

CHARLES D. HUTCHESON - REBUTTAL/UPDATE
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1 Q. Please state your name.

2 A. My name is Charles D. Hutcheson.

3 Q. Did you previously testify in this proceeding?

4 A. Yes, I did.

5 Q. What is the purpose of your rebuttal testimony?

6 A. My rebuttal testimony: (1) explains the reasons for my
7 update to the Company's New York City property tax
8 forecast; (2) rebuts an adjustment made by the Staff
9 Accounting Panel to my updated New York City property
10 tax forecast; and (3) rebuts direct testimony offered
11 by various parties as to depreciation.

12 Q. Please summarize your update testimony.

13 A. My update testimony explains the reasons why I have
14 updated my forecast on property taxes. Since my
15 original forecast was filed, New York City has
16 implemented new tax rates and assessed values for the
17 2007/2008 fiscal year and I have used that actual data
18 to replace forecasted data I had developed for that
19 period. I then revised my future estimates to reflect
20 those updated amounts. I have also incorporated a
21 decrease in property taxes for an approved tax benefit
22 under the City's Industrial and Commercial Incentive
23 Program ("ICIP") that was approved subsequent to the
24 filing of my original forecast.

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1 Q. Does your update include any changes to your previous
2 exhibits?

3 A. No. I have updated the forecast only. I did not have
4 any exhibits related to property taxes.

5 Q. Please summarize the rebuttal portion of your
6 testimony.

7 A. My rebuttal testimony for property taxes includes
8 reasons why I disagree with the Staff Accounting
9 Panel's adjustment to my property tax update. My
10 rebuttal testimony for depreciation addresses
11 adjustments made by Staff witness Michael J. Rieder;
12 Harvey Arnett on behalf of the City of New York; Ronald
13 J. Liberty and Frank W. Radigan (the "Westchester
14 Panel") on behalf of the County of Westchester; John
15 Chamberlin, Don Bennett, and Brian Hedman ("the NYPA
16 Panel") on behalf of the New York Power Authority; and
17 Douglas W. Elfner on behalf of the New York State
18 Consumer Protection Board.

19 PROPERTY TAXES

20 Q. Please explain the reasons for your updated property
21 tax forecast.

22 A. Since the initial filing, New York City has issued
23 final assessed values for our properties as well as
24 final tax rates. My updated forecast reflects both of

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1 those developments and reduces property taxes to
2 account for certain additional tax benefits. I have
3 estimated more benefits for fiscal year 2008/2009 due
4 to the ICIP benefit for the Company's Mott Haven
5 Substation. Reductions associated with that tax
6 benefit were effective for fiscal 2007/2008 and were
7 not known when the initial forecast was prepared. I
8 have now reflected those benefits in the forecast for
9 2007/2008 as well as some additional benefits for the
10 Mott Haven Substation that I believe will be effective
11 in 2008/2009.

12 Q. What was the impact of your updated property tax
13 forecast?

14 A. The combination of reduced tax rates and increased
15 assessed valuations, along with the additional
16 reductions for the Mott Haven Substation have resulted
17 in a reduction in rate year property taxes of about
18 \$26.4 million.

19 Q. Has the Staff Accounting Panel accepted your rate year
20 decrease of \$26.4 million?

21 A. Staff accepted the Company's updated forecast and also
22 proposed to reduce the rate year amount by an
23 additional \$1.771 million.

24 Q. What is the basis for their adjustment?

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1 A. The Staff Accounting Panel has proposed additional
2 reductions to my forecasted tax rates for both classes
3 3 and 4 (the utility tax classes) for fiscal year
4 2008/2009. The City imposed a significant (i.e., 18.5
5 percent), across-the-board mid-year tax increase
6 enacted in the middle of the 2002/2003 fiscal year. In
7 my forecast, I ignored this huge tax rate increase as
8 not being representative of "normal" tax rate changes.
9 In contrast, Staff used the rate in effect for only the
10 second-half of that year as the starting point for
11 analyzing the tax rate changes. Therefore, their
12 starting point included the full impact of the 18.5
13 percent rate increase and is much higher than the
14 effective rate for the entire year.

15 Q. Why is the Staff method incorrect in your opinion?

16 A. It is incorrect for two reasons. First, they have
17 elected to base their analysis on a rate in effect for
18 only part of the year. Since Staff elected not to
19 ignore the rate for 2002/2003, they should have
20 computed an effective rate for the entire year, which
21 they did not do. Second, by using only the second-half
22 rate for 2002/2003, which was higher than the first-
23 half rate, that higher rate necessarily caused their
24 calculation to show a decrease in the following period,

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1 as it is only logical that rates would have to drop, or
2 correct themselves, after such a significant one-time
3 increase.

