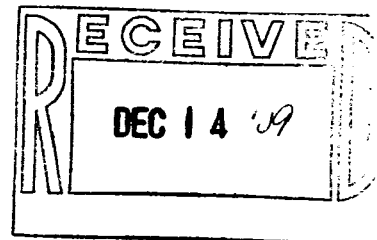

A Review Of Electric Discount
And Energy Competition Act (EDECA),
Energy Purchase, And Affiliate Relationships Of
The Rockland Electric Company



Docket No. EA08080560

**Division Of Audits
New Jersey Board Of Public Utilities
Two Gateway Center
Newark, New Jersey 07102**

November 2, 2009

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TABLE OF CONTENTS

2009 EDECA REPORT	1
A. SUMMARY OF THE AUDIT PROCESS	3
A.1 THE ACT	3
A.2 PURPOSE OF THE AUDIT	3
A.3 MAJOR ISSUES	4
A.4 THE STANDARDS FOR THE CODE OF CONDUCT	5
A.5 SCOPE	5
A.6 GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS ...	6
B. EDECA AUDIT	7
B.1 NON-DISCRIMINATION	7
B.2 INFORMATION DISCLOSURE STANDARDS	9
B.3 SEPARATION STANDARDS	10
B.4 UTILITY COMPETITIVE BUSINESS SEGMENTS	11
C. PROCUREMENT AND PURCHASING	13
C.1 THE COMPANY'S PROCUREMENT AND PURCHASING PROCEDURES ARE SOUND AND ENSURE THAT PRICING IS NON- DISCRIMINATORY AND DOES NOT EXCEED MARKET RATES	13
D. AFFILIATE RELATIONSHIPS	18
D.1 THE HOLDING COMPANY STRUCTURE, AFFILIATES AND THEIR DIVERSIFIED ACTIVITIES HAD NO DETRIMENTAL EFFECTS ON RECO	18
D.1.1 Recommendation	18
D.2 TRANSACTIONS O&R AND RECO ARE LIMITED	19
D.3 ACCORDING TO OUTSIDE AUDITOR SARBANES OXLEY REPORTS, RECO'S INTERNAL CONTROL SYSTEM PROVIDES REASONABLE ASSURANCE TO ITS RATEPAYERS	20
D.4 COMMUNICATIONS BETWEEN BOARD DIRECTORS AND OFFICERS IS LIMITED TO BOARD MEETINGS AND SPECIALLY PREPARED BRIEFING PACKETS	21
E. MARKET CONDITIONS	22
E.1 RECO EFFECTIVELY TRANSFERS POWER TO THIRD PARTY SUPPLIERS	22
E.2 THE COMPETITIVENESS OF THE TPS MARKET IS DEPENDENT ON WHETHER THE TPSs CAN COMPETE WITH BGS PRICE	25

TABLE OF CONTENTS

E.3	RECO'S STRATEGY AND PHILOSOPHY OF MARKET TRANSACTIONS WITH REGARD TO POWER INCLUDING ENERGY AND CAPACITY IS REASONABLE	26
E.4	TRANSACTIONS IN ANY OTHER MARKET INCLUDING TO THE EMISSIONS AND SOLAR RENEWABLE ENERGY CERTIFICATES ARE WELL DOCUMENTED AND EFFECTIVE	27
E.5	NON-UTILITY GENERATOR (NUG) TRANSACTIONS	28
E.6	NON-UTILITY GENERATOR MITIGATION EFFORTS ARE EFFECTIVE	29
F.	RECOMMENDATIONS OF THE 2003 REPORT	30
F.1	REQUIRE THE DISCLOSURE NECESSARY TO EXAMINE RELATIONSHIPS AND TRANSACTIONS THAT EXIST BETWEEN EITHER O&R AND RECO...AND ALL RCBS OF CEI AND CECONY AS A COMMON SERVICE SUPPLIER	30
F.2	TREAT ALL CEI RCBSs AS COVERED BY THE STANDARDS IF THEY HAVE, OR OFFER, TO SERVE RETAIL CUSTOMERS IN NEW JERSEY, WHETHER OR NOT IN RECO SERVICE TERRITORY	30
F.3	VERIFY THAT REGULAR CUSTOMER COMMUNICATIONS COMPORT WITH THE OBLIGATION NOT TO PROVIDE A PREFERENCE TO AN (sic) RCBS	31
F.4	AMEND THE RECO COMPLIANCE PLAN TO CLEARLY PROHIBIT TYING ACTIVITY TO ANY RCBSs OF O&R OR CEI THAT SERVES IN-STATE CUSTOMERS, WHETHER OR NOT IN THE RECO'S NEW JERSEY UTILITY SERVICE TERRITORY	31
F.5	INCLUDE IN THE RECO WEBSITE SECTION "SHOPPING FOR SAVINGS' A LINK TO THE BPU WEBSITE	31
F.6	VERIFY THAT RECO'S REGULAR COMMUNICATIONS WITH CUSTOMERS DO NOT MAKE REPRESENTATIONS OF THE TYPE PROHIBITED BY SECTIONS 14:4-5.3(n)	32
F.7	REVISE COMPANY POLICY TO PERMIT ACCESS TO AFFILIATES AND RECORDS AS NECESSARY TO VERIFY COMPLIANCE WITH THE STANDARDS	32
F.8	STRENGTHEN IT SECURITY POLICIES AND PROCEDURES TO ADDRESS THE INFORMATION EXCHANGE PROVISIONS OF SECTION 14:4-5.5(e)	32
F.9	INTRODUCE A METHOD BY WHICH INDIRECT COSTS FOR JOINT PURCHASES ARE PROPERLY ASSIGNED	33

TABLE OF CONTENTS

F.10	UPDATE THE CORPORATE ACCOUNTING POLICIES REGARDING THE DISTRIBUTION OF COSTS BETWEEN COMPANIES AND CONFORM THEM TO THE STANDARDS; DEVELOP A CLEAR AND CONSISTENT SET OF METHODS FOR IMPLEMENTING THESE POLICIES	33
F.11	IMPROVE EXISTING PROCEDURES TO STRENGTHEN CONTROL OVER THE DATA COLLECTION, ANALYSIS AND PRICING CALCULATION FOR SHARED SERVICES	33
F.12	CONDUCT AN EXAMINATION BY INTERNAL AUDIT TO VALIDATE THAT DATA COLLECTION, ANALYSIS, AND PRICING OF SHARED SERVICES ARE DONE ACCURATELY AND CONSISTENTLY	34
F.13	CONDUCT AN EXAMINATION OF ALL SHARED ADMINISTRATIVE SERVICE COSTS FOR THE YEARS 2001 AND 2002 TO DETERMINE THE EXTENT OF ERRORS SIMILAR TO THOSE UNCOVERED DURING TRANSACTION TESTING. MAKE NECESSARY CORRECTIONS, AND VALIDATE THE ACCURACY AND COMPLETENESS OF ADMINISTRATIVE SERVICE COSTS	34
F.14	DEVELOP AND INSTITUTE AN A&G LOADER TO BE INCLUDED IN STANDARD RATES USED FOR DIRECT CHARGES TO NON-REGULATED AFFILIATES AND CEI	35
F.15	PROVIDE FOR A SYSTEMATIC REVIEW OF UNRECORDED USAGE OF CECONY SHARED ADMINISTRATIVE SERVICES BY THE NON-REGULATED AFFILIATES	35
F.16	RECONCILE THE STANDARD RATE TO ACTUAL COSTS FOR SHARED SERVICES DIRECTLY CHARGED TO UNREGULATED AFFILIATES AND CEI	35
F.17	REPOSITION THE DUTIES OF INDIVIDUALS WHO SERVE AS A DIRECTOR AND/OR AN OFFICER FOR BOTH A UTILITY AND A RELATED COMPETITIVE BUSINESS SEGMENT OF THE UTILITY'S HOLDING COMPANY	36
F.18	REVISE THE COMPLIANCE PLAN TO INCORPORATE THE REQUIREMENTS OF SECTION 14:4-5.5u(2) WITH THE REGARD TO THE TRANSFER OF ASSETS FROM A PUHC RCBS TO THE UTILITY	36
F.19	MAKE TRAINING IN THE O&R STANDARDS OF COMPETITIVE CONDUCT MANDATORY FOR ALL NEW EMPLOYEES	37
F.20	INCLUDE ROUTINELY SCHEDULED, MANDATORY REFRESHER TRAINING THAT IS APPROPRIATE TO THE NATURE AND EXTENT OF EMPLOYEE INVOLVEMENT IN ACTIVITIES AFFECTED BY THE STANDARDS	37

