Company filed $6.057 million.

Q. Please explain the process used by the Company to develop its rate year interference expense forecast related to the City's infrastructure improvement projects.

A. The Interference Panel (IP) develops the rate year interference expense forecast based on the City's published Capital Commitment Plan. The City publishes its five year capital commitment plans in each April, September, and following January. These plans identify the infrastructure improvement projects the City plans to implement in its following fiscal year (July to June) and beyond. The capital commitment plan also sets a commitment target (commitment) because the City realizes that not all planned projects will actually proceed. Con Edison has determined that 98.3% of the City commitments have resulted expenditures in the following fiscal year. And the Company’s interference expenditures are 11.6% of the City’s actual expenditures in the related categories, based on actual data from 2003 through 2006. The IP provides that steam interference expense is 4% of the total Company amount. The 4% ratio was also developed with actual data from 2003 through 2006.

Q. Why do you think this forecasting methodology is inappropriate?

A. Our analysis indicates that the City’s capital commitment plan is not a reliable source for the purpose of forecasting the Company’s future interference expenditures.

Q. Please explain.

A. First of all, the capital commitment target varies in different publications from 62%-66% in January and September publications to 81%-96% in the April publications. These varying commitment ratios result in unreliable expected City expenditures. Second, there is a disconnect between the capital commitment target derived from the Capital Commitment Plan, as the Company used in its forecast, and the data used to determine the percentage of City's actual expenditures to the City's commitment targets. The IP workpaper labeled Worksheet 1 for IP-2 lists the City's actual expenditures in fiscal year 1991 through 2006 and compares the actual expenditure in each year with the Commitment target determined in the previous fiscal year. These numbers were derived from the City's Monthly Transaction Reports, according to IP response to Staff IR DPS-122. The commitment targets provided in Worksheet 1 for IP-2 are significantly lower than those derived from the Capital Commitment Plans. We compared the capital commitment targets derived from the September Capital Commitment Plans in City fiscal years 2004 to 2007 with those listed in

Worksheet 1 for IP-2, taken from the Monthly Transaction Reports. The commitment targets derived from the two sources varied between 11% and 98%. Since the 98.3% ratio of City actual expenditures to its commitment targets were developed with data from the City’s Monthly Transaction Reports, these reports should be the basis to develop the future forecasts.

Q. Do you have other observations with regard to the methodology used to develop the interference forecast?

A. Yes. In response to Staff IR DPS-161, the Company updated its forecast in IP-2 Revised based on the City’s September 2007 Capital Commitment Plans. The update provided the expected City’s capital expenditures for the relevant categories in the amount of $1.599 million and $1.706 million in City’s fiscal years 2009 and 2010, more than double the City’s actual annual expenditures in the historic years. In the current environment of economic downturn, these dramatic changes are questionable.

Q. Please provide your observations with regard to the City's historic actual expenditures.

A. The Company workpaper Worksheet 1 for IP-2 provided the City's actual expenditures in fiscal years 1991 through 2006, ranging between $390 million in 1994 and $716 million in 2005. The Company provided the City's actual expenditures of $644 million for fiscal year 2007 in response to Staff DPS-193. The trend line indicates approximately 15.5% increase between year 2000 and 2006. The general inflation rate for the same period was about 16%, calculated from the Gross Domestic Product (GDP) indexes the Company provided to support its general escalation rate. The comparison indicates that the City's actual expenditures, on average, increased at a rate comparable to general inflation.

Q. How does Staff propose to forecast Con Edison's rate year interference expense?

A. We propose to use the City's five year average actual expenditures from 2003 to 2007, adjusted for inflation, to project the City's expenditures for fiscal years 2008 and 2009. We then apply the 11.6% ratio to the City's expected expenditures to determine the Company’s interference expense. Steam interference expense is 4% of the total Company amount. Staff’s methodology results in rate year steam interference expense of $2,900,000, which reduces the Company’s forecast in the original filing by $3,156,800.

Q. What is Staff’s adjustment to steam interference O&M expenses in Lower Manhattan?

A. Staff’s adjustment reduces the rate year interference O&M expenses related to WTC by $1,011,517.

Q. Please explain your adjustment.

A. Con Edison utilizes a different methodology in forecasting WTC related interference expense. The Company does not provide sufficient workpapers other than a listing of projects, and the costs of these projects are estimated based on the Company’s experience with similar projects, according to IP testimony. Staff’s adjustment is based on the Company’s actual experience in the historic years.

Q. How much did the Company spend on steam interference in Lower Manhattan in the historic years?

A. Con Edison’s response to Staff IR DPS-173 provided that the Company incurred $18,977,668 for steam interference in Lower Manhattan from January 2002 through November 2007. The Company noted that the actual spending for 2007 is abnormally low due to delays in implementing the joint bid projects with the City’s scope of work.

