LONG ISLAND LIGHTING COMPANY

SHOREHAM NUCLEAR POWER STATION

P.O. BOX 618, NORTH COUNTRY ROAD • WADING RIVER, N.Y. 11792

January 4, 1980 SNRC-453

Mr. Harold R. Denton, Director
Office of Nuclear Reactor Regulation
U. S. Nuclear Regulatory Commission
Washington, D. C. 20555

Shoreham Nuclear Power Station - Unit 1
Docket No. 50-322

Dear Mr. Denton:

Enclosed herein are six (6) copies of additional financial information. This information updates and supplements our previous submittal forwarded to you via LILCO letter SNRC-378 dated April 19, 1979 in response to the NRC letter dated January 23, 1979 from Mr. S. A. Varga to Mr. A. W. Wofford.

Please note that certain bulky testimony and exhibits from the New York Public Service Commission cases 27374 (electric) and 27375 (gas) which were previously submitted, have not been reproduced herein and are incorporated by reference to SNRC-378.

If you have any questions please do not hesitate to contact us.

Very truly yours,

J. P. Novarro,
Project Manager
Shoreham Nuclear Power Station

JPM/cc

Enclosures

cc: J. Higgins (NRC Inspector)

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QUESTION 1.a.

Indicate the estimated annual cost by year to operate the subject facility for the first five full years of commercial operation. The types of costs included in the estimates should be indicated and include (but not necessarily be limited to) operation and maintenance expense (with fuel costs shown separately), depreciation, taxes and a reasonable return on investment. (Enclosed is a form which should be used for each year of the five year period). Indicate the projected plant capacity of the unit for each of the above years.

RESPONSE

See the attached forms for the response to question 1.a. for each of the five years beginning 1981.

ATTACHMENT FOR ITEM NO. 1.a.

ESTIMATED ANNUAL COST OF OPERATING NUCLEAR GENERATING UNIT: SHOREHAM NUCLEAR POWER STATION, UNIT NO. 1 FOR THE CALENDAR YEAR 1981

(thousands of dollars)

Operation and maintenance expenses	
Nuclear power generation	
Nuclear fuel expense (plant factor 66%)	$ 16182
Other operating expenses	5896
Maintenance expenses	4231
Total nuclear power generation	26309
Transmission expenses	100
Administrative and general expenses	
Property and liability insurance	3100
Other A.&G. expenses	1620
Total A.&G. expenses	4720
TOTAL O&M EXPENSES	31129
Depreciation expense	32300
Taxes other than income taxes	
Property taxes	15800
Other	11053
Total taxes other than income taxes	26853
Income taxes - Federal	2427
Income taxes - other	-
Deferred income taxes - net	19520
Investment tax credit adjustments - net	(2000)
Return (rate of return: 10.20 %)	155978
TOTAL ANNUAL COST OF OPERATION	$266207

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ATTACHMENT FOR ITEM NO. 1.a.

ESTIMATED ANNUAL COST OF OPERATING NUCLEAR GENERATING
UNIT: SHOREHAM NUCLEAR POWER STATION, UNIT NO. 1
FOR THE CALENDAR YEAR 1982

(thousands of dollars)

Operation and maintenance expenses	
Nuclear power generation	
Nuclear fuel expense (plant factor 66 %)	$ 27600
Other operating expenses	16442
Maintenance expenses	12782
Total nuclear power generation	56824
Transmission expenses	107
Administrative and general expenses	
Property and liability insurance	3250
Other A.&G. expenses	4676
Total A.&G. expenses	7926
TOTAL O&M EXPENSES	64857
Depreciation expense	55300
Taxes other than income taxes	
Property taxes	28900
Other	14824
Total taxes other than income taxes	43724
Income taxes - Federal	2628
Income taxes - other	-
Deferred income taxes - net	29534
Investment tax credit adjustments - net	(2000)
Return (rate of return: 10.20 %)	147329
TOTAL ANNUAL COST OF OPERATION	$341372

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ATTACHMENT FOR ITEM NO. 1.a.

ESTIMATED ANNUAL COST OF OPERATING NUCLEAR GENERATING UNIT: SHOREHAM NUCLEAR POWER STATION, UNIT NO. 1 FOR THE CALENDAR YEAR 1983

(thousands of dollars)

Operation and maintenance expenses	
Nuclear power generation	
Nuclear fuel expense (plant factor 71%)	$ 29106
Other operating expenses	15941
Maintenance expenses	11814
Total nuclear power generation	56861
Transmission expenses	114
Administrative and general expenses	
Property and liability insurance	3400
Other A.&G. expenses	4441
Total A.&G. expenses	7841
TOTAL O&M EXPENSES	64816
Depreciation expense	55300
Taxes other than income taxes	
Property taxes	30900
Other	14667
Total taxes other than income taxes	45567
Income taxes - Federal	3262
Income taxes - other	-
Deferred income taxes - net	33734
Investment tax credit adjustments - net	(2000)
Return (rate of return: 10.20 %)	138251
TOTAL ANNUAL COST OF OPERATION	$338930

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ATTACHMENT FOR ITEM NO. 1.a.

ESTIMATED ANNUAL COST OF OPERATING NUCLEAR GENERATING UNIT: SHOREHAM NUCLEAR POWER STATION, UNIT NO. 1 FOR THE CALENDAR YEAR 1984

(thousands of dollars)

Operatic and mainte expenses	
Nuclear power gener	
Nuclear fuel exp ant factor 74%)	$ 32998
Other operating e	16948
Maintenance expenses	12560
Total nuclear power generation	62506
Transmission expenses	121
Administrative and general expenses	
Property and liability insurance	3570
Other A.&G. expenses	4721
Total A.&G. expenses	8291
TOTAL O&M EXPENSES	70918
Depreciation expense	55300
Taxes other than income taxes	
Property taxes	33100
Other	16082
Total taxes other than income taxes	49182
Income taxes - Federal	40726
Income taxes - other	-
Deferred income taxes - net	28734
Investment tax credit adjustments - net	(2000)
Return (rate of return: 10.20 %)	129683
TOTAL ANNUAL COST OF OPERATION	$ 372543

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ATTACHMENT FOR ITEM NO. 1.a.

ESTIMATED ANNUAL COST OF OPERATING NUCLEAR GENERATING UNIT: SHOREHAM NUCLEAR POWER STATION, UNIT NO. 1 FOR THE CALENDAR YEAR 1985

(thousands of dollars)

Operation and maintenance expenses	
Nuclear power generation	
Nuclear fuel expense (plant factor 78%)	$ 37922
Other operating expenses	19399
Maintenance expenses	14421
Total nuclear power generation	71742
Transmission expenses	136
Administrative and general expenses	
Property and liability insurance	3750
Other A.&G. expenses	4922
Total A.&G. expenses	8672
TOTAL O&M EXPENSES	80550
Depreciation expense	55300
Taxes other than income taxes	
Property taxes	35400
Other	16631
Total taxes other than income taxes	52031
Income taxes - Federal	59985
Income taxes - other	-
Deferred income taxes - net	16834
Investment tax credit adjustments - net	(2000)
Return (rate of return: 10.20 %)	122329
TOTAL ANNUAL COST OF OPERATION	$ 385029

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ATTACHMENT FOR ITEM NO. 1.a.

ESTIMATED ANNUAL COST OF OPERATING NUCLEAR GENERATING UNIT: SHOREHAM NUCLEAR POWER STATION, UNIT NO. 1 FOR THE CALENDAR YEAR 1986

(thousands of dollars)

Operation and maintenance expenses	
Nuclear power generation	
Nuclear fuel expense (plant factor 78%)	$ 43705
Other operating expenses	19399
Maintenance expenses	14421
Total nuclear power generation	77525
Transmission expenses	136
Administrative and general expenses	
Property and liability insurance	3940
Other A.&G. expenses	5411
Total A.&G. expenses	9351
TOTAL O&M EXPENSES	87012
Depreciation expense	55300
Taxes other than income taxes	
Property taxes	37900
Other	12079
Total taxes other than income taxes	54979
Income taxes - Federal	66054
Income taxes - other	-
Deferred income taxes - net	16834
Investment tax credit adjustments - net	(2000)
Return (rate of return: 10.20 %)	114974
TOTAL ANNUAL COST OF OPERATION	$ 393153

QUESTION 1.b.

Indicate the unit price per KWh experienced by each applicant on system-wide sales of electric power to all consumers for the most recent twelve month period.

RESPONSE

For the twelve (12) months ending January 31, 1979, the KWh unit price experienced by each applicant on the LILCO system was 5.8 cents.

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QUESTION 2

Indicate the estimated costs of permanently shutting down the facility, stating what is included in such costs, the assumptions made in estimating the costs, the type of shutdown contemplated and the expected source of funds to cover these costs.

RESPONSE

The Long Island Lighting Company has reviewed the various alternatives for decommissioning an 850 MWe boiling water reactor (BWR) plant at the end of its useful life. They range from mothballing the plant nearly intact to complete dismantling of the plant and removal of all structures to one foot below grade level. Selection of the best technique to use will naturally depend on many factors which can only be properly evaluated at the time of decommissioning. Estimates of the costs of various alternatives can be made, however, based on the actual costs experienced in the decommissioning of several civilian reactors.

Three different levels of decommissioning were considered and the estimated cost (1975 dollars) were obtained for each:

(1) Mothballing

Leaving the plant essentially intact after flushing all systems and removing all loose radioactive items and wastes, providing a security fence around the plant, and maintaining a perpetual around-the-clock guard and watchman service, with semi-annual inspection of the plant performed.

Decommissioning Cost:	$ 3,500,000
Annual Charges After Decommissioning:	80,000/year

(2) Entombment

Leaving all buildings intact; flushing and dismantling system piping; isolating, sealing, and entombing the reactor pressure vessel; providing closed shield housings around major radioactive items such as the turbine generator, heat exchangers, moisture separators, etc.; removing all piping and other loose radioactive items and wastes; providing a security fence and performing semi-annual inspection of the plant.

Decommissioning Cost:	$ 9,000,000
Annual Charges After Decommissioning:	30,000/year

[redacted]

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(3) Complete Dismantling

Removal of the plant down to one foot below grade level, leaving the subgrade foundations essentially intact, backfilling to grade level, and restoration of landscaping to the approximate original condition.

Decommissioning Cost: $54,000,000

These numbers show the range of decommissioning costs for the Shoreham Unit. A 1977 Atomic Industrial Forum report, AIF/NESP-009SR, "An Engineering Evaluation of Nuclear Power Reactor Decommissioning Alternatives" indicated that the cost of decommissioning could be reduced if the plant were first mothballed or entombed, and then left in that condition for a period of time before dismantling. This approach to dismantling appears preferable to LILCO at this time. The Applicant will continue to monitor industry developments and, at an appropriate time, a detailed decommissioning plan will be submitted to the NRC.

The source of funds will come from internal cash generation plus external financing as required.

QUESTION 3

Provide an estimate of the annual cost to maintain the shutdown of the facility in a safe condition. Indicate what is included in the estimate, assumptions made in estimating costs and the expected source of funds to cover these costs.

RESPONSE

Annual costs to maintain the shutdown of the facility in a safe condition, a description of what is included in the estimate, and assumptions made in estimating costs are included in response to question 2.

The source of funds will come from internally generated cash plus external financing as required.

QUESTION 4.a.

Provide copies of the prospectus for the most recent security issue and copies of the most recent SEC Form 10-K. Provide copies of the preliminary prospectus for any pending security issue. Submit copies of the Annual Report to Stockholders each year as required by 10 CFR 50.71(b).

RESPONSE

The below listed documents are herein provided:

1. Prospectus dated October 30, 1979 and Supplement dated November 20, 1979.

2. SEC Form 10-K for the fiscal year ended December 31, 1978

3. LILCO Annual Report for 1975

4. LILCO Annual Report for 1976

5. LILCO Annual Report for 1977

6. LILCO Annual Report for 1978

NOTE: Item 1 is provided herein.
Items 2 through 6 have been submitted via the LILCO letter SNRC-378 dated April 19, 1979.

QUESTION 4.b.

Describe aspects of the applicant's regulatory environment including, but not necessarily limited to, the following: prescribed treatment of allowance for funds used during construction and construction work in progress; form of rate base (original cost, fair value, other); accounting for deferred income taxes and investment tax credits; fuel adjustment clauses in effect or proposed; historical; partially projected, or fully projected test year.

RESPONSE

The following describes various aspects of LILCO's regulatory environment:

1. The test year now utilized for rate making purposes in New York State is the 12 month period at the end of a calendar quarter no earlier in time than 150 days before the date of filing. This test year is to be fully adjusted to show the operating results for the first 12 months during which the proposed rates will be in effect. There have been no restrictions placed on the types of adjustment which may be made to the test year to make it represent the future period.

2. There are certain items included in construction work in progress (CWIP) on which allowance for funds used during construction (AFC) is not calculated, since they are either too small or are of too short a duration in time. These items are often referred to as "non-interest bearing" CWIP. Currently the average balance for these items is $45 million on the electric side of the business and $4 million on the gas side of the business. AFC generally would be calculated on the remainder of CWIP unless the Commission decides to permit some of it to be included in rate base. (Such permission is normally only granted to enable a utility company to continue its financing program). The Company is presently allowed to include $300 million of electric and $4 million of gas CWIP in its rate base.

3. In New York, the rate base is normally the average plant in service at original cost, less the accumulated depreciation reserve, less the deferred taxes on plant-related items, plus an allowance for working capital and any CWIP which the Commission has allowed to be included.

4. The Commission permits deferred tax treatment on some of the differences between book and tax depreciation which produces something which can be described as between flow-through accounting and normalized accounting. There is also deferred income tax treatment for the investment tax credit in excess of the first 4%. The Company also capitalizes a portion of its AFC net of income taxes.

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5. The Commission permits both electric and gas fuel adjustment clauses. The electric fuel adjustment clause includes the cost of fuel, excluding the cost of fuel used to make sales for resale, plus the cost of economy purchases and the cost of fuel included in non-economy purchases. The Commission also permits deferred fuel accounting so that fuel expenses and fuel revenues may be more closely in phase with each other.

QUESTION 4.c.

Describe the nature and amount of the applicant's most recent rate relief action(s). In addition, indicate the nature and amount of any pending rate relief action(s). Use the attached form to provide this information. Provide copies of the submitted financially-related testimony and exhibits of the staff and company in the most recent rate relief action or pending action. Furnish copies of the hearing examiner's report and recommendation, and final opinion last issued with respect to each participant, including all financial exhibits referred therein.

RESPONSE:

4c. Rate Developments

Granted	Electric	Gas
Test year utilized	12/31/77 (a)	12/31/77 (a)
Annual amount of revenue increase requested-test year basis (000's)	$ 147,100	$23,900
Date petition filed	5/31/78	5/31/78
Annual amount of revenue increase allowed-test year basis (000's)	$ 26,000	16,580
Percent increase in revenues allowed	[illegible].3%	9.1%
Date of final order	4/27/79	4/27/79
Effective date	5/04/79	5/04/79
Rate base finding (000's)	$1,558,728	238,761
Construction work in progress included in rate base (000's)	$ 300,000	4,120
Rate of return on rate base authorized	10.26%	10.26%
Rate of return on common equity authorized	13.7%	13.7%
Revenue Effect (000's)		
Amount received in year granted	$ 15,300	7,200
Amount received in subsequent year	$ 25,700	16,900

Pending Requests	Electric	Gas
Test Year	6/30/79 (b)	
Amount	$25.6 million	None
Percent	2.5%	
Date filed	9/21/79	
Date by which decision must be issued	8/80	

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4c. Rate Developments

Pending Requests (Cont.)	Electric	Gas
Rate of Return on Rate Base Requested	10.49%	
Rate of Return on Common Equity Requested	13.7%	
Amount of Rate Base Requested	$1,684,859	
Amount of CWIP included in Rate Base	$300 million	

NOTES:

(a) The Public Service Commission of the State of New York (PSC) in making its final determination recognized certain major adjustments to the 12/13/77 test year and concluded that such adjustments created a new test year, called the rate year, the 12 months ended 4/30/80.

(b) The test year of 6/30/79 has been adjusted to a rate year of 4/30/81.

The following financially-related testimony and exhibits of Staff and Company witness in rate cases 27374 (electric) and 27375 (gas) have been previously submitted via LILCO letter SNRC-378 dated April 19, 1979 except for items C.1 and D which are provided herein:

Financially-related testimony and exhibits of Staff and Company witness in rate cases 27374 (electric) and 27375 (gas) will consist of:

A. Prepared testimony and prepared exhibit #196 of Vincent A. Macri, Chief Utility Financial Analyst, Utility Finance Section, Office of Accounting and Utility Finance, N.Y. State Public Service Commission, Empire State Plaza, Albany, N.Y. 12223, dated October 1978 for the Staff:

   Exhibit #196 contains the following:

   1. LILCO - Cash Funds Requirements Excluding the Trusts for the years 1979 and 1980
   2. LILCO - Capital Structure - June 30, 1978 - Pro Forma
   3. LILCO - Average Capital Structure for the Rated Year
   4. LILCO - Moody's Utility Common Stocks - Average Long Term Debt Positions
   5. LILCO - Moody's Utility Common Stocks - Average Preferred Stock Positions
   6. LILCO - Moody's Utility Common Stocks - Average Common Equity Positions
   7. LILCO - Cost of Long Term Debt - June 30, 1978 - Pro Forma
   8. LILCO - Cost of Preferred Stock - June 30, 1978
   9. LILCO - Financial Statistics
   10. LILCO - 1978 Yields for Long Island Lighting
   11. LILCO - Moody's Utility Common Stocks - Financial Statistics
   12. LILCO - Moody's Utility Common Stocks - Financial Statistics - 1976
   13. LILCO - Moody's Utility Common Stocks - Financial Statistics - 1977
   14. LILCO - Moody's Utility Common Stocks - Financial Statistics - Current
   15. LILCO - Flowthrough Electric Utilities - Financial Statistics for 1976
   16. LILCO - Flowthrough Electric Utilities - Financial Statistics for 1977
   17. LILCO - Flowthrough Electric Utilities - Financial Statistics - Current
   18. LILCO - Standard & Poor's 400 Industrials - Financial Statistics
   19. LILCO - Moody's Utility Common Stocks - AFC as a Percentage of Earnings

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20. LILCO - Flowthrough Electric Utilities AFC as a Percentage of Earnings
21. LILCO - Common Stock Issuances 1976 - $20,000,000 or more
22. LILCO - Common Stock Issuances 1977 - $20,000,000 or more
23. LILCO - Common Stock Issuance in 1978 - $20,000,000 or more
24. LILCO - Derivation of Formula for Converting Investors Expected Return to Required Return on Equity
25. LILCO - Divisors Necessary to Convert Total Return To Required Return on Equity at Given Market to Book Ratios* (*Assumes 66% payout ratio)
26. LILCO - Average Capital Structure and Cost Rates for the Rate Year
27. LILCO - Pre-Tax Rate of Return
28. LILCO - Pro Forma Pre-Tax Coverage For the Rate Year
29. LILCO - Pre-Tax Coverage Based on the 10% Limitation of Other Income
30. LILCO - Moody's Utility Common Stocks Pre-Tax Coverage for the Twelve Months Ended December 31, 1977
31. LILCO - Flowthrough Utilities Pre-Tax Coverage for the Twelve Months Ended December 31, 1977
32. LILCO - Moody's Utility Common Stocks Pre-Tax Coverage for the Twelve Months Ended June 30, 1978
33. LILCO - Flowthrough Utilities Pre-Tax Coverage for the Twelve Months Ended June 30, 1978
34. LILCO - AFC as a Percentage of Earnings For the Rate Year

B. Financially-related testimony and exhibits of company witnesses in rate cases 27374 (Electric) and 27375 (Gas):

1. Thomas H. O'Brien
2. Raymond J. Forrer
3. Roger F. Murray the 2nd
4. Zvi Bendry (testimony and exhibit #64 which contains Schedules 1&2 and a Technical Appendix)

C. The Hearing Examiner's report and recommendations, and final opinion last issued with respect to each participant, including all financial exhibits referred therein consists of the following:

1. Recommended Decision by Administrative Law Judge David Schechte Issued 2/13/79 - Case 27374 & 27375
2. Opinion and Order Determining Increased Revenue Requirements - Issued 4/27/79 , Case 27374 (Electric Rates) and 27375 (Gas Rates). (Attachment C to question 4C provided with this submittal)

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D. Financially-related testimony and exhibits of Company witnesses in support of the pending rate case:

1. Raymond J. Forrer (pages 1 and 12 through 20 and exhibits 12 through 18)
2. Zvi Benderly (testimony and exhibit 56 which contains schedules 1 and 2 and a technical appendix).

ATTACHMENT A TO QUESTION 4.C

TESTIMONY OF
RAYMOND J. FORRER

Q. Please state your name and business address.
A. Raymond J. Forrer, 250 Old Country Road, Mineola, New York

Q. What is your position with Long Island Lighting Company?
A. I am Associate Controller, a position I have held since 1974.

Q. Have you testified in other proceedings before this Commission?
A. Yes. I have testified in several of the Company's rate proceedings including its last electric and gas rate Cases 27374 and 27375, in Case 27136, in Case 80003 "Jamesport Siting Application", and in Case 26798 "Empire State Power Resources, Inc."

Q. Mr. Forrer, I show you a two page document entitled "Long Island Lighting Company - Balance Sheet." Was this document prepared under your direction?
A. Yes.

~~Q. I ask that this document be marked for identification as Exhibit No. 1. Mr. Forrer, would you please explain what Exhibit No. 1 shows?~~
~~A. It shows the Balance Sheet of the Company as of December 31, in each of the years 1975, 1976, 1977 and 1978 and as of June 30, 1979 extracted from the books of the Company by PSC prime account.~~

NOTE: Pages 2 through 11 inclusive have been omitted intentionally.

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of which is entitled "Net Utility Plant - Electric - Book Cost of Plant and Accumulated Depreciation - Monthly Balances May 1, 1980 to April 30, 1981." The second page refers to "Net Utility Plant - Common." The third page refers to "Deferred Taxes - Electric." Was this document prepared under your supervision?

A. Yes.

Q. I ask that this document be marked as Exhibit 12 for identification. Mr. Forrer, what does this Exhibit show?

A. Page 1 shows monthly balances after CVRs for the period May 1, 1980 to April 30, 1981, in the various electric property accounts and accumulated depreciation, including that portion of common plant from page 2 which is allocated to electric operations. Page 2 shows the related common plant and accumulated depreciation balances. The result shown on each page is net utility plant. Page 3 shows monthly balances in the various deferred federal income tax items for electric operations. Also shown on the bottom of each page is the average annual balances for each of the items stated above.

Q. I show you a two-page document entitled, "Long Island Lighting Company - Weighted Average Cost of Senior Securities at June 30, 1979." Was this prepared under your direction?

A. Yes.

Q. I ask that this document be marked as Exhibit 13 for identification. Would you please explain this Exhibit?

A. Exhibit 13 shows that as of June 30, 1979, the weighted average cost of long-term debt was 7.86% and the weighted average cost of preferred stock was 8.02%.

Q. I show you a two-page document entitled, "Long Island Lighting Company - Estimated Cost of Senior Securities, Capital Structure, and Rate of Return." Was this prepared under your direction?

A. Yes.

Q. I ask that this document be marked as Exhibit 14 for identification. Would you please explain this Exhibit?

A. Exhibit 14, Schedule 1 of 2 shows that the estimated changes in the senior securities during the period of July 1, 1979, and April 30, 1981, and the cost of those changes. It reflects the pending sale in October 1979 of $14.4 million of authority financing notes and a proposed sale in May, 1980 of $85 million of General and Refunding Bonds at a cost of 10%. Also, an expected sale in December, 1980 of $70 million of General and Refunding Bonds at an estimated interest rate of 10%. The schedule also indicates a refunding of the Series A 1st Mortgage Bonds of $20 million at a 3% rate in September, 1980. The resulting weighted average cost of debt at April 30, 1981, is 8.16%. The Exhibit further reflects (a) the

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recent issuance of Preferred Series S $75 million, with proceeds to the Company of $73,715,000 at a cost of 9.97% and (b) an adjustment for the Series Q Preferred Stock Amortization of the redemption premium as per Case 27236. The Preferred Stock has been reduced for the sinking fund requirements relating to the Series L stock in July, 1979; Series Q in June, 1980; Series L in July, 1980; and Series M in November, 1980. The weighted average cost of Preferred Stock at April 30, 1981 is 8.56%.