TABLE OF CONTENTS

F.21	CONFIRM THE PERMANENT IMPLEMENTATION OF THE PROPOSALS RELATED TO EMPLOYEE UNDERSTANDING OF INFORMATION DISCLOSURE RULES AS SET FORTH IN THE FEBRUARY 28, 2002 LETTER TO THE BOARD IN THE COMPLIANCE PLAN	37
G.	AFFILIATE COST ALLOCATION METHODOLOGIES	43
G.1	THE ACCOUNTING AND ALLOCATION PROCEDURES FOR SEPARATING THE COSTS OF INTERCOMPANY TRANSACTION OF RECO FROM ITS AFFILIATE ARE REASONABLE AND CONSISTENTLY APPLIED SINCE THE INCEPTION OF THE JOA	44
G.2	THE ALLOCATION OF JOINT/Common COSTS TO RECO, ORU AND CEI ARE ACCURATE AND CONSISTENTLY MAINTAINED	46
G.3	AS LONG AS THE ALLOCATION METHODOLOGIES SPECIFIED IN THE JOA REMAIN REASONABLE AND ARE CONSISTENTLY APPLIED, THE OPPORTUNITY FOR CROSS-SUBSIDIZATION IS EXTREMELY SMALL	47
G.4	PRICING POLICIES BETWEEN AFFILIATE INTERESTS ARE APPROPRIATE	47
G.5	BIDDING PROCEDURES ARE COMPETITIVE AND ARE IN THE BEST INTEREST OF RECO RATEPAYERS	47
G.6	THE LEASE ARRANGEMENT IS REASONABLE	48
G.7	AFFILIATE CHARGES AND COST ALLOCATION METHODOLOGIES ARE IN COMPLIANCE WITH ALL APPLICABLE LEGAL, REGULATORY AND CONTRACTUAL REQUIREMENTS	48

2009 EDECA REPORT

2009 EDECA REPORT

The governing request for proposal (RFP) issued by the New Jersey Board of Public Utilities (NJBPU) defines a two-phased audit of Rockland Electric Company (RECO). This report covers the defined scope of work for the first of the two phases. The RFP specifically provides for five areas of investigation:

1. Procurement and Purchasing;
2. Affiliate Relationships;
3. Market Conditions;
4. Review of the 2003 Electric Discount and Energy Competition Act (EDECA) audit; and
5. Affiliate Cost Allocation Methodologies.

PMC Management Consultants determined that the BPU also desired an audit of the utility's EDECA compliance. PMC is in a unique position to provide such a review. We designed the structure of the EDECA audit in the initial review conducted in 2000. In 2003, the second audit was conducted using the PMC template. During our review of the 2003 audit by three PMC consultants, who were part of the 2000 PMC review, noted little change in RECO's need for compliance in 2003. Consequently, PMC provides its analysis of RECO's EDECA compliance in an efficient and economical format. We compare our present findings with the 2000 and 2003 audits.

The standards for utility compliance with EDECA fall into three primary categories:

- Non-Discrimination (§14:4-5.3);
- Information Disclosure (§14:4-5.4); and
- Separation. (§14:4-5.5)

2009 EDECA REPORT

A Fourth section of EDECA §14:4-5.6 covers the definition of utility competitive business segments. In the initial EDECA audit, it was determined that Rockland Electric Company (RECO) had no competitive services offered in its service territory. This was affirmed in the second EDECA audit of 2003.

The impact on an EDECA audit today is significant if no competitive services have been introduced. Consequently, our first chapter provides a comparative to 2000 and 2003 findings and today's structure.

The request for proposal (RFP) describes the scope of work for phase one of the audit of Rockland Electric Company (RECO) as a "review of the Utility's compliance with the competitive service statutes and the New Jersey Administrative Code". Further, the RFP wishes a review of the RECO "transactions with the affiliates of O&R and CEI on a retail and wholesale basis". The description goes on to include a compliance review of RECO with the Electric Discount and Energy competition Act (EDECA).

The content of this Report reflects the EDECA compliance review, which covers affiliate relationships and cost allocations. Also included is a review of the 2003 EDECA audit. Market conditions affecting energy supply are summarized and energy purchase is described.

The organization of this EDECA Report is:

- A. Summary of the audit process
- B. EDECA audit for 2009
- C. Procurement and purchasing
- D. Affiliate Relationships
- E. Market Conditions
- F. Review of 2003 EDECA report
- G. Affiliate cost allocation methodologies

A. SUMMARY OF THE AUDIT PROCESS

In 1999, New Jersey passed the “Electric Discount and Energy Competition Act” (the Act), or New Jersey Statutes Annotated (NJSA) 48:3-49, *et seq.* The Act provided for customer choice in energy services. The Act also provided for the restructuring of New Jersey’s seven utility companies such that the delivery of the energy service would remain regulated and a “protected monopoly.” However, the actual provision of source energy and energy related services were to be available and subject to the competitive forces of the marketplace.

A.1 THE ACT

The Act provides for assurances that the protected monopoly will not unfairly use its market power to undo the expected benefits of a competitive marketplace. At NJSA 48:3-55, 48:3-56 and 48:3-38, the Act empowers the New Jersey Board of Public Utilities (BPU or the Board) to secure services of independent consultants to conduct audits of the utilities and their related competitive business segments (RCBS) to determine whether they enjoy unfair competitive advantage.

A.2 PURPOSE OF THE AUDIT

The purpose of the audit is to provide an assessment to the Board of the results of the introduction to the competitive arena. Specifically, the purpose is to evaluate and report to the Board whether a level playing field exists for all participants in a competitive service offering. Where unfair competitive advantages may exist, the consultant is expected to recommend corrective actions. These audits are to be conducted at least every two years.

A.3 MAJOR ISSUES

For the Board, there are two major issues. The first issues is whether the standards developed by the Board to cover the utility, the RCBS and the public utility holding company (PUHC) are sufficient and working effectively. In essence, does this “Code of Conduct” provide for the level playing field with non-affiliated purveyors of competitive services having access to all the existing benefits the RCBSs have with the utility.

The second major issue is to provide, through the Board, to the energy customers of New Jersey, the assurances of fair and proper allocations of costs between the non-competitive (regulated) and competitive products or services. The Act and the Board specifically work to prevent and avoid any cross-subsidization.

A.4 THE STANDARDS FOR THE CODE OF CONDUCT

The Board has published “Affiliate Relations, Fair Competition and Accounting Standards and Related Reporting Requirements”. The Standards serve as the road map for the generic work plan. The major tasks of the work plan are defined as:

- *Nondiscrimination*

The standards of conduct are designed to assure the absence of preferential treatment by the utility or any affiliate or RCBS. Consequently, seventeen (17) standards covering the utility’s specific processing of transactions have been constructed. These standards also prohibit the utility from partaking in any activity that would provide unfair advantage in business development and customer relations.

- *Information Disclosure*

The Board recognizes that information is a valuable commodity and would be an unfair competitive business practice. The Board has defined that privileged access to such information

sources, such as customer lists, must be equally available. We use eleven (11) standards to cover this issue. The standards cover conduct between the utility and RCBS plus the utility and the utility customer or potential customer.

- ***Separation***

The legal and structural separation of the utility, its PUHC, and RCBS are provided for by the Standards. The Board specifies certain physical separation requirements. We use twenty-one (21) general standards to cover books and records, sharing of assets and services, relationship of the utility to the PUHC and RCBS, employees and transfers of services and assets.

- ***Competitive Products/Services Offered By A Utility Or RCBS Of a Utility***

The Board has designed standards plus prescribed remedies for violations to these standards of conduct. All competitive services/products offered by the utility or an RCBS must be reviewed, and have approval, by the Board of a proposed tariff. The Board holds itself the decision-maker as to what is an allowable competitive product/service.

A.5 SCOPE

The Board wished to receive, from the auditors, an informed and supported opinion of each utility's compliance plan and historic actions since inception of competition and energy choice in New Jersey. Key to this opinion are the Board's standards. Further, based on technical accounting guidelines and process information flow auditing, we determined the degree of separation and allocation of each utility's revenues, costs, assets, risks and functions between and among the utility and its RCBSs. To achieve this scope of effort, determination was made as to whether:

- Cross subsidies exist between the utility and its non-utility segments within a PUHC;

- The separation of utility and non-utility organizations is reasonable based on the above noted standards;
- There is any impact on the use of utility assets in the provision of non-safety related competitive services;
- There is any impact or effect on the utility's employees with particular interest in professional assignments to RCBS;
- The utility is unfairly affecting competitive services; and
- The utilities can completely demonstrate compliance with the Act.

A.6 *GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS (GAGAS)*

PMC followed Generally Accepted Government Auditing Standards (GAGAS), also called the "*Yellow Book*". The germane chapters of the "*Yellow Book*" are Chapter 6: Field Work Standards for Performance Audits and Chapter 7: Reporting Standards for Performance Audits. This continues PMC's history as the first consulting firm to use GAGAS during a utility performance audit.