Q. How does staff use the historic actuals in the forecast of rate year WTC interference expense?

A. We developed the actual four-year average between 2003 and 2006 to exclude the abnormal spending in 2007. We use this average as the estimate for the historic period, and adjust it for general inflation to develop the rate year forecast. The labor component is 5% of the WTC interference expenditures, according to Company response to Staff IR DPS-173. Staff’s approach results in a rate year interference expense (O&M, excluding labor) of $4,028,483, which is $1,011,517 lower than the Company filed $5,040,000.

Q. Does Staff support the Company’s proposal to recover the WTC interference expense in base rates beginning in rate year?

A. Interference in Lower Manhattan was considered a Category 3 expenses under Lower Manhattan Development Corporation's Partial Action Plan. The filing deadline for this category was December 31, 2007. The Company's proposal is based on the assumption that it has exhausted all the government funds and insurance reimbursements for this category of costs. Staff has no objection to the Company's proposal. However, if the Company receives any reimbursements from any sources during the rate year, the funds have to be deferred for customer benefits.

Interference Expense Reconciliation

Q. The Company's Interference Panel proposed a full reconciliation of the interference expense. Does the Panel support the Company's proposal?

A. No. The Panel proposes no reconciliation for a one-year rate plan.

Q. Is there any Commission precedent for not reconciling Interference Expenses in a single-year rate plan?

A. No, however, in the Company's current electric rate proceeding in Case 07-E-0523, the Administrative Law Judges' recommended no reconciliation of interference expense for a one-year rate plan.

<u>Regulatory Commission Expense</u>

Q. Please explain the Company's forecast of regulatory commission expense regarding the Public Service Commission (PSC) Assessments.

A. The Company forecasts the rate year level of regulatory commission expense at $2,543,000 including $2,325,000 for PSC Assessment and $217,000 for other expenses. The Company stated on page 63, lines 4 – 8, that it intends to update this item to reflect the latest PSC Assessment bill and any adjustments of the bill, if necessary, in this proceeding.

Q. Is the Panel aware of any known changes relating to an update regarding the PSC Assessment during the rate year in this proceeding?

A. Yes, the PSC billed utility companies on January 31, 2008, for the estimated assessment for the 2008-2009 state fiscal year ending March 31, 2009, based on the adjusted intrastate revenue from the 2006 calendar year. The PSC also stated in this letter that a revised assessment will be made in August 2008 based upon 2007 revenue information and the 2008-2009 Enacted Budget. Finally, the PSC will issue a final statement of assessment that reflects actual 2008-2009 state fiscal year expenditures by October 20, 2009.

Q. Based on the January PSC letter, please explain any adjustment that the Company should reflect in this proceeding.

A. Staff projects the rate year level of PSC assessment at $2,376,000 for Con Edison, an increase of $51,000 based on the January estimated assessment, plus general inflation for the August revised assessment update.

Q. What have the past results been for Con Edison in the October PSC letter issued reflecting the final statement of assessment?

A. The Company has routinely received a refund for the past four years. The Panel has developed a 4-year historic average ratio of 5.25 percent for Con Edison.

Q. Does the Panel recommend an adjustment regarding refunds the Company has routinely received?

A. Yes, the Panel recommends the ratio (5.25%) be applied to the revised 2007-2008 fiscal year assessment of $2,324,696 reflected in the August 10, 2007 PSC letter. This approach produces a reduction to PSC assessment of $122,000 and results in the rate year level for PSC assessment of $2,254,000.

Q. Has the Company agreed to the methodology proposed by this Panel to forecast this expense?

A. Yes, the Company has agreed to the methodology. In its response to Staff IR DPS-205, Con Edison reviewed Staff's calculation of this item provided in the information request and indicates its agreement with Staff's adjustment.

Q. Is there a tracking adjustment required for PSC assessment?

A. Yes, a working capital adjustment is required because PSC assessments are prepaid by the utility companies. After receiving the January 31, 2008, PSC letter for the 2008-2009 estimated assessment, Con Edison's average prepayment of PSC assessment is calculated at a rate year level of $689,000; resulting in an increase of $8,000.

Shared Services

Q. What is shared services expense?

A. Shared service expense reflects net billings between Con Edison and its affiliates for allocation of certain corporate costs and direct services performed between the Company and its affiliates, including Orange and Rockland Utilities (O&R) and Con Edison's holding company, Consolidate Edison, Inc. (CEI).