Schedule 2 of 2 reflects the estimated capital structure, cost rate, and the return components for long-term debt, Preferred Stock, Common Equity and customer deposits as estimated for the rate year ending April 30, 1981. In addition to the additional bonds and preferred stock noted on Schedule 1, this schedule reflects (a) a planned issue of $120 million offering of common stock in November 1979, (b) a proposed $88.8 million offering of common stock in November, 1980, (c) proceeds of $2 million from the sale of shares of common stock under the Employee Stock Purchase Plan and (d) proceeds of $16 million from the sale of shares of common stock under the Automatic Dividend Reinvestment Plan during the rate year. Finally, it reflects additional retained earnings of $58.7 million and the estimated changes of $0.2 million to the capital stock expense.

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Q. What else does Exhibit 14 show?

A. It shows the capitalization ratios of the capital structure and the cost rates for each of the senior securities, 9% for customer deposits and 13.7% for common equity. It also shows the resultant return components yielding a total required rate of return of 10.49%.

Q. Mr. Forrer, would you comment on the apparently high common equity in the Company's capital structure?

A. Although the common equity ratio in the Company's capital structure seems high, two factors must be considered. First, in accordance with past rate case treatment, the Resources and Construction Trust have been excluded from the capital structure for rate purposes. Second, theoretically, the Company could decrease the amount of common equity by selling more long-term debt. But as shall be demonstrated later on in my testimony, bond indenture coverage is below acceptable levels, even with the full rate relief requested. Therefore, the sale of additional bonds to reduce the common equity might not be feasible. Other possibilities of reducing the common equity ratio are to increase use of the Trusts as a financing vehicle and to sell more Preferred Stock. With respect to the Trusts, these were created to finance nuclear fuel and the construction of the Company's share of Nine Mile Point 2 nuclear unit. It is possible for the Company to borrow from the Trusts for "Other Corporate Purposes" but this is merely another temporary expediency

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for financing and does not have a material effect on our financing program. As far as Preferred Stock is concerned, the preferred stock ratios are near maximum levels. In addition, without rate relief the amount of Preferred Stock that could be issued may be limited by the Certificate of Incorporation coverage test. For the recently issued Series S 9.8% preferred, the coverage was 1.51 times. The minimum required is 1.50 times.

Q. I show you a two-page document entitled, "Long Island Lighting Company - Fund Requirements and Financing." Was this prepared under your direction?

A. Yes.

Q. I ask that this document be marked as Exhibit 15 for identification. Would you please explain this Exhibit?

A. Schedule 1 of the Exhibit shows the fund requirements, internal cash generation, and financing for the calendar years 1979, 1980 and for the twelve months ended April 30, 1981. The Exhibit shows the funds required for our construction program and nuclear fuel and Nine Mile Point #2 expenditures to be financed through the resources and construction trusts. Also, the funds required for sinking funds and bond redemption. Funds derived from internal sources are shown without rate increases requested in this case. The financing program including resources and construction trust

financing is shown in the section headed "Funds Provided." Schedule 2 of the exhibit is similar to Schedule 1 except that I have assumed the rate increase requested in this filing to be effective May 1, 1980.

Q. I show you a two-page document entitled, "Long Island Lighting Company - Bond Indenture Coverage and Ratio of Earnings to Fixed Charges (SEC Coverage)." Was this prepared under your direction?

A. Yes.

Q. I ask that this document be marked as Exhibit 16 for identification. Would you please explain this Exhibit?

A. Schedule 1 of the Exhibit reflects the computation of the bond indenture coverages and ratios of earnings to fixed charges at December 31, 1979, December 31, 1980, and April 30, 1981. The coverages are based on available income stated in the Schedule and proposed bond financings. Schedule 1 is tabulated without rate increases while Schedule 2 reflects the requested rate increase effective on May 1, 1980.

Q. Mr. Forrer, on Exhibit 16 you show the forecasted G&R bond indenture coverage for the years 1979, 1980 and the rate year respectively as 2.23 times, 2.02 times and 1.99 times without rate relief and 2.23 times, 2.17 times and 2.22 times with

rate relief. Do any of these calculations include bond sales that will take place subsequent to the particular 12 months period?

A. No. All calculations include only the annualized interest on all bonds outstanding at the conclusion of the particular 12 month period. For example, the coverages for the year 1979 do not reflect any interest on bonds to be issued in 1980. If I were to include the interest on the first bond issue in the spring of 1980 in the 1979 calculation, the resultant coverage would be 2.05 times. In Opinion 78-1, the Commission, in establishing rate levels for the Company utilized as its criteria a coverage of 2.3 times for the rate year including the first issue of bonds to be sold <u>after</u> the rate year. It is clear that the Company will not meet this standard at any time. Furthermore, the bond indenture coverage throughout the entire period is approximately at the levels which the Commission has considered appropriate for granting interim rate relief. This coverage situation will be exacerbated by the fact that expenses in this presentation are based upon the levels found appropriate by the Commission in the Company's most recent rate decision, Opinion 79-14, issued April 29, 1979 in order to reduce the controversial issues. As Associate Controller, I am familiar with the Company's proposed 1980 budget and I can state that, despite the strictest controls possible, it appears most likely

that actual expenditures for operation and maintenance for the year 1980 and at least the first four months of 1981 will exceed those reflected in the Company's filing. Thus, all of the financial criteria reflected in my exhibits are conservative in that they present an optimistic view contrasted to what will probably occur.

Q. Mr. Forrer, I show you a one-page document entitled, "Long Island Lighting Company - Internal Cash as a Percent of Capital Expenditures and Dividends Paid as a Percent of Cash Income." Was this document prepared under your supervision?
A. Yes.

Q. I ask that this document be marked as Exhibit 17 for identification. Would you kindly describe this Exhibit?
A. The Exhibit shows internal cash as a percent of capital expenditures and dividends paid as a percent of cash income for the year 1979, 1980 and the twelve months ended April, 1981. The data shown on this Exhibit were extracted from Exhibit 15. The top half of the Exhibit assumes no rate increase and the bottom half of the Exhibit assumes the proposed rate increase effective May 1, 1980.

Q. Mr. Forrer in computing the percentage of dividends to the amount

of internal cash generation as reflected on Exhibit 17, what common stock dividend rates did you assume?

A. Beginning in August, 1979, I used a quarterly rate of 44 1/2¢ per share, the most recent quarterly payment. I used this rate for the November 1, 1979 and February 1, 1980 common stock dividend payments. Beginning with the May 1, 1980 dividend, I assumed quarterly payments would be 46 1/2¢ per share. As can be seen from Exhibit 17, dividends paid would exceed cash income for the rate year if no rate relief is granted and will amount to more than 95% of cash income even if full rate relief is granted.

Q. Mr. Forrer, I show you a one-page document entitled, "Long Island Lighting Company - Allowance for Funds Used During Construction as a Percent of Income for Common Stock." Was this document prepared under your supervision?

A. Yes.

Q. I ask that this document be marked as Exhibit 18 for identification. Would you kindly describe this Exhibit?

A. This Exhibit shows the Allowance for Funds Used During Construction (AFC) as a percent of income for common stock for the years 1979, 1980 and the twelve months ended April, 1981. The top half of the Exhibit assumes no rate relief. The bottom half of the Exhibit assumes the proposed rate increase effective May 1, 1980.

90027054

Exhibit No.13
Page 1 of 2
P.S.C. Case No.
Witness: Forrer

LONG ISLAND LIGHTING COMPANY

WEIGHTED AVERAGE COST OF SENIOR SECURITIES AT JUNE 30, 1979
LONG-TERM DEBT
$(000)

	Coupon Rate	Principal Amount	Amount at Offering Price	Underwriters Compensation	Expenses to Company (2)	Net Proceeds to Company (A)	Net Cost to Company (B)	Product (A X B)
Long-Term Debt								
First Mortgage Bonds								
Series A (1) Due 9/1/80	3.00 %	$ 20,000	$ 20,305		$ 101	$ 20,204	2.95%	$ 596
E 10/1/82	3.375	20,000	20,200	$ 138	115	19,947	3.39	676
F 9/1/83	3.50	25,000	25,232	180	153	24,899	3.52	876
G 12/1/84	3.25	15,000	15,437	88	90	15,259	3.16	482
H 11/1/85	3.375	15,000	15,213	93	92	15,028	3.37	506
I 12/1/86	4.75	20,000	20,550	230	113	20,207	4.69	948
J 5/1/88	4.125	20,000	20,200	156	115	19,929	4.15	827
L 8/1/91	5.00	25,000	25,391	208	136	25,047	4.99	1,250
M 4/1/93	4.40	40,000	40,000	100	181	39,719	4.44	1,764
N 6/1/94	4.625	25,000	25,375	166	134	25,075	4.61	1,156
O 6/1/95	4.550	25,000	25,000	63	126	24,811	4.60	1,141
P 3/1/96	5.25	40,000	40,731	259	154	40,318	5.20	2,097
Q 4/1/97	5.50	35,000	35,622	356	141	35,125	5.48	1,925
R 9/1/99	8.20	35,000	35,000	306	195	34,499	8.33	2,874
S 9/1/00	9.125	25,000	25,500	260	140	25,100	9.09	2,282
U 4/1/01	7.25	40,000	40,741	360	233	40,148	7.22	2,899
V 12/1/01	7.50	50,000	50,903	373	294(3)	50,236	7.46	3,748
W 9/1/02	7.625	50,000	50,742	317	293(3)	50,132	7.60	3,810
X 12/1/03	8.125	60,000	60,506	470	340(3)	59,696	8.17	4,877
Y 6/1/81	10.00	60,000	60,000	450	374(3)	59,176	10.28	6,083
Z 11/1/82	9.25	50,000	50,000	413	364(3)	49,223	9.53	4,691
General and Refunding Bonds								
Series 9 1/4 Due 6/1/83	9.25	80,000	80,000	700	804(3,4)	78,496	9.59	7,528
9 7/8 Due 9/1/84	9.875	90,000	90,000	788	546(3,4)	88,666	10.13	8,982
9 5/8 Due 6/1/06	9.625	70,000	70,000	613	433(3,4)	68,954	9.78	6,744
8 5/8 Due 12/1/06	8.625	50,000	50,675	411	337(3,4)	49,927	8.64	4,314
8 5/8 Due 5/1/07	8.625	85,000	84,150	744	483(3,4)	82,923	8.87	7,355
9 1/5 Due 4/1/08	9.20	75,000	74,063	523	738(3,4)	72,802	9.47	6,894
9 3/4 Due 3/1/99	9.75	100,000	100,000	-	690(3,4,5)	99,310	9.83	9,762
Authority Financing Notes								
7 1/2 Due 12/1/06	7.50	30,375	30,375	653	348	29,374	7.79	2,288
		$1,275,375	$1,281,911	$9,418	$8,263	$1,264,230	7.86%	$99,375

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(1) Series A Issued in November 29, 1951 to institutional holders in exchange for former bonds of same coupon and maturity (Series A includes premium of $305 transferred from the old Series H).

(2) Net of Income Tax Reduction on Mortgage Recording Tax (except for Authority Financing Notes).

(3) Actual Including portion of mortgage tax paid under protest.

(4) Excludes any mortgage recording tax on pledged First Mortgage Bonds.

(5) Estimated expenses of Company per Exhibit 1 in Case 27491.

7/31/79

LONG ISLAND LIGHTING COMPANY

WEIGHTED AVERAGE COST OF SENIOR SECURITIES AT JUNE 30, 1979
PREFERRED STOCK
$(000)

	Rate (A)	Principal Amount (B)	Amount at Offering Price	Underwriters' Compensation	Expenses to Company	Net Proceeds to Company	Net Cost to Company	Product (A X B)
Preferred Stock								
Preferred Stock Series B	5.00%	$ 10,000	$ 10,000	$ 207	$ 51	$ 9,742	5.13%	$ 500
D	4.25	7,000	7,000	133	39	6,828	4.36	298
E	4.35	20,000	20,000	380	42	19,578	4.44	869
F	4.35	5,000	5,000	25	20	4,955	4.39	218
H	5.125	20,000	20,000	100	42	19,858	5.16	1,024
J	8.12	25,000	25,000	313	44	24,643	8.24	2,030
K	8.30	30,000	30,366	328	69	29,969	8.31	2,490
L	7.40	35,000	35,000	-	40	34,960	7.41	2,590
M	8.40	35,000	35,000	-	37	34,963	8.41	2,940
O	9.88	50,000	50,000	1,880	135	47,985	10.29	4,940
P	9.72	35,000	38,500	1,372	140	36,988	9.20	3,402
Q	7.50	48,000	48,000	142 (1)	6,236 (1)	41,622	8.65	3,600
R	8.50	60,000	60,000	213	74	59,713	8.54	5,100
Total Preferred Stock (Excluding Series I)		380,000	383,866	5,093	6,969	371,804	8.07	30,001
Preferred Series I - Convertible	5.75	8,948	8,948	154	88	8,706	5.91	515
		$388,948	$392,814	$5,247	$7,057	$380,510	8.02%	$30,516

(1) Original totals of $180,000 for Underwriters' Compensation and $8,242,000 for Expenses to Company less amortization to date.

7/31/79

90027056

Exhibit 14
Schedule 1 of 2
P.S.C. Case No.
Witness: Forrer

LONG ISLAND LIGHTING COMPANY
ESTIMATED COST OF SENIOR SECURITIES, CAPITAL STRUCTURE
AND RATE OF RETURN
$(000)

Estimated Cost of Senior Securities as of April 30, 1981	Amount	Rate	Cost
Long-Term Debt			
As of June 30, 1979 - (As Per Exhibit 13 Page 1 of 2)	$1,264,230	7.86%	$ 99,375
Authority Financing Note Issue - October 1979	14,400	7.38%	1,066
Bond Issue May 1980	85,000	10.00%	8,500
Refund Series A September 1980	(20,204)	2.95%	(596)
Bond Issue December 1980	70,000	10.00%	7,000
	$1,413,426	8.16%	$115,345
Preferred Stock			
As of June 30, 1979-(As per Exhibit 13 Page 2 of 2)	$ 380,510	8.02%	$ 30,516
Adjustment for Series Q - As per Case 27236	2,158	-	1,178
Refunding of Series L - July 1979	(1,049)	7.41%	(78)
New Series S Preferred - September 1979	73,715	9.97%	7,350
Refunding of Series Q - June 1980	(4,280)	8.41%	(360)
Refunding of Series L - July 1980	(1,049)	7.41%	(78)
Refunding of Series M - November 1980	(1,998)	8.41%	(168)
	$ 448,007	8.56%	$ 38,360

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LONG ISLAND LIGHTING COMPANY
ESTIMATED COST OF SENIOR SECURITIES, CAPITAL STRUCTURE
AND RATE OF RETURN
$(000)

	Long Term Debt	Preferred Stock	Capital Stock	Capital Stock Expense	Retained Equity	Total	Customer Deposits	Total Capitalization
As of June 30, 1979	$ 1,275,375	$ 388,948	$ 710,855	$ (27,919)	$ 331,602	$ 1,014,538	$ 8,175	$ 2,687,036
Estimated Changes thru April 30, 1980	14,400	73,950	134,025	(1,270)	58,269	191,024	-	279,374
Balance As of April 30, 1980	$ 1,289,775	$ 462,898	$ 844,880	$ (29,189)	$ 389,871	$ 1,205,562	$ 8,175	$ 2,966,410
May 1980	$ 1,374,775	$ 462,898	$ 848,875	$ (29,126)	$ 398,834	$ 1,218,583	$ 8,175	$ 3,064,431
June 1980	1,374,775	458,098	848,875	(29,028)	383,774	1,203,621	8,175	3,044,669
July 1980	1,374,775	457,048	848,875	(28,930)	400,396	1,220,341	8,175	3,060,339
August 1980	1,374,775	457,048	853,890	(28,871)	417,599	1,242,618	8,175	3,082,616
September 1980	1,354,775	457,048	853,890	(28,773)	411,098	1,236,215	8,175	3,056,213
October 1980	1,354,775	457,048	853,890	(28,676)	421,332	1,246,546	8,175	3,066,544
November 1980	1,354,775	455,048	946,685	(29,814)	430,993	1,347,864	8,175	3,165,862
December 1980	1,424,775	455,048	946,685	(29,715)	411,391	1,328,361	8,175	3,216,359
January 1981	1,424,775	455,048	946,685	(29,616)	430,875	1,347,944	8,175	3,235,942
February 1981	1,424,775	455,048	951,700	(29,558)	447,644	1,369,786	8,175	3,257,784
March 1981	1,424,775	455,048	951,700	(29,461)	433,794	1,356,033	8,175	3,244,031
Eleven Months Total	15,262,525	5,024,428	9,851,750	(321,568)	4,587,730	14,117,912	89,925	34,494,790
April 1981	1,424,775	455,048	951,700	(29,362)	448,618	1,370,956	8,175	3,258,954
April 1980	1,289,775	462,898	844,880	(29,189)	389,871	1,205,562	8,175	2,966,410
Total April 1980 and 1981	2,714,550	917,946	1,796,580	(58,551)	838,489	2,576,518	16,350	6,225,364
April 1980 and 1981 Average	1,357,275	458,973	898,290	(29,276)	419,245	1,288,259	8,175	3,112,682
Twelve Months Total	$16,619,800	$5,483,401	$10,750,040	$(350,844)	$5,006,975	$15,406,171	$98,100	$37,607,472
Annual Avverage 1/12	$ 1,384,983	$ 456,950	$ 895,837	$ (29,237)	$ 417,248	$ 1,283,848	$ 8,175	$ 3,133,956
Ratios	44.19%	14.58%				40.97%	0.26%	100.00%
Cost Factors	8.16%	8.56%				13.7 %	9.0 %	
Return Components	3.61%	1.25%				5.61%	0.02%	10.49%

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Exhibit No. 14
Schedule 2 of 2
P.S.C. Case No.
Witness: Forrer

Exhibit No. 15
Schedule 1 of 2
P.S.C. Case No.
Witness: Forrer

LONG ISLAND LIGHTING COMPANY
FUND REQUIREMENTS AND FINANCING
$(000)

	Without Rate Increase 1979	Without Rate Increase 1980	12 Mos. Ended April 30, 1981
Funds Required			
Construction Expenditures	$370,170	$350,793	$318,358
Nine Mile Point #2	30,568	30,700	32,400
Nuclear Fuel	17,988	20,004	20,560
Bokum Advances	21,000	0	0
Allowance for Funds	(79,931)	(101,356)	(106,750)
Preferred Sinking Fund	1,070	7,850	7,850
1st Mortgage Bond Redemption	0	20,000	20,000
Total Funds Required	$360,865	$327,991	$292,418
Internal Cash			
Net Income	$171,525	$198,794	$196,697
Preferred Dividend Payment	(32,433)	(37,739)	(37,512)
Common - Dividend Payment	(89,155)	(109,906)	(118,458)
Depreciation	54,106	57,175	58,333
Deferred Taxes	(73)	(5,852)	(5,901)
Other - Working Capital	(67,268)	2,129	2,726
Allowance for Funds	(79,931)	(101,356)	(106,750)
Total Internal Cash	$(43,229)	$ 3,245	$(10,865)
Funds Provided - Financing			
Bonds	$100,000	$155,000	$155,000
Notes	10,569	2,700	2,700
Trust Proceeds	69,556	50,704	52,960
Preferred	75,000	0	0
Common - Stock	120,000	88,800	88,800
- Employee & ADRP	17,888	18,020	18,020
Short Term	11,081	9,522	(14,197)
Total Funds Provided - Financing	$404,094	$324,746	$303,283
Total Funds Provided	$360,865	$327,991	$292,418

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Exhibit No. 15
Schedule 2 of 2
P.S.C. Case No.
Witness: Forrer

LONG ISLAND LIGHTING COMPANY
FUND REQUIREMENTS AND FINANCING
$(000)

	Assuming Rate Increase (5/1/80) 1980	12 Mos. Ended April 30, 1981
Funds Required		
Construction Expenditures	$350,793	$318,358
Nine Mile Point #2	30,700	32,400
Nuclear Fuel	20,004	20,560
Bokum Advances	0	0
Allowance for Funds	(101,356)	(106,750)
Preferred Sinking Fund	7,850	7,850
1st Mortgage Bond Redemption	20,000	20,000
Total Funds Required	$327,991	$292,418
Internal Cash		
Net Income	$207,339	$214,627
Preferred Dividend Payment	(37,739)	(37,512)
Common Dividend Payment	(109,906)	(118,458)
Depreciation	57,175	58,333
Deferred Taxes	(1,009)	(2,724)
Other - Working Capital	2,275	1,956
Allowance for Funds	(101,356)	(106,750)
Total Internal Cash	$ 16,779	$ 9,472
Funds Provided - Financing		
Bonds	$155,000	$155,000
Notes	2,700	2,700
Trust Proceeds	50,704	52,960
Preferred	0	0
Common - Stock	88,800	88,800
- Employee & ADRP	18,020	18,020
Short Term	(4,012)	(34,534)
Total Funds Provided Financing	$311,212	$282,946
Total Funds Provided	$327,991	$292,418

Exhibit No. 16
Schedule 1 of 2
P.S.C. Case No.
Witness: Forrer

LONG ISLAND LIGHTING COMPANY
BOND INDENTURE COVERAGE AND RATIO OF EARNINGS
TO FIXED CHARGES (SEC COVERAGE)
$(000)

Bond Indenture Coverage	Without Rate Increase 1979	1980	12 Mos. Ended Apr. 1981
Income Available For Coverage			
Electric Operating Income Before Income Tax	$166,852	$166,794	$164,358
Gas Operating Income Before Income Tax	29,192	38,194	37,756
Other Income Allowed	19,604	20,499	20,211
Total Income Available	$215,648	$225,487	$222,325
Mortgage & G&R Bond Interest			
Bonds Existing @ June 30, 1979	$ 96,680	$ 96,680	$ 96,680
New $85 Million @ 10% May 1980	-	8,500	8,500
$70 Million @ 10% Dec 1980	-	7,000	7,000
Refund - $20 Million Series A 3%	-	(600)	(600)
Total Bond Interest	$ 96,680	$111,580	$111,580
Identure Coverage - Times Earned	2.23	2.02	1.99

Ratio Of Earnings To Fixed Charges	1979	1980	12 Mos. Ended Apr. 1981
Income Available for Coverage			
Electric Operating Income Before Income Tax	$166,852	$166,794	$164,358
Gas Operating Income Before Income Tax	29,192	38,194	37,756
Allowance for Funds Used During Constr.	79,931	101,356	106,750
Other Income and Deductions	4,086	4,476	4,436
Capitalized Trust Interest	24,125	33,383	36,849
Total Income Available	$304,186	$344,203	$350,149
Fixed Charges			
Interest on Bonds	$ 94,772	$102,734	$107,701
Interest on Notes	6,697	8,752	8,752
Amortization DD&E - Premium Net	931	1,022	1,060
Interest on Loans	4,908	4,047	3,964
Other Interest	843	953	1,026
Capitalized Trust Interest	24,125	33,383	36,849
Total Fixed Charges	$132,276	$150,891	$159,352
Coverage - Times Charges Earned	2.30	2.28	2.20

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Exhibit No. 16
Schedule 2 of 2
P.S.C. Case No.
Witness: Forrer

LONG ISLAND LIGHTING COMPANY
BOND IDENTURE COVERAGE AND RATIO OF EARNINGS TO FIXED CHARGES (SEC COVERAGE)
$(000)

	Assuming Rate Increase (5/1/80)	
Bond Indenture Coverage	1980	12 Mos. Ended April 30, 1981
Income Available for Coverage		
Electric Operating Income Before Income Tax	$182,030	$187,438
Gas Operating Income Before Income Tax	38,194	37,756
Other Income Allowed	22,022	22,519
Total Income Available	$242,246	$247,713
Mortgage & G&R Bond Interest		
Bonds Existing @ June 30, 1979	$ 96,680	$ 96,680
New $85 Million @ 10% May 1980	8,500	8,500
$70 Million @ 10% Dec 1980	7,000	7,000
Refund - $20 Million Series A 3%	(600)	(600)
Total Bond Interest	$111,580	$111,580
Indenture Coverage - Times Earned	2.17	2.22

	1980	12 Mos. Ended April 30, 1981
Ratio of Earnings to Fixed Charges		
Income Available for Coverage		
Electric Operating Income Before Income Tax	$182,030	$187,438
Gas Operating Income Before Income Tax	38,194	37,756
Allowance for Funds Used During Construction	101,356	106,750
Other Income and Deductions	4,476	4,567
Capitalized Trust Interest	34,458	37,908
Total Income Available	$360,514	$374,419
Fixed Charges		
Interest on Bonds	$102,734	$107,701
Interest on Notes	8,752	8,752
Amortization DD&E - Prem Net.	1,022	1,060
Interest on Loans	3,750	3,248
Other Interest	953	1,026
Capitalized Trust Interest	34,458	37,908
Total Fixed Charges	$151,669	$159,695
Coverage - Times Charges Earned	2.38	2.34

90027062

Exhibit No. 17
P.S.C. Case No.
Witness: Forrer

LONG ISLAND LIGHTING COMPANY
INTERNAL CASH AS A PERCENT OF CAPITAL EXPENDITURES AND DIVIDENDS PAID AS A PERCENT OF CASH INCOME
$(000)

	Without Rate Increase		
	1979	1980	12 Mos. Ended April 30, 1981
Internal Cash as a Percent of Capital Expenditures			
Funds Required	$360,865	$327,991	$292,418
Sinking Fund and Redemption	(1,070)	(27,850)	(27,850)
Total Capital Expenditures	$359,795	$300,141	$264,568
Internal Cash	$(43,229)	$ 3,245	$(10,865)
Percent	(12.0)	1.1	(4.1)
Dividends Paid as a Percent of Cash Income			
Net Income	$171,525	$198,794	$196,697
Depreciation	54,106	57,175	58,333
Deferred Taxes	(73)	(5,852)	(5,901)
Allowance for Funds	(79,931)	(101,356)	(106,750)
Total Cash Income	$145,627	$148,761	$142,379
Dividends Paid	$121,588	$147,645	$155,970
Percent	83.5	99.2	109.5

	Assuming Rate Increase (5/1/80)	
Internal Cash as a Percent of Capital Expenditures		
Funds Required	$327,991	$292,418
Sinking Fund and Redemption	(27,850)	(27,850)
Total Capital Expenditures	$300,141	$264,568
Internal Cash	$ 16,779	$ 9,472
Percent	5.6	3.6
Dividends Paid as a Percent of Cash Income		
Net Income	$207,339	$214,627
Depreciation	57,175	58,333
Deferred Taxes	(1,009)	(2,724)
Allowance for Funds	(101,356)	(106,750)
Total Cash Income	$162,149	$163,486
Dividends Paid	$147,645	$155,970
Percent	91.1	95.4

Note: All Data On This Exhibit Extracted From Exhibit 15.

