ACCOUNTING CONSIDERATIONS FOR LONG-TERM POWER PURCHASE AGREEMENTS

May 30, 2008

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# Accounting Consolidation Models

<table>
<thead>
<tr>
<th>Traditional Voting Interest Model</th>
<th>FIN 46 “Variable Interest” Model</th>
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</thead>
<tbody>
<tr>
<td>Consolidation based on equity ownership and voting interests</td>
<td>Consolidation based on economic risks and rewards Ownership <strong>NOT</strong> a criteria for determining consolidation</td>
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</tbody>
</table>
Definition of a Variable Interest Entity

Equity holders do not have a controlling financial interest (any one of the following conditions)

- Entity is thinly capitalized
- Equity holders lack decision-making rights
- Equity holders’ rights to return are capped
- Equity holders are protected from losses
When is a PPA a Variable Interest?

Does the contract create or absorb risk?

Case-by-case evaluation

Variable Interest

Risk absorbers
- Variable price contract tied to fuel
- Fixed price contract for a hydro plant

Not a Variable Interest

Risk creators
- Fixed price contract for a gas-fueled plant

Recovery mechanism not considered
Consolidation Issues

Financial reporting risk if consolidation is required

- Quarterly financial information for SEC reporting
- Sarbanes-Oxley certification of internal controls
- Deficiencies in either of the above could result in a qualified audit opinion
Debt Imputation Issues

• Restricted borrowing capacity
• Higher costs of capital
• Need to rebalance capital structure
• Overall decrease in market value
Other Utility PPA Considerations

• Risk transfer to utility customers/investors
• Retail access
• Strandable costs
• Impact of market mitigation measures
How to Better Encourage New Supply

• Predictability, consistency and transparency in market design
• Forward capacity markets
• Price or credit support from government if needed
• Utility build option - reliability backstop solution if market fails