Q. Does the Panel propose any adjustment to the Company's forecast of rate year shared service expense?

A. Yes. The Company's original filing contained some errors. In response to Staff IR DPS-125, the Company acknowledges these errors and provides corrections to its initially filed position. Staff's adjustment reflects both these corrections and Staff's labor escalation rate of 3.43%, compared to the Company's 6.77% rate used in the rate year forecast. Consequently, we are increasing the Company's rate year forecast from $573,035 to $590,600, or by $17,541.

Water Treatment

Q. What are water treatment expenses?

A. According to testimony filed by the Con Edison Steam Operations Panel, they are those costs incurred at East River Units 1 and 2 to eliminate particulate and other scaling and corrosive constituents from the City water supply to ensure the quality of water for steam sendout from the units.

Q. How much did the Company request for a rate allowance for water treatment expense?

A. As set forth on the Company's pre-filed Exhibit__(AP-6), Schedule 1, Page 3 of 4, the rate year forecast of water treatment expense is $5,723,000. This is $2,582,000, or approximately 82%, more than the expense of $3,141,000 actually incurred in the HTY.

Q. What is causing the significant increase?

A. A scheduled program change; in particular, the replacement of both the Reverse Osmosis ("RO") and Electrode Deionization ("EDI") consumable elements with a projected cost of $2,302,000.

Q. Please explain how Con Edison projected its rate year water treatment expense.

A. The Company started out with the actual HTY expense of $3,141,000, then increased that amount for the scheduled program change of $2,302,000, and then increased those amounts by $280,000 for inflation.

Q. Please explain in more detail the scheduled program change request of $2,302,000 for RO and EDI membrane replacement at East River Units 1 & 2.

A. In its testimony, the Steam Operations Panel indicates that the RO and EDI elements need to be replaced at certain intervals. They claim that the intervals are based on usable lifetime ranges provided by the equipment manufacturers as well as existing conditions. They also claim that the lifetime ranges are dependent on operating conditions of the supply of water quality and may be either longer or shorter than their design lives. Further, they state that the lifetime ranges for RO, EO and Auto Pulse Filtration (APF) elements vary in length, and their significant replacement costs can, therefore, greatly impact water treatment costs incurred in any give year.

Q. Please continue.

A. The Panel discloses that since the start of operations of East River Units 1 & 2 in 2005, the RO and EDI membranes have been chemically cleaned numerous times to remove particulate and biological fouling due to the quality of water used at the facility. They claim that over time, the cleaning becomes less effective in sustaining the performance and operation of these elements, and their useful lives are exhausted.

Q. What are the useable lifetime ranges provided by the equipment manufacturers for the RO and EDI membrane elements?

A. In its response to Staff IR DPS-185, the Company indicates equipment manufacturers lifetime ranges of 1.5 to 3 years and 3 to 5 years for the RO and EDI membrane elements, respectively.

Q. What are the useable lifetime ranges anticipated by Con Edison for the RO and EDI membrane elements?

A. The Company, in its response to Staff IR DPS-185, indicates anticipated lifetime ranges of

1.5 to 2 years and 3.5 to 4.5 years for the RO and EDI membrane elements, respectively.

Q. Does the Staff Accounting Panel oppose Con Edison’s rate request of $2,302,000 for RO and EDI membrane elements at East River Units 1 & 2?

A. No. However, we take exception with the Company’s proposed rate recovery through full inclusion of the $2,302,000 in its rate year forecast of operating and maintenance expense.

Q. Please explain.

A. It is clear from the testimony of the Steam Operations Panel as well as the response to Staff IR DPS-185 that the RO and EDI membrane elements are non-recurring annual expenditures and have a useful live greater than one rate single year. Accordingly, it would extremely unfair to ratepayers, especially in light of the Company’s substantial overall rate request, to build this non-recurring cost into the Company’s base rates.

Q. What are you proposing?

A. We are proposing that Con Edison be allowed to recover its program change request equally over a four-year period, or $575,500 per year. The

Company would be allowed to accrue carrying charges on the remaining balance, not to exceed $1,727,000, at the Commission authorized other customer capital rate.

Q. Explain the effect of your proposal on the Company’s rate year forecast of water treatment expense?

A. We are reducing the rate year forecast by $1,845,600, from $5,723,000 to $3,877,400

<u>Other O&M Expense</u>

Q. Panel, please explain any adjustments you have to Other O&M expenses.

A. The Panel would reclassify the following amounts in Other O&M to a more proper expense account classification:

- Fringe benefits relating to new employees of $113,000 to employee welfare expenses and employee pension and OPEBs.
- The costs relating to the steam advertising campaign, public affairs education and awareness, and public affairs web upgrade of $747,000 to informational advertising.

Q. Do these reclassification adjustments have any effect on the overall revenue requirement?

A. No, these reclassification adjustments do not have any impact on the revenue requirement. These adjustments merely move the expenses from Other O&M to an expense account that more clearly defines the nature of the expenses.