PMC complied with applicable elements of GAGAS by demonstrating the following:

- **Adequate Planning** demonstrated by the proposal and the required detailed work plan;
- **User Needs** were considered by our analysis of the BPU's standards and the Act;
- **Understanding** was shown in our description of the assignment in the proposal;
- **Criteria** covering our evaluation were based on the BPU standards;
- **Management Controls** were maintained through the use of electronic requests and recording of responses;
- **Supervision** was adequately maintained through the use of the utility lead consultant and prescribed performance check lists;
- **Compliance** with GAGAS was maintained by the utility lead consultant;

2009 EDECA REPORT

- **Evidence** was enhanced in quality by the cooperative approach used by PMC;
- **Working papers** were provided for by filings that are kept at the utility for BPU use;
- **Reports** are in accordance with BPU requirements;
- **Timeliness** was held by tracking to the BPU pre-set schedule for completion; and
- **Views** of utility officials concerning accuracy were sought through the cooperative approach and reading of draft reports.

B. EDECA AUDIT

The following is based on the format established in the year 2000 when PMC Management Consultants performed the first EDECA audit. That format follows the Act.

This format was followed in 2003's EDECA audit. In our review of that second audit, PMC discovered little had changed at RECO with respect to needed EDECA compliance. Consequently, when PMC found little change with EDECA compliance in 2009, we established a discovery process that would affirm each of the standards for applicable performance. Since the results show little change, we have designed a matrix to compare all three audits.

B.1 NON-DISCRIMINATION

B.1 NON-DISCRIMINATION		Year of Audit		
		2000	2003	2009
B.1.1	Affiliate Preferences	N/A	N/A	N/A
B.1.2	Prohibited Transactions	N/A	N/A	N/A
B.1.3	Access to Information	N/A	N/A	N/A
B.1.4	Short Term Sales of Energy or Capacity	N/A	N/A	N/A

2009 EDECA REPORT

B.1 NON-DISCRIMINATION STANDARDS-CONTINUED				
B.1.5	Long Term Sales of Energy or Capacity	N/A	N/A	N/A
B.1.6	Discounts	N/A	N/A	N/A
B.1.7	Documentation	N/A	N/A	N/A
B.1.8	Non Discriminatory Tariff	N/A	N/A	N/A
B.1.9	Tariff Enforcement	N/A	N/A	N/A
B.1.10	Affiliate Service Requests	N/A	N/A	N/A
B.1.11	Tying	N/A	recommended strengthened prohibitions of Tying	Updated compliance plan
B.1.12	Customer Assignments	N/A	N/A	N/A
B.1.13	Customer Enrollment, Marketing and Business Development	N/A	N/A	N/A
B.1.14	Customer Advice or Assistance	N/A	N/A	Website improvements made
B.1.15	Posting Discounts, Rebates and Waivers	N/A	N/A	N/A
B.1.16	Information Retention For Discounts, Rebates and Waivers	N/A	N/A	N/A
B.1.17	Compliance with FERC	N/A	N/A	N/A

B.2 INFORMATION DISCLOSURE STANDARDS

B.2 INFORMATION DISCLOSURE		Year of Audit		
		2000	2003	2009
STANDARD		2000	2003	2009
B.2.1	Provision Of Customer Proprietary Information	N/A	N/A	Compliance
B.2.2	Training of CSRs	N/A	N/A	Compliance
B.2.3	Provision of Non-Public Information	N/A	N/A	N/A
B.2.4	Provision of Generation Service Providers	N/A	N/A	Compliance
B.2.5	Provision of Information Concerning Unaffiliated Suppliers	Compliance	N/A	Compliance
B.2.6	Solicitation of Information Concerning Unaffiliated Suppliers	N/A	N/A	N/A
B.2.7	Highlighted Lists	N/A	N/A	N/A
B.2.8	Supplemental Information About Affiliated Providers	N/A	N/A	N/A
B.2.9	Record Keeping Concerning Transaction With Affiliates	N/A	N/A	Compliance through Electronic Data Interchange
B.2.10	Record Retention	N/A	N/A	Compliance
B.2.11	Inspection of Records	N/A	N/A	Compliance
B.2.12	Bid and Contract Records	N/A	N/A	N/A

B.3 SEPARATION STANDARDS

B.3 SEPARATION STANDARDS		Year of Audit		
		2000	2003	2009
STANDARD		2000	2003	2009
B.3.1	Separate Corporate Entities	Compliance	Affirmative	Affirmative
B.3.2	Separate Books	Compliance	Affirmative	Affirmative
B.3.3	Conformity of Books and Records With USOA	Compliance	Compliance	Compliance
B.3.4	Availability of Books and Records for Board Examination	Compliance	Non-Compliance	Compliance
B.3.5	Sharing of Space, Services, and Equipment	N/A	N/A	N/A
B.3.6	Authorized Joint Products and Services	N/A	N/A	N/A
B.3.7	Joint Purchases	N/A	N/A	N/A
B.3.8	Pricing and Reporting of Joint	N/A	Accounting lacked compliance for costs as per standards	N/A
B.3.9	Shared Services	Compliance	Write up	See § C, D & G of this report
B.3.10	Protection of Confidential and Market Information	N/A	N/A	Compliant
B.3.11	Use of Utility Name and Logo	N/A	N/A	N/A
B.3.12	Non-New Jersey Use of Utility Name and Logo	N/A	N/A	N/A

2009 EDECA REPORT

B.3 SEPARATION STANDARDS CONTINUED				
B.3.13	Promising or Implying Preferred Treatment	N/A	N/A	N/A
B.3.14	Use Of Utility Advertising Space	N/A	N/A	N/A
B.3.15	Joint Advertising or Marketing	N/A	N/A	N/A
B.3.16	Joint Employees	N/A	N/A	N/A
B.3.17	Common Directors and Officers	N/A	N/A	N/A
B.3.18	Employee Transfers	N/A	N/A	N/A
B.3.19	Use of Utility Information After Employment Transfers	N/A	N/A	N/A
B.3.20	Service Transfers	N/A	N/A	N/A
B.3.21	Utility Asset Transfers	N/A	N/A	N/A

B.4 UTILITY COMPETITIVE BUSINESS SEGMENTS

The 2000 and 2003 EDECA audits found that RECO had no competitive business segments. Further, O&R had no competitive business segments operating in RECO's franchise area. In the present EDECA audit, RECO provided information concerning Con Edison Energy and Con Edison Solutions; the latter has been qualified to provide retail access services since June 2008.

Technology such as Electronic Data Interchange (EDI) is used to provide a level of independence to comply with EDECA objectives.

Con Edison Energy participates in the New Jersey BPU's "Basic Generation Service Auction" (BGS) and consequently has contracts

2009 EDECA REPORT

with various local distribution companies. The BPU oversight of the auction process provides assurances of compliance with the Standards. Con Edison Solutions offers electricity, as a third party supplier (TPS), and energy audits to RECO customers.

The O&R and RECO web pages list TPSs in alphabetical order. As with all TPSs, RECO has little direct contact with those offering services in its territory. All enrollment and discontinuance of service are handled by the EDI system. Solutions is subject to the TPS Customer Account Services Master Service Agreement (Agreement). This Agreement was developed on a collaborative basis with New Jersey suppliers.

RECO does hold customer events to educate its customers. An Energy Choice Market Expo was held in June 2008. All TPSs doing business in the RECO franchise area were invited. Those wishing to make presentations were afforded the opportunity.

C. PROCUREMENT AND PURCHASING

C.1 THE COMPANY'S PROCUREMENT AND PURCHASING PROCEDURES ARE SOUND AND ENSURE THAT PRICING IS NON-DISCRIMINATORY AND DOES NOT EXCEED MARKET RATES

This area covers the RFP's requirement to review and determine if the pricing of RECO's goods and services to and from ORU, CEI, and its affiliates are non-discriminatory and do not exceed market rates.

The Consolidated Edison Purchasing Department is responsible for the procurement of all goods and services for Orange and Rockland (including RECO) with the exception of fuel, real estate, financial services, and insurance. (Fuel purchases are discussed in the Affiliate Relationships and Affiliate Cost Allocation Methodologies sections of this report. The procurement of real estate, financial services, and insurance are covered in Phase II.) Purchasing uses the Orange & Rockland Walker Purchasing System (Walker System) which is a module of the Walker Financial Enterprise Package in the performance of its work. The Walker System is specific to ORU transactions and is used for the purchase and administration of all stock items that are maintained in Company inventory and for the purchase of all non-stock materials and services.

The Purchasing Department handles the sale of disposed assets in its resource recovery group. Purchasing is also responsible for maintaining contractor performance information and qualifying new suppliers. The Supplier Diversity Program, which is part of the Purchasing Department, qualifies diverse businesses to act as vendors for Orange and Rockland. The responsibilities of the Purchasing Department include:

- Processing, terms and conditions;
- Managing the Supplier Diversity Program;
- Administering the Walker Procurement System (Walker);

2009 EDECA REPORT

- Administering the Contractor Oversight System;
- Administering purchase requisitions;
- Preparing bid packages;
- Performing commercial evaluations of bids;
- Preparing purchase orders – including spot buys, term or blanket orders;
- Negotiating prices the Procurement Card (P-Card) Program; and
- Qualifying new suppliers.