4 Q. Why is the method used by the Company preferable?

5 A. It is preferable because it ignores the unprecedented
6 rate increase and in effect, added-on the prior year so
7 that an average change for five full years was
8 computed, which is more reflective of a normal increase
9 in tax rates.

10 Q. What are the tax rate changes that were computed by
11 both parties?

12 A. Staff computed a 1.61 percent reduction for class 3 and
13 a 2.72 percent reduction for class 4. I computed a
14 1.25 percent reduction for class 3 and a 2.33 percent
15 reduction for class 4. The logic I used to compute the
16 rate changes is correct for the reasons I have
17 explained. Therefore, Staff's \$1.7 million tax
18 adjustment should be rejected.

19 DEPRECIATION

20 Q. Please discuss your rebuttal testimony concerning
21 depreciation, specifically as it addresses the direct
22 testimony of Mr. Rieder.

23 A. Mr. Rieder and I disagree on the selection of a total
24 of six proposed average service life changes and two

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1 net salvage changes. For two of those changes, Mr.
2 Rieder agrees that a shorter average service life is
3 appropriate, but he believes I lowered the lives too
4 far. For two other accounts, Mr. Rieder believes that
5 my proposal to shorten the lives was not appropriate
6 and he recommends leaving the current lives unchanged.
7 For the final two accounts, my proposal was to leave
8 the lives unchanged while Mr. Rieder argues that longer
9 lives are appropriate. As explained in both my direct
10 testimony as well as Mr. Rieder's testimony, a change
11 toward a shorter average service life will increase
12 depreciation expense, while a change to a longer life
13 will decrease depreciation expense. Therefore, the
14 effect of all six of the average service life changes
15 proposed by Mr. Rieder is to decrease depreciation
16 expense for each of the accounts when compared to my
17 own proposals.

18 Similarly, for net salvage factors, Mr. Rieder
19 disagrees with my proposals to increase the negative
20 net salvage factors for two accounts. In both
21 instances, he has proposed to increase the negative net
22 salvage factor, but not as far as I had proposed.
23 Since raising a negative net salvage factor (e.g., from
24 10 percent negative to 20 percent negative) increases

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1 depreciation expense, the effect of Mr. Rieder
2 proposing a lower negative percentage is to lower
3 annual depreciation expense.

4 Q. What is the dollar impact of your disagreements with
5 Mr. Rieder?

6 A. His changes lower annual depreciation expense by \$10.2
7 million and result in a reserve variation that is \$92.8
8 million lower than the reserve variation derived from
9 my proposed depreciation rates. The annual effect of
10 that change is to decrease the amortization for each of
11 15 years by \$6.2 million. In total, Mr. Rieder
12 decreases the Company's proposed depreciation expense
13 by \$16.4 million annually, based on the book cost of
14 plant at December 31, 2006.

15 Q. Please discuss your specific disagreements with Mr.
16 Rieder concerning your average service life selections.

17 A. Concerning Account 9514 - Structures and Improvements,
18 I proposed to lower that life, from 65 years to 40
19 years. Mr. Rieder has proposed to lower the life as
20 well, but only to 55 years. Our differences on this
21 life are two-fold. First, my interpretation of the
22 study indicates that the life has dropped considerably
23 and the study results support that. Second, I have
24 based my analysis on a single current study only, study

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1 number 055144, while Mr. Rieder has relied somewhat on
2 a second study I had submitted in the case for that
3 account which was designated study number 055141. For
4 all the reasons explained throughout my testimony, I
5 believe Mr. Rieder has erred in relying on study number
6 055141. That study was included only so that users of
7 the information could readily compare the variations in
8 the studies due to the adjustments I have described in
9 my testimony.

10 As to my interpretation of the study results, the
11 recent rolling bands for the second and third degrees
12 indicate extremely low average service lives that range
13 below 20 years. These bands indicate lives of 12 and
14 13 years. The shrinking bands for this account
15 indicate lives that support a 40-year life for the
16 widest bands, but degrees 2 and 3 indicate trends
17 toward significantly lower lives. I have relied on the
18 trends toward lower for my proposal. I believe the
19 study supports such a decrease and that lower life
20 should be recognized at this time.