Q. Does the Panel have any other adjustments to this expense item?

A. Yes, the final adjustment relating to Other O&M is related to the general escalation costs proposed by the Company. The Company uses a different general escalation rate for this item as well as costs included in the base used to forecast the rate year.

Q. Please explain.

A. The Company's Accounting Panel states on page 64, line 10, that its general escalation rate is 5.1 percent. The Company also lists the various O&M expenses that are subject to general inflation in Exhibit__(AP-6), Schedule 9. On line 54, Other O&M has a base of $3,022,000 with $223,000 reflected for inflation; however, this represents 7.38 percent as the general inflation rate instead of the 5.1 percent.

Second, the Company states that the program changes of $909,000 were forecasted as rate year costs. The Company has applied the general inflation rate to the base of $3,022,000 which includes the program changes of $909,000. The historic year costs may be subject to escalation but the projected program changes already include escalation; so, applying the general inflation factor to the program changes is a double-count.

The base for other O&M expense should be reduced by the program changes proposed by the Company of $909,000 and by the reclassification for the historic costs of $117,000 associated with the steam marketing program to a level of $1,996,000. The general escalation rate of 5.1 percent should be applied to the corrected base. This correction produces a reduction of $114,000 to the rate year level for other O&M expense.

Steam Incident – O&M Expense Effects

Q. Has the Company forecast any increase in rate year expenses due to the steam incident?

A. The steam incident occurred on July 18, 2007, which is subsequent to the historic test year, so all of the effects of the incident on rates are included as program changes.

Q. What program changes related to O&M expenses did the Company propose due to the steam incident?

A. The Company proposed a program change of $514,000 of additional labor, $181,000 of additional manhour expenses and $78,000 of other expenses for a total of $800,000 of additional expenses related to the incident.

Q. How did the Company justify this increase in expense?

A. In its response to Staff IR DPS-6, the Company stated, “This program change request is an estimate for the implementation of operational initiatives that the Company anticipates it will undertake in response to the July 18, 2007 steam incident at 41st Street. This estimate was not intended as a comprehensive response to all programs that may be implemented subsequent to the completion of the investigation related to this incident. Specific programs are not yet defined, but this estimate is the minimum amount that the Company expects to spend during the rate year. The Company will provide calculations and descriptions when programs are developed."

Q. Has the Company provided any calculations or descriptions of new programs related to the steam incident?

A. Yes. The Company provided an update on February 22, 2008, which was much too late for any meaningful analysis and review in this case, considering Staff's response to the Company's filing is due on February 29, 2008, not even allowing Staff a single round of interrogatories or information requests to be exchanged on the update. As for the update, we observe that the Company lists 9 broad elements of their "Action Plan" that will incrementally impact O&M expenses. They forecast approximately $3.2 million dollars of incremental expenses in the 2008 calendar year. We recommend that these new programs, and potential rate recovery of any new programs, should be considered in the current prudence investigation in Case 08-S-0153.

Q. Do you propose an adjustment for this program change?

A. Yes. We propose to eliminate all $800,000 of this program change because the Company has not specifically detailed what changes they will make and what the incremental costs will be.

Taxes Other Than Income Taxes

Property Tax Expense

Q. Does the Panel have an adjustment to rate year Property Tax Expense?

A. Yes.

Q. What is the basis of your adjustment to the rate year property tax expense?

A. Our adjustment to the Company's property tax expense reflects our use of an escalation factor based on the average tax growth rates for the past five years to forecast the tax rates for the 2008-2009 tax year.

Q. How did the Company determine its rate year estimate of New York City property tax expense?

A. As described in Company witness Hutcheson’s testimony, the Company forecasts the rate year level based on the forecast assessed values of the steam properties, including forecast construction expenditures, and forecasted tax rates for the properties that are classified as class 3 and class 4.

Q. Do you agree with the Company’s methodology regarding property tax expense?

A. We agree with the methodology that the expense should be computed by applying a tax rate to the assessed value of properties segregated into class 3 and class 4. We also accept the Company’s forecast of assessed values of steam properties. However, we take exception to the estimated tax rate used by the Company in its rate year forecast.

Q. Please explain.

A. Both Staff and the Company use a five-year historic average of tax rate changes to forecast the estimated rate year tax rate. Staff starts with the tax rates in effect at the end of the 2002/2003 tax year, tabulates the yearly variations from that tax year to the 2007-2008 tax year to arrive at its five-year average tax rate. This resulted in tax rate decreases of 1.61% for class 3 properties and 2.72% for class 4 properties.