The operating groups at Orange and Rockland participate with the Purchasing Department in several components of the purchasing process. They generally include:

- Identifying new vendors and qualifying their products/services; and
- Determining the best procurement method for handling a given business requirement.

For material purchases, the operating groups are primarily responsible for the following functions:

- Purchasing goods and services under the Procurement Card (P-Card) Program;
- Specifying products and services to be purchased, and requisitioning them;
- Expediting purchases and coordinating delivery;
- Inspecting materials received from vendors;
- Receipting for delivery of goods and services;
- Authorizing payment of vendor invoices;
- Authorizing releases against blanket, term, and system orders; and
- Performing technical evaluations.

The Company's general policy is to procure materials, equipment, and services competitively. Purchasing will generally place blanket purchase orders, when possible, for commonly used material, equipment and services, rather than procuring them individually for

2009 EDECA REPORT

each project. This allows for improved volume purchase savings. Those vendors solicited by the Company have been previously qualified by the Company. The Company decides which vendors are solicited for bids/proposals based on a variety of factors including the vendor's capability, prior job performance, dollar value of procurement, other work being performed. An Invitation for Bid or Proposal (IFB) conveys to the vendor the requirements for the material or service that the company intends to buy, and is an organized, proactive means of soliciting quotes from prospective vendors. The invitation is generally solicited electronically. As a general matter, the Company prefers firm or fixed-price contracts: either a lump sum where the entire scope of work is performed for a single price, or, when a job unit price is impractical, contracts wherein each item of supply or service is defined and carries a separate price.

However, there may be circumstances where the competitive method may not be practical. In such cases, a non-competitive or sole-source procurement may be used. Such procurements require appropriate written justification for the non-competitive or sole-source procurement, which could be done for several reasons, including availability of technology, unique design, or engineering skills. For example, it may make sense for a tap changer maintenance contract to be awarded to the same vendor who supplied the equipment because the manufacturer of the tap changer is most knowledgeable about its own equipment.

A contract award may be made to the vendor with the lowest bid or lowest evaluated price. The lowest evaluated bid is that proposal which represents the optimal combination of quality, delivery, service, price, and any other factor critical to the purchase. When all bids are evaluated in this manner, selection of the lowest evaluated bid will result in acquiring maximum value for the Company at the lowest total cost. Awards may be split among two or more vendors for a variety of reasons, including, so that there are a sufficient number of vendors to perform the work, and to encourage competition in the market.

2009 EDECA REPORT

The Company is committed to the development of its supplier diversity. To support this program, awards or portions of awards may be made to diverse firms whose bid price exceeds the lowest bid. Bids will be invited when the specifications of the material or services to be furnished are generally standard, there are a number of equally acceptable suppliers, and the award will be based on price or other quantifiable non-technical factors.

Proposals will be invited when it is anticipated that there will be measurable differences in the technical or commercial portions of the vendor offerings in response to our requirements. Vendors are usually advised in the invitation that their proposals are subject to bid evaluation or other considerations in addition to price (e.g., technical specifications, delivery schedules).

In capital projects, the user organization issues requisitions to the Purchasing Department for major equipment, long lead materials, and construction contracts. The Purchasing Department obtains proposals for major equipment and long-lead-time material items and awards the contract. Materials and supplies are also available through Company storerooms or blanket orders.

Under a lump sum contract, the contractor performs a specified scope of work for a defined price and schedule. This type of contract is advantageous in that it provides cost certainty to the Company. The lump sum methodology is best used when there is a clear defined scope of work, a finite schedule for completion, and low probability of changes to the scope-of-work after the solicitation is issued.

A unit price contract provides a firm price for the completion of a specified unit of work. Under a unit price contract, specific rates, which may be measured in units of time (e.g., hourly or daily rates), volume or length (e.g., price per ton or per foot), or on a per task basis (e.g., per inspection), are developed and applied on an "as used" basis. The unit price methodology is best used when there is a clear definable scope associated with each task, but it is not

2009 EDECA REPORT

possible to define the quantity of work that will be required. Unit price methodologies are often used on blanket contracts covering a broad range of services, such as trenching contracts.

The Company uses a variety of methods to determine the award of a contract. The bid and proposal evaluation process is intended to provide a systematic manner in which to compare the factors affecting the quality and cost of materials or services being procured by the company. It is a general policy to award contracts to those vendors whose offer meets the requirements, provides the maximum value for the procurement, and is in the best interest of the Company. An award may be made to the vendor with the lowest bid or evaluated price. The Company reserves the right, in its discretion, to reject any or all bids or proposals in any procurement. The Company may, upon notice to vendors, evaluate pricing upward or downward based on vendor capability and past performance. Awards may be split among two or more acceptable vendors to help establish future competition or to assure adequate supply. In support of the development of its supplier diversity, awards or portions of awards may be made to diverse firms whose bid price exceeds the lowest bid. Negotiations will be conducted, as appropriate, to reduce pricing.

All purchases require approval before commitments may be made or purchase order documents issued. The dollar levels for such approvals are in accordance with Corporate Policy 000-1 "Delegation of Authorities."

D. AFFILIATE RELATIONSHIPS

The RFP requires an examination of holding company structure, affiliates and their diversified activities.

D.1 THE HOLDING COMPANY STRUCTURE, AFFILIATES AND THEIR DIVERSIFIED ACTIVITIES HAD NO DETRIMENTAL EFFECTS ON RECO.

An agreement was made on February 5, 1976 between Orange and Rockland Utilities (ORU) and Rockland Electric Company (RECO) referred to as the Joint Operating Agreement (JOA). Since ORU has the facilities and organization enabling it to conduct the electric work ordinarily done by an operating force, the JOA has had no detrimental effects on RECO.

ORU constructs and maintains the electric system, handles new business, performs commercial and general administrative work. RECO has no facilities of its own for doing construction or maintenance work, nor does it employ an operational force.

If there were no state lines between the territories served, the operations would be carried out by one company as an integrated system.

RECO pays for the services of ORU in performing the work usually carried on by an operating force. Charges are made on a direct basis in all cases when practical and where it is impractical, RECO's portion of the costs is based on ratios of revenues and customer counts.

D.1.1 Recommendation

PMC proposes that the JOA be periodically reviewed by ORU and a formal opinion of the applicability of the intercompany transactions be formally attested.

The basis of this recommendation is to provide assurances that the algorithms employed have not changed or any change is understood by ORU. It has been suggested by BPU representatives that a seven-year cycle could apply to the current situation. An acceptable demonstration is the 2005 Internal Audit Report that formally reviewed the CECONY and ORU shared services agreement and tested transactions.

D.2 TRANSACTIONS BETWEEN O&R AND RECO ARE LIMITED.

Aside from the arrangement between Orange and Rockland and RECO pursuant to their FERC-approved Power Supply Agreement (described below), there were only two transactions between RECO and an affiliate during the years 2006 – 2008. Both of these transactions occurred between RECO and Con Edison Energy (CEE) and both were for the period June 2008 – May 2009. Both transactions were reviewed and approved by the NJBPU. One was a financial swap contract for energy in the New York Independent System Operator (NYISO) market for 100% of the load in RECO's Central and Western Divisions. The other was in the Pennsylvania, Jersey, Maryland Independent System Operator (PJM ISO) market for physical supply of a portion of RECO's Basic Generation Service (BGS) load (in RECO's Eastern Division) under the BGS auction. The volumes associated with these two contracts were:

2008 CEE NYISO – 114,033 MWh

2008 CEE BGS – 206,309 MWh

In addition, pursuant to the terms of the FERC-approved Power Supply Agreement between Orange and Rockland and RECO, Orange and Rockland secures the physical supply for the RECO load in NYISO (i.e., the BGS load in RECO's Central and Western Divisions). Pursuant to the terms of the FERC-approved Power Supply Agreement between Orange and Rockland and RECO, Orange and Rockland allocates to RECO the costs for energy, capacity and ancillary services associated with such physical supply.

Specifically, Orange and Rockland allocated charges to RECO associated with the following physical supply:

2006 RECO Load – 204,013 MWh

2007 RECO Load – 197,583 MWh

2008 RECO Load – 189,306 MWh

D.3 ACCORDING TO THE OUTSIDE AUDITOR SARBANES OXLEY REPORTS, RECO'S INTERNAL CONTROL SYSTEM PROVIDES REASONABLE ASSURANCE TO ITS RATEPAYERS.

To adequately assess the internal control system, we reviewed Sarbanes Oxley (SOX) reports provided by PriceWaterhouseCoopers. We reviewed the June 1 – June 30, 2009 SOX summary reports, project status reports and various control deficiency reports.