21 Q. Please describe your differences for the next account.

22 A. The next account is Account 9526 - Miscellaneous Power
23 Plant Equipment. As with the previous account, my
24 analysis was once again limited to a single designated

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1 study, 055264. Mr. Rieder should not have relied on
2 two studies for this account, as only the one I relied
3 on is the correct study as I have explained in my
4 testimony. I have proposed to drop the life from 50 to
5 40 years, while Mr. Rieder again agrees the life should
6 be lower, but only to the extent of moving to a 45-year
7 life. My analysis of the statistical study
8 demonstrates my 40-year proposal is fully supported.
9 For instance, the more recent rolling bands for study
10 number 055264 for the third degree indicate lives that
11 are generally below the existing average service life.
12 The widest shrinking bands indicate a life for the
13 first and third degrees of 31 and 33 years
14 respectively. Notably the third degree, which is the
15 degree of best fit, trends toward lives that are
16 significantly below the 40-year life I have proposed.

17 Q. Please continue.

18 A. For Accounts 9534 - Station Equipment and 9565 - Line
19 Transformers (Overhead), Mr. Rieder believes that my
20 proposed changes to lower the lives for both of these
21 accounts by five years are premature and he recommends
22 that the lives remain unchanged. I disagree. For
23 Account 9534 - Station Equipment, I have proposed to
24 lower the life from 50 to 45 years while Mr. Rieder

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1 proposes to leave it unchanged at 50 years. My review
2 of study number 055341 indicates that the recent
3 rolling bands for the second and third degrees show
4 lives below the current 50-year life. The widest
5 shrinking bands for the third degree, the degree of
6 best fit, (although the fit is not materially different
7 from degrees 1 or 2) indicate 46 years and do not vary
8 much from that life. In my opinion, the combination of
9 the indications noted by the third degree shrinking
10 bands and the indications seen in most of the recent
11 rolling bands justify dropping the service life of this
12 account to 45 years.

13 For Account 9565 - Line Transformers (Overhead), I have
14 proposed the life be set at 30 years instead of the 35-
15 year life now in effect. Mr. Rieder proposes to leave
16 the life unchanged. My analysis of study number 055652
17 indicates that the most recent rolling bands for the
18 first and third degrees indicate lives that are
19 slightly lower than the existing 35-year service life.
20 The widest shrinking bands for degree 1, the only
21 degree with all bands fit, indicate a 34-year life but
22 trend toward lower lives. In my opinion, the trend
23 toward lower lives in conjunction with the lower lives

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1 indicated by the rolling bands justified the need to
2 lower the life for this account.

3 Q. Please continue.

4 A. For Account 9567 - Underground Services, and Account
5 9576 - Underground Street Lighting and Signal Systems,
6 I have proposed to leave the existing service lives
7 unchanged at 70 and 65 years respectively. Mr. Rieder
8 proposes the lives for both of these accounts should be
9 increased by five years. The studies for each of the
10 accounts indicate lives for the most part above the
11 current average service lives. I have elected to leave
12 the lives unchanged because I believe the
13 infrastructure work being performed on the underground
14 system will result in retirements in the near future
15 that will tend to decrease lives as we move forward in
16 time. Moreover, the lives for the accounts are already
17 very long and I do not believe that it is logical to
18 continue to increase them.

19 Q. Please now discuss your disagreements with Mr. Rieder
20 concerning net salvage factors.

21 A. Mr. Rieder and I disagree on only two net salvage
22 factors. In both instances, Mr. Rieder agrees the net
23 salvage factors should be increased to higher negative
24 rates, but he believes I have increased them too high.

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1 For Account 9534 - Station Equipment, I have proposed a
2 30 percent negative net salvage factor while he
3 proposed a 25 percent negative factor. The existing
4 rate is 20 percent negative. In my analysis of the net
5 salvage study for this account, I noted that the full
6 experience percentage indicates a value of 26.58
7 percent negative, slightly below the rate I am
8 proposing. However, the shrinking bands trend toward
9 increased negative percentages with the more recent
10 shrinking bands all in excess of 40 percent negative.
11 Although the full experience bands trend only as high
12 as 26.58 percent negative, they are clearly trending
13 toward higher negative percentages. The 5-year rolling
14 bands likewise trend toward higher negative
15 percentages, and those recent bands are in excess of 40
16 percent negative. I believe the study data clearly
17 supports the need to change to my proposal of 30
18 percent negative.

19 For Account 9554 - Station Equipment, the existing net
20 salvage factor is 20 percent negative and I have
21 proposed to increase the negative percentage to 30
22 percent. Mr. Rieder agrees that the net salvage factor
23 should be increased, but only to a 25 percent negative
24 rate. My analysis of the net salvage study for this

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1 account indicates the need for the move to 30 percent
2 negative. The full experience percentage is 28.56
3 percent negative, slightly below my proposal. However,
4 the recent shrinking bands indicate very high negative
5 percentages. The full experience bands, although not
6 indicating results as high as I have proposed, do
7 indicate a trend toward increased negative percentages.
8 I believe that the indications for this account
9 demonstrate the need to increase the negative net
10 salvage factor to my proposed 30 percent negative rate.