90027063

Exhibit No. 18
P.S.C. Case No.
Witness: Forrer

LONG ISLAND LIGHTING COMPANY
ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION
AS A PERCENT OF INCOME FOR COMMON STOCK
$(000)

	Without Rate Increase 1979	1980	12 Mos. Ended April 30, 1981
Income for Common			
Income (Exhibit 16 Schedule 1 of 2)	$304,186	$344,203	$350,149
Fixed Charges (Exhibit 16 Schedule 1 of 2)	(132,276)	(150,891)	(159,352)
Federal Income Tax	(386)	5,483	5,900
Preferred Dividends	(33,021)	(37,663)	(37,452)
Income For Common	$138,503	$161,132	$159,245
Allowance for Funds Used During Construction	$ 79,932	$101,356	$106,750
Percent	57.7	62.9	67.0

	Assuming Rate Increase (5/1/80) 1980	12 Mos. Ended April 30, 1981
Income for Common		
Income (Exhibit 16 Schedule 2 of 2	$360,514	$374,419
Fixed Charges (Exhibit 16 Schedule 2 of 2)	(151,669)	(159,695)
Federal Income Tax	(1,505)	(97)
Preferred Dividends	(37,663)	(37,452)
Income For Common	$169,677	$177,175
Allowance for Funds Used During Construction	$101,356	$106,750
Percent	59.7	60.3

90027064

TESTIMONY

OF

ZVI BENDERLY

Q. Will you give your name and address, please?

A. My name is Zvi Benderly. My business address is 80 Broad Street, New York City.

Q. What is your occupation?

A. I am an economist and Vice President employed by National Economic Research Associates, Inc.

Q. Please describe your education and employment background.

A. I received a Bachelor of Science degree in Civil Engineering in 1957 from the Technion, Israel Institute of Technology. In 1958, I entered New York University Graduate School of Engineering where I received, in 1959, a Master of Science degree in Civil Engineering. I have held a professional engineering license in New York State since 1963 and in New Jersey since 1968. Since 1966, I have been enrolled in New York University Graduate School of Business Administration and I received a Master of Business Administration degree from that institution in 1967. My major areas of concentration were Corporate Finance and Quantitative Analysis. In addition, I have completed all courses and examination requirements for a Ph.D. degree in Finance and Operations Research and

am currently working on my dissertation.

From 1960 to 1968, I was employed by Alexander Potter Associates, a consulting engineering firm in New York City. In my capacity as a project engineer, I directed engineering and economic studies of civil engineering projects related to public works improvements in the United States and abroad. These studies involved the areas of water pollution control, water resources, land development and urban planning.

During the period 1968-1969, I served as an engineering economist with Public Service Electric and Gas Company in New Jersey. In this capacity, I prepared financial and economic analyses relating to utility revenue requirements and studies dealing with profitability and economic choice as applied to public utilities. During my employment at Public Service, I conducted cost-benefit analyses and empirical studies pertaining to the measurement of the cost of capital.

Since joining National Economic Research Associates, Inc., in 1969, I have concentrated on the financial analysis of regulated industries. I have prepared empirical studies concerned with estimating the cost of capital and the fair rate of return for regulated enterprises. These studies included collection, statistical analysis and interpretation of financial data and the construction of econometric models. I have participated in preparing

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direct and rebuttal testimonies pertaining to the fair rate of return to be allowed to regulated companies.

I am a member of the American Finance Association, the Western Finance Association and the Operations Research Society of America.

Q. Have you ever testified before a regulatory agency in the past?

A. Yes. I have presented testimony before the Federal Energy Regulatory Commission, the Federal Maritime Commission, and the regulatory agencies in the following states: Arkansas, Connecticut, Massachusetts, Michigan, Minnesota, Nevada, New Hampshire, New Mexico, New York, Rhode Island, Vermont, and Virginia. This testimony was presented on behalf of the following companies: Boston Edison Company, Central Vermont Public Service Company, Consolidated Edison Company, Consumers Power Company, Long Island Lighting Company, subsidiaries of Middle South Utilities, Minnesota Power & Light Company, subsidiaries of New England Electric System, Niagara Mohawk Power Corporation, subsidiaries of Northeast Utilities, Northern States Power-Minn., Pacific Gas and Electric Company, Public Service Company of New Hampshire, Public Service Company of New Mexico, Sierra Pacific Power Company, and Virginia Electric and Power Company.

Q. What is the purpose of your testimony in the present proceeding?

A. The purpose of my testimony in this proceeding is to examine the cost of common equity capital for Long Island Lighting Company (hereinafter referred to as LILCO).

Q. Have you prepared an exhibit in conjunction with your testimony?

A. Yes. In support of my testimony, I have prepared Exhibit 56, consisting of 2 Schedules and a Technical Appendix.

Q. Was this exhibit prepared by you or under your supervision?

Q. Yes, it was.

Q. Please define the term "the cost of equity capital."

A. The cost of equity capital, in my view, is a market-oriented concept and, therefore, should be determined within the context of the marketplace. It is the minimum current rate of return required by investors on their investment in a firm's common shares for them to be willing to buy or continue to hold those shares. Based on this minimum rate, investors determine the price they are willing to pay for the firm's common shares and thereby they establish the terms at which a firm can acquire new equity capital from the public. This minimum rate is, generally, referred to be economists as the firm's "barebones" cost of equity capital, market capitalization rate, or investor's discount rate.

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Since investors are the sole suppliers of equity capital funds to the firm, the firm must pay the going rate for these funds in the marketplace in order to induce investors to buy or to continue to hold the firm's shares. Thus, the firm must hold out to investors the prospect of earning at least the minimum return which they (the investors) require. This minimal return is the barebones cost to the firm of obtaining equity capital.

The price which investors are willing to pay for a firm's common stock depends upon the present value of expected future earnings from an investment in the stock. The present value is determined by applying the appropriate discount rate to investors' expected future returns--returns which are comprised of dividends and proceeds from the sale price of the common stock. As is indicated in a subsequent part of the testimony, the discounted cash flow (DCF) method for estimating the "barebones" cost of equity is predicted on this theoretical proposition. The appropriate discount rate is the same as the rate of return investors require on the price they pay for the common stock. Therefore, the terms investors' discount rate, market-capitalization rate of return, and "barebones" cost of equity capital are all synonymous.

It is important to note here that the investors' discount rate--the market-required rate of return--or,

alternatively, the barebones cost of equity, is determined in the market by the relative riskiness of the firm's common stock as perceived by investors. The rate of return investors require on their investment in a particular common stock takes into account the return available from investments in other common stocks, bonds and other investment media, weighing these returns against the relative risks involved. In other words, a market-required rate of return for a particular firm is the same as the returns investors require on their investment in the common stock of other firms or enterprises of similar perceived risks.

The barebones cost of equity capital is alternatively defined as the minimum rate of return on equity capital investment required by a firm to bring its market price into equality with its book value. If investors expect that a firm will fail to earn a return on its equity capital at least equal to its barebones cost of equity, the market price of the firm's common stock will decline to a level below its book value, thus effecting the process of dilution whenever the firm has to issue new common stock. A mathematical demonstration of this point is shown on the Technical Appendix in my exhibit.

The cost of equity capital (as distinguished from the barebones cost of equity) is that minimum rate of return which the firm must earn on its equity investment

if it is to attract equity capital without diluting the equity of existing shareholders. It is equal to the investors' discount rate or the barebones cost of equity capital adjusted for the costs of issuance and market pressure effects which are incurred when new common stock is issued.

The cost of equity capital reflects the capital attraction rate. If the capital attraction rate is actually earned, the financial integrity of an enterprise is preserved. An allowed rate of return on common equity which is, at least, equal to the cost of equity capital affords the firm an opportunity to be able to issue new equity capital without diluting the equity investment of existing stockholders.

In summary, since it is my view that the cost of equity capital is a market-oriented concept, my approach to determining the cost of equity is based on an assessment of current investors' requirements as reflected in their behavior in the marketplace. Such determination embodies the evaluation of investors' expected return and their perception of the risks attendant with their investment.

Q. Are you aware that, in this proceeding, the Company is filing for rates based on a return on common equity capital of 13.7 percent?

A. Yes, I am. It is my understanding that the Company,

in its effort to mitigate controversy surrounding this proceeding, is asking for the same rate of return on common equity capital which it was allowed by this Commission in its last rate case. In that last case, the Commission concluded that 13.7 percent is a fair return on LILCO's common equity (see Opinion 79-14, page 44). According to the studies delineated in my present testimony, a return on common equity capital of 13.7 percent is below the current barebones cost of equity for LILCO. Moreover, it is significantly below the rate of return required by LILCO to attract equity capital without diluting the equity of existing shareholders.

Q. What approach are you using in your present testimony as to the cost of equity for LILCO?

A. My approach as to LILCO's cost of equity capital is based on the discounted cash flow (DCF) analysis. I should point out that in rate-of-return testimonies which I present in other jurisdictions, I rely principally on the price-book approach. I have testified before this Commission, in a number of cases, as to the cost of equity capital, relying on the price-book approach. The price-book approach attempts to identify the risk and other factors besides expected rates of return on equity which affect the price-book ratios of electric utilities. The Commission, however, has found that this particular approach requires "further refinement" before it can be

reliably used for estimating the cost of equity capital. It is for this reason, therefore, that my testimony in this proceeding does not rely on the price-book approach. However, it is important to note here that the DCF method for estimating the cost of equity capital and the price-book approach are based on the same theoretical principles.

Q. Before proceeding with the presentation of your DCF analysis of the cost of equity for LILCO, please describe in general terms the DCF method.

A. According to the DCF theory, and as demonstrated on the Technical Appendix in my exhibit, the value which an investor will put on a share of stock is given by the following simplified formula:

$$P = \frac{D}{k-g}$$

In this formula, P is the price of the stock. It depends on D, which is the expected dividend per share over the coming year. It also depends on k, a discount rate applied by the investor to all future dividends; this discount rate is the rate of return the investor requires on this stock in light of the cost of money and the relative riskiness of the stock, and this discount rate k is known as the barebones cost of equity capital. P also depends on g, which is the average long-term growth rate in dividends which the investor expects.

What this formula tells us is that if the investor

expects dividends of D per share in the first year, and if he expects that dividends will grow at an annual rate of g over the indefinite future, then the discounted present worth (using k as the discount rate) of the entire expected future flow of dividends will be P, the price the investor is willing to pay for the stock.

We can solve the above formula for k, the barebones cost of equity, and we get:

$$k = \frac{D}{P} + g$$

Thus, in order to know k at any given point in time, we need information about D, P and g at the same point in time. Information about P, the price of the stock, is readily available for listed securities. Information about D, the dividend expected by investors over the coming year, can usually be estimated with a fair degree of accuracy. However, there is a problem in estimating g, for g is the long-term growth rate in future dividends which investors expect, on the basis of which they were willing to pay the price P for the stock. It should be noted that in estimating g, we are not forecasting the future. Rather, we are attempting to ascertain what investors are forecasting. This objective is fairly difficult to obtain even in relatively normal times. In past periods, prior to the emergence of the energy crisis, it was possible to argue that investors were

probably forecasting a continuation of past trends. Even so, there was often considerable disagreement among analysts as to precisely what growth rate investors were actually expecting; these differences often meant spreads of several percentage points among alternative estimates of the cost of equity.

In present circumstances, the difficulties in objectively estimating the growth rate which investors are now forecasting are even greater due to the unsettled state of money markets and utility finances over the past several years. It is possible, however, to make certain reasonable assumptions about investor expectations and, thus, arrive at an estimate of the growth factor to be included in the DCF method for estimating the investors' discount rate.

Q. Please indicate the approach you have taken in this proceeding in implementing the DCF approach as to the barebones cost of equity capital for LILCO.

A. As indicated earlier, to examine the barebones cost of equity according to the DCF method, it is necessary, first, to measure the recent level of prices; second, to estimate the reasonably expected dividends per share in the next 12 months; and, third, to add an estimate of the growth which investors are currently expecting.

Q. How did you determine the appropriate dividend-price ratio for LILCO to be used in the DCF model?

A. It is generally agreed that in deriving the dividend-price ratio component of the DCF formulation, one should not analyze spot market data only, but rather the yield component should be calculated based on recent data, over a representative period of time.

During the first half of 1979, the price of LILCO common stock fluctuated between $18.25 and $15.13. The average of the monthly high-low prices of LILCO common stock in the first half of 1979 was about $17. This average price of LILCO's common stock during the first half of 1979 reflects the level of prices at which LILCO's common stock traded before the Three Mile Island incident, as well as the utility stock market reaction to the accident and its recovery which has since taken place. I should also note that most recently the price of LILCO's common stock has been about $17.5. According to the DCF theory as shown on the Technical Appendix in my exhibit, the dividend-yield component of the DCF model is derived on the basis of the indicated dividend rate over the coming year, rather than on the past 12 months actual dividend rate. The indicated dividend rate for LILCO over the coming 12 months is $1.76. The coming 12 months period is taken starting at the second quarter of 1979. Thus, the dividend-price ratio for LILCO, based on the indicated dividend for the 12 months period indicated above, is a little over 10 percent even on the basis of a price of

$17.5. In my view, therefore, the proper level of the dividend yield to be used in the DCF model in determining the barebones cost of equity for LILCO is at least 10 percent.

Q. Please address yourself to your estimation of investors' expectations of future growth for LILCO.

A. The growth component of the DCF model reflects investors' expectations as to future long-term growth in dividends per share. For electric utilities having a relatively stable payout ratio, growth in dividends per share will, on average, be the same as the growth in earnings per share. Since earnings of electric utilities are regulated, future growth in earnings per share will be derived from future growth in book value per share. An implicit assumption here is that investors do not expect the rate of return earned by the regulated company to increase continually into the indefinite future.

Growth in the book value per share and, consequently, in dividends per share can arise from two basic sources: the retention of earnings and the sale of new common stock at net proceeds above book equity per share.

As I have indicated earlier, it is very difficult to objectively estimate the future growth rate investors expect the company to experience. A plausible assumption, in today's circumstances with respect to LILCO, as to the estimate of investors' expectations of future growth

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is that investors anticipate that growth will occur through retained earnings.

It is a mistake to make a DCF calculation in LILCO's case on the basis of a projection into the future of past net increases in book value for several reasons. The first of these is that growth from retained earnings in a particular year can be distorted if the company engages in massive sales of new common stock at net proceeds either above or below book value per share. However, focusing for the moment on past sales of stock at less than book value, it is implausible to assume that investors expect LILCO to incur significant dilution into the indefinite future when issuing new common equity capital. In order to assume that investors expect LILCO to incur dilution in the future on a continuous basis when issuing new equity capital, one must also assume that investors expect regulation to be unable or unwilling to take measures to prevent repeated economic confiscation of LILCO's stockholders' equity, when the Company seeks to raise equity capital in order to meet its public utility obligations. Former Chairman Kahn has pointed out how foolhardy and counter-productive it would be for a Commission to persist too long in forcing a utility to sell additional shares at a discount, below book value, and we must assume that a rational investor will have confidence that a rational Commission will not do it.

The same point is applicable when past sales of common stock have been made at a substantial premium. Since the Commission avowedly now seeks to arrive at substantial parity between price and book, it would be irrational for the investor to project continual sales at a premium over the indefinite future and, thus, to estimate growth by projecting past increases in book value derived from both reinvested earnings and sales of stock at a premium.

It seems clear that predicating a future growth estimate on a projection into the indefinite future of sales of stock at either a discount or a premium is to ignore the pronounced goal of the New York Commission and build in a distortion, whether on the upside or the downside. It would be irrational. I will assume, therefore, that investors, in formulating their expectations of future growth for LILCO, will anticipate that growth will occur through retained earnings.

Q. Have recent past sales of LILCO stock resulted in dilution?

A. Yes. Since 1974, LILCO experienced massive sales of new common stock below book value. These sales of LILCO's common stock have resulted in substantial dilution. With the exception of 1977, LILCO has issued each year new equity at net proceeds per share substantially below book value since 1974. For example, when LILCO issued 6.4 million shares on October 18, 1978, its book value per share was

$19.58, while its net proceeds from the sale were about $16.81. Considerably larger dilution was incurred by LILCO as a result of the sales of new common equity in 1974 and in 1975.

The substantial dilution suffered by LILCO in 1974 and in 1975 more than wiped out the growth from retained earnings, thus, giving rise to a decline in total book value per share. Even in 1977, when LILCO was able to sell new common equity capital without incurring dilution, net proceeds per share were only slightly above book value per share. (Net proceeds per share were $18.47, while book value per share was $18.34.) Each of the sales of new common equity yielding net proceeds below book value constituted economic confiscation of LILCO's existing stockholders' equity--a phenomenon which investors will not expect to repeat itself, on a continuous basis, into the indefinite future.

Q. You said that there are several reasons why rational investors would not calculate LILCO's long-term future growth rate in dividends per share based on historic net increases in book value per share. The first reason you gave is that a reasonable investor would not assume that the Commission would, into the distant future, require LILCO to market its shares on a confiscatory basis. What are the other reasons?

A. The second reason is that LILCO's basic method of

marketing its common shares--rights offerings--involves a distribution of value to its stockholders which is concealed by such an application of the DCF method. The easiest way to see this is to put yourself in the position of a stockholder who, at intervals of about one year, is given rights to buy additional shares at a discount below market. Those rights, under the rules of the NYSE, are listed and immediately saleable and, indeed, a very large volume of them are sold. The investors pockets the proceeds. Of course, in the odd case, the market for the stock can go down so far that the rights can become worthless, but this very rarely happens.

It is easy to see, in the case of the stockholder who sells the rights that there is that extra value of rights which is being distributed; in the case of those stockholders who exercise the rights there is exactly the same value distributed to them but they realize it in the form of additional shares of stock.

There are still other respects in which LILCO's method of marketing shares involves distribution of value which does not show up in the traditional DCF calculations. One such distribution occurs under LILCO's dividend reinvestment plan, under which a shareholder is able to purchase additional shares at market with no brokerage commission. This is no small matter--in recent years, 500,000 and more shares have been distributed in that way annually,

even though not all investors take advantage of it.

Another distribution takes place under the Employee Stock Purchase Plan, where shares are sold at a discount of at least 10 percent below market to employees. The amounts per employee are limited, but the Company has been selling between 80,000-100,000 shares per annum for several years. The value of the discount goes to the employees in the first instance as a kind of fringe benefit. In other words, this dilution of the book value of the stock is reflected in any calculation of net growth in book value, but is really an employee benefit and should not be considered a negative element with respect to expected growth.

Q. Please continue with your estimation of investors' expectations of future growth for LILCO.

A. For the reasons I have given, a rational investor would expect that future growth will be due to growth from retained earnings. The growth from retained earnings will depend on the rate of return which investors expect the company to earn on its equity capital. It is, of course, very difficult to ascertain directly what rate of return on equity investors expect the company will be earning over time.

LILCO earned over 13.2 percent return on average book equity in 1975, and over 14 percent return in both 1976 and in 1977. In 1978, earnings per share declined to a level of $2.44 indicating a return on average book

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value per share of about 12.9 percent. The decline in earnings per share has continued during 1979 to a level of $2.36 for the 12 months ended June. This level of earnings reflects a return on average book value of about 12.2 percent.

However, from the point of view of projected future level of earnings, a reasonable investor in LILCO would pay great attention to the 13.7 percent return on common equity allowed by this Commission in its most recent decision (April 27, 1979). In recent months, Value Line and other financial analysts have been projecting 1979 earnings per share at the $2.60 to $2.65 level--a return on common equity of about 13.3 percent.

It would appear, therefore, that an assumption that investors expect LILCO to earn, on average, a return of 13 percent on its book equity is ultraconservative and underestimates investors' expectations. With an indicated dividend per share of $1.76 and earnings of $2.51 (which is 13 percent of the average book value of $19.34 in the 12 months ended June 1979), the retained earnings would be $0.75, representing an expected growth rate from retained earnings of about 3.9 percent.

As shown on Schedule 1 of my exhibit, such an estimate of expected future growth is quite conservative in light of the actual growth in book value due to retained earnings experienced by the Company. In the period

1965-1972, growth from retained earnings had been at the rate of about 4.5 percent, except in the recession of 1970, when LILCO's earnings per share experienced a decline. In 1973 and 1974, when another decline in earnings had been experienced, the growth from retained earnings was no more than about 3.2 percent. However, it is unreasonable to assume that investors are forming their expectations as to future growth by confining themselves to the dismal earnings picture experienced by LILCO and the electric utility industry as a whole during the 1973-1974 period. In 1975, the growth in LILCO's book value per share due to retained earnings was about 4.7 percent, rising to a rate of growth of about 5.6 percent in 1976 and 5.4 percent in 1977. In 1978, due to the depressed level of earnings, growth from retained earnings declined to about 4 percent. A 3.9 percent estimate of investors' expected future growth in dividends per share for LILCO is, likewise, on the conservative side when compared with the 5 percent growth in dividends per share currently projected by Value Line over the 1982-1984 period.