The SOX Steering Committee Update reports address controls at CEI, CECONY, O&R and Competitive Companies. The project status report shows the following items that are tracked:

- Cycle Start Date
- Number of Walk- throughs
- Pre-testing Work Completed
- Controls to be Tested
- Percentage Completed - Current Year versus Prior Year
- Reliance on Internal Audit – Planned Reliance %

The result of the above culminates in an improved understanding of the Internal Control system. Controls are to be improved due to an Update of Process Narratives, Update of Process Maps and the ongoing Test of controls.

We reviewed a summary report for the entire “Transaction Cycle” for CEI, CECONY and O&R and the Competitive Energy Businesses. As of June 30, 2009, there were eight “Total Control

Deficiencies". These control deficiencies did not affect RECO or ORU. They were financial reporting issues (3) and CEI, energy and gas revenue accounting (2) at CECONY, a revenue recording issue in the Steam division, and an accounting record process in each of Energy Management and payroll. Each of these deficiencies had target dates for revision or correction by October of 2009.

D.4 COMMUNICATIONS BETWEEN BOARD DIRECTORS AND OFFICERS IS LIMITED TO BOARD MEETINGS AND SPECIALLY PREPARED BRIEFING PACKETS.

On a strict technical note, the Chairman of O&R is also the Chair of CEI and all subsequent utility affiliate boards but not the chair of RCBSs. This is in compliance with EDECA [see § G, Review of Previous Audit]. The single outside director has regional presence as Chairman of a leading bank corporation. He indicated that he took the appointment to the ORU Board seriously since the structure of the Board precluded committees; a normal structure in his experience. One of his primary contributions to the Board is the understanding of Community Standards for corporate behavior.

E. MARKET CONDITIONS

PMC was asked to examine and document the level of customer activity in transferring electric power to third party suppliers (TPS) as well as the competitiveness of the TPS market in RECO's service territory.

PMC also reviewed RECO's strategy and philosophy of market transactions with regard to power including energy and capacity. PMC assessed transactions in the emissions and solar renewable energy certificates. PMC was also asked to evaluate the effects on pricing, refunds, and the impact on ratepayers.

PMC was asked to review all Non Utility Generator (NUG) transactions and NUG mitigation efforts.

E.1 RECO EFFECTIVELY TRANSFERS POWER TO THIRD PARTY SUPPLIERS (TPS).

RECO has contracts with third party suppliers. Third party suppliers are entities determined to be eligible by the BPU and hold a BPU issued license to provide Competitive Energy Supply to customers in accordance with applicable legal authorities. The BPU approves the Third Party Customer Account Services Master Service Agreement or also known as the Billing Services Agreement.

RECO provides services to third party suppliers. The services are in connection with the supplier's provision of Competitive Energy Supply to their own customer via RECO's local distribution system including support for NYISO or PJM related obligations as set forth in the TPS agreement.

2009 EDECA REPORT

The TPSs with contracts include the following companies:

1. Green Mountain Inc. Clean Power Choice (CPC) – New Jersey (NJ)
2. Community Energy Inc. CPC - NJ
3. Sterling Planet Inc. CPC – NJ
4. Glacial Energy
5. CONED Solutions – MSA
6. CONED Solutions – TPS
7. Strategic Energy LLC
8. Sempra Energy Guaranty

Provided below is a synopsis of each TPS.

1. Green Mountain Inc. Clean Power Choice (CPC) - NJ:

Green Mountain is a Clean Power Supplier. Green Mountain will provide clean power choice through the sale of environmental attributes to residential, commercial and industrial customers. Per their material, Green Mountain offers residential, business, institutional and governmental customers the choice to support cleaner electricity generated from sources such as wind, solar, water, geothermal, and biomass. Green Mountain Inc. has a Green Power Marketer Master Billing Services Agreement with RECO.

2. Community Energy Inc. CPC – NJ:

Community Energy is a Clean Power Supplier. Community Energy will provide clean power choice through the sale of environmental attributes to residential, commercial and industrial customers. Per their material, Community Energy

supports wind generation resources. Community Energy Inc. has a Green Power Marketer Master Billing Services Agreement with RECO.

3. Sterling Planet Inc. CPC – NJ:

Sterling Planet is a Clean Power Supplier. Sterling Planet will provide clean power choice through the sale of environmental attributes to residential, commercial and industrial customers. Sterling Planet Inc. has a Green Power Marketer Master Billing Services Agreement with RECO.

4. Glacial Energy:

Glacial Energy will provide electric service to commercial and industrial customers. Glacial Energy of New Jersey has a Third Party Supplier Agreement with RECO.

5. CONED Solutions – MSA and

6. CONED Solutions – Third Party Supplier:

Con Edison Solutions will provide electric service and green power to residential, commercial and industrial customers. Con Edison Solutions has a Third Party Supplier Agreement and a Third Party Supplier Customer Account Services Master Service Agreement (MSA) with RECO. The MSA provides for billing services by RECO.

7. Strategic Energy LLC:

Strategic Energy LLC will provide electric service to commercial and industrial customers. Strategic Energy has a Third Party Supplier Agreement with RECO.

8. Sempra Energy Solutions:

Sempra Energy Solutions is a Third Party Supplier that will provide electric service to industrial customers. Sempra Energy Solutions has a Third Party Supplier Agreement with RECO.

2009 EDECA REPORT

There are TPS charges including any fee or charge billable by RECO to the supplier under the relevant agreement, RECO tariff or O&R's Open Access Transmission Tariff (OATT) pertaining to RECO's provision of TPS services. There is a General Supplier Fee of \$25.00 per MW capacity obligation per month. Through this fee, RECO recovers costs associated with its Retail Access Operations Group in providing technical support and assistance to TPS.

E.2 THE COMPETITIVENESS OF THE TPS MARKET IS DEPENDENT ON WHETHER THE TPSS CAN COMPETE WITH THE BGS PRICE.

The BGS price is one that is a blended price from three separate auctions. The blended feature has been consistently approved by the NJBPU. Because of competitive safeguards in place, along with the affiliate restrictions RECO must operate under, the market is reasonably "competitive".

Based on the chart shown below, the number of Energy Service Companies (ESCOs) has not increased since July 2008. The number of retail customers has increased from 35 to 133 for the time period.

ESCO ACTIVITY 2008-2009

ESCO ACTIVITY 2008-2009						
	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09
# of Participating ESCOs	6	6	6	6	6	6
# of Retail Access Customers	56	62	71	86	104	133
% of Total Customers	N/A	N/A	N/A	N/A	N/A	N/A
Total Peak Load (MW Capacity)	33	39	39	44	40	46
% of System Requirements	6%	7%	7%	8%	8%	9%
Monthly Requirements (% Billed Sales)	10%	9%	12%	13%	15%	14%
YTD Requirements (% Billed Sales)	10%	10%	11%	11%	12%	12%

ESCO ACTIVITY 2008-2009 CONTINUED

	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08
# of Participating ESCOs	6	6	6	6	6	6
# of Retail Access Customers	35	35	37	44	44	53
% of Total Customers	N/A	N/A	N/A	N/A	N/A	N/A
Total Peak Load (MW Capacity)	30	30	30	31	31	33
% of System Requirements	6%	6%	6%	6%	6%	6%
Monthly Requirements (% Billed Sales)	9%	8%	11%	11%	11%	10%
YTD Requirements (% Billed Sales)	10%	10%	10%	10%	10%	10%

E.3 RECO'S STRATEGY AND PHILOSOPHY OF MARKET TRANSACTIONS WITH REGARD TO POWER INCLUDING ENERGY AND CAPACITY IS REASONABLE.

PMC reviewed three tranches to assess RECO's strategy and philosophy of market transactions with regard to power including energy and capacity. It should be noted that "tranche 1" had expired before the audit was started. The Standard Service Offer (SSO) Load is divided into identical units called tranches, each tranche represents the same fixed percentage of SSO Load. These tranche agreements are with Consolidated Edison Energy and Constellation Energy Commodities Group, Inc.

The NJBPU approved these physical energy supply contracts associated with RECO's BGS load in the PJM market (i.e., RECO's Eastern Division), and the financial swap contracts for energy and capacity in the NYISO market (i.e., RECO's Central and Western Divisions) for 100% of the RECO BGS load.

ACTIVE TRANCHE CONTRACTS PAST 12 MONTHS

Tranche	Start date of Contract and Expiration of Contract	Contract Price	Counterparty
2	6/1/08 and 5/31/09	\$83.54 MWh	Consolidated Edison Energy
3	6/1/09 and 5/31/10	\$81.85 MWh	Constellation Energy Commodities Group, Inc.
4	6/1/07 and 5/31/10	\$3.40/kW-mo	Constellation Energy Commodities Group, Inc.

BPU Docket ER08050310 approved in November 2008, Electric Distribution Companies (EDC) such as RECO are required to provide separate BGS-FP and BGS-CIEP Peak Load Contribution data to a BGS supplier that wins tranches to supply portions of the EDC's BGS-FP and BGS-CIEP load.