The Company, in contrast, starts its computation with the 2001/2002 tax rates, computes the variation to the rates in effect at the beginning of 2002/2003, skipped the variations from the fiscal year 2002/2003 as compared to the 2003/2004 fiscal year, and computes the yearly variations for the remaining periods (i.e. 2003/2004 through 2007/2008) in order to determine its five-year average tax rate. It is our understanding that the reason for excluding the variations from the tax year 2002/2003 to tax year 2003/2004 from the computation was that New York City imposed a significant (i.e., 18.5 percent), across-the-board mid-year tax rate increase in the middle of the 2002/2003 fiscal year. The exclusion was an attempt to normalize for this significant tax rate increase as not being representative of "normal" tax rate changes.

Staff's five-year average, however, also eliminates the effects of this substantial rate increase. Indeed, Staff's computation starts with the rates in effects after the significant tax rate increase at the end of the 2002/2003 fiscal year and the mere fact of starting our computation with the rates in effect at the end of that tax year does by itself eliminate the effect of the 18.5% tax rate increase that occurred during that tax year since it does not compare those rates to what was in effect prior to the increase. Such a rate hike would have affected the determination if the year or the rates in effect immediately prior to the rate increase was included in the computation (e.g. it would have affected a six year average commencing with the 2001/2002 tax rates). But, since the rates in effect prior to the rate hike were not included in Staff's computation, the effect of the hike is, by default, not reflected in the five-year average; and therefore, does not skew the result whatsoever. Accordingly, we estimate tax rate decreases of 1.61% for class 3 properties and 2.62% for class 4 properties for the 2008-2009 tax year as compared to 1.25% and 2.33% decreases used by the Company in its rate year forecast.

Q. What is the impact of your estimated tax rates on the Company's forecast of rate year property tax expense?

A. We are reducing the Company's rate year forecast by $365,000 from $62,461,000 to $62,096,000. A concomitant adjustment is also required decreasing rate year rate base by $77,000 related to forecast of prepaid property tax expense included in the Company's rate year rate base.

Q. Have such differences in methodology been addressed in the Company's previous cases?

A. Yes. Staff and the Company argued their respective positions in the Company's current electric case (Case 07-E-0523). In that case, yet to be decided by the Commission, the Administrative Law Judges stated that Staff's methodology was proper and recommended that Staff's position be adopted.

<u>Reconciliation and Deferred Accounting Property Taxes</u>

Q. In his testimony, Company witness Rasmussen proposes to eliminate the current dead-band 90/10 deferral limitation for property tax expense variances that was in effect during the multi-year rate plan and replace it with a fully trued-up reconciliation mechanism for property tax expense variances. Do you support the Company's proposal?

A. No. Although the Company requested a property tax reconciliation mechanism to reconcile the difference between its actual tax expense and its rate allowance, it is our opinion that reconciliation is not necessary in the context of establishing rates for a single rate year as Staff is proposing at this time.

Q. Regarding the treatment of property tax refunds and assessment reductions, do you agree with the Company's proposal to continue the current 86/14% Customer/Company sharing mechanism?

A. Yes, we do.

Payroll Taxes

Q. Do you have any adjustments to Payroll Taxes?

A. Yes. We use the blended payroll tax rate of 7.03% developed by the Company, and multiply it by all of Staff's net adjustments to labor. The adjustment amounts to $297,000. This expense will be updated accordingly for any changes to labor.

Rate Base

Earnings Base Capitalization (EBC)

Q. What is the purpose of the EBC calculation?

A. The EBC is a computation intended to bring rate base and capitalization into phase so that the basis upon which a utility is given an opportunity to earn a return reflects only the investor-supplied capital dedicated to public service. Simply stated, the EBC comparison represents the difference between the capitalization, or the earnings base and rate base.

Q. What data is used to calculate the EBC?

A. Traditionally, the EBC is based on data from the Company’s books and records for the historical year or test year. In this instance, the test year is the year ended June 30, 2007.

Q. Please quantify the impact of your proposed EBC adjustment.

A. Our adjustment reduces the Company’s rate year rate base by $20.107 million.

Q. Please explain your adjustment.

A. Our adjustment eliminates a portion of the capitalization that is equivalent to the prepaid pension expenses resulted from pension credits above the rate allowances while the Company was off the Pension Policy Statement.

Q. Did Con Edison include its prepaid pension expense in its rate base request?

A. Yes. The Company’s Accounting Panel, on page 74, acknowledges that the Company included its prepaid pension expense in its rate base compilation as part of its Earnings base versus capitalization (EBC) measure. The Company indicated that its inclusion is one of the reasons that its earnings base is larger than its rate base.