Q. Are there any other factors which should be considered in analyzing LILCO's cost of equity capital?

A. It is generally agreed that it is desirable to have the market price of the utility's stock at least moderately above the book value so as to make it possible for the utility to sell new shares without diluting the equity

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of its existing stockholders. The issuance of new stock involves certain expenses, and often results in a temporary downward market pressure on the price of the stock. As shown on Schedule 2 of my exhibit, costs of issuance and market pressure for the last four issues of new common stock by LILCO were, on average, about 7 percent.

There is a lot of dispute with respect to market pressure and there is an especial controversy whether conclusions drawn from companies with direct offerings are applicable in cases of rights offerings. But, in this instance, it is not necessary to enter into that controversy because it is so clear from the data which I already have introduced that 13.7 percent return is significantly below the Company's cost of equity capital. That conclusion is evident when we consider that the proper dividend yield for LILCO in a DCF formulation is at least 10 percent and that an ultraconservative estimate of future long-term growth is, at least, 3.9 percent.

Q. Does this complete your testimony?

A. Yes, it does.

Exhibit No. 56
P.S.C. Case No.
Witness: Benderly

LONG ISLAND LIGHTING COMPANY

SCHEDULES 1 AND 2
AND A TECHNICAL APPENDIX

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LONG ISLAND LIGHTING COMPANY

1965 - 1978

Year	Earnings per Share	Dividends Paid per Share	Average Book Value per Share	Retained Earnings per Share	Growth from Retained Earnings per Share
	------------(Dollars)	------------	------------	------------	(Percent)
				(1)-(2)	(4) ÷ (3)
	(1)	(2)	(3)	(4)	(5)
1965	$1.56	$0.98	$12.62	$0.58	4.60%
1966	1.67	1.06	13.18	0.61	4.63
1967	1.80	1.14	13.80	0.66	4.78
1968	1.86	1.22	14.42	0.64	4.44
1969	1.94	1.28	15.07	0.66	4.38
1970	1.91	1.33	15.74	0.58	3.68
1971	2.08	1.37	16.42	0.71	4.32
1972	2.18	1.41	17.24	0.77	4.47
1973	2.02	1.45	17.99	0.57	3.17
1974	2.03	1.46	18.04	0.57	3.16
1975	2.31	1.49	17.50	0.82	4.69
1976	2.52	1.54	17.56	0.98	5.58
1977	2.59	1.61	18.32	0.98	5.35
1978	2.44	1.68	18.91	0.76	4.02

Source: Long Island Lighting Company, annual reports, various issues.

LONG ISLAND LIGHTING COMPANY

Subscription Offerings

Date of Prospectus	Number of Shares	Flotation Costs	Market Pressure	Total Flotation Costs and Market Pressure (3) + (4)
(1)	(2)	(3)	(4)	(5)
8/27/75	3,988,040	4.33%	3.03%	7.36%
7/28/76	4,633,104	2.26	6.95	9.21
7/20/77	5,443,729	1.55	4.31	5.86
10/18/78	6,402,515	2.00	2.03	4.03

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Mathematical Derivation of the Traditional Discounted Cash Flow (DCF) Model and a Demonstration That When the Expected Rate of Return on Common Equity is Equal to the Investors' Discount Rate the Market Price Will Equal Book Value Per Share

Definitions:

P_0 = Current price of stock, or present value of expected future dividends.

B_0 = Current book value per share.

k = Investors' discount rate or barebones cost of equity capital.

D_0 = Most recent cash dividend.

g = Investors' expected future constant growth rate in dividends.

r = Expected rate of return on common equity capital.

E = Earnings per share.

b = Retention ratio.

RE = Retained earnings.

t = Time index. $(t = 1, 2, 3, \ldots \infty)$

The following formulation assumes that investors expect dividends to increase at a constant rate g into the indefinite future. The current stock price is the present worth of all expected future dividends:

$$(1) \quad P_0 = \frac{D_1}{(1+k)} + \frac{D_2}{(1+k)^2} + \frac{D_3}{(1+k)^3} + \ldots.$$

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Assuming a constant expected growth rate in dividends, we can write:

$$(2)\quad \begin{aligned} D_1 &= D_0(1+g) \\ D_2 &= D_0(1+g)^2 \\ D_3 &= D_0(1+g)^3\text{, etc.} \end{aligned}$$

Equation (1) becomes:

$$(3)\quad P_0 = \frac{D_0(1+g)}{(1+k)} + \frac{D_0(1+g)^2}{(1+k)^2} + \frac{D_0(1+g)^3}{(1+k)^3} + \ldots.$$

or

$$(4)\quad P_0 = \sum_{t=1}^{\infty} \frac{D_0(1+g)^t}{(1+k)^t}$$

It can be shown that Equation (4) can be simplified as follows:

$$(5)\quad P_0 = \frac{D_1}{k-g}$$

or

$$(6)\quad k = \frac{D_1}{P_0} + g$$

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Equation (6) is, of course, the well-known and most often used DCF formulation for estimating the barebones cost of equity capital.

Let us now assume that investors expect the firm to earn a constant rate of return on equity capital r and

that they expect the firm to retain a constant fraction b of its earnings as well.

The expected earnings per share in time t are equal to the product of the expected rate of return on equity capital r and the beginning-of-the-period book value per share:

$$(7) \quad E_t = rB_{t-1}$$

The dividends per share in time t are expected to be:

$$(8) \quad D_t = (1-b)E_t = (1-b)rB_{t-1}$$

The retained earnings during time t are, thus, equal to:

$$(9) \quad RE_t = E_t - D_t = rB_{t-1} - (1-b)rB_{t-1}$$

$$RE_t = brB_{t-1}$$

Assuming that investors expect growth to occur through retained earnings, we conclude that the investors' expected future growth rate g can be expressed as:

$$(10) \quad g = \frac{RE_t}{B_{t-1}} = br$$

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Substituting Equations (8) and (10) into Equation (5), and letting *t=1*, we get:

$$(11)\quad P_0 = \frac{(1-b)rB_0}{k - br}$$

or

$$(12)\quad \frac{P_0}{B_0} = \frac{(1-b)r}{k - br}$$

If investors expect the firm to earn a rate of return on <u>its</u> common equity capital which is equal to <u>their</u> required rate of return or discount rate, then:

$$r = k$$

Equation (12) becomes:

$$(13)\quad \frac{P_0}{B_0} = \frac{(1-b)r}{r - br} = \frac{(1-b)r}{(1-b)r} = 1$$

Equation (13) indicates that, according to the traditional DCF theory and method for estimating the bare-bones cost of equity capital, if investors expect a company to <u>earn</u> on its equity capital the same rate of return as they require in the marketplace, then market price and book value will tend to be in equality.

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Exhibit No. 56
P.S.C. Case No.
Witness: Benderly

LONG ISLAND LIGHTING COMPANY

SCHEDULES 1 AND 2
AND A TECHNICAL APPENDIX

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LONG ISLAND LIGHTING COMPANY

1965 - 1978

Year	Earnings per Share	Dividends Paid per Share	Average Book Value per Share	Retained Earnings per Share	Growth from Retained Earnings per Share
	(Dollars)				(Percent)
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LONG ISLAND LIGHTING COMPANY

Subscription Offerings

Date of Prospectus	Number of Shares	Flotation Costs	Market Pressure	Total Flotation Costs and Market Pressure (3) + (4)
(1)	(2)	(3)	(4)	(5)
8/27/75	3,988,040	4.33%	3.03%	7.36%
7/28/76	4,633,104	2.26	6.95	9.21
7/20/77	5,443,729	1.55	4.31	5.86
10/18/78	6,402,515	2.00	2.03	4.03

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Mathematical Derivation of the
Traditional Discounted Cash Flow (DCF) Model
and a Demonstration That When the Expected Rate of Return
on Common Equity is Equal to the Investors'
Discount Rate the Market Price
Will Equal Book Value Per Share

Definitions:

P_0 = Current price of stock, or present value of expected future dividends.

B_0 = Current book value per share.

k = Investors' discount rate or barebones cost of equity capital.

D_0 = Most recent cash dividend.

g = Investors' expected future constant growth rate in dividends.

r = Expected rate of return on common equity capital.

E = Earnings per share.

b = Retention ratio.

RE = Retained earnings.

t = Time index. $(t = 1, 2, 3, \ldots \infty)$

The following formulation assumes that investors expect dividends to increase at a constant rate g into the indefinite future. The current stock price is the present worth of all expected future dividends:

$$(1) \quad P_0 = \frac{D_1}{(1+k)} + \frac{D_2}{(1+k)^2} + \frac{D_3}{(1+k)^3} + \ldots .$$

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Assuming a constant expected growth rate in dividends, we can write:

$$(2)\quad D_1 = D_0(1+g)$$
$$D_2 = D_0(1+g)^2$$
$$D_3 = D_0(1+g)^3, \text{ etc.}$$

Equation (1) becomes:

$$(3)\quad P_0 = \frac{D_0(1+g)}{(1+k)} + \frac{D_0(1+g)^2}{(1+k)^2} + \frac{D_0(1+g)^3}{(1+k)^3} + \ldots.$$

or

$$(4)\quad P_0 = \sum_{t=1}^{\infty} \frac{D_0(1+g)^t}{(1+k)^t}$$

It can be shown that Equation (4) can be simplified as follows:

$$(5)\quad P_0 = \frac{D_1}{k-g}$$

or

$$(6)\quad k = \frac{D_1}{P_0} + g$$

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Equation (6) is, of course, the well-known and most often used DCF formulation for estimating the barebones cost of equity capital.

Let us now assume that investors expect the firm to earn a constant rate of return on equity capital r and

that they expect the firm to retain a constant fraction b of its earnings as well.

The expected earnings per share in time t are equal to the product of the expected rate of return on equity capital r and the beginning-of-the-period book value per share:

$$(7) \quad E_t = rB_{t-1}$$

The dividends per share in time t are expected to be:

$$(8) \quad D_t = (1-b)E_t = (1-b)rB_{t-1}$$

The retained earnings during time t are, thus, equal to:

$$(9) \quad RE_t = E_t - D_t = rB_{t-1} - (1-b)rB_{t-1}$$

$$RE_t = brB_{t-1}$$

Assuming that investors expect growth to occur through retained earnings, we conclude that the investors' expected future growth rate g can be expressed as:

$$(10) \quad g = \frac{RE_t}{B_{t-1}} = br$$

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Substituting Equations (8) and (10) into Equation (5), and letting $t=1$, we get:

$$(11) \quad P_0 = \frac{(1-b)rB_0}{k - br}$$

or

$$(12) \quad \frac{P_0}{B_0} = \frac{(1-b)r}{k - br}$$

If investors expect the firm to earn a rate of return on <u>its</u> common equity capital which is equal to <u>their</u> required rate of return or discount rate, then:

$$r = k$$

Equation (12) becomes:

$$(13) \quad \frac{P_0}{B_0} = \frac{(1-b)r}{r - br} = \frac{(1-b)r}{(1-b)r} = 1$$

Equation (13) indicates that, according to the traditional DCF theory and method for estimating the bare-bones cost of equity capital, if investors expect a company to <u>earn</u> on its equity capital the same rate of return as they require in the marketplace, then market price and book value will tend to be in equality.

ATTACHMENT C to QUESTION 4.C

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

OPINION NO. 79-14

CASE 27374 - LONG ISLAND LIGHTING COMPANY - Electric Rates

CASE 27375 - LONG ISLAND LIGHTING COMPANY - Gas Rates

OPINION AND ORDER DETERMINING
REVENUE REQUIREMENT

Issued: April 27, 1979

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CASES 27374 and 27375

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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

COMMISSIONERS:

Charles A. Zielinski, Chairman
Edward P. Larkin, dissenting
Carmel Carrington Marr
Harold A. Jerry, Jr.
Anne F. Mead, dissenting
Karen S. Burstein, dissenting
Richard S. Bower

CASE 27374 - LONG ISLAND LIGHTING COMPANY - Electric Rates

CASE 27375 - LONG ISLAND LIGHTING COMPANY - Gas Rates

OPINION NO. 79-14

OPINION AND ORDER DETERMINING
REVENUE REQUIREMENT

(Issued April 27, 1979)

BY THE COMMISSION:

On May 31, 1978 Long Island Lighting Company filed tariff revisions designed to increase its annual electric revenues by $147.1 million (18.5%) and its annual gas revenues by $23.9 million (13.1%). By various orders, we suspended the effective date of the proposed revisions to April 28, 1979 in order to examine their propriety in public hearings. Upon consideration of an extensive record compiled during 42 days of evidentiary hearings, Administrative Law Judge David Schechter issued a recommended decision on February 13, 1979. The Judge found that the company had shown a need for rate increases designed to produce $52.3 million (6.6%) additional annual electric revenues, and $15.7 million (8.6%) additional annual gas revenues, in order to earn a 10.13% overall return on its investment.

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LILCO, staff, Nassau and Suffolk counties, Long Island Consumer Action and the Town of Hempstead have submitted briefs objecting to a variety of the Judge's recommended dispositions of revenue issues.[1]

BACKGROUND OF THE CASE

In previous LILCO electric rate cases, we found it necessary to depart from our usual rate case standards to determine the revenues required by this company to provide reliable service in light of its massive construction program, dominated by the Shoreham nuclear generating station.[2] In those cases, we found that the company was plagued by extreme cash flow problems that threatened its ability to borrow the funds necessary to finance its construction program. In those circumstances, we found it necessary to adopt such special measures to improve cash flow as temporary rates, inclusion of construction work in progress (CWIP) in rate base, and interperiod tax allocations. As a result of these actions, LILCO no longer faces such severe financing problems. Its indenture coverage ratio is no longer close to the limit of 2.0 times. In fact, because

1/Some parties submitting briefs violated Section 2.7 of our Rules of Procedure by excessive incorporations by reference to earlier briefs, serving us with an inadequate number of copies of their briefs, and exceeding authorized page limits. Rule 2.7(c)(3) clearly states that briefs to the Commission should be self contained. Given the circumstances of this case, some waiver of the 50-page limit would have been granted. In the future, moreover, we will expect parties burdened by the requirements of Section 2.7 to seek waivers of the page limits as provided by Section 2.7(f) of our Rules and not attempt to circumvent the rules by incorporation by reference. Briefs not conforming to our rules are subject to rejection.

2/See Case 27136, Long Island Lighting Company - Electric Rates, 18 NY PSC ___ (Opinion No. 78-1, issued January 9, 1978, mimeo p. 2-5); Case 26887, Long Island Lighting Company - Electric Rates, 16 NY PSC 497 (1976); and Case 26552, Long Island Lighting Company - Electric Rates, 15 NY PSC 15 (1975). LILCO's last gas rate increase came in Case 27087, Long Island Lighting Company - Gas Rates (Order issued August 5, 1977).

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interest on trust financed construction is not considered for indenture coverage purposes, but is considered for SEC coverage purposes, LILCO's indenture coverage ratio has been higher than its SEC (or book) coverage ratio. Moreover, LILCO has, in recent years, earned returns on equity that have approximated those we have allowed in deciding its rate cases.

Nonetheless, the company chose to present and argue its case here in a manner similar to that employed in previous cases. A major portion of its proposed electric increases would result from inclusion of an additional $400 million of construction work in progress in rate base which the company seeks to justify on the basis of alleged necessity to improve its interest coverage, and the ratios of the allowance for funds used during construction (AFC) to net income, the market price to book value of its stock and internal funds to construction expenditures. Staff has argued that the company's target ratios are overly conservative; that existing ratios can be improved by alternative strategies; and that the rate increases sought by the company are greater than what is needed to achieve even LILCO's target ratios. A key part of staff's argument relies on the relationship it found between the AFC to net income ratio (which can be reduced by increasing the amount of CWIP in rate base) and the cost of equity capital to the company. Staff believes that if we included an additional $200 million of CWIP in rate base, we could reduce significantly the return on equity that we would otherwise have to allow in this case. Finally, various intervenors took the position that LILCO's financial position was now strong enough to allow us to measure LILCO's revenue requirement by application of our usual rate case standards, and without cash flow allowances.

The principal cause of LILCO's financing problems in recent years has been its construction of the 820 megawatt Shoreham nuclear generating station at a cost of something

like $1.3 billion. Staff and the Counties of Nassau and Suffolk raise several issues concerning the Booz, Allen & Hamilton (BAH) report on the Shoreham project. By order issued July 11, 1978, we directed that the BAH report be evaluated in this proceeding to determine what rate impact, if any, would result from the consultant's findings. The BAH project manager testified and was cross-examined on the report and two LILCO witnesses testified and were cross-examined on several aspects of the Shoreham project. The subject is not discussed in the recommended decision.

Staff and the Counties call for a Commission proceeding to address the issue of whether Shoreham costs have been incurred prudently and to determine to what extent LILCO's ratepayers should be asked to support Shoreham expenditures. For reasons that will be set forth in more detail in a subsequent order, we have decided that an investigation of the Shoreham project, along the lines suggested by staff and the Counties is necessary. We shall, therefore, institute a proceeding shortly for that purpose. The scope of the investigation and the issues to be considered will be delineated in the order establishing the case.

LILCO believes it will complete construction of the Shoreham plant and that it will be ready for service as early as September, 1980. In view of Shoreham's imminent completion, and our review of LILCO's financing opportunities, we have decided not to adopt the recommendations of the company, our staff, and the Judge that we include additional CWIP in rate base.1/ We did add CWIP to rate base in LILCO's last electric rate case, but only after we found that there was a "compelling need" to do so because the integrity of electric service on Long Island was at stake.2/ That need no longer exists.

1/The proximity of the Shoreham completion date leads us to conclude that staff has also overestimated the extent to which investors discount AFC earnings and thus the extent to which the equity return allowance can be reduced when cash flow allowances are provided. Our allowed return does not assume any additional cash flow allowances.

2/Case 27136, Long Island Lighting, supra, mimeo p. 4.

Even though we do not provide additional cash flow allowances here, we will fix rates that will allow LILCO to generate earnings sufficient to attract the capital needed to finance planned construction, meet its normal operating expenses, and provide its investors with a reasonable opportunity to earn a fair return in the period during which the newly authorized rates will be in effect as we are obligated to do.[1/] With this background in mind, we turn to the parties' specific exceptions to the Administrative Law Judge's recommended decision.

CONSTRUCTION EXPENDITURES

The amount of LILCO's construction expenditures in 1978, 1979 and 1980 will increase the company's revenue requirement directly, to the extent the expenditures relate to plant that will go into service by the end of the rate year, and indirectly, to the extent they affect its tax liability and the cost of capital. There are three issues on exceptions:

1. Will LILCO's actual construction expenditures through the middle of 1980 vary from its rate case estimates by the same percentage as its actual expenditures varied from its budget forecasts in the period 1973 to 1977?

2. Should a revised construction expenditures forecast, excluded from the record by the Judge, be relied on for ratemaking purposes?

3. Should expenditures for pursuing the licensing of the proposed New Haven/Stuyvesant generating facilities be considered for ratemaking purposes?

1/This standard is embodied in our Statement of Policy on Test Periods in Major Rate Proceedings, issued November 23, 1977 (mimeo p. 3) Accord: Case 27032, Central Hudson Gas & Electric Corp. - Electric Rates, 17 NY PSC 401 (1977); Cases 27094-5, Orange & Rockland Utilities, Inc. - Electric and Gas Rates, 17 NY PSC ___ (Opinion No. 77-14, issued October 7, 1977, mimeo. p. 3-4); Cases 27108-9, Rochester Gas & Electric Corp. - Electric and Gas Rates, 17 NY PSC ___ (Opinion No. 77-18, issued November 1, 1977, mimeo. p. 5); Cases 27215-7, Niagara Mohawk Power Corp. - Electric, Street Lighting, and Gas Rates, 18 NY PSC ___ (Opinion No. 78-14, issued June 28, 1978, mimeo. p. 3).

LILCO's Exceptions

The first two issues are raised in LILCO's exception to Judge Schechter's adoption of staff adjustments to LILCO's construction expenditure forecast. Staff argued that LILCO's actual construction expenditures through mid-1980 can be expected to vary from its forecast by the same ratio that LILCO's budget forecasts varied from the actual expenditures in 1973-77.[1] For this reason, staff witness Edwards testified that the company's forecast of its construction expenditures should be reduced by about $110 million. This testimony resulted in rate base and depreciation accrual adjustments by staff that were accepted by the Judge.[2]

LILCO excepts on two grounds. First, it argues that staff's reliance upon the company's own original construction forecast is in error because that forecast has been updated. Second, it argues that the staff's CVR's are too large because conditions in 1978-80 are unlikely to result in the same construction delays the company experienced in 1973-77.

Updated Forecast Issue. Judge Schechter refused to admit LILCO's updated construction forecast when the company declined to extend the suspension period for the 45 additional days deemed necessary to give staff and interested members of the public an opportunity to review and rebut the evidence presented. On exceptions, the company urges us to consider the excluded evidence. While LILCO's arguments in support of its updated estimates may have some merit, we cannot ignore the fact that staff and other interested parties have not had an opportunity to review and rebut the

1/The measure of the difference is the ratio of the actual expenditures to the forecast expenditures and, in this case, was called the "construction variance ratio," or CVR.

2/In addition, staff's rate of return witness based his testimony on this revised forecast of construction requirements.

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basis for the new figures. We can give little weight to the raw, untested estimates which are before us as an offer of proof. The Judge's decision precluding admission of the new estimates was proper and consistent with recent decisions we have made on the use of revised forecasts for ratemaking purposes.[1/]

Revised CVR Issue. LILCO's second argument is based on evidence in the record. Its witness presented a revised electric construction expenditure forecast, accepting substantial portions of staff witness Edwards' forecast, but making adjustments based largely on revised "long-term" (more than one year) CVR's, as shown below:

Long-Term CVR Comparison

	Staff and ALJ	LILCO
New Production (mostly Shoreham)	100%	122.0%
Other Production	30%	64.9%
Transmission	65%	84.9%
Distribution	80%	106.4%

LILCO contended that the 1973-77 CVR's will produce a more accurate forecast only if the 1978-80 period is comparable to 1973-77. It urged that the 122% ratio for new production properly reflects Shoreham cost overruns and that its other long-term CVR's are more accurate because they are adjusted to eliminate the effect of 1973-77 construction delays attributable to unforeseen declines in load growth and problems

1/See Cases 27215-7, Niagara Mohawk, supra, (mimeo p. 4-6), where a sales forecast revision was excluded from the record and not otherwise considered for ratemaking purposes, and Case 27296, National Fuel Gas - Rates, 18 NY PSC (Opinion 78-29, issued December 29, 1978, mimeo p. 5) where construction expenditure forecast revisions were not used to estimate rate base. See also Case 27136, Long Island Lighting, supra (mimeo p. 10-12) where an untested sales forecast revision was not used to estimate operating revenue.

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in obtaining regulatory permits. The company's witness testified that these factors are not likely to delay construction scheduled for 1978-80.

We think it would be foolish to project that Shoreham expenditures will be less than 100% of LILCO's original forecast, as assumed by staff and the Judge. LILCO's cost overruns at Shoreham; its past tendency to underestimate Shoreham expenditures; and its inability to keep project expenses within forecasts are well documented in the record in this case, in previous cases, and in the Booz, Allen, & Hamilton study we ordered. The record suggests that past CVR's on production plant have rarely been less than 100.0%, and have often substantially exceeded 100.0%. In light of the record, it seems sensible to us to adopt LILCO's 122.0% CVR. We observe, however, that this issue concerns almost exclusively a project that will not be in rate base in the period for which we are setting rates. Therefore, LILCO's new production CVR will be relevant for ratemaking purposes only to our forecasts of rate year financial position and tax liability and not otherwise.[1]

For the other categories, we are persuaded that the staff construction expenditure estimates, as modified by the Judge, are more accurate than LILCO's. LILCO makes a plausible case for a somewhat higher transmission CVR on the ground that its Article VII cases were subject to delays during the 1973-77 period. But staff correctly points out that the Judge had already allowed 100% of the Shoreham related transmission facilities expenditures, so the remaining amounts for transmission subject to a lower CVR are *de minimis* in any event. With respect to distribution expenditures, LILCO's argument is, at best, tenuous. It contends

1/ As computed in Appendix A, Schedule 3, page 4, the increase in Shoreham investment, which accrues AFC net of tax, increases tax expense by $765,000. This interperiod tax allocation for Shoreham was authorized in Case 26887, *Long Island Lighting, supra*, 16 NY PSC 517.