RECO's strategy includes their participation in the annual NJBPU supervised BGS auction process. We reviewed the copies of the agreements that RECO has entered into pursuant to the BGS auction process. In addition, RECO's transactions for RECO's central and Western Divisions are NJBPU supervised.

Before RECO enters into these agreements, the supplier must satisfy RECO's creditworthiness standards, obtain a license from the BPU and any other governmental approvals required for participation in the New Jersey retail energy market, satisfy all FERC requirements and apply to, register with, obtain certificates from, become member of, and/or enter agreements with, if appropriate, PJM or the NYISO.

Before RECO gives effect to customer selection of the supplier, the supplier must demonstrate to RECO's satisfaction that the supplier is equipped with and has tested all communications capabilities necessary to send data to and receive data from RECO in order to satisfy its obligation under the specific agreement with RECO and must comply with EDI standards.

E.4 TRANSACTIONS IN ANY OTHER MARKET INCLUDING TO THE EMISSIONS AND SOLAR RENEWABLE ENERGY CERTIFICATES ARE WELL DOCUMENTED AND EFFECTIVE.

On April 13, 2005, the NJBPU approved the New Jersey Green Power Choice Program allowing Basic Generation Service Customers to select among multiple Green Power Marketers to purchase additional renewable resources in the form of Renewable Energy Certificates.

A Green Power Marketer (GPM) is an entity that has been licensed by the NJBPU to sell Renewable Energy Certificated within the state of New Jersey in accordance with the applicable legal authorities.

2009 EDECA REPORT

RECO is “rate Ready” and can render Green Power Marketers’ customers a consolidated bill for both GPM and utility charges on a monthly basis. As dictated by Rate Ready, GPMs will provide a rate to be charged for each customer for each unit of electricity consumed.

The billing requirements must meet EDI standards. Each GPM will provide RECO a single rate (\$/kWh) and percentage of use to be charged each customer for each unit of electricity consumed by that customer via EDI. The bill will display the amount, price and percentage of the energy sold by the GPM. RECO’s charges are per tariff. The GPM’s charges appear on a dedicated line item on page one of the customer bills. Finally, RECO can print a generic message for each marketer on the GPM’s page of the bill.

RECO’s GPMS are:

Green Mountain Inc. CPC - NJ
 Community Energy Inc. CPC - NJ
 Sterling Planet Inc. CPC - NJ

E.5 NON-UTILITY GENERATOR (NUG) TRANSACTIONS.

PMC received responses to two data requests pertaining to NUG transactions. RECO has no generating assets from which it can make sales. Thus, PMC reviewed O&R NUG transactions as listed in the chart below.

SUMMARY OF NUG TRANSACTIONS									
2009	O&R NUGa KWh Purchased								
Plant	Description	Jan-09	Feb-09	Mar-09	Apr-09	May-09	June-09	Jul-09	Total
Dodson	West Point Hydro (E131)	5,436	12,888	11,268	14,220	8,892	12,780	5,904	71,388
2009	O&R NUGs Dollars Paid								
Plant	Description	Jan-09	Feb-09	Mar-09	Apr-09	May-09	June-09	Jul-09	Total
Dodson	West Point Hydro (E131)	368	915	676	853	534	767	354	4,467
2009	O&R NUGs Energy Prices Paid (\$/MWh)								
Plant	Description	Jan-09	Feb-09	Mar-09	Apr-09	May-09	June-09	Jul-09	Ave.
Dodson	West Point Hydro (E131)	67.75	70.98	60.00	60.00	60.00	60.00	60.00	62.57

Section 210 of PURPA now requires utilities to purchase energy from NUGs which qualify at the utility's avoided cost. This allows NUGs to receive a reasonable to excellent price for the energy they produce and insures that energy generated by small producers won't be wasted.

E.6 NON-UTILITY GENERATOR MITIGATION EFFORTS ARE EFFECTIVE.

The effects on pricing, refunds and the impact on ratepayers were reviewed when the BPU approved all of these agreements. RECO has no generating assets from which it can make sales.

F. RECOMMENDATIONS OF 2003 REPORT

In this chapter, PMC complies with the RFP, which requires a “review of Liberty’s report and comment on the continued viability of the recommendations”. Our format is to list the 2003 recommendation, provide a succinct opinion and current status. The matrix following the below text provides current 2009 status of each recommendation.

F.1 REQUIRE THE DISCLOSURE NECESSARY TO EXAMINE RELATIONSHIPS AND TRANSACTIONS THAT EXIST BETWEEN EITHER O&R AND RECO...AND ALL RCBS OF CEI AND CECONY AS A COMMON SERVICE SUPPLIER.

At the time of the 2003 audit, O&R had no retail competitive business segments in New Jersey. The 2003 report took a broad interpretation of RCBS by including all of ConEdison’s affiliates. When such affiliates do have business with O&R, RECO incurs a charge based on the allocation methodologies. Consequently, the BPU should have access to information covering these relationships.

F.2 TREAT ALL CEI RCBS AS COVERED BY THE STANDARDS IF THEY HAVE, OR OFFER, TO SERVE RETAIL CUSTOMERS IN NEW JERSEY, WHETHER OR NOT IN RECO SERVICE TERRITORY.

At the time of the 2003 audit, O&R had no retail competitive business segments in New Jersey. The 2003 report took a broad interpretation of RCBS by including all of ConEdison’s affiliates. When such affiliates do have business with O&R, RECO incurs a charge based on the allocation methodologies. Consequently, the BPU should have access to information covering these relationships.

F.3 VERIFY THAT REGULAR CUSTOMER COMMUNICATIONS COMPORT WITH THE OBLIGATION NOT TO PROVIDE A PREFERENCE TO AN (SIC) RCBS.

The summary at page 2 of the 2003 report references page 11 for discussion of this recommendation. Actual discussion is on page 14. the 2003 report failed to find violation of the prohibitions against preference to a RCBS.

PMC found compliance in the review of bill stuffers and event calendars.

F.4 AMEND THE RECO COMPLIANCE PLAN TO CLEARLY PROHIBIT TYING ACTIVITY TO ANY RCBS OF O&R OR CEI THAT SERVES IN-STATE CUSTOMERS, WHETHER OR NOT IN THE RECO'S NEW JERSEY UTILITY SERVICE TERRITORY.

At page 2 of the 2003 report, the reference is page 15. Actual discussion was found on page 27. This is a valid recommendation for future possible application. O&R revised its Compliance Plan. This is a non-issue.

F.5 INCLUDE IN THE RECO WEBSITE SECTION "SHOPPING FOR SAVINGS" A LINK TO THE BPU WEBSITE.

A review of the web page shows compliance.

F.6 VERIFY THAT RECO'S REGULAR COMMUNICATIONS WITH CUSTOMERS DO NOT MAKE REPRESENTATIONS OF THE TYPE PROHIBITED BY SECTIONS 14:4-5.3(n).

A review of bill stuffers and calendars failed to produce any violations and, indeed, followed alphabetical listing.

F.7 REVISE COMPANY POLICY TO PERMIT ACCESS TO AFFILIATES AND RECORDS AS NECESSARY TO VERIFY COMPLIANCE WITH THE STANDARDS.

The 2003 audit was unable to review the books and records of CEI. However, PMC was able to review the check register of RECO and O&R. No instances of charges other than wire transfers for allocated charges from CECONY were noted.

The compliance Plan at page 14 does invoke attorney-client privilege. In the present audit, PMC signed a confidentiality agreement and did not experience any barriers to viewing any responses to data requests.

F.8 STRENGTHEN IT SECURITY POLICIES AND PROCEDURES TO ADDRESS THE INFORMATION EXCHANGE PROVISIONS OF SECTION 14:4-5.5 (e).

At the time of the 2003 audit, this recommendation was forward looking to a time when RECO and a RCBS might share office space, office equipment, services and systems. Then, as in 2009, this is not the case. The Compliance Plan at page 14 specifically states that RCBSs "will establish and maintain separate and distinct offices and work space".

F.9 INTRODUCE A METHOD BY WHICH INDIRECT COSTS FOR JOINT PURCHASES ARE PROPERLY ASSIGNED.

The accounting procedures were updated in April 2006 superceding the March 2003 edition. Cost allocations were designed based on Cost Accounting Standards Board (CASB) standards. Actual standards are CASB 403, 410, and 418.

F.10 UPDATE THE CORPORATE ACCOUNTING POLICIES REGARDING THE DISTRIBUTION OF COSTS BETWEEN COMPANIES AND CONFORM THEM TO THE STANDARDS; DEVELOP A CLEAR AND CONSISTENT SET OF METHODS FOR IMPLEMENTING THESE POLICIES.