Q. Does Staff have any concerns with Con Edison's proposed treatment?

A. Yes, the majority of the prepaid pension balance was amassed while the Company was off the Statement of Policy and Order Concerning the Accounting and Ratemaking for Pensions and Post Retirement Benefits Other Than Pensions (Case 91-M-0890, issued September 7, 1993) (Pension Policy Statement). Moreover, a significant portion of the so-called prepaid pension expense does not represent a cash investment for Con Edison.

Q. For what period was Con Edison’s steam operation off the Pension Policy Statement?

A. Con Edison went off the Pension Policy Statement, effective April 1, 1997, consistent with the terms of the rate plan adopted by the Commission in Case 96-E-0897. Steam operations returned to the provisions of the Pension Policy Statement effective October 1, 2004.

Q. How large is the prepaid pension expense?

A. Con Edison has accumulated a significant prepaid pension expense balance. As noted by the Company's Accounting Panel, the average balance of the steam prepaid pension expense was $47 million for the historic year ended June 2007.

Q. How do prepaid pension expense balances arise?

A. There are two ways a prepaid pension balance can occur. It can occur when management, at its discretion, makes contributions to, or funds, its pension plan with cash in excess of the rate allowances provided by the Commission. A prepaid pension balance can also occur when a negative pension expense is accrued on a company's books. Con Edison's prepaid pension balance developed as the result of this latter situation rather than the Company actually making cash contributions to the pension fund in excess of its rate allowances. Thus, Con Edison's prepaid pension expense balance is not a cash prepaid expense, but rather the balance sheet effect that results from the accrual of negative pension expense.

Q. Were negative pension expenses reflected in Con Edison’s steam rates?

A. Partially. Con Edison steam rates reflected negative pension expense accruals. However, the Company booked negative pension expense accruals well in excess of the levels that were reflected in steam rates.

Q. Were differences between rate allowances and actual pension accruals reconciled and deferred for the benefit of ratepayers?

A. No. Effective April 1, 1997, Con Edison went off the Pension Policy Statement and suspended the reconciliation of rate allowances to actual pension and OPEB accruals. As noted previously, the Company returned to this Policy Statement requirement effective October 1, 2004 for its steam operations.

Q. How did Con Edison’s actual pension accruals compare to its rate allowances while the Company was off the Pension Policy Statement?

A. Based on information provided by the Company in its last steam rate proceeding Case 05-S-1376, we determined that Con Edison’s actual steam pension expenses were negative $59.358 million for the period it was off the Pension Policy Statement. During this period, rate allowances for steam pensions totaled negative $26.282 million. Therefore, the Company’s actual pension expenses were $33.076 million lower than the level set in rates. Since the Company was off the Pension Policy Statement at that time, the benefits of these savings flowed to shareholders, not customers.

Q. Why is the inclusion of the prepaid pension expense balance in rate base problematic?

A. The inclusion of the prepaid pension expense will provide the Company a cash return on the prepaid pension expense balance. A significant portion of the Company’s prepaid pension expense is not associated with any cash outlay. As such, the request to include the non-cash component in rate base has no merit. Moreover, the non-cash component of the prepaid pension expense is not associated with any benefits realized by customers. Customers received a benefit only to the extent that pension credits were reflected in the rates they paid. Con Edison retained pension credits in excess of those reflected in rates since it was not on the Pension Policy Statement and now is attempting to earn a return on the resultant profits it earned while off the Pension Policy Statement. To require customers to pay carrying costs on the portion of a benefit they never received (because it flowed to shareholders) is inequitable and inappropriate.

Q. The Company’s Accounting Panel, starting on page 74, suggests that negative pension costs resulted in a cash financing requirement for the Company. Do you agree?

A. No, not completely. While the Company’s Accounting Panel properly states that negative pension expenses or credits were non-cash, they also suggest that these non-cash credits were used to reduce the Company’s operating costs. As a result, the revenue requirement was reduced and cash flow was reduced. The Company’s argument misses the point, however, because it fails to focus on the fact that the prepaid balances were also derived from differences between the negative pension credits reflected in rates and the even greater negative pension expenses actually booked by the Company. While the Company is correct that cash flow was reduced by the credits reflected in rates, its position does not consider the fact that cash flow was in no way affected by the prepaid balances generated by the even greater negative pension expenses booked by the Company. Put another way, the Company’s position is true only to the extent the pension credits were reflected in rates. Credits in excess of those reflected in rates resulted in non-cash earnings on which the Company now inappropriately seeks to earn a return.

Q. How do you propose to remedy this situation?

A. We propose that the Commission consider the portion of the prepaid pension balance that is equivalent to the pension credits that were not reflected in rates as a non-regulated asset. We propose to adjust the Company's capitalization to eliminate the capital supporting this non-regulated asset. We reflected our adjustment in the EBC adjustment to the Company's rate base. This adjustment is necessary to ensure that the Company only has an opportunity to earn a return on its cash investments.