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that distribution expenditures will be higher than staff expects because they vary with growth in customers, rather than load, as staff assumes. Even if LILCO were correct, we observe that the company has been revising downward the expected number of customers on its system. Since load on its system is also declining, we can find no substance in LILCO's position here.

New Haven/Stuyvesant

A major portion of staff's brief on exceptions is devoted to an argument that LILCO's planned licensing expenditures on the New Haven/Stuyvesant generating project (including approximately $28 million already spent) should not be recognized for ratemaking purposes because there is "no need" for the New Haven/Stuyvesant plants. Various intervenors, and the Counties, which propose a similar adjustment for Jamesport, have endorsed the staff proposal.

The wisdom of the New Haven/Stuyvesant Article VIII application is certainly open to question. LILCO's decision to spend $28 million on a second Article VIII application before a decision on its first one is even rendered is cause for justifiable concern. Yet, this rate case clearly is not the proper procedural vehicle to test the wisdom of those expenditures. Our revenue requirement determination here does not reflect the New Haven/Stuyvesant expenditures as operating expenses or as part of rate base. And they have not affected our decisions on the cash flow issues in this case. While it could be argued that these expenditures have caused a marginal increase in LILCO's cost of capital, that amount would be difficult to quantify precisely and, in any event, likely to be so small as to be relatively insignificant.

The ultimate determination regarding the need for new electric generating facilities is, under Article VIII of the Public Service Law, largely a matter for the Board on Electric Generation Siting and the Environment, rather than the Public Service Commission. The record necessary to determine whether the New Haven/Stuyvesant generating plants should be built is in Siting Board Case 80008, and that proceeding has barely begun.

Our rejection of the staff adjustment in this case should not be construed as a tacit approval of the expenditures for the New Haven/Stuyvesant application. If the application is denied, the recovery of these expenditures in future rates would depend on a finding, in some future rate case, of the prudence of seeking a certificate in the first instance.

OPERATING REVENUES

Sales Forecasts

Staff, the Counties and the Judge have accepted the company's final electric and gas sales revenue forecasts. On exceptions, LILCO proposed two adjustments, one increasing gas revenues by $549,000 to reflect the changed temperature setting for S.C. 5 temperature control customers, and a second reducing electric revenues by $2.2 million because of a recently discovered S.C. 2 MRP billing error. We have reviewed these adjustments, which were not opposed by any party, and have found them to be proper. They will be recognized in our revenue determination.

Meter Tampering

In order to reduce losses from meter tampering and theft of service, LILCO has instituted a regular meter tampering program with an estimated annual cost of $736,000, consisting largely of payroll expense. The program is

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expected to convert the cost of some amount of kilowatt-hours of electricity and cubic feet of gas that would otherwise be "lost and unaccounted for" into revenue. LILCO conceded that the program therefore required some revenue offset to the costs it estimated. The precise amount of revenues that the program might produce is somewhat speculative, because the extent of meter tampering and the amount that will be recovered as a result of the program are unknown. LILCO said it was willing to assume that the program would produce revenue equal to its cost. However, staff, using company supplied revenue and expense estimates from its pilot meter tampering program in effect in 1977 and 1978, constructed a "cost benefit index" indicating that LILCO has recovered 2.1 revenue dollars for every dollar previously spent on meter tampering investigations. Staff argued that a fully developed program could be expected to be even more productive and therefore proposed an adjustment contemplating recovery of 2.5 dollars in revenue for every dollar spent on the program. The Judge adopted the staff adjustment and the company has excepted.

Staff's adjustment is correct in principle. But its estimate of probable revenues is based on tenuous estimates of past expenditures. LILCO developed a revised projection, reflecting its actual 1978 experience with the tampering program, that suggests a $1.1 million revenue recovery. This is approximately $350,000 more than its original estimate, and about $900,000 less than the staff estimate. In light of the weakness in the data staff relied upon here, we adopt the company's revised estimate.

Uncollectibles

Judge Schechter estimated that .576% of the company's additional revenues would be uncollectible. LILCO objects,

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claiming that the Judge has given no explanation for his use of this ratio. The company proposed a figure of .594%. In 1978, its lowest ratio was .571%, and recent ratios have been in excess of .600%.

It appears that the company has been experiencing an increasing uncollectible ratio. In Case 27136, we used the .536% ratio experienced for the 12 months ended June 30, 1976, and noted that the previous ratio had been .511%. Increasing uncollectibles are a matter of particular concern to us because they increase the cost of service for all customers. The problem can and should be ameliorated through improved collection and customer relations efforts by the company. Because we are providing an additional expense allowance for these functions, we believe that LILCO should be able to hold its future uncollectibles ratio to the .594% figure assumed in the original filing.

OPERATING EXPENSES

Large parts of the record in this proceeding were devoted to analysis of the principles underlying the assertions by various witnesses that differing proposed operating expense allowances were reasonable. Staff and the intervenors found that there was inadequate record support for expense allowance increases in the amounts sought by the company. LILCO objected to many of the adjustments they proposed on the ground that establishing proper expense levels is, absent a showing of imprudence, a matter of management discretion and contrary proposals constitute an unwarranted intrusion upon management prerogatives.

Management prerogatives have their place--but it is not in the determination of what expense allowances are reasonable for ratemaking purposes. That is our obligation. Management has the opportunity to prove to us that its

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proposed expense allowances are reasonable and not excessive. Staff and intervenors have an opportunity to challenge those explanations and suggest alternative allowances. The ultimate decision as to what is reasonable is ours. And the Public Service Law provides that a reasonable amount is that which will enable the company to provide safe and adequate service at just and reasonable rates.

The allowances we provide in these cases will be based on our analysis of the evidence presented by all of the parties and sufficient to enable LILCO to provide normal service. We shall not provide expense allowances for claimed abnormal, so-called "backlog," activities which may occur in the rate year. This decision is based on an important regulatory principle that is applicable to all companies under our jurisdiction: when circumstances have allegedly required a utility to adopt an austerity program, we expect to see evidence that those circumstances have diminished stockholders' returns before management cuts back on expenditures necessary to maintain safe and reliable service. That evidence has not been presented here. We expect LILCO, and all other companies, to follow this principle in their operations. In our view moreover, it is not within management's prerogatives to avoid the statutory obligation to provide safe and adequate service in order to provide investors what management deems to be an adequate return.

In this Opinion we will discuss only the expense items contested in the briefs on exceptions.[1] We adopt the allowances recommended by our staff for the other expense items because we believe staff approached the overall question of expense allowances by seeking conscientiously to balance the consumer's interest in good service with their interest in reasonable rates. While the expense allowances recommended

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1/Our specific adjustments are set out in the Appendices.

by various intervenors, notably the Counties, were occasionally below those recommended by staff or the Judge, the basis for their arguments was, in large part, the inadequacy of LILCO's proof. The defect in this approach, and in the "budget overestimation factor" adjustments proposed by the Counties as well, is that both ignore the relationship of operating expense allowances and the quality of consumer service. The "budget overestimation factor" approach is further flawed by its sponsor's failure to establish the comparability of the historic period he used to develop the factor and the period for which we are setting rates. The record as a whole, including service complaints at the public statement hearings, the testimony of our staff, our public files of consumer complaints (of which we take official notice), and even the testimony of the Counties' own rate of return witness, provide ample proof that LILCO must improve its service performance. It is the consumer who suffers from service cutbacks, and it is the consumer we must protect by assuring that the company's rates are sufficient to produce the revenue necessary to meet normal operating expenses.

Overhaul Expense

Judge Schechter adopted the major overhaul expense allowance LILCO proposed on the ground that it was necessary to provide for the normal level of three generator overhauls per year. But he rejected the company's request for an allowance sufficient to cover a second periodic overhaul for two specific units. LILCO contended that the two units involved will receive an extra periodic overhaul in the rate year because the first Shoreham overhaul will disrupt the ordinary maintenance schedule for the following year. The Judge accepted LILCO's argument but concluded that it proved only that this was an abnormal expense. He therefore adopted

staff's proposal to amortize it, as an unusual expense, over five years. LILCO, staff, and the intervenors each except to aspects of the recommendation.

We will affirm the Judge's resolution of these issues. LILCO's exception is unpersuasive because, in the end, it fails to show how a decision to allow full recovery of all normal periodic overhauls, and amortize the two unusual periodic overhauls is unfair. The mere fact that the two unusual overhauls will occur in the rate year does not require their cost to be built permanently into LILCO's rates. Staff and the Counties observe on exceptions that one of the three major overhauls scheduled for the rate year is on Far Rockaway Unit No. 4, a job that was deferred from a previous year. They contend, therefore, that this is a "backlog" adjustment that should be disregarded for purposes of establishing a normal rate year expense level. Their argument ignores the undisputed fact, relied on by the Judge, that the normal activity level for LILCO is three major overhauls per year. As the company notes, if it were not overhauling Far Rockaway Unit No. 4 in the rate year, it would be overhauling some other unit.

Major Maintenance Project Expense

Judge Schechter rejected the company's request for a $500,000 allowance for major maintenance projects. He termed the projection "speculative" and a "contingency request without reasonable basis or foundation." In its brief on exceptions, the company argues that its exhibit listing a dozen planned major maintenance projects between 1978 and 1982, ranging in cost from $250,000 to $1,050,000, provides a reasonable basis for its request. We agree that the company has provided a reasonable basis for some contingency amount to cover the kinds of projects listed in

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the exhibit. What the company has failed to prove, however, is that these projects will increase its operating expenses by the $500,000 it claims. If, for example, the work involved were to be performed by LILCO's own crews, without overtime, there would be no increase in total operating expenses. In these circumstances, we must rely on what guidance the record gives as to the company's past experience. The only example of actual major maintenance expenditures LILCO has provided is the replacement of the turbine shaft at Port Jefferson No. 1 in 1978, which added about $200,000 to its annual operating expenses. We will limit our allowance to that amount.

Tree Trimming Expense

Judge Schechter rejected LILCO's request for increases in its tree trimming expense allowance. The company introduced evidence to prove that $2.3 million should be spent on tree trimming in order to keep service interruptions caused by untrimmed trees during the next twelve months at the normalized 1977 level, i.e., 11.6 interruptions per 100 circuit miles per year. The Judge found LILCO's evidence on the service interruption trend unpersuasive and concluded that there would be 11.5 interruptions per 100 circuit miles in the next twelve months without additional expenditures for tree trimming. Since this interruption rate was below the one the company had characterized as "normal," the Judge rejected LILCO's proposal.

On exceptions, LILCO denies that it characterized 11.6 interruptions as a "normal" level. While its evidence showed that 11.6 was the 1977 normalized level of interruptions, the company argues that the evidence used by the Judge to forecast the level of interruptions in the next twelve months implies a normalized 1977 level of 10.8 interruptions per year. The company's point here is persuasive. There is a

somewhat worsening trend which tends to show that LILCO's past tree trimming efforts have been inadequate. As a result, consumers have received less reliable service. We will allow the company enough to reverse the deteriorating trend. The evidence relied on by the Judge shows a normalized 1977 outage rate (10.8) that should be our target here if service is to be improved. Using the assumptions in LILCO's original presentation, we estimate that an additional $880,000 will be sufficient to reach this target. We will make no specific separate allowance, however, for emergency tree trimming, or to fill requests for tree trimming by customers. The increased preventive tree trimming contemplated by our allowance should reduce the need for emergency and request tree trimming activities, which tend to increase when preventive trimming is deferred.

Administrative and General Expense

Judge Schechter adopted staff's estimate of LILCO's rate year administrative and general expense, which was developed by multiplying LILCO's actual 1977 payroll by a 1.118 wage increase factor and other expenses by a 1.15 inflation factor. LILCO objects to the recommended allowance because some 1978 actual figures are greater than the company's estimates for the rate year. It suggests that this proves that its original forecast is reasonable. LILCO made this same argument to the Judge. He rejected it because the specific expense increases cited by the company tended to be offset by other specific staff allowances that exceeded those sought by the company. LILCO's exception ignores the Judge's reasoning, which we find to be basically sound, particularly in the absence of a showing that the specific expense increases are necessary. LILCO's exception is therefore denied.

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Customer Accounts Expense

Personnel. Judge Schechter rejected most of the company's request for a $2.8 million increase in its expenses for customer accounts personnel. LILCO claimed that additional personnel were needed to improve its billing, collection and consumer relations functions. The Judge adopted staff adjustments eliminating the requested allowances (except for the meter tampering program) on the ground that the company did not meet its burden of proving the "feasibility" of these hirings and that the beneficial results of the hirings were "elusive." LILCO has excepted.

Our reading of the record indicates that staff and LILCO failed to join this issue properly. The company introduced substantial evidence to show that its past billing, collection, meter reading, and complaint-handling efforts have been inadequate. Evidence from our complaint files and the public statement hearings confirms LILCO's claims. But the company failed to show how the additional money it requested would be spent to improve its shortcomings. Staff, on the other hand, focused on the reasonableness of past expenditures as a measure of what should be allowed here and ignored LILCO's poor service performance under previous budgets.

It is obvious to us that the company must take action to reduce the number of unread meters, unattended past due bills, and unanswered consumer complaints. And it seems clear that such measures will not be costless. But the company's presentation gives us no assurance that these problems will be attacked properly. Providing an allowance so that more money can be spent for additional people does not assure that available personnel will be properly trained and managed so they can be used productively. Indeed, staff has argued that if the dollars spent in the past for overtime and part-time help were used instead to finance a properly

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trained and managed workforce, service could be improved without additional cost. We are left, therefore, with an important issue to resolve and insufficient guidance from the litigants on the costs and benefits of their respective proposals. If we adopt the full expense allowance LILCO has requested, it may involve more costs to consumers in rates than benefits in improved service. Conversely, the allowances recommended by staff provide the benefit of somewhat lower rates with the potential cost that those rates will be insufficient to improve service and end consumer dissatisfaction.

In these circumstances, our resolution of the difference between staff and LILCO must be a compromise. LILCO requested an increase of about $2.8 million, including $736,000 for the meter tampering program. Recognizing that the same personnel can be used for various customer accounts functions, we will approve a total allowance equal to half the requested amount. LILCO is free to appropriate this sum for hiring, training or management in the meter reading, billing, collections, customer relations, and tampering investigations functions within this category as it sees fit. But the company will be required to report to our consumer service staff regularly on its efforts to improve service and the program of expenditures it is undertaking to do so.

Equipment. Judge Schechter found an $82,000 staff adjustment to eliminate the increase in the annual cost of payment processing equipment "inappropriate." The $82,000 was originally described as the additional rent for new equipment, but the company witness provided no basis for his estimate of the rental cost of a new machine. Not until its initial brief did LILCO indicate that it had purchased the equipment instead. On exceptions, staff complains mostly about the manner in which LILCO's evidence in support of

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this allowance was presented. According to staff, LILCO failed to recognize the trade-in value of the old machine or other savings the new purchase might produce. In response, LILCO claims that the $82,000 reflects the trade-in value of the old machine, that its original rent expense estimate is approximately equal to the annual carrying charges on the purchased equipment, and that no savings are anticipated as a result of the purchase because the new machine will do essentially the same work as the machine it has replaced.

In light of the arguments, we find that the Judge's conclusion is correct.

Advertising and Public Affairs Expense

Judge Schechter determined that LILCO's advertising and public affairs allowance should be limited to .075% of its revenues, the same ratio we adopted in Case 27136, the last LILCO electric rate case. He also recommended additional allowances of $156,000 for area development, $90,000 for internal communications and $18,000 for library materials. LILCO, staff, and the intervenors have all excepted to various aspects of the Judge's recommendation. The company argues that the .075% allowance will not be enough to cover the cost of conveying all the information it would like to convey, and that it intends to spend more than the allowed amount in the rate year. We considered and rejected this same argument in Case 27136 and do so again here. Staff objects to the separate, additional allowance for area development advertising on the ground that this activity was intended to be covered by the percentage allowance limits specified in our Policy Statement.[1] Staff is correct. It also objects to the increased allowance for internal communications because of the company's alleged failure to demonstrate that improvement is needed and can be achieved

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1/ 17 NY PSC 1-R.

only through additional expenditures. It claims the base year level of internal communications expense adequately provides for the cost of reasonable employee bulletins and meetings as well as union news letters. We agree. Finally, staff argues that the increase in expense, from $2,000 to $20,000, for materials and supplies given to libraries is unsupported. We view this final item as something close to a charitable contribution. The amount involved is so small that we see little point to requiring utilities to provide "support" for it so long as the total amount for contributions of this nature is reasonable. Staff has not attacked the allowance on this ground. This staff exception is therefore denied.

Research and Development Expense

Judge Schechter adopted two staff adjustments, one to eliminate estimated payments to the Breeder Reactor Corporation (for the Clinch River project) and the other to reduce the estimated LILCO contribution to ESEERCO to reflect delays in various ESEERCO projects. On exceptions, LILCO argues that if the Breeder Reactor Corporation demands payment, it is contractually obligated to make the payment. While this may be true, it offers no evidence that the BRC is likely to demand payment this year. The Clinch River project remains in suspension. LILCO's exception is therefore denied. Staff's ESEERCO adjustment was correct when it was made. But in its brief opposing exceptions, staff concedes that recent changes in ESEERCO funding require a reduction of its $220,000 original adjustment to $50,000. With this modification, we adopt the Judge's resolution of this issue.[1]

[1] In accordance with the principles of multi-year planning and financing of research and development programs we announced in Case 27154, 1977 Long Range Electric Plans, 18 NY PSC ___ (Opinion 78-3, issued March 6, 1978) the company will ultimately be reimbursed for these amounts if they are properly spent.

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Storm Damage Reserve and Accrual

The enormous expenditures LILCO incurred to effect restoration of service after the devastating 1978 ice storms are duly noted in the record. LILCO requested that it be allowed to amortize over a three-year period the extraordinary \$2.8 million net cost of the ice storms. It also sought an increase in its reserve for storm damage because its exposure was increased when the deductible amount on its insurance was raised from [illegible] million to \$5 million last year. Judge Schechter approved the amortization request but rejected the plea to increase storm damage reserve by \$500,000 on the ground that his special amortization allowance would serve the same purpose. Both staff and the company except to the Judge's rejection of the accounting change and the increase in the accrual. Staff, joined by other parties, also excepts to the recommended special amortization.

Staff's position is that the storm damage reserve exists specifically to cover the cost of these extraordinary storms; therefore, no special additional amortization allowance is necessary. It also points out that with the increase in the reserve accrual it is supporting in this case, the extraordinary loss of the 1978 storms will be absorbed by April, 1980--before the end of the rate year--without a special amortization. The company responds that its territory is uniquely subject to potentially devastating weather. The result of the staff position is that its reserve will not reach the maximum level for at least five years. In the intervening period it will have to face the potential of storm damage with less than adequate protection.

Where it is difficult for us to anticipate expenses attributable to extraordinary storm losses, our usual procedure is to defer and amortize such losses. Given the

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frequency of LILCO rate cases in recent years, we question whether this company needs to employ reserve accounting for storm damage expenses any longer. The possible advantages of deferral accounting are worth investigating. For now, we must agree with the company's position that the 1978 storms were beyond anything we contemplated when we modified its reserve and accrual in Case 27136. Some amortization allowance beyond the proposed increase in the reserve, which we will approve, is therefore in order. The extraordinary costs of the storm[1/] should be charged, in the first instance, to the new limit of the reserve, and the remainder should be amortized over three years. This procedure will reduce the amount of the amortization by \$166,667 (\$500,000 ÷ 3 years).

Injuries and Damages Reserve and Accrual

LILCO estimated its rate year injuries and damages accrual on the basis of a three-year moving average and sought a \$2.5 million allowance. The Judge found that staff's estimate, based on a four-year average, was reasonable and adopted its \$763,000 adjustment. He noted that staff's method was comparable to the one we adopted in Case 27078, Long Island Lighting Company - Gas Rates. On exceptions, the company complains that staff's method will produce "deficiencies," i.e., its injuries and damages expenses will be recovered over nine years instead of three. It also recomputes its estimate using staff's method to show that the adjustment should only have been \$129,000. Finally, it observes that the estimate should be made on the basis of the most recent three years' experience, as we did in Case 27078. It complains that staff artificially reduced its estimate by using a four-year average. In response, staff argues that its decision to use a four-year average was

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1/We accept the staff's computation of this amount in Attachment C to staff's reply brief to the Judge.

proper because the annual fluctuations in this account make an average over a greater number of years a more reliable estimate for ratemaking purposes. Staff also relies on the record in Case 27078 which shows that the 1975 accrual was inflated by an accounting change in that year, and that our allowance in that case used a normalized 1975 accrual.

Both staff and the company departed from the method we used in Case 27078--staff by using a four-year average and the company by using a moving average and failing to normalize the 1975 accrual. Neither method gives any weight to actual claims, which during the 1975-77 period were $3.5 million, or $4.4 million less than the accruals. Comparing the latest three years, including 1978, the average accruals decline to $1.9 million while average claims increase to $1.6 million. This latest experience indicates a convergence of the average accruals and claims which would justify an expense allowance midway between the two averages. This method results in an expense allowance which is essentially the same as the staff's. LILCO's exception is denied.

Amortization of Unfunded Pension Liability

Judge Schechter rejected LILCO's proposal to eliminate its unfunded pension liability over a ten-year (rather than thirty-year) period on the ground that the company has not demonstrated either a need to reduce the amortization period or that the reduction proposed is "realistic." LILCO excepts on the ground that the unfunded pension reserve is increasing, implying that future customers will have to pay pension costs related to service provided by LILCO employees in the past. It criticizes the recommended decision for its failure to consider this alleged intergenerational inequity. LILCO's characterization of this

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issue is somewhat misleading. This is not an issue of whether future ratepayers will be required to pay for the present cost of service. It is an issue of whether present or future ratepayers should pay the cost of past service. We can find no logical reason for requiring present ratepayers to pay all of this cost. Absent a showing that the thirty-year amortization period, which is also used by other utilities of this state, is improper in some way, we will not approve a change.

Wage and Inflation Index

LILCO applied wage and inflation factors to base year expenses to estimate expenses for the year ended June 30, 1980. Staff observed that the rate year in this case will end on April 30, 1980. It therefore argued that the company has, in effect, claimed an allowance for two extra months of inflation and proposed an adjustment to eliminate it. The Judge adopted the staff adjustment and LILCO has excepted.

On exceptions, LILCO mainly points out various reasons why its use of a rate year equal to four calendar quarters was reasonable. More information was available and it made historic comparisons and analysis easier. The company's reasons for adopting the year ended June 30, 1980 as a test period, while logical, are irrelevant, since neither staff nor the Judge objected to it as such. Their adjustment is based on a strict application of the future rate year concept--rate case allowances should be designed to make the company whole for the first twelve months that rates will be in effect, not the test period the company happens to select. LILCO makes two additional points that are more compelling. First, the probable lag in our approval

of its compliance filings, and the practice of the industry to base revenue recognition for accounting purposes on meter readings during the accounting period, rather than on service estimated to have been rendered during the accounting period, means that the company will not recognize some of its additional rate case revenue until July, 1979. Second, the company's wage and inflation index assumed a 6-1/2% increase through 1978 while the actual rate, as measured by the GNP deflator, was 7.4%. According to LILCO, this would require additional allowances of $457,000 for its Electric Department and $102,000 for its Gas Department.

The staff adjustments reflect our usual practice and they were properly adopted by the Judge. While we see merit in the two relevant points made by the company, we will not provide any additional allowances on account of them. The amount of the revenue increase not accounted for in the rate year because of regulatory delays, and delay in their recognition for accounting purposes is not quantifiable from this record. LILCO's argument that it offsets, and is thus equal to, the staff adjustment is speculative. We would have been willing to provide LILCO with additional allowances to the extent it demonstrated its actual 1978 unit cost increases exceeded the 6.5% assumed in its presentation. But it has not done so. It did not use the GNP deflator to develop its original estimate, so the GNP deflator cannot be used properly and reliably to revise that estimate.