The 2006 revision of “Accounting for Transactions between the Regulated and Unregulated Affiliates” follows the Securities and Exchange Commission’s Staff Accounting Bulletin No. 55 “Allocation of Expenses and Related Disclosure in Financial Statements of Subsidiaries, Divisions or Lesser Business Components of Another Entity”

F.11 IMPROVE EXISTING PROCEDURES TO STRENGTHEN CONTROL OVER THE DATA COLLECTION, ANALYSIS AND PRICING CALCULATION FOR SHARED SERVICES.

PMC believes no action has been taken on this recommendation since no reports verifying shared costs have been prepared. However, see section G of this report Affiliate Cost Allocation Methodologies.

F.12 CONDUCT AN EXAMINATION BY INTERNAL AUDIT TO VALIDATE THAT DATA COLLECTION, ANALYSIS, AND PRICING OF SHARED SERVICES ARE DONE ACCURATELY AND CONSISTENTLY.

Initially, it was reported that no action has been taken on this recommendation. However, in 2005, an audit of shared services was conducted by Internal Audit.

F.13 CONDUCT AN EXAMINATION OF ALL SHARED ADMINISTRATIVE SERVICE COSTS FOR THE YEARS 2001 AND 2002 TO DETERMINE THE EXTENT OF ERRORS SIMILAR TO THOSE UNCOVERED DURING TRANSACTION TESTING, MAKE NECESSARY CORRECTIONS, AND VALIDATE THE ACCURACY AND COMPLETENESS OF ADMINISTRATIVE SERVICES COSTS.

The 2003 report states that it was not able to perform transactions testing [page 69 paragraph following footnote 110]. However, during the attempt to perform transactions testing, the authors of the 2003 report noted inconsistencies in the composition of the standard rates. We believe this is the basis for the recommendation.

Initially, we believed that this recommendation had not been implemented. However, as noted, the 2005 Internal Audit did cover this.

F.14 DEVELOP AND INSTITUTE AN ADMINISTRATIVE & GENERAL EXPENSE LOADER TO BE INCLUDED IN STANDARD RATES USED FOR DIRECT CHARGES TO NON-REGULATED AFFILIATES AND CEI.

The Joint Operating Agreement and RECO's Compliance Plan of EDECA have been accepted by the BPU. Our review showed no action on this recommendation. With direct regard to RECO, this is a moot point.

F.15 PROVIDE FOR A SYSTEMATIC REVIEW OF UNRECORDED USAGE OF CECONY SHARED ADMINISTRATIVE SERVICES BY THE NON-REGULATED AFFILIATES.

The response to PMC's queries indicate that this recommendation was not implemented. We received a copy of an email reflecting how to record affiliate transactions.

F.16 RECONCILE THE STANDARD RATE TO ACTUAL COSTS FOR SHARED SERVICES DIRECTLY CHARGED TO UNREGULATED AFFILIATES AND CEI.

This recommendation is based on a disagreement with the algorithms used to determine overhead rates. A revised General Accounting Procedure was issued in March 2006 that superceded the April 2003 version. The recommendation is implemented.

F.17 REPOSITION THE DUTIES OF INDIVIDUALS WHO SERVE AS A DIRECTOR AND/OR AN OFFICER FOR BOTH A UTILITY AND A RELATED COMPETITIVE BUSINESS SEGMENT OF THE UTILITY'S HOLDING COMPANY.

The actual situation in 2003 was corrected. However, during the audit a new situation was encountered.

The utility was not in compliance with §14:4-5.5(g) of the standards. The current Chief Financial Officer holds this position for all utility operations. He is also a director of two non-regulated affiliates. In the current audit, this is emphasized by the fact that two non-regulated affiliates operate in New Jersey. This is a violation of the Standards. However, during the audit, this situation was addressed with consideration of 1) the appointment of a new CFO for ORU and 2) application to FERC for a variance to this organizational issue.

F.18 REVISE THE COMPLIANCE PLAN TO INCORPORATE THE REQUIREMENTS OF SECTION 14:4-5.5U(2) WITH REGARD TO THE TRANSFER OF ASSETS FROM A PUHC RCBS TO THE UTILITY.

A review of the compliance plan shows that at page 18 the Company remains in non-compliance with the Act. However, the Standards open the way for asymmetric pricing; transfers... "shall be recorded at fair market value or book value as determined by the Board" (from the utility to the RCBS). [§14:4-5.5(u) of the Standards]. From the RCBS to the utility, transfers "shall be recorded at the lesser of book value or fair market value." [§14:4-5.5(u)].

F.19 MAKE TRAINING IN THE O&R STANDARDS OF COMPETITIVE CONDUCT MANDATORY FOR ALL NEW EMPLOYEES.

The Company formalized a response to this recommendation in the Compliance Plan.

- Copy of Competitive Conduct Standards posted in the intranet.
- Copy of Affiliate Relations Conditions posted on the intranet.
- Annual presentation regarding compliance with both to principal management employees.
- New employees to be instructed in both.
- An article on compliance place in the inside communication magazine "Currents".

F.20 INCLUDE ROUTINELY SCHEDULED, MANDATORY REFRESHER TRAINING THAT IS APPROPRIATE TO THE NATURE AND EXTENT OF EMPLOYEE INVOLVEMENT IN ACTIVITIES AFFECTED BY THE STANDARDS.

This is answered in F.19 and the recommendation no longer applies.

F.21 CONFIRM THE PERMANENT IMPLEMENTATION OF THE PROPOSALS RELATED TO EMPLOYEE UNDERSTANDING OF INFORMATION DISCLOSURE RULES AS SET FORTH IN THE FEBRUARY 28, 2002 LETTER TO THE BOARD IN THE COMPLIANCE PLAN.

The Company believes its annual presentation and the updated Compliance Plan provides compliance with this recommendation.

As requested the status of each 2003 Report recommendation is put into the following matrix format.

SUMMARY OF 2003 RECOMMENDATIONS

Summary of 2003 Recommendations	Done	Not Needed	Not Done
<p>1. Require the disclosure necessary to examine relationships and transactions that exist between either O&R and RECO...and all RCBS of CEI and CECONY as a common service supplier.</p>	<input type="checkbox"/>		
<p>2. Treat all CEI RCBSs as covered by the standards if they have, or offer, to serve retail customers in New Jersey, whether or not in RECO service territory.</p>		<input type="checkbox"/>	
<p>3. Verify that regular customer communications comport with the obligation not to provide a preference to an [sic] RCBS.</p>	<input type="checkbox"/>		
<p>4. Amend the RECO Compliance Plan to clearly prohibit tying activity to any RCBSs of O&R or CEI that serve in-state customers, whether or not in RECO's New Jersey utility service territory.</p>	<input type="checkbox"/>		
<p>5. Include in the RECO website section "Shopping for Savings" a link to the BPU website.</p>	<input type="checkbox"/>		

2009 EDECA REPORT

6. Verify that RECO's regular communications with customers do not make representations of the type prohibited by sections 14:4-5.3(n).	<input type="checkbox"/>		
7. Revise Company policy to permit access to affiliate books and records as necessary to verify compliance with the Standards.	<input type="checkbox"/>		
8. Strengthen IT security policies and procedures to address the information exchange provisions of Section 14:4-5.5(e).	<input type="checkbox"/>		
9. Introduce a method by which indirect costs for joint purchases are properly assigned.	<input type="checkbox"/>		
10. Update the corporate accounting policies regarding the distribution of costs between companies to conform them to the Standards; develop a clear and consistent set of methods for implementing these policies.	<input type="checkbox"/>		
11. Improve existing procedures to strengthen control over the data collection, analysis and pricing calculations for shared services.	<input type="checkbox"/>		

2009 EDECA REPORT

<p>12. Conduct an examination by Internal Audit to validate the data collection, analysis and pricing of shared services are done accurately and correctly.</p>	<input type="checkbox"/>		
<p>13. Conduct an examination of all shared administrative service costs for the years 2001 and 2002 to determine the extent of errors similar to those uncovered during transaction testing, make necessary corrections, and validate the accuracy and completeness of administrative services costs.</p>	<input type="checkbox"/>		
<p>14. Develop and implement an A&G loader to be included in standard rates used for direct charges to non-regulated affiliates and CEI.</p>	<input type="checkbox"/>		
<p>15. Provide for a systematic review of unrecorded usage of CECONY shared administrative services by the non-regulated affiliates.</p>		<input type="checkbox"/>	
<p>16. Reconcile the standard rate to actual costs for shared services directly charged to unregulated affiliates and CEI.</p>		<input type="checkbox"/>	

2009 EDECA REPORT

17. Reposition the duties of individuals who serve as a Director and/or and Officer for both a utility and a related competitive business segment of the utility's holding company so that RECO and O&R are in compliance with the Standard.	<input type="checkbox"/>		
18. Revise the Compliance Plan to incorporate the requirements of Section 14:4-5.5(u)(2) with regard to the transfer of assets from a PUHC RCBS to the utility.	<input type="checkbox"/>		
19. Make training in the O&R Standards of Competitive Conduct mandatory for all new employees.	<input type="checkbox"/>		
20. Include routinely scheduled, mandatory refresher training that is appropriate to the nature and extent of employee involvement in activities affected by the Standards.	<input type="checkbox"/>		

2009 EDECA REPORT

21. Confirm the permanent implementation of the proposals related to employee understanding of information disclosure rules as set forth in the February 28, 2002 letter to the Board in the compliance plan.	<input type="checkbox"/>		
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**G. AFFILIATE COST ALLOCATION
METHODOLOGIES**

This area covers the RFP's requirement to review and describe the cost allocation methods, determine whether the cost allocation methods are the result of arms-length negotiations and whether costs are allocated on a direct assignment basis insofar as possible. In addition, PMC is to explain the allocations and rationale for the allocation methods and make recommendations for adjustments, if applicable.