Q. What is the amount of your proposed adjustment?

A. Our proposed adjustment to the Company’s EBC is $20.107 million.

Q. How did you calculate your adjustment?

A. We calculated that, for the period April 1997 through September 2004, Con Edison’s actual steam pension expense was $33.076 million less than the amounts provided for in rates. This over-collection increased the Company’s steam earned return. We recommend that the net-of-tax amount of this difference, $20.107 million, be reflected as an adjustment to the Company's capitalization supporting steam operations.

Q. How did the Commission treat the prepaid pension issues in the Company’s previous rate cases?

A. Since returning to the Pension Policy Statement, the Commission has acted on a number of Con Edison rate cases (Cases 03-G-1671, 03-S-1672, 04-E-0572, 05-S-1376, and 06-G-1332). However, these cases were all negotiated multi-year rate plans in which all parties tried to reach diverse, sometimes conflicted goals. The Company's current electric rate proceeding Case 07-E-0523 is the first litigated case since the Company returned to compliance with the Pension Policy Statement. Staff's position in the Company's recent electric rate case was the same as what Staff proposes here, that is, to adjust the Company's capitalization to eliminate the portion resulting from pension credits not reflected in rates, or the EBC adjustment. Though the Commission's final decision is still pending, the ALJs support Staff's position in their Recommended Decisions (RD).

Change of Accounting Section 263A

Q. Do you have any concerns that may impact the accumulated deferred income taxes reflected in the Company's rate base in this case?

A. Yes. The Company's rate base includes average accumulated deferred taxes for the rate year of $42.3 million associated with tax accounting changes made under Section 263A of the Internal Revenue Code. ($32.8 million on line 49 and $9.5 million on line 51 of the Rate Base Schedule.)

Starting in 2002, Con Edison began to use the “simplified service cost method”. This permitted the Company to obtain expense deductions for costs and assets that would have otherwise been depreciated over a 15 to 20 year period.

As noted in the Company’s Annual Report filed with the Commission: “In August 2005, the Internal Revenue Service (IRS) issued Revenue Ruling 2005-53 with respect to when federal income tax deductions can be taken for certain construction-related costs. The Company used the ‘simplified service cost method’ *(*SSCM) to determine the extent to which these costs could be deducted in 2002, 2003, 2004 and 2005, and as a result reduced its current tax expense by $318 million. The Company expects that it will be required to repay, with interest, a portion of its past SSCM tax benefits and to capitalize and depreciate over a period of years costs it previously deducted under SSCM.”

The rate filing simply reflects an amortization of historic deductions. It is our understanding that the Company has been working with the IRS to resolve the disputed deductions, as well as the future applicability of the Section 263A for Con Edison. The Company has reflected the 263A deduction on its 2007 tax accrual and plans to take it on the 2007 tax return. The Company estimates that 60% of the 263A deductions will be sustained and has segregated the 40% uncertain portion for inclusion in the SEC reporting of the liability for Uncertain Income Taxes (FIN 48). The uncertain tax amount is shown on line 51. The deferred state income tax effect is included in line 53.

Because of the uncertainty, we are concerned that the Company's estimate may not reflect the level of actual deferred tax balances for the rate year.

Q. Does the Panel propose to adjust rate base?

A. No. Since the resolution of this matter is still pending and there is a potential for a significant disallowance, we recommend that the Company provide an update based on the latest available information. The update should reflect any related offset to the ADR/ACRS/MACRS rate base balances. Should a resolution with the IRS be reached during the course of this proceeding, the Company should notify the parties and, depending upon the current status of the proceeding, an update should be required of the Company.

WTC Deferral Recovery

Q. Would you give a brief background on the recovery in rates of deferred costs related to the World Trade Center?

A. Yes. In 2001, Con Edison filed a petition with the Commission in which it sought authority to defer and recover its WTC-related costs, Case 01-M-1958. The Commission found that it was premature to consider the petition because other avenues of recovery of these costs have not yet been exhausted. We expect that once those reimbursement options are settled, the Commission will address the appropriate treatment of these costs in that proceeding.

In the interim while that case is still pending, the Company has been allowed to recover in rates some of World Trade Center deferrals in order to make sure the deferral level remained at a reasonable level and the recovery from ratepayers was spread out over a reasonable timeframe. Currently the Company is recovering $4 million per year in steam rates.

Q. What is the Company’s recovery proposal in this case?

A. Con Edison seeks to recover $23 million of deferred O&M expenditures and accrued interest that relate to the WTC incident over a three-year period, or $7.7 million per year. In addition, the Company seeks to recover $10.3 million of deferred capital expenditures over a thirty-year period, or $342,000 per year. The unamortized deferred balances have been included in the Company’s rate base request. The Company believes it is unlikely that it will be reimbursed for these costs from government sponsored programs.