LILCO's exception is, therefore, denied.

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Labor Productivity

LILCO's original case included a productivity adjustment that assumed it would achieve 1% annual force reductions through the rate year. The company offered no evidence that these gains could be achieved, nor did it suggest where the force reductions might take place. In fact, LILCO's evidence showed probable negative productivity through the rate year. Nonetheless, Judge Schechter adopted the LILCO productivity adjustment.

The Counties have called the 1% productivity adjustment "arbitrary" and have excepted to the Judge's failure to adopt their productivity adjustment, based on LILCO's historic 2.3% rate. In opposing the Counties' exception, LILCO points to studies which show that its productivity will probably decline in the rate year and that much of its past productivity has been capital-related.

The Counties' mechanical application of historical productivity rates to adjust forecasted expenses in a forward-looking rate year is not a reliable measure of expected productivity. At best it could be used only for some guidance, in the absence of more specific analysis. Specific adjustments to various operating expenses are a more accurate way to reflect future productivity. The reduction in labor expense inherent in the adjustments to LILCO's estimates we have adopted is about 10%. We consider the productivity reflected in those adjustments reasonable, and therefore make no further productivity adjustment.

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DEPRECIATION

Gas Depreciation

Production Structures. The recent retirement of LILCO's Bay Shore gas plant has led the company to seek a change in the depreciation rate on all its gas production structures. The relative position of LILCO, staff and the Judge on this issue are shown below:

	Current	LILCO	ALJ and Staff
Average Service Life	35 years	20 years	30 years
Salvage Value	(10%)	(5%)	(10%)

Judge Schechter, relying on testimony from staff, concluded that the recent Bay Shore plant retirement distorted average service life calculations; that the "full band" indicated average service life was about 30 years; and that a more modest average service life reduction to 30 years and retention of a 10% negative salvage rate would produce a reasonable depreciation accrual. On exceptions, the company argues that the accrual rate for gas production structures should be the same as the rate for other gas production accounts because (1) gas plants will henceforth be retired in their entirety and (2) the trend in the gas production plant account is toward a shorter average service life. The company's first point is irrelevant because no LILCO gas plants will be retired in the forseeable future. Its second argument fails because it has not demonstrated that the modest reduction in the average service life recommended by the Judge is unsatisfactory, particularly in light of his provision for negative salvage, which is greater than the company's. LILCO's exception is denied.

Steel Transmission Mains. At various times, gas transmission and distribution mains have been studied as similar and different property classes for depreciation purposes. When distribution and transmission mains were studied as a single class, the assumed negative salvage was 15%. Distribution mains are now studied separately, and the accrual provides for 20% negative salvage. Although the weighted average negative salvage for the two plant accounts has been 21.4%, the Judge concluded that 15% negative salvage was fair for the transmission account because the salvage study in the record indicated that actual negative salvage has been only 12%. On exceptions, the company complains that because transmission and distribution mains were in a single account until 1968, the data on which the 12% negative salvage factor was determined is quite limited. It therefore argues that the two accounts should be treated on the same basis and, since the weighted cumulative average negative salvage of the two accounts is negative 21.4%, a negative 20% allowance for each is fair. The actual studies, although based on somewhat limited current data, are the best evidence available. They show that transmission negative salvage is 12%, less than the 15% now allowed, and far less than the 20% sought by the company. We therefore conclude that the Judge's allowance is reasonable.

Cathodic Protection Devices. LILCO has been depreciating cathodic protection devices at the same rate it uses for all distribution plant, a rate reflecting a 75-year average service life and 15% negative salvage. In this case, LILCO requested that a special subaccount for cathodic protection devices be established to reflect a 15-year average service life and zero net salvage. The Judge rejected the company's request and found that cathodic protection

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devices may increase the average service life of the associated mains, as evidenced by LILCO's actual experience between 1971 and 1977. Although it is true, as LILCO points out on exceptions, that these devices probably will not last 75 years and that they are attached to many mains with short life expectancies, they do not necessarily reduce the average service life of the account as a whole. For this reason, we rejected a similar request to establish a special separate account for cathodic protection devices in Case 27296, National Fuel Gas - Rates, 18 NY PSC ____ (Opinion No. 78-29, issued December 29, 1978, mimeo p. 30). We will adopt the Judge's resolution of this issue.

Electric Street and Parkway Lighting

As LILCO's street lighting plant is gradually turned over to municipal and state agencies, premature retirements are producing unforeseen losses which the company now seeks to recover in rates. The company proposed to depreciate the value of the remaining street lighting plant on the assumption that it would retire approximately 30,000 units per year for two years and a lesser amount in each of the next eight years with zero net salvage. The company also proposed remaining life treatment of its parkway lighting plant, with a five-year remaining life and 62% net salvage for 1-1/2 years and zero thereafter.

Judge Schechter found that the street lighting retirements were taking place much more slowly than assumed by the company and that an amortization assuming 10% salvage and a fifteen-year remaining life was more reasonable. Since the recommended decision, however, LILCO has effected several transfers of its street lighting plant. On exceptions, the company points to its sale of 33,777 units to the Town of Oyster Bay resulting in about $10 million of unrecovered net plant. In light of this experience, it believes its

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original remaining service life assumption was reasonable. Staff responds that the actual salvage value of the street lighting plant involved in the sales to five other municipalities we approved on March 6, 1979, as well as the Oyster Bay sale, was about 40%, and that this demonstrates that its amortization rate is more reasonable than the company's. It appears that municipalities are no longer interested in obtaining street lighting service from LILCO, so we accept the proposition that the company should recover its investment over a relatively short period. Because it seems likely that the systems with higher salvage values will be sold first, the 40% salvage realized from the recent transfers is probably too high to expect in the future. Our allowance will therefore assume a ten-year amortization period an a 25% salvage value to reflect both the evidence of quickening sales and recent salvage values. We leave the issue of how and from whom LILCO should recover these costs for resolution in the rate design phase of this proceeding.

In view of the uncertainties regarding projected parkway lighting retirements and the absence of retirement experience, the Judge adopted staff's recommendation that the accrual reflect a ten-year remaining life and a 10% salvage value. The difference between this accrual and the one recommended by the company is about $200,000; it would be greater, but the company assumed that its current suit against the State would be successful and has reduced its plant in service estimate to reflect the anticipated award. Such speculation about the outcome of the suit could result in an under accrual. We therefore adopt the Judge's recommendation.

Electric Production Structures

Judge Schechter rejected LILCO's proposal to increase its depreciation allowance to reflect a decline in

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the average service life of its electric production structures from the current 45 years to 35 years. Instead, he adopted the 40-year average service life recommended by staff. On exceptions, the company argues that a reduction of the average service life from 45 to 35 years will (1) help close the $7.2 million gap between book and theoretical depreciation and (2) give all production plant the same average service life. The Judge focused on the second justification and found it insufficient because, in one case, LILCO was able to turn a production structure into a training facility after the generating unit was retired. LILCO claims that such recycling is unlikely in the future because many of its remaining structures are the semi-outdoor type and useful only as electric production structures. In reply, staff argued that a change in theoretical reserve resulting from a change in life table does not warrant the large reduction in the average service life estimate sought. The results of the mortality study for this account are of limited value because of the large discontinuities in the observed life table. We agree with staff and accept the more gradual reduction to 40 years rather than to 35 years.

Environmental Control Equipment

Judge Schechter adopted LILCO's proposal to amortize the environmental control equipment at Northport Units 1 and 2 over the remaining lives of those units. On exceptions, staff argues that use of remaining service life depreciation should be discouraged because it results in a proliferation of subaccounts, each with its own rate, and makes review of property accounts virtually impossible. In reply, LILCO argues that late additions to existing plant are usually replacement parts that extend the plant's useful life, but these pollution control facilities will not have the same effect. It therefore supports the Judge's resolution of this issue.

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We have examined the question of the impact of pollution control equipment on depreciation allowances in three successive Niagara Mohawk electric rate cases.[1/] There we decided not to depreciate the equipment over the remaining life of the related generating plant, in part because we had previously recognized that the expected average service life of Niagara Mohawk's generating plant was reduced because of the added equipment. Adopting a similar approach here, we reach the same result as the Judge without assuming that the usefulness of the Northport units will suddenly come to an end in 2007. A good average service life estimate, properly reflecting past and anticipated events, will, if reviewed and updated periodically, avoid the deficiencies LILCO claims it will experience if the remaining life technique is not used for this property. We therefore accept the Judge's allowance, and authorize LILCO to modify its depreciation accounting to reflect the implicit reduction in the average service lives of its facilities. We will also expect the company to analyze the effect of environmentally imposed plant additions on average service life in its next rate proceeding and reflect its analysis in the determination for the affected accounts.

PROPERTY TAXES

Judge Schechter rejected LILCO's estimate of its rate year property taxes and adopted instead a considerably lower figure that reflected historic expense levels, plus allowances for known assessment and rate changes. His adjustments reduced electric expense by $5 million and gas expense by $1.3 million. He suggested that these allowances be revised to reflect known changes up to the time of final decision and that the company be permitted a second-stage filing to recover further increases during the rate year.

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1/Case 26088, 11 NY PSC 1475, 1486-8 (1971); Case 26594, 15 NY PSC 268, 275-6 (1975); and Case 27943, 16 NY PSC 908, 918 (1976).

On exceptions, LILCO and the Counties complain that it is "inconsistent" to treat property taxes differently from other expense items. LILCO further claims that since its forecast was the "only" forecast of rate year property taxes in the record it must be adopted. Property taxes are annual payments set by government decision and are certainly distinguishable from most other rate year expenses. We have regularly allowed the second-stage filings to permit utilities to recover property tax increases.[1/] LILCO's forecast of property taxes was not the only one in the record--staff and the Counties both submitted forecasts--and information in staff's brief opposing exceptions indicates that even the most current estimates may turn out to be inaccurate. Accordingly, we will authorize a second-stage tariff revision in January, 1980 to reflect actual property tax changes through that month. We do so with two caveats: first, as in the other cases cited in the margin, we will permit LILCO to recover only 90% of the increases related to higher estimated assessments, and second, if LILCO should file another major rate case in the next year, we will make such offsets as may be necessary to prevent an overrecovery of these expenses resulting from overlapping rate periods.

1/See Case 27029, Consolidated Edison Company - Electric Rates, 17 NY PSC 241, 263 (1977); Cases 27094-5, Orange & Rockland Utilities, Inc., supra, mimeo. p. 26; Cases 27108-9, Rochester Gas and Electric Corporation, supra, mimeo. p. 15; Case 27100, New York Telephone Company, 17 NY PSC ___ (Opinion No. 77-22, issued December 1, 1978, mimeo. p. 7); Case 27209, Jamaica Water Supply Company, 18 NY PSC ___ (Opinion No. 78-24, issued October 6, 1978, mimeo p. 11); Cases 27215-7, Niagara Mohawk Power Corporation, supra, mimeo p. 28; Case 27275, Brooklyn Union Gas Company, 18 NY PSC ___ (Opinion No. 78-28, issued November 28, 1978, mimeo p. 19; Case 27296, National Fuel Gas Corporation, 18 NY PSC ___ (Opinion No. 78-29, issued December 29, 1978, mimeo. p. 26).

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FEDERAL INCOME TAX

Trust Interest Deductions

A substantial part of LILCO's investment in Nine Mile Point No. 2 and its future nuclear fuel requirements are being financed by the debt of LILCO's construction and resources trusts. After determining that LILCO would be deducting the interest on the debt of the trusts on its own current tax returns, Judge Schechter decided that these deductions should be recognized for ratemaking purposes. The Judge was convinced that the deductions could properly be used to reduce the company's taxes by a memo from LILCO's own tax counsel. His recommendation that these deductions be used to reduce the income tax expense borne by current consumers is consistent with our general policy in favor of flowing through tax benefits to customers.

On exceptions, LILCO attacks the Judge's action on the ground that its right to take the deductions for the trust interest on its tax return is too uncertain without a conclusive IRS ruling on this matter. We believe that the Judge properly relied on the memorandum of LILCO's tax counsel, as we did when we approved the trust financing arrangements, as persuasive evidence that the interest is deductible for income tax purposes. Flowing through the deductions arising from construction of future plant to reduce today's rates gives today's ratepayers the benefit of tax deductions that could be reserved for tomorrow's ratepayers. Tomorrow's ratepayers will have to pay the cash returns on the investment in the plants involved, but we continue to believe this policy is reasonable, as we did in the last LILCO electric rate case. In that case, when the company sought extension of this interperiod tax allocation to the deductions related to the Nine Mile Point 2 and Jamesport generating facilities, we said:

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> It has long been our policy that current tax deductions should be reflected in current rates. We have made exceptions only in cases where utilities demonstrated that deferral was necessary to protect their ability to raise necessary capital on reasonable terms. LILCO has failed to demonstrate that the cash flow allowances authorized in Opinion No. 78-1 are inadequate, so we continue to draw the line on interperiod tax allocations at the Shoreham related interest deductions.1/

In this decision we have not reduced the cash flow allowances we approved in Opinion No. 78-1. LILCO has again failed to show that those allowances are inadequate. Its exception is therefore denied.

TRASOP Tax Credits

Judge Schechter, in his tax calculation, used all available tax credits to reduce taxes to the 10% statutory limit without recognizing any of the 1% "TRASOP" tax credits.2/ LILCO is generating more tax credits than it can use on its current tax returns, so the unused credits are carried forward or inventoried for use in future years on a first-in, first-out basis. Thus, 1% TRASOP credits generated in 1977 will be used before 4% or 6% credits generated in 1978. On exceptions, LILCO argued that Judge Schechter's failure to recognize the 1% credits gives the benefit of those credits to consumers, rather than employees as Congress intended. LILCO reasons that if it is to continue to be

1/Case 27136, supra, Order issued April 17, 1978, mimeo p. 5. Insofar as the relative burdens between today's and tomorrow's ratepayers are concerned, we observe that plant being financed today for the use of future ratepayers tends to cause current ratepayers to have to pay for higher returns on investment.

2/TRASOP is the acronym for Tax Reduction Act Stock Ownership Plan, a tax program designed to encourage corporate employers to buy stock for the benefit of their employees with funds the employer would otherwise pay in taxes.

eligible for the investment tax credit, it must invest the entire tax savings produced for the benefit of employees; and if all savings are instead used to reduce consumer rates, there will be nothing left for its employees unless LILCO spends its own money, something it says it is unwilling to do. It concludes that the Judge's approach will force it to terminate the program.

We approved LILCO's TRASOP program on the assumption that it would benefit employees at no cost to consumers. It now appears that there is a cost to consumers since the existence of the TRASOP carry-forward credits bars our recognition of other credits we could otherwise use to hold down rates. In these circumstances, we are compelled to adopt staff's approach. At the same time, we must forbid further TRASOP investments by the company until it reaches a tax position that will enable it to use the TRASOP credits without imposing costs on consumers. We therefore expect that there will be no unused TRASOP tax credits available in the rate year.

Gas Department Tax Credits

On exceptions, LILCO complains that the Judge, without discussion, accepted staff's proposal to reduce its Gas Department's revenue requirement by subtracting tax credits equal to the sum of all the 1978 and 1979, and one-half of the 1980 credits. The company argues that no more than 12 months' worth of tax credits can be used in determining the revenue requirement. It is our policy to minimize Federal income tax expense to be funded by consumers by accounting for use of all available tax credits and deductions.1/ These credits, adopted by the Judge, although

1/See Case 26538, Consolidated Edison Company - Electric Rates, 14 NY PSC 1503, 1534 (1974) Aff'd on appeal, Consolidated Edison Company of New York, Inc. v. Public Service Commission, 385 NYS2d 209 (1976).

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generated in prior periods, can and should be properly used to reduce the part of LILCO's tax liability attributable to its Gas Department in the rate year. Its exception is therefore denied.

Earned Vacation Deduction

The Judge resolved a dispute between LILCO and staff regarding the amount of earned, but unpaid, vacation pay that would available in the rate year as a deduction to LILCO's tax liability by adopting a staff adjustment that reduced the proposed electric expense allowance by $266,000 and gas expense by $75,000. The company estimate of the deduction was $600,000, equal to the 1974-1978 average, plus $72,000. The staff estimate adopted by the Judge was equal to the 1977 actual figure ($328,000) times its 1.118 wage increase factor. The actual vacation deductions taken in recent years, shown below, exhibit the kind of volatility that usually justifies normalization:

1978	$593,003
1977	828,212
1976	588,742
1975	3[illegible]0,896
1974	[illegible]59,590

On the basis of these figures, LILCO's estimate, which includes the very low 1974 and 1975 figures, seems low, while staff's estimate, based on the very high 1977 figure, seems high. We judge that a total deduction of $760,000, equal to the most recent three-years experience, times the staff's wage increase factor, is a reasonable estimate.

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Amortization of Deferred Taxes

The Counties, in their brief on exceptions, urge us to require a three-year amortization of the "excess" deferred taxes on LILCO's books that result from the reduction of the corporate tax rate from 48% to 46%. Staff and LILCO agree that whatever the merit of the Counties' position, the ratemaking problems created by the tax reduction are generic and should be resolved in the context of our investigation of this matter. We agree. The Counties' exception will therefore be denied.

Revised Computations

Our substantial revisions to the operating revenue, expense, rate base and return allowances recommended by the Judge have required substantial revisions to the income tax computations he made. Our computations are set out in the appendices.

RATE BASE

Deferred Tax Credits

Judge Schechter adopted a staff proposal to reduce the rate year rate base by: (1) the shareholder half of the 4% flow-through tax credits generated by the Shoreham construction; and (2) the difference between the rate year actual flow-through credits and the three-year average we used to determine the "normal" level in the last LILCO electric rate case. LILCO excepts.

The company makes a number of arguments with respect to the first item. First, it notes that we did not make this rate base adjustment for the reallocated flow-through credits in Case 27136 and that, allegedly in accordance with the accounting procedure it negotiated with staff, the reallocated credits are "deferred credits" rather than "deferred tax credits" that can be deducted from rate base.

Second, it argues that capturing the stockholder share of the 4% credits to reduce revenue requirement is unfair because it would not have adopted flow through accounting if we had not adopted a sharing policy. Finally, it argues that using these credits both to reduce rate base now and to reduce income later would be unfair. It even suggests that this approach may be against Internal Revenue Service regulations.

The company says the second adjustment is also unfair because in Case 27136 we used an averaging approach, including credits estimated to be available in the rate year, to increase the nominal amount of flow-through credits when the actual amount of test period flow-through credits available was below average. Now staff wants to use the actual amount available when it is above average.

We believe the staff adjustments are fair and consistent with our decision in Case 27136, where we said:

> The cost of financing the Shoreham CWIP is imposing a severe burden on current ratepayers while, at the same time, abnormally high ITC benefits generated by Shoreham progress payments are providing stockholders with an abnormally high return on equity. But LILCO's cash flow requirements prevent us from reducing the above-the-line tax expense by allocating all of the flow through credits to the ratepayer at this time. Instead, we hold that the portion of all future Shoreham flow through credits that would be allocated to the stockholders under our general policy, should be allocated to the ratepayers. This should be done by deferring them now, for accounting purposes, and amortizing them later, as an offset to the attrition produced when Shoreham is fully included in rate base. (Opinion No. 78-1, mimeo p. 23)

We have made an equitable determination that the 4% credits from Shoreham construction should be allocated entirely to the ratepayers. There is no reason why they

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should not be considered customer-contributed capital and an offset to rate base, regardless of the manner in which they are accounted for on the books of the company. Otherwise, the company would have free use of the customer's money. It should be understood that we are not reducing rate base by any part of the stockholders' credits which are not related to Shoreham. Indeed, the staff estimate of the accumulated rate year Shoreham credits is conservative. Also, we see no violation of IRS regulations since the tax credits in question are Option 3 (flow-through) credits to which ratemaking restrictions do not apply.

The second staff adjustment is similar; like the rate base deduction for the Shoreham tax credits described above, they represent funds available for use by the company because of credits which normally would reduce revenue requirement. In Case 27136, the three-year average was expected to be the actual amount of flow-through tax credits utilized over the period. The same average used in this case is less than the expected utilization. As a result, a rate base deduction is required to reflect the expected excess credits available to the company. Since our revenue requirement is considerably less than that recommended by staff and the Judge, the impact of this treatment is relatively small--a rate base reduction of less than $2 million. LILCO's exceptions are, therefore, denied.

Shoreham Switchyard

Judge Schechter adopted staff's $4 million rate base deduction to exclude the Shoreham switchyard from plant in service and to include it in construction work in progress, where it would accrue AFC. He concluded that there was "no specificity" to the company claims that the facility will be in service in April, 1979, a year before the related Shoreham generating facility is in service. The company excepts.

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The Judge incorrectly framed this issue. Staff did not dispute the company's claim that the Shoreham switchyard would be in service before the Shoreham generating facility. It argued, however, that since the switchyard was constructed primarily to connect the Shoreham generating unit and the Shoreham transmission line, it should not be placed in service until the Shoreham generating station is in service. While there is merit to staff's position, and its recommendation may be consistent with past LILCO practice, it is not consistent with Part 168.3 of our Uniform System of Accounts, which requires that the completed portions of larger projects be included in plant in service. While we would, for adequate cause, diverge from the policy of Part 168.3 for ratemaking purposes, we would be willing to do so only in cases where a major distortion in rates would occur if we failed to act. This is not such a case. LILCO's exception is granted.

Rate Base Capitalization Adjustments

The company, staff, and the Judge computed LILCO's working capital requirements using the standard FPC formula. The Counties' witness decided, on the basis of his "balance sheet" analysis, that the FPC formula resulted in an excessive working capital allowance. For this reason, the Counties except both to Judge Schechter's failure to adopt their $39 million adjustment to working capital, and a similar rate base adjustment to recognize the $6.3 million injuries and damages reserve. Staff and the company agree that the Counties have essentially proposed a rate base/capitalization adjustment without adequate support. Staff's analysis indicated that there is a $1 million difference between the two, an amount too small to justify an adjustment. Further, LILCO and staff criticize the computation since the adjustment was based on a comparison of the average balance sheet working

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capital for the twelve months ended August, 1978 with the rate year working capital derived using the FPC formula. When the balance sheet working capital calculation for the 1977 base year is compared to FPC formula working capital for the same period, the difference is eliminated. The Counties' piecemeal working capital adjustments are inconsistent with the rationale of the FPC formula. We believe the LILCO and staff capitalization comparisons provide an accurate measure of LILCO's rate base and working capital requirements. The Counties' exception is denied.

ALLOWED RETURN

Judge Schechter recommended that LILCO be allowed a 10.13% overall return; a figure that recognizes his use of a pro forma rate year capital structure, staff's estimates of the cost of long-term debt and preferred stock; and a return on equity of 13.4%. LILCO, which sought a 10.4% to 10.5% overall return allowance, and the Counties, whose witness recommended a 9.6% overall return, have excepted to his recommendation.

At this point in the proceeding, the differences among the parties have largely narrowed to the issue of what a fair return on LILCO's common equity would be. The 12.25% allowance supported by the Counties' witness was the lowest recommended and the 14.3% allowance sought by LILCO was the highest. Staff recommended 13.4%. Because staff and the Judge predicated their recommendations on the incorrect assumption that we would add $200 million CWIP to rate base, and since there have been substantial changes in the financial markets and in LILCO's earnings since the rate of return testimony was developed, it would serve no useful purpose to review in detail the positions of each of the parties. They are fully described in the recommended decision and based on somewhat stale data.

Our own rate of return analysis, using the same discounted cash flow approach used by witnesses in the case, leads us to conclude that 13.7% is a fair allowed return on equity for LILCO. Over the past several months the yield on LILCO's common stock has averaged 9.50-9.75%. This is substantially higher than the yields assumed by any witness in the case. But it does reflect the change in interest rates that has occurred since the receipt of testimony in the case. This yield would be consistent with a growth estimate based on LILCO's recent experience, for it is likely that there have been changes in investor growth expectations as well.[1/] Witnesses in the case provided growth estimates that ranged from 3.5% to 5.0%. LILCO's 1978 return and retention rates make current growth expectations in excess of 4% seem too high. The staff's figures on historic growth in book value per share, a proper indicator of growth and one which reflects the impact of new issues as well as the effect of return and retentions, demonstrate that 3.5% is a better estimate. Investor growth expectations are thus in the 3.5% to 4.0% range. Combining these figures for yield and growth produces a "bare bones" cost of equity in the 13.0% to 13.75% range. From this, we conclude that 13.7%, which includes an allowance for issuance costs, is a fair return on LILCO's common equity.