Specifically, PMC is asked to address seven separate cost allocation-related topics. Each is considered individually, as follows:

1. Identify the accounting and allocations procedures for separating the costs of intercompany transactions of RECO from its affiliates.
2. Determine the accuracy of allocations when allocating joint/common costs. Any discrepancies shall be corrected by providing direct cost assignments when possible and explanations where the costs cannot be directly allocated.
3. Review the time sheet reporting practices of employees with shared RECO/ORU/CEI responsibilities to determine allocations. Further, determine if the duties of employees who bill time for RECO, ORU and CEI and /or its affiliates permit for cross-subsidization
4. Review and assess pricing policies between affiliate interests, e.g. the market price of electricity compared to the cost of electricity purchased by RECO.
5. Evaluate competitive and noncompetitive bidding procedures.
6. Identify all of RECO's lease arrangement with ORU, CEI and its affiliates. Determine if the terms of the arrangements are consistent with lease arrangements in competing local markets, have recommended cost allocations and are set at arms length.

7. Review affiliate charges and cost allocation methodologies for adherence to applicable legal, regulatory and contractual requirements.

G.1 THE ACCOUNTING AND ALLOCATION PROCEDURES FOR SEPARATING THE COSTS OF INTERCOMPANY TRANSACTION OF RECO FROM IT AFFILIATE ARE REASONABLE AND CONSISTENTLY APPLIED SINCE THE INCEPTION OF THE JOA.

The assignment and allocation of all costs to RECO by its parent company ORU is governed by the Joint Operating Agreement (JOA) effective February 5, 1976. This agreement acknowledges that ORU has all the facilities and organization enabling it to conduct the electric work ordinarily performed by an operating electric utility, including electric system construction and maintenance, new business, commercial and general administrative work, and that RECO has no facilities or its own for performing construction or maintenance work, nor does it employ an operating force. If there were no State line between the territories served by the two companies, the operations of the two companies would be carried out by one company (ORU) as an integrated system operated as a unit.

The JOA specifies that ORU shall conduct all operations and make all ordinary additions, extensions and repairs to RECO's electric system incident to furnishing the service requirements of RECO's customers, including transmission, distribution, new business, commercial, and general and administrative operations. These services constitute all the work normally performed by an operating utility, except the supply of electrical energy which is provided for by a separate contract between the two companies.

The JOA identifies two different categories of costs to be charged to RECO: operating costs and charges for jointly used property. In all instances, charges are made on a direct assignment basis when it

is practical to do so. When such accounting treatment is not practical or possible, several different allocations algorithms are employed, based on the nature of the cost involved.

Operating Costs:

These are the costs of performing work usually carried on by an operating force. This work includes the construction, maintenance and operations of RECO's transmission and distribution system and the new business, commercial, and general and administrative operations of RECO. When charges cannot be made on a direct basis, RECO's portion of these costs is determined by the use of one of two ratios which are based on the revenues for the preceding calendar year and the number of customers at the end of the preceding calendar year.

The Revenue Ratio is applicable to new business, and general and administrative expenses and is calculated as the ratio of RECO revenue to total ORU (including all subsidiaries) revenue. The Customer Ratio is applicable to all other expenses and is calculated as the ratio of RECO customers to total ORU (including all subsidiaries) revenue. Further specificity is developed for each activity based on the revenue and customers involved in those activities.

Jointly Used Property:

The costs of jointly used property are specified in the JOA as investment costs, Federal income taxes, insurance, depreciation, and property taxes.

Investment costs chargeable to RECO are computed as a percent of the original cost less related depreciation reserves of ORU's General Plant allocable to RECO. This percentage allocator is generally based on the Customer Ratio adjusted for the cost of money, which takes into account the weighted cost of long term debt, preferred stock at its imbedded cost, and the cost of common equity as determined by the New Jersey Board of Public Utilities.

Federal income taxes are allocated to RECO monthly, the algorithm taking into consideration the currently effective cost of money, ORU's net utility operating income, ORU's twelve-month average net utility plant investment for the prior calendar year, and ORU's general plant investment allocable to RECO for the current month. December of each year is reserved for true-ups, which can also take place in subsequent month(s) as better information becomes available.

Insurance is generally allocated to RECO based on a ratio of net insurable property. Depreciation generally follows the assignment of general plant, as do property taxes, with some minor adjustments for specific cases, such as depreciation charged directly to RECO through clearing accounts (an accounting technique for accumulating period costs for later assignment to specific activities).

G.2 THE ALLOCATION OF JOINT/COMMON COSTS TO RECO, ORU AND CEI ARE ACCURATE AND CONSISTENTLY MAINTAINED.

The allocation of costs between and among entities was reviewed on a monthly basis for the calendar year 2008. Specifically, we tested the calculation of revenue and customer ratios used to allocate costs each month as specified by the JOA. We then applied the appropriate ratio to the allocation of administrative costs for each month, including salaries, general and administrative expenses, employee benefits, and miscellaneous expenses. Of total 2008 administrative costs of approximately \$24.82 million, approximately \$5.68 million was allocated to RECO, or approximately 22.88%. The recalculated allocation ratio was 22.89%. No exceptions were noted.

G.3 AS LONG AS THE ALLOCATION METHODOLOGIES SPECIFIED IN THE JOA REMAIN REASONABLE AND ARE CONSISTENTLY APPLIED, THE OPPORTUNITY FOR CROSS-SUBSIDIZATION IS EXTREMELY SMALL.

No employees with shared responsibilities maintain time sheets which split time between corporate entities. By specifying the allocation ratios for all costs assigned to RECO, the JOA obviates the need to maintain separate time reporting. As a result, costs are shared ratably across the board by ORU and RECO, thus precluding the possibility for any material cross-subsidization.

G.4 PRICING POLICIES BETWEEN AFFILIATE INTERESTS ARE APPROPRIATE.

Pricing policies between affiliate interests are governed by the Separations Standards of the EDECA, as well as embedded general accounting procedures of Consolidated Edison. We reviewed pertinent accounting procedures of the Company and the responses to the EDECA-related data requests pertinent to this Phase I report. The Company's general accounting procedures fully embrace the standards promulgated by EDECA. Further, our review of intercompany charges disclosed no departures from these standards.

G.5 BIDDING PROCEDURES ARE COMPETITIVE AND ARE IN THE BEST INTERESTS OF RECO RATEPAYERS.

All bidding is competitive. There are no noncompetitive bidding procedures.

In February 2008, Consolidated Edison Energy (CEE) completed bidding and won the right to supply one tranche of Basic Generation Service – Fixed Pricing to RECO. The represents approximately 25% of RECO's load requirements. The term of this

agreement runs for three years through May 31, 2011. During 2008 RECO incurred approximately \$24 million in purchase power costs with CEE. In addition RECO received approximately \$2 million in transmission credits paid by PJM to RECO for use of transmission facilities by the BGS suppliers (inclusive of CEE). PJM collects from the BGS suppliers and pays out to RECO. The Company does not have any other intercompany transmission agreement with any other Consolidated Edison entity.

G.6 THE LEASE ARRANGEMENT IS REASONABLE.

RECO has one lease arrangement with ORU for its operating center in Saddle River, New Jersey. For 2008 the annual lease expense was \$73,500 for 3,000 square feet of space (or \$24.50/sf/annum) and is charged directly to RECO. This compares favorably with, for example, the \$24.20/sf/annum cost of ORU's lease of its Blue Hill facilities in Pearl River, NY

G.7 AFFILIATE CHARGES AND COST ALLOCATION METHODOLOGIES ARE IN COMPLIANCE WITH ALL APPLICABLE LEGAL, REGULATORY AND CONTRACTUAL REQUIREMENTS.

During our above review of affiliate charges and cost allocation methodologies, each calculation and/or algorithm was agreed to its corresponding Article in the JOA, an intercompany contractual agreement between ORU and RECO. In every instance, the contractual agreement was adhered to. Further, because the JOA is subject to regulatory oversight and has been approved by the New Jersey Board of Public Utilities, adherence to the JOA constitutes adherence to regulatory requirements. The EDECA standards have been incorporated into the Company's embedded general accounting procedures and have been consistently followed as discussed above, the Company is in compliance with legal requirements.