Q. Are you comfortable with Company’s estimate?

A. No. There is uncertainty about the Company’s ultimate costs and reimbursement levels. The Company is seeking recovery of WTC-related costs from customers when neither the Company nor Staff can definitively state what the net cost will be. Estimates of various costs and expected reimbursement levels are all that can be offered. Costs are still being incurred and the federal review process is still underway. Even at this late date, much remains unknown regarding the federal reimbursement levels. The Company is seeking recovery of interference costs from customers and its filing does not reflect any anticipated reimbursements for interference costs. On December 26, 2007, the Company filed an application for reimbursement from the Empire State Development Corporation for $197 million companywide. The amount they will ultimately recover for these costs is not known at this time, but it is reasonable to assume that it will be significantly more than zero, which is currently in the Company’s forecast.

The Company’s proposal to include deferred costs and related deferred interest in rate base is very problematic given the known and expected changes that have not been addressed by the Company.

Q. Does the Panel have any interim recommendations on this issue?

A. Yes. We recognize the extraordinary nature of these expenditures and that in the end insurance and other sources of reimbursement may not cover all the underlying costs. While we have not audited the WTC-related expenditures in any significant detail, Staff has monitored the Company's restoration and rebuilding activities as well as Empire State Development Corporation's review of the Company's reimbursement claims. We recognize that the ultimate determination as to the prudence of the underlying costs will be the Commission's. We believe that costs in excess of our recommended recovery level here will be considered prudent expenditures. Therefore, as an interim measure, until all of the costs are known and all of the reimbursement issues are settled, we recommend that the Commission allow the Company to continue the current rate treatment. Currently, the Company is recovering and amortizing $4 million of WTC related costs per year. In addition, the Company is deferring carrying charges on net of tax deferred balances at its pre-tax rate allowance for funds used during construction. Continuation of this treatment will eliminate our concerns regarding expected changes that have not been reflected by the Company. The accrual of carrying charges on actual book balances is, in essence, self correcting. This approach by default addresses our concerns over potential double recoveries and forecasting errors by limiting the Company's return to actual net investments. The recommended amortization level is reasonable after consideration of all our concerns. This treatment should be subject to full reconciliation based on actual expenditures net of federal and insurance recoveries, the establishment of appropriate amortization periods for the various categories of both capital and O&M expenditures, or other treatment as the Commission may prescribe in Case 01-M-1958. To reflect this recommendation, we adjusted other operating revenues and eliminated the deferred costs from the Company's rate base.

Accumulated Deferred Income Taxes

ADR / ACRS / MACRS Depreciation Differences

Q. Please explain the Panel’s adjustment to the Company’s rate year forecast of accumulated deferred income taxes (ADIT) related to ADR/ACRS/MACRS book versus tax depreciation differences.

A. In its response to Staff IR DPS-114, the Company recognizes that its rate year forecast was incorrect and resulted in an understatement of the projected deferred tax liability balance. Consequently, we are increasing the Company’s rate year forecast (i.e. reduce rate year rate base) by $12,926,000, from $156,675,000 to $169,601,000, to correct the deferred tax liability balance related to ADR/ACRS/MACRS book versus tax depreciation differences.

Unbilled Revenues

Q. Please explain the Panel’s adjustment to the Company’s rate year forecast of ADIT related to unbilled revenues.

A. In its response to Staff IR DPS-117, the Company acknowledges that its rate year forecast was incorrect and resulted in an understatement of the projected deferred tax asset balance. Accordingly, we are increasing the Company’s rate year forecast (i.e. increase rate year rate base) by $8,507,000 from $819,000 to $9,326,000, to correct the deferred tax asset balance related to unbilled revenues.

Income Taxes

Cost of Removal Tax Deduction

Q. Are you proposing to adjust the Company's forecasted rate year tax deduction associated with cost of removal?

A. Yes. In its response to Staff IR DPS-138, the Company discloses that the cost of removal reflected in its SIT and FIT expense calculations and rate year reserve for depreciation should be the same. Con Edison indicates that the amount reflected in the development of rate year steam reserve for depreciation was correct and the amount reflected in its tax schedules was incorrect. Consequently, we are increasing the rate year forecast of state (normalized) and federal (flow through) tax deductions associated cost of removal by $2,872,000, from $9,416,000 to $12,288,000. A concomitant adjustment is also required decreasing rate year rate base by $204,000 for the accumulated deferred taxes related to the deduction in the state tax calculation.

Q. Does this conclude your testimony at this time?

A. Yes.