An allowed return of 13.7% compares with the 13.3% allowed in LILCO's last electric rate case, and the 13.5% we allowed in its last gas rate case. A higher return is now justified by the general increase in interest rates since then, and our decision not to add more electric CWIP to rate base. While it is true, as Suffolk County observed, that

1/We believe the very recent increase in yield above this range relates to a downward revision in growth expectations attributable to circumstances other than the change in market interest rates. Thus, any further increase in yield assumptions would be matched by an offsetting reduction in growth expectations.

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13.7% is a higher return than those earned by most energy utilities in past years, it recognizes the concerns of the 1979 investor, and some of the unusual circumstances that make the risk of investing in LILCO stock different from the risk inherent in other securities.

Our overall return allowance, reflecting a 13.7% return on equity and minor changes in LILCO's cost of debt and financing plans since the close of the record, is 10.26% as derived from the following table:

	Amount	%	Cost	Return
Long-Term Debt	$1,275,375	46.0%	7.88%	3.62%
Preferred Stock	387,710	14.0	8.35	1.17
Customer Deposits	8,300	.3	9.00	.03
Common Equity	1,103,450	39.7	13.70	5.44
Total	$2,774,835	100.0%		10.26%

CONCLUSION

Our estimates of LILCO's probable revenues, expenses, rate base and cost of capital for the next twelve months indicate a need to increase its electric rates by 3.3% to produce about $26.0 million in additional revenue and its gas rates by 9.1% to produce about $16.6 million. Our computation of these revenue requirements is detailed in Appendices A and B. The electric rate increases are substantially less than those sought by the company, or even those recommended by our staff and the Judge, primarily because we have concluded the company does not need cash flow allowances to finance its construction program. Where our expense allowances exceed those recommended by staff and the Judge, we found they were necessary to enable LILCO to provide the service to which its customers are entitled under the Public Service Law. We have also recognized that LILCO's cost of

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capital will be somewhat more than either the Judge or staff expected, because general inflation--a phenomenon over which neither we nor LILCO's management has much control--in the past six months has driven interest rates much higher than they assumed. LILCO has, in accordance with our November 3, 1978 Statement of Policy on Federal Anti-Inflation Guidelines, demonstrated that an electric rate increase of less than 7.0% ($87.7 million) would comply with the primary Federal "price deceleration" standard. It also claimed that a gas rate increase as high as 13.1% ($23.9 million) would comply with the Federal "profit margin" standard. The authorized electric rate increase is far less than the increase allowed under the Federal price deceleration guideline. By our own computation, the authorized gas increase will exceed the allowable increase under both the Federal "price deceleration" and "profit margin" anti-inflation standards. We believe, however, that the indicated gas rate increase is not in violation of the Federal Anti-Inflation program because the company's gas operations qualify for an exception under the guidelines. Here, as in the recently decided Rochester Gas and Electric Corporation gas rate case,[1/] gas rates held within the limits set by the Federal standards would result in a gas department return on equity that would be substantially less than the current yield on LILCO's long-term bonds. Also, LILCO's common stock is selling at less than 90% of book value, just as RG&E's was. This fact is attributable in part to the depressed earnings of its gas department in the past. These considerations lead us to conclude that the company's gas department should be granted an exception to the Federal guidelines in this case for extreme hardship and gross inequity. We are satisfied that these increases will not hamper the nation's effort to control inflation.

1/Case 27372, Rochester Gas and Electric Corporation, 19 NY PSC ___ (Opinion No. 79-12, issued April 23, 1979, mimeo p. 50).

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Finally, we are investigating the propriety of LILCO's electric and gas rate design in a second phase of this proceeding to determine how and from whom the company should receive the revenue it requires. During the pendency of that investigation, across-the-board increases to obtain the additional required revenue, as proposed by staff and recommended by the Judge, will be acceptable.

The Commission orders:

1. Long Island Lighting Company is directed to cancel immediately the suspended tariff leaves and supplements enumerated in Appendix C.

2. The company is authorized to file amendments to its electric and gas tariff schedules designed to produce an increase in revenues in an amount and manner consistent with the findings and conclusions contained in the foregoing decision. The company shall serve copies of its compliance fili g on all parties listing appearances in this proceeding. Comments of interested parties may be filed with the Secretary to the Commission within three (3) days of service of the company's proposed revisions, if personally served, and within five (5) days if served by mail. The revisions shall not take effect until approved by the Commission.

3. The company is directed to report all changes in its property tax expenses through January, 1978 to the Secretary on or before January 31, 1980 and is authorized to file tariff revisions for second-stage rate increases at that time if necessary to recover property tax expense increases. The company shall serve copies of the report, and notice of any proposed tariff revisions on all parties listing appearances in this proceeding. Comments of interested parties may be filed with the Secretary to the Commission within three (3) days of service of the company's proposed

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revisions, if personally served, and within five (5) days if served by mail. The revisions shall not take effect until approved by the Commission.

4. The company is directed to file with the staff of the Consumer Service Sections of the Power and Gas Divisions a quarterly report containing the information described in Appendix D in a form and manner approved by staff.

5. Except as granted herein, all exceptions to the Administrative Law Judge's recommended decision are denied.

6. Except as modified herein, the findings and conclusions of the recommended decision are adopted as part of this Opinion and Order.

7. This proceeding is continued.

By the Commission,

(SEAL) (SIGNED) SAMUEL R. MADISON
Secretary

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Appendix A
Schedule 1

LONG ISLAND LIGHTING COMPANY
Commission Revenue Requirement
Electric Department
(000)

Revenue Requirement per Schedule 2, Page 1			$ 26,000
Less: Revenue Taxes	4.02%	$1,005	
Advertising	0.075%	19	
Uncollectibles	0.594%	195	(1,219)
Operating Income			24,781
Less: Federal Income Taxes			8,155
Balance Available for Return			16,626
Adjusted Balance Available at Present Rates			143,340
Total Available for Return			$ 159,966
Adjusted Rate Base per Schedule 2, Page 1			$1,558,728
Rate of Return			10.26%

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LONG ISLAND LIGHTING COMPANY
Statement of Operating Income, Rate Base, Rate of Return
For the 12 Months Ending June 30, 1980
Electric Department
(000)

Appendix A
Schedule 2
Page 1

	As Finally Adjusted By Company* (1)	ALJ Adjustments (2)	As Adjusted By ALJ** (3)		Commission Adjustments (4)	As Adjusted By Commission (5)	Commission Rates (6)	After Rate Increase (7)
Operating Revenues								
Sales of Electricity	$ 784,471	$ 1,212	$ 785,683	(1)	$ (3,092)	$ 782,591	$26,000	$ 808,591
Other Operating Revenues	4,901		4,901			4,901		4,901
Total	789,372	1,212	790,584		(3,092)	787,492	26,000	813,492
Operating Expenses								
Operation & Maintenance Expenses	469,221	(17,946)	451,275	(2)	3,184	454,459	174	454,633
Charitable Contributions	270		270			270		270
Depreciation	50,926	(1,672)	49,254	(3)	377	49,631		49,631
Taxes Other Than Income Taxes	127,807	(4,977)	122,830	(4)	1,689	124,519	1,015	125,534
Total	648,224	(24,595)	623,629		5,250	628,879	1,219	630,098
Operating Income	141,148	25,807	166,955		(8,342)	158,613	24,781	183,394
Federal Income Taxes-As Allocated	20,793	(2,053)	18,740	(5)	(3,467)	15,273	8,155	23,428
Net Operating Income	$ 120,355	$ 27,860	$ 148,215		$ (4,875)	$ 143,340	$16,626	$ 159,966
Rate Base								
Net Plant	$1,196,770	$ (17,081)	$1,179,689	(6)	$ 3,509	$1,183,198		$1,183,198
Working Capital	132,401	(4,184)	128,217	(7)	479	128,696		128,696
Construction Work in Progress	700,000	(200,000)	500,000	(8)	(200,000)	300,000		300,000
Less: Deferred Federal Income Taxes	(20,773)	2,130	(18,643)	(9)	(869)	(19,512)		(19,512)
Deferred Invest. Tax Credits	(29,622)	(947)	(30,569)	(10)	1,409	(29,160)	$(4,494)	(33,654)
Total	$1,978,776	$(220,082)	$1,758,694		$(195,472)	$1,563,222	$(4,494)	$1,558,728
Indicated Rate of Return	6.08%		8.43%			9.17%		10.26%

* Per Exhibit 248, Schedule 1, Column 3.
**Per ALJ, RD, Appendix C, Page 2.

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LONG ISLAND LIGHTING COMPANY
Explanation of Commission Adjustments
To Electric Operating Income
For the 12 Months Ending June 30, 1980
(000)

Adjustment	Explanation			Effect On Operating Income
Operating Revenues				
1(a)	Decrease revenue to reflect reduction of meter tampering recoveries to company revised level.			
	Increase Per ALJ	$1,212		
	Increase Per Commission	339		
	Commission Adjustment		$ (873)	
(b)	To adjust operating revenues to correct S.C. 2 MRP billing error.		(2,219)	$(3,092)
			Effect On Operating Expense	
Operation and Maintenance Expenses				
2(a)	Production Expenses			
	(1) Allowance for Maintenance Project contingencies.			
	Per ALJ	$ -0-		
	Per Commission	200		
	Commission Adjustment		$ 200	$ (200)
	(2) Reversal of ALJ reduction of Boiler Maintenance Projects.			
	Per ALJ	$ -0-		
	Per Commission	283		
	Commission Adjustment		283	(283)
(b)	Transmission and Distribution Expenses			
	(1) Commission allowance for tree trimming expenses.			
	Per ALJ	$ -0-		
	Per Commission	880		
	Commission Adjustment		880	(880)
	(2) Reversal of ALJ reduction of Public Works expenses.			
	Per ALJ	$ -0-		
	Per Commission	173		
	Commission Adjustment		173	(173)

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LONG ISLAND LIGHTING COMPANY
Explanation of Commission Adjustments
To Electric Operating Income
For the 12 Months Ending June 30, 1980
(000)
(Cont'd)

Adjustment	Explanation		Effect On Operating Expense	Effect On Operating Income
Operation and Maintenance Expenses				
2(c)	Customer Accounts Expenses			
	Commission allowance for increase in Customer Relations expenses.			
	Per ALJ ($2,193 - $1,137)	$1,056		
	Per Commission (50% of $2,193)*	1,096		
	Commission Adjustment		$ 40	$ (40)
(d)	Administrative and General Expenses			
	Commission reversal of ALJ adjustment to ESEERCO costs resulting from PASNY withdrawal.			
	Per ALJ	$ 220		
	Per Commission	50		
	Commission Adjustment		170	(170)
(e)	Advertising and Public Affairs Expense			
	Adjustment to ALJ disallowance.			
	Area Development	$ 156		
	Employee Communication	90		
	Change in Revenue	2		
	Commission Adjustment	248		
	Electric Portion @ 90%		(223)	223
(f)	Storm Damage Reserve and Accrual			
	Adjustment to increase reserve limit and reflect resultant lower amortization.			
	Per ALJ	$ 601		
	Per Commission	434		
	Commission Adjustment		(167)	167
(g)	Labor Productivity			
	Reversal of company's productivity adjustment.		1,730	(1,730)

* Company Adjustment - Exhibit 38A	$2,811
Electric @ 78%	2,193
Gas @ 22%	618

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LONG ISLAND LIGHTING COMPANY
Explanation of Commission Adjustments
To Electric Operating Income
For the 12 Months Ending June 30, 1980
(000)
(Cont'd)

Adjustment	Explanation		Effect On Operating Expense	Effect On Operating Income
Operation and Maintenance Expenses				
2(h)	Wage Increase Indexing			
	Adjustment to reflect restoration of indexing due to revisions caused by Commission adjustments to labor base.			
	Adjustments to labor base ($1,576 X 68.36%)	$1,077		
	Wage increase factor	13.3%		
	Commission Adjustment		$ 145	$ (145)
(i)	Inflation Indexing			
	Adjustment to reflect restoration of indexing due to revisions caused by Commission adjustments to inflation base.			
	Adjustments to inflation base ($1,576 X 31.64%)	$ 499		
	Inflation factor	17.5%		
	Commission Adjustment		86	(86)
(j)	Wage Increase - "Proper Period"			
	Recalculation of elimination of two extra months Wage Increase compounding resulting from Commission adjustments.			
	Per ALJ	$ 234		
	Per Commission	313		
	Commission Adjustment		(79)	79
(k)	Inflation Increase - "Proper Period"			
	Recalculation of elimination of two extra months Inflation Increase compounding resulting from Commission adjustments.			
	Per ALJ	$ 265		
	Per Commission	319		
	Commission Adjustment		(54)	54
Total Operation and Maintenance Adjustments			$ 3,184	$ 3,184

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LONG ISLAND LIGHTING COMPANY
Explanation of Commission Adjustments
To Electric Operating Income
For the 12 Months Ending June 30, 1980
(000)
(Cont'd)

Adjustment	Explanation		Effect On Operating Expense	Effect On Operating Income
Depreciation Expense				
3(a)	Commission revision of ALJ's change in Depreciation rates on Street Lighting Plant to ten-year life and 25% salvage. Commission Adjustment		$ 245	$ (24[illegible]
(b)	Allowance for Depreciation Expense related to placing Shoreham Switchyard in Rate Base (per Exhibit 212).		132	(13[illegible]
Total Depreciation Adjustments			$ 377	$ (3[illegible]
Taxes Other Than Income Taxes				
4(a)	Adjustment to update Property Taxes to latest known tax bills.			
	Per ALJ	$4,977		
	Per Co. letter 3/29/79	3,199		
	Commission Adjustment		$ 1,778	$ (1,77[illegible]
(b)	Adjustment to reduce Revenue Taxes related to Adjustment 1(b) above. ($2,219 X 4.02%)		(89)	8[illegible]
Total Taxes Other Than Income Tax Adjustments			$ 1,689	$ (1,68[illegible]
Federal Income Taxes				
5	Per Appendix A, Schedule 3, Page 1.		$ (3,467)	$ 3,467

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LONG ISLAND LIGHTING COMPANY
Explanation of Commission Adjustments
To Electric Rate Base
For the 12 Months Ending June 30, 1980
(000)
(Cont'd)

Adjustment	Explanation			Effect On Rate Base
Net Plant				
6(a)	Reverse ALJ adjustment related to Shoreham Switchyard in Rate Base (per Exh. 212).		$ 4,113	
(b)	Modification of Rate Base allowance for deferred Storm Damage expenses.			
	Change in reserve	$ 500		
	Less one-half of first year's change in amortization	84		
	Commission Adjustment		(416)	
(c)	Adjustment to Depreciation Reserve to reflect changes in Depreciation expense (Adjustment 3).			
	Commission Adjustment ($377 X 1/2)		(188)	
	Total Adjustment to Net Plant			$ 3,509
Working Capital				
7	Adjustment to reflect changes resulting from Commission adjustments.			
	Commission Adjustment ($3,184 + $167 X 1/7)			$ 479
Construction Work in Progress				
8	Disallowance of Shoreham CWIP from Rate Base.			$(200,000

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LONG ISLAND LIGHTING COMPANY
Explanation of Commission Adjustments
To Electric Rate Base
For the 12 Months Ending June 30, 1980
(000)
(Cont'd)

Adjustment	Explanation			Effect On Rate Base
Deferred Federal Income Taxes				
9	Change in Average Accumulated Deferred Taxes due to Commission adjustments to current Deferred Taxes (before rate increase).			
	Current Deferred per ALJ	$ 16,709		
	Current Deferred per Commission	18,446*		
	Additional Deferred Taxes		$ 1,737	
	Rate Base effect (1/2)			$ (869)
Deferred Investment Tax Credits				
10	Change in Average Accumulated Deferred Investment Tax Credits due to Commission adjustments (before rate increase).			
	Current Deferred and Stockholder ITC per ALJ	$ 2,817		
	Current Deferred and Stockholder ITC per Commission	-0-		
	Reduction		$ (2,817)	
	Rate Base effect (1/2)			$ 1,409

*Per Appendix A, Schedule 3, Page 4.

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LONG ISLAND LIGHTING COMPANY
Computation of Federal Income Taxes - Per Commission
Electric Department
For the 12 Months Ending June 30, 1980
(000)

Appendix A
Schedule 3
Page 1

	As Adjusted By ALJ (1)		Commission Adjustments (2)	As Adjusted By Commission (3)	Commission Rate Increase (4)	As Adjusted For Commission Rate Increase (5)
Total Operating Income	$166,955		$ (8,342)	$158,613	$24,781	$183,394
Other Income - AFC	64,680	(1)	29,204	93,884		93,884
Trust Interest Charges	(22,700)	(2)	(900)	(23,600)		(23,600)
Other Interest Charges	(69,734)	(3)	(23,629)	(93,363)		(93,363)
Subtotal	(27,754)		4,675	(23,079)		(23,079)
Income Before Income Taxes	139,201		(3,667)	135,534	24,781	180,315
Deduct Non-Taxable Items						
Allowance for Funds Used During Construction	64,680		29,204	93,884		93,884
Add-Back of Items Not Tax-Deductible						
Accrual for Injuries and Damages Reserve	-			-		-
Accrual for Bad Debts Reserve	-			-		-
Accrual for Storm Damage Reserve	1,601	(4)	(167)	1,434		1,434
Supplemental Provision	1,468			1,468		1,468
Amortization of Mortgage Recording Taxes	275			275		275
FAC Costs - Deferred	(2,274)			(2,274)		(2,274)
Subtotal	1,070		(167)	903		903
Deduct Additional Tax Deductions						
Tax Depreciation in Excess of Book Depreciation	15,586	(5)	1,086	16,672		16,672
Losses Charged to Reserve:						
Injuries and Damages	-			-		-
Storm Losses	-			-		-
Bad Debts	-			-		-
Cost of Removing Retired Property	1,085			1,085		1,085
Costs Charged to Construction:						
Payroll Taxes	1,161			1,161		1,161
Pensions	2,013			2,013		2,013
Sales Taxes	2,546			2,546		2,546
Real Property Taxes	16,731			16,731		16,731
Research and Development Costs	517			517		517
Property Taxes - Lien Date	3,272			3,272		3,272
Nine Mile #2 - Construction Charges	1,267			1,267		1,267
Earned Vacation Adjustment	734	(6)	(141)	593		593
Subtotal	44,912		945	45,857		45,857
Taxable Income (Loss)	$ 30,679		$(33,983)	$ (3,304)	$24,781	$ 21,477
Federal Income Tax at 46%	$ 14,112		$ (15,632)	$ (1,520)	$11,399	$ 9,879
Less: Investment Tax Credit	(4,045)		4,045	-	(12,232)	(12,232)
Federal Income Tax - Current	10,067		(11,587)	(1,520)	(833)	(2,353)
Deferred Federal Income Tax - Current	16,709	(7)	1,737	18,446		18,446
Deferred Federal Income Tax - Amortization	(1,653)			(1,653)		(1,653)
Deferred Investment Tax Credit	1,589	(8)	(1,589)	-	5,744	5,744
Stockholder Investment Tax Credit	1,228	(9)	(1,228)	-	3,244	3,244
Net Federal Income Taxes (Adjustment 5)	$ 27,940		$ (12,667)	$ 15,273	(10) $ 8,155	$ 23,428

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LONG ISLAND LIGHTING COMPANY
Explanation of Commission Adjustments
To Electric Department Federal Income Taxes
For the 12 Months Ending June 30, 1980
(000)

Adjustment	Explanation		Effect On Taxable Income
Other Income - AFC			
1(a)	Reversal of ALJ reduction of AFC related to additional Shoreham in Rate Base. ($200,000 X 7.63%).	$ 15,260	
(b)	Additional AFC on revised Shoreham construction expenditures allowed by Commission. ($43,000 X 7.63%).	3,281	
(c)	Revision of AFC to allow use of the FERC method to compute AFC rate.	10,663	
	Adjustment to Other Income - AFC	$ 29,204	$ 0
Trust Interest Charges			
2	Recalculation of Trust Interest to update interest rate to 10.5% estimate of prime rate.		
	Commission Adjustment (.5% over ALJ rate)		$ (900)
Other Interest Charges			
3	Revision of interest deduction to change Long-Term Debt cost rate.		

	Amount	Cost Rate	Interest
Long Term Debt	$1,275,375	7.87%	$100,372
Customer Deposits	8,300	9.00	747
			$101,119

Electric portion at 92.33%	$ 93,363	
Interest Per ALJ	89,734	
Commission Adjustment		$(3,629)

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LONG ISLAND LIGHTING COMPANY
Explanation of Commission Adjustments
To Electric Department Federal Income Taxes
For the 12 Months Ending June 30, 1980
(000)
(Cont'd)

Adjustment	Explanation			Effect on Taxable Income
Accrual for Storm Damage Reserve				
4	Adjustment to revise add-back of Storm Damage accrual to level allowed by Commission.			
	Accrual per ALJ		$ 1,601	
	Accrual per Commission		1,434	
	Commission Adjustment			$ (167)
Tax Depreciation in Excess of Book Depreciation				
5	Additional tax depreciation related to change in book depreciation rates (per Adj. 3).			$(1,086)
Earned Vacation Adjustment				
6	Revision of Earned Vacation deduction to three year average inflated for Wage Increase.			
	Per ALJ	$ 941		
	Per Commission	760		
	Commission Adjustment		$ 181	
	Electric portion at 78%			$ 141

C. 27374

Appendix A
Schedule 3
Page 4

LONG ISLAND LIGHTING COMPANY
Explanation of Commission Adjustments
To Electric Department Federal Income Taxes
For the 12 Months Ending June 30, 1980
(000)
(Cont'd)

Adjustment	Explanation	Effect On Income Taxes
7	Recalculation of Deferred Taxes - Current under the APB #11 method.	

	48% Deferral 1979-80 Average	46% Deferral As Recomputed
Asset Depreciation Range	$ 6,223	$ 5,969
Cost of Removal	527	505
Mortgage Taxes	310	297
Fuel Cost Adjustment	(922)	(884)
Gas Cost Adjustment	268	257
Deferred Taxes	$ 6,411	$ 6,144
		÷ 46%
Originating Timing Differences		$13,356
Tax at 46%		$ 6,144
Additional ITC at 70% limit		$(4,301)
Resulting Deferred Tax		$ 1,843

Deferred Tax Computation

	Total Deferrals	Electric At 86.87%	Gas At 13.13%
APB #11 Items	$ 1,843	$ 1,601	$242
Shoreham AFC Net of Tax	16,845*	16,845	-
	$18,688	$18,446	$242

*AFC Net of Tax Revision

Deferred Per ALJ	$13,122
Commission reversal of CWIP in Rate Base	3,771
Deferral at 1.87%	16,893
Percentage Reduction to 1.78% FERC Rate	(.0481)%
Reduction	(813)
Net	16,080
Plus: Deferral related to additional Shoreham expenditures $85,000 X 1/2 = $43,000 X 1.78%	765
Revised Deferral	$16,845

Deferred Taxes Per ALJ (Electric Portion)	$16,709	
Deferred Taxes Per Commission (Electric Portion)	18,446	
Commission Adjustment		$1,737

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LONG ISLAND LIGHTING COMPANY
Explanation of Commission Adjustments
To Electric Department Federal Income Taxes
For the 12 Months Ending June 30, 1980
(000)
(Cont'd)

Adjustment	Explanation	Effect On Income Taxes
Deferred Investment Tax Credits		
8	Elimination of Deferred ITC because of negative current income tax before rate increase.	$ (1,589)
Stockholder Investment Tax Credits		
9	Elimination of Stockholder ITC because of negative current income tax before rate increase.	$ (1,228)

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27375

Appendix A
Schedule 3
Page 6

LONG ISLAND LIGHTING COMPANY
Explanation of Commission Adjustments
E-10 and G-5 to Electric and Gas
Income Taxes After Rate Increase
For the 12 Months Ending June 30, 1980
(000)

		Total	Electric	Gas
(1)	Federal Income Tax @ 46%	$ 20,601	$ 9,879	$ 10,722
(2)	ITC utilization @ 70%	14,421	12,232	2,189*
(3)	Federal Income Tax - Current	6,180	(2,353)	8,533
(4)	Flow-through	7,364	6,488	876
(5)	Less: Stockholder portion - 50%	3,682	3,244	438
(6)	Deferred ITC	$ 7,057	$ 5,744**	$ 1,313

* Maximum allocable based on generated credits.

**Maximum flow-through allowable	$10,300
Actual flow-through - line 4	7,364
Difference - Option 3 - Electric - deferred	2,936
Total Electric deferred - line 6	5,744
Electric deferred - Option 1	$ 2,808

Summary of ITC	Total	Electric	Gas
Option 3 - flow-through	$ 7,364	$ 6,488	$ 876
Option 3 - deferred	2,936	2,936	-
Option 1 - deferred	4,121	2,808	1,313
	$ 14,421	$ 12,232	$ 2,189

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Appendix B
Schedule 1

LONG ISLAND LIGHTING COMPANY
Commission Revenue Requirement
Gas Department
(000)

Revenue Requirement per Schedule 2, Page 1				$ 16,580
Less:	Revenue Taxes	4.02%	$ 666	
	Advertising	0.075%	12	
	Uncollectibles	0.594%	98	(776)
	Operating Income			15,804
Less:	Federal Income Taxes			7,271
	Balance Available for Return			8,533
	Adjusted Balance Available at Present Rates			15,974
	Total Available for Return			$ 24,507
	Adjusted Rate Base per Schedule 2, Page 1			$238,761
	Rate of Return			10.26%

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C. 27375

Appendix B
Schedule 2
Page 1

LONG ISLAND LIGHTING COMPANY
Statement of Operating Income, Rate Base, Rate of Return
For the 12 Months Ending June 30, 1980
Gas Department
(000)

	As Finally Adjusted By Company* (1)	ALJ Adjustments (2)	As Adjusted By ALJ** (3)		Commission Adjustments (4)	As Adjusted By Commission (5)	Commission Rates (6)	After Rate Increase (7)
Operating Revenues								
Sales of Gas	$180,203	$ 5	$180,208	(1)	$ 546	$180,754	$16,580	$197,334
Other Operating Revenues	1,536		1,536			1,536		1,536
Total	181,739	5	181,744		546	182,290	16,580	198,870
Operating Expenses								
Operation & Maintenance Expenses	133,644	(3,126)	130,518	(2)	982	131,500	110	131,610
Charitable Contributions	30		30			30		30
Depreciation	6,870	(541)	6,329			6,329		6,329
Taxes Other Than Income Taxes	26,189	(1,306)	24,883	(3)	248	25,131	666	25,797
Amortization of Property Losses	518		518			518		518
Total	167,251	(4,973)	162,278		1,230	163,508	776	164,284
Operating Income	14,488	4,978	19,466		(684)	18,782	15,804	34,586
Federal Income Taxes - As Allocated	(225)	3,575	3,350	(4)	(542)	2,808	7,271	10,079
Net Operating Income	$ 14,713	$ 1,403	$ 16,116		$ (142)	$ 15,974	$ 8,533	$ 24,507
Rate Base - Average								
Net Plant	$214,744	$ 270	$215,014			$215,014		$215,014
Working Capital	24,690	(203)	24,487	(5)	$ 122	24,609		24,609
Construction Work in Progress	4,120		4,120			4,120		4,120
Less: Deferred Federal Income Taxes	(3,254)	(20)	(3,274)			(3,274)		(3,274)
Deferred Investment Tax Credits	(843)	(865)	(1,709)	(6)	419	(1,289)	$ (419)	(1,708)
Total	$239,457	$ (818)	$238,639		$ 541	$239,180	$ (419)	$238,761
Indicated Rate of Return	6.14%		6.75%			6.68%		10.26%

* Per Exhibit 25B, Schedule 1, Column 3.
**Per ALJ, RD, Appendix C, Page 2.

LONG ISLAND LIGHTING COMPANY
Explanation of Commission Adjustments
To Gas Operating Income
For the 12 Months Ending June 30, 1980
(000)

Adjustment	Explanation			Effect On Operating Income
Operating Revenues				
1(a)	Adjustment to increase revenues to reflect change in S.C. 5 temperature setting.		$ 549	
(b)	Decrease in revenues to reflect reduction of meter tampering revenues to company revised level.			
	Increase Per ALJ	$ 5		
	Increase Per Commission	2		
	Commission Adjustment		(3)	$ 546

Adjustment	Explanation		Effect On Operating Expense	Effect On Operating Income
Operation and Maintenance Expenses				
2(a)	Transmission and Distribution Expenses			
	(1) Elimination of normalizing adjustment to servicing customer equipment expense.		$ 277	$ (277)
	(2) Elimination of adjustment to normalize routine operations expense.		120	(120)
(b)	Customer Accounts Expense			
	Commission allowance for increase in Customer Relations expenses.			
	Per ALJ	$ 297		
	Per Commission (1/2 X $618)*	309		
	Commission Adjustment		12	(12)
(c)	Advertising and Public Affairs Expense			
	Adjustment to ALJ disallowance.			
	Per Commission ($248 X 10%)		(25)	25

* See Appendix A, Schedule 2, Page 3.

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LONG ISLAND LIGHTING COMPANY
Explanation of Commission Adjustments
To Gas Operating Income
For the 12 Months Ending June 30, 1980
(000)
(Cont'd)

Adjustment	Explanation		Effect On Operating Expense	Effect On Operating Income
Operation and Maintenance Expenses				
2(d)	Labor Productivity			
	Reversal of company's productivity adjustment.		$ 577	$ (577)
(e)	Wage Increase Indexing			
	Adjustment to reflect restoration of indexing due to revisions caused by Commission adjustments to labor base.			
	Change in labor base ($409 X 76.77%)	$ 314		
	Wage increase factor	13.3%		
	Commission adjustment		42	(42)
(f)	Inflation Indexing			
	Adjustment to reflect restoration of indexing due to revisions caused by Commission adjustments to inflation base.			
	Change in inflation base ($409 X 23.23%)	$ 95		
	Inflation factor	17.5%		
	Commission adjustment		16	(16)
(g)	Wage Increase - "Proper Period"			
	Recalculation of elimination of two extra months wage increase compounding resulting from Commission adjustments.			
	Per ALJ	$ 147		
	Per Commission	171		
	Commission Adjustment		(24)	24
(h)	Inflation Increase - "Proper Period"			
	Recalculation of elimination of two extra months inflation increase compounding resulting from Commission adjustments.			
	Per ALJ	$ 127		
	Per Commission	140		
	Commission Adjustment		(13)	13
Total Operation and Maintenance Adjustment			$ 982	$ (982)

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LONG ISLAND LIGHTING COMPANY
Explanation of Commission Adjustments
To Gas Operating Income
For the 12 Months Ending June 30, 1980
(000)
(Cont'd)

Adjustment	Explanation	Effect On Operating Expense	Effect On Operating Income
Taxes Other Than Income Taxes			
3(a)	Adjustment to update Property Taxes to latest known tax bills. Per ALJ $ 1,306; Per Co. ltr. 3/29/79 1,080; Commission Adjustment	$ 226	$ (226)
(b)	Adjustment to reflect Revenue Taxes related to Adjustment 1(a) ($549 X 4.02%)	22	(22)
	Total Taxes Other Than Income Tax Adjustment	$ 248	$ (248)
Federal Income Taxes			
4	Per Appendix B, Schedule 3, Page 1.	$ (542)	$ 542

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LONG ISLAND LIGHTING COMPANY
Explanation of Commission Adjustments
To Gas Rate Base
For the 12 Months Ending June 30, 1980
(000)
(Cont'd)

Adjustment	Explanation		Effect On Rate Base
Working Capital			
5	Adjustment to reflect changes resulting from Commission adjustments.		
	Commission Adjustment ($982 X 1/8)		$ 122
Deferred Investment Tax Credits			
6	Reduction in Average Accumulated Deferred Investment Tax Credits due to Commission adjustments.		
	Change in Deferred ITC per Commission	$ 838	
	Rate Base effect (1/2)		$ 419

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C. 27375

Appendix B
Schedule 3
Page 1

LONG ISLAND LIGHTING COMPANY

Computation of Federal Income Taxes - Per Commission

Gas Department

For the 12 Months Ending June 30, 1980

(000)

	As Adjusted By ALJ (1)		Commission Adjustments (2)	As Adjusted By Commission (3)		Commission Rate Increase (4)	As Adjusted For Commission Rate Increase (5)
Total Operating Income	$ 19,466		$ (684)	$ 18,782		$15,804	$ 34,586
Other Income - AFC	-			-			-
Total Interest Charges	(7,764)	(1)	8	(7,756)			(7,756)
Subtotal	(7,764)		8	(7,756)			(7,756)
Income Before Income Taxes	11,702		(676)	11,026		15,804	26,830
Deduct Non-Taxable Items							
Allowance for Funds Used During Construction	-			-			-
Add-Back of Items Not Tax-Deductible							
Accrual for Injuries and Damages Reserve	-			-			-
Accrual for Bad Debts Reserve	-			-			-
Supplemental Provision	332			332			332
Amortization of Property Loss	514			514			514
Amortization of Mortgage Recording Taxes	31			31			31
CAC Costs Deferred	756			756			756
Subtotal	1,633			1,633			1,633
Deduct Additional Tax Deductions							
Tax Depreciation in Excess of Book Depreciation	3,261	(2)	541	3,802			3,802
Losses Charged to Reserve:							
Injuries and Damages	-			-			-
Bad Debts	-			-			-
Cost of Removing Retired Property	288			288			288
Costs Charged to Construction:							
Payroll Taxes	175			175			175
Pensions	300			300			300
Sales Taxes	180			180			180
Property Taxes - Lien Date	243			243			243
Earned Vacation Adjustment	207	(3)	(40)	167			167
Subtotal	4,654		501	5,155			5,155
Taxable Income (Loss)	$ 8,681		$ (1,177)	$ 7,504		$15,804	$ 23,308
Federal Income Tax at 46%	$ 3,993		$ (541)	$ 3,452		$ 7,270	$ 10,722
Less: Investment Tax Credit	(2,189)		837	(1,352)		(837)	(2,189)
Federal Income Tax - Current	1,804		296	2,100		6,433	8,533
Deferred Federal Income Tax - Current	242			242			242
Deferred Federal Income Tax - Amortization	(448)			(448)			(448)
Deferred Investment Tax Credit	1,314	(4)	(838)	476		838	1,314
Stockholder Investment Credit	438			438			438
Net Federal Income Taxes (Adjustment 4)	$ 3,350		$ (542)	$ 2,808	(5)	$ 7,271	$ 10,079

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LONG ISLAND LIGHTING COMPANY
Explanation of Commission Adjustments
To Gas Department Federal Income Taxes
For the 12 Months Ending June 30, 1980
(000)

Adjustment	Explanation			Effect On Taxable Income
Total Interest Charges				
1	Revision of interest deduction to reflect change in Long-Term Debt cost rate.			
	Interest per ALJ		$ 7,764	
	Commission Interest 7.67% of total shown on Appendix A, Schedule 3, Page 2		7,756	
	Commission Adjustment			$ 8
Tax Depreciation in Excess of Book Depreciation				
2	Additional tax depreciation related to change in book depreciation rates.			$ (541)
Earned Vacation Adjustment				
3	Revision of Earned Vacation deduction to three year average inflated for Wage Increase.			
	Per ALJ	$ 941		
	Per Commission	760		
	Commission Adjustment		$ 181	
	Gas portion at 22%			$ 40

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C. 27375

Appendix B
Schedule 3
Page 3

LONG ISLAND LIGHTING COMPANY
Explanation of Commission Adjustments
To Gas Department Federal Income Taxes
For the 12 Months Ending June 30, 1980
(000)
(Cont'd)

Adjustment	Explanation	Effect On Income Taxes
Deferred Investment Tax Credits		
4	Recalculation of Investment Tax Credit utilization using the APB #11 method (before rate increase).	
	Reduction of Deferred ITC to level indicated from Commission adjustments.	$ (832)

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CASES 27374 and 27375

APPENDIX C

LONG ISLAND LIGHTING COMPANY

Amendments to Schedule P.S.C. No. 7 - Electricity

First Revised Leaf No. 31C
Sixth Revised Leaves Nos. 33I and 47
Tenth Revised Leaf No. 42A
Fourteenth Revised Leaf No. 38
Sixteenth Revised Leaf No. 42
Seventeenth Revised Leaves Nos. 31A and 33H
Eighteenth Revised Leaf No. 43
Twenty-first Revised Leaf No. 45
Twenty-seventh Revised Leaf No. 33F
Twenty-eighth Revised Leaf No. 33G
Thirty-second Revised Leaf No. 34
Thirty-third Revised Leaf No. 30
Thirty-fourth Revised Leaf No. 28

Suppplement No. 42
Supplement No. 47

Amendments to Schedule P.S.C. No. 4 - Gas

Fourteenth Revised Leaf No. 34
Sixteenth Revised Leaf No. 30
Seventeenth Revised Leaf No. 32
Nineteenth Revised Laaf No. 27
Twentieth Revised Leaf No. 25

Supplement No. 25
Supplement No. 28

90027175

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 27374 - LONG ISLAND LIGHTING COMPANY - Electric Rates

EDWARD P. LARKIN, Commissioner, dissenting:

I dissent from the majority's electric revenue requirement determination on the basis of a fundamental regulatory precept. The electric rate increase authorized by the majority does not, in my opinion, provide the company with enough internally generated cash to guarantee its ability to meet its financial and service commitments.

I cannot sanction a rate award that will require a public service corporation to rely heavily on short-term borrowings, or elaborate trust financing schemes and sales of stock at substantially less than book value to meet its service and financial obligations. The interest coverage, dividend coverage, and AFC ratios implicit in the majority's revenue requirement will make it difficult for LILCO's management to attract the capital the majority concedes the company will need to complete the Shoreham project. There is no margin for error in the majority's revenue requirement calculation: its sales revenue estimate is optimistic, its expense allowances are minimal, its tax estimates reflect a flow-through of almost every conceivable credit and dedu cion, and its return allowance is at the extreme low end of the range of reasonableness.

I have no objection to tough-minded regulation, but I believe we have an obligation to look beyond the immediate result to see who will be hurt if our determinations are wrong. It is naive to think LILCO's stockholders will be the primary, or even the major, victims if the majority's

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rate award proves insufficient. Experience shows it is consumers who ultimately pay when rates are kept at artificially low levels. Consumers can be exploited just as effectively by poor service as by high rates.[1] In this case, I see a real possibility that financing delays could result in slippage of the Shoreham in-service date, an event that would be most unfortunate for LILCO consumers, for they will continue to pay the high cost of electricity generated mostly with oil purchased at OPEC-dictated prices, until Shoreham comes on line. Thus, consumers face the double jeopardy of high fuel adjustment charges and poorer service.

The tragic part of the majority's decision is that it is so unnecessary. In LILCO's last electric rate case, this Commission had the will to approve the cash flow allowances the company needed to provide service and finance construction. It could have done so again here by adopting the cash flow and return recommendations of the Staff and the Judge. In its rush to keep this electric rate increase to the minimum, the majority has found it necessary to allow LILCO's stockholders a higher return than either the Staff or the Judge recommended. It would have been better to follow Staff and the Judge and provide LILCO with more cash while reducing its paper profits.

For what does the majority risk service degradations, delay in Shoreham's completion, impairment of capital, and excess profits? As far as I can see, the only reason is to give consumers a few more months of relatively low base rates before the addition of $1 billion of Shoreham investment to rate base requires an extraordinarily large increase in base electric rates. When Long Island consumers find their household budgets stretched by that increase, there will be no thanks or remembrance for the majority's decision to

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1/Cases 26522 and 26523, Rochester Gas and Electric Corporation - Rates, 14 NY PSC 1064, 1068 (Chairman Kahn, concurring).

reduce the modest electric rate increase recommended by the Judge here, because the necessary result is that what promises to be a large increase in the next LILCO electric rate case will be even larger.

I therefore dissent from the electric rate increase authorized by the majority. I would have accepted their determinations, if cash flow allowances from inclusion of CWIP in rate base or interperiod tax allocations had been recognized to produce additional revenues in the $60-$75 million range.

90027178

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 27374 - LONG ISLAND LIGHTING COMPANY - Electric Rates

CASE 27375 - LONG ISLAND LIGHTING COMPANY - Gas Rates

ANNE F. MEAD, KAREN S. BURSTEIN, Commissioners, dissenting:

We dissent from various portions of the opinion of the majority.

Before reaching the issues on which we dissent, we believe it is necessary to put into perspective the conditions which obtain in the franchise area served by the Company and the impact that increased rates will have on business and industry as well as residential ratepayers.

The decision of the majority does not, nor did the Administrative Law Judge's Recommended Decision, discuss the public outcry that occurred at the outset of this case. There were four public statement hearings held in Nassau and Suffolk Counties at its inception. Some 115 persons spoke at these hearings during July 1978. In addition no less than 10,000 protests and petitions were received by the Public Service Commission from ratepayers objecting to the proposed rate increase. With few exceptions, people at the hearings voiced opposition to the rate increase. They pointed out the difficulty that the elderly and the poor, who already face severe financial hardships, will have if rates are increased. In addition middle class families plagued by high taxes,

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sewer assessments, inflation and unemployment argued that hardship will result from higher utility prices.

In addition to those who wrote to the Commission or appeared at public statement hearings, several witnesses presented by the Counties of Nassau and Suffolk testified to the impact increased rates would have on residential ratepayers as well as upon industry and business, thus exacerbating the serious economic problems which beset Long Island at this time.

It is important to note that this rate increase application is the fourth made by the Company since 1974. In 1975 in Case 26552 this Commission granted an increase of $64.3 million. On May 22, 1976 in Case 26837 this Commission granted an increase of $33.2 million and on January 9, 1978 this Commission granted an increase of $59.7 million--a total increase in three years of $157.2 million. In addition, in two of these cases, temporary rates were allowed prior to the decision in the permanent rate case and second stage rate increases totalling over $11 million were authorized by this Commission.

Although the Company was granted an increase on January 9, 1978, barely five months later the Company was once again at our doorstep with a request for $171,000,000! A review of the Company's presentation clearly indicates that this request is based on an overstated budget designed to inflate its rate request.

While it is true that the rate of return earned by the Company in 1978 fell below its allowed rate of return of 13.3%, nevertheless the Company has achieved an average return of 13.6% for the years 1975-78.

While there is some continued cash flow problem, this is the result of a large construction program and AFC accruals. This problem should be reduced considerably by the completion and inclusion in rate base of the Shoreham plant in 1980.

We conclude, as we did in Case 27370/1/2, Rochester Gas and Electric Corporation, and in Cases 27361/2, New York State Electric and Gas Corporation, that the economic conditions in a utility franchise area should be considered in arriving at an appropriate cost of equity capital and establishing rates so that the impact on consumers is minimized to the greatest extent possible, while at the same time allowing the company sufficient funds to provide safe and reliable service and raise necessary capital in the financial market.

We turn now to those areas in the majority opinion from which we dissent:

1. Rate of Return. The analysis used by the majority in determining the rate of return on common equity indicates that a "bare bones" cost of equity in the 13.25 - 13.75% range is proper. Because of the impact of these rates on consumers of service as discussed above this Commission should adopt the lower end of the range of reasonableness. This would equate to a return of 13.5% including issuance costs--a fair return on common equity under the circumstances that prevail.

2. Meter Tampering Recoveries. We disagree with the majority in the revenue estimate adopted with respect to revenue protection activities proposed by the Company. Initially the

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Company request was based upon the premise that LILCO was willing to assume that the program would produce revenue equal to its cost. Staff used a test year benefit/cost ratio to project revenues attributable to the program and determined that revenues of $1,112,700 over and above the cost of the program would be a reasonable, even conservative, estimate. The Company then recomputed its figures and agreed that additional revenues of $350,000.00 could be imputed on the basis of 1978 data. Since the 1978 data are derived from a six month period when the program was being developed, they do not properly reflect all the revenues to be expected in the test year. The Commission should instead adopt the revenue figure as recommended by the Administrative Law Judge.

In all other respects we concur with the opinion of the majority.

QUESTION 4.d.

Complete the enclosed form entitled, "Financial Statistics," for the most recently available period and the calendar years 1977, 1976 and 1975.

RESPONSE

See the attached form entitled "Financial Statistics," for the calendar years 1975 through 1978.

FINANCIAL STATISTICS
LONG ISLAND LIGHTING COMPANY

	1978	1977	1976	1975
	($000)			
Earnings available to common equity	$111,305	$104,593	$ 86,787	$ 66,984
Average common equity	884,918	754,642	615,192	512,859
Rate of return on average common equity	12.58%	13.86%	14.11%	13.06%
Times total interest earned before FIT:				
Gross income (both including and excluding (1)	2.62	2.62	2.62	2.53
AFC) + current and deferred FIT + total interest charges + amortization of debt discount and expense (2)	1.91	1.85	1.92	1.95
Times long-term interest earned before FIT:				
Gross income (both including and excluding (1)	2.74	2.76	2.80	2.87
AFC) + current and deferred FIT + long-term interest charges + amortization of debt discount and expense (2)	2.01	1.95	2.05	2.20
Bond ratings (end of period) (3)				
Standard and Poor's	A-/A	A-/A	A-/A	A-/A-
Moody's	A/AA	A/AA	A/AA	A/AA
Times interest and preferred dividends earned after FIT:				
Gross income (both including and excluding (1)	1.86	1.92	1.89	1.82
AFC) ÷ total interest charges + amortization of debt discount and expense + preferred dividends (2)	1.32	1.34	1.37	1.37
AFC (all) (4)	$ 69,739	$ 65,801	$ 50,681	$ 36,345
Net income after preferred dividends	111,305	104,593	86,787	66,984
%	62.7%	62.9%	58.4%	54.3%
Market price of common	$ 17-1/4	$ 18-5/8	$ 18-1/4	$ 15-7/8
Book value of common	$ 19.12	$ 18.70	$ 17.93	$ 17.19
Market-book ratio (end of period)*	90.2%	99.6%	101.8%	92.[illegible]%
Earnings avail. for common less AFC + depreciation and amortization, deferred taxes, and invest. tax cr. adjust.-deferred	$107,470	$ 87,497	$ 87,750	$ 76,606
Common dividends	74,759	63,473	51,836	41,936
Ratio of Earnings to Dividends	143.8%	137.8%	169.3%	182.7%
Short-term debt (5)				
Bank loans	--	--	--	--
Commercial paper	--	--	--	--

* If subsidiary company, use parent's data.

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(Continued)

	1978	1977	1976	1975
Capitalization (Amount & Percent):				
Long-term debt (6)	$1,175,751	$1,102,003	$1,017,977	$892,475
Preferred stock	390,449	394,436	331,431	304,980
Common equity	982,942	823,483	674,828	551,341
Long-term debt	46.1%	47.5%	50.3%	51.0%
Preferred stock	15.3%	17.0%	16.4%	17.5%
Common equity	38.6%	35.5%	33.3%	31.5%

Notes:

(1) Gross income includes all AFC

(2) Gross income excludes all AFC

(3) The ratings are listed for the Company's two mortgages as follows: General and Refunding Bonds/First Mortgage Bonds.

(4) Includes AFC applicable to Trust financings in 1978 of $3.6 million.

(5) No short-term debt was outstanding at any one of the four years ended December 31, 1975, 1976, 1977, or 1978.

(6) Includes long-term debt (and current maturities of $25 million at 12/31/75) and unamortized premium and discount on debt, but excluding $30.0 million of Trust Obligations-the Company's promissory note, due 1982, to Tri-Counties Resources Trust (at 12/31/77 and at 3/31/78).