11 Q. Please now address the depreciation testimony offered
12 by the other witnesses in this proceeding.

13 A. Mr. Arnett and the Westchester Panel proposed similar
14 adjustments which seek to eliminate net salvage
15 recovery from depreciation rates. The NYPA Panel and
16 Mr. Elfner proposed to eliminate all depreciation rate
17 changes. I will specifically address my disagreements
18 with the proposals separately as each is different in
19 some way. However, all of the proposals are a one-time
20 attempt to decrease a proper depreciation request. If
21 accepted, these proposals will serve to increase costs
22 in the long-term by pushing out recovery to the next
23 rate proceeding and beyond. The Commission should
24 reject such shortsighted proposals.

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1 Q. Since some of these adjustments refer to the handling
2 of net salvage, please briefly discuss the concept of
3 net salvage.

4 A. In addition to providing for recovery of the original
5 cost of plant over its estimated average service life,
6 the Company's annual depreciation rates include an
7 estimated net salvage factor. Net salvage occurs when
8 an asset is retired and is measured by the dollars
9 realized from the sale or scrap disposal of the asset
10 less its cost of removal. The purpose of a net salvage
11 factor is to reflect, over the life of the plant, the
12 anticipated economic cost of its retirement including
13 the sale of any scrap material, and the cost of
14 removal. When the amount received for the retired
15 asset exceeds the cost of removal, positive net salvage
16 is generated which decreases depreciation rates. When
17 the cost to remove exceeds the amount received for the
18 retired asset, negative net salvage is generated which
19 increases depreciation rates.

20 Q. Please summarize why you disagree with removing net
21 salvage recovery from the annual depreciation rate as
22 Mr. Arnett and the Westchester Panel propose.

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- 1 A. I will refer to this method as the "cash basis method"
2 throughout my rebuttal testimony. I disagree with this
3 concept for the reasons set forth below:
- 4 • It is inconsistent with current rate and
5 accounting principles;
 - 6 • It is an arbitrary and "results driven" exercise
7 to artificially lower current revenue requirements
8 by pushing costs that should be recovered now far
9 into the future;
 - 10 • It creates intergenerational inequity by
11 arbitrarily pushing recovery of net salvage into
12 the future for future customers to pay;
 - 13 • It relieves today's ratepayers of any cost
14 responsibility for assets serving them currently;
 - 15 • It requires the Company to pay for removal cost
16 programs using funds that have not been recovered
17 from customers;
 - 18 • It is likely to result in wide variations in the
19 income statement since net salvage costs often
20 fluctuate from year-to-year but will need to be
21 paid for within a short time after they are spent;
22 and

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- 1 • It increases the risk of recovery because it will
2 result in the need for greater recovery in the
3 future.

4 Q. Please now provide details to the points you have
5 summarized above.

6 A. The National Association of Regulatory Utility
7 Commissioners ("NARUC"), in its publication entitled
8 "Public Utility Depreciation Practices", describes some
9 salvage considerations as follows:

10 "Under presently accepted concepts, the
11 amount of depreciation to be accrued
12 over the life of an asset is its
13 original cost less net salvage" (NARUC,
14 page 18).

15 The passage continues later with:

16 "The goal of accounting for net salvage
17 is to allocate the net cost of an asset
18 to accounting periods, making due
19 allowance for the net salvage, positive
20 or negative, that will be obtained when
21 the asset is retired. This concept
22 carries with it the premise that
23 property ownership includes the
24 responsibility for the property's

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1 ultimate abandonment or removal. Hence,
2 if current users benefit from its use,
3 they should pay their pro rata share of
4 the costs involved in the abandonment or
5 removal of the property and also receive
6 their pro rata share of the benefits of
7 the proceeds realized" (NARUC, page 18).

8 One additional passage then goes on to state that:

9 "This treatment of net salvage is in
10 harmony with generally accepted
11 accounting principles and tends to
12 remove from the income statement any
13 fluctuations caused by erratic, although
14 necessary, abandonment and removal
15 operations. It also has the advantage
16 that current consumers pay or receive a
17 fair share of costs associated with the
18 property devoted to their service, even
19 though the costs may be estimated"
20 (NARUC, page 18).

21 The above passages highlight many of the problems with
22 the concept of removing net salvage from depreciation
23 rates.

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1 Q. Do you have other reasons for objecting to the removal
2 of net salvage from the depreciation rate?

3 A. Yes. Removing net salvage from the depreciation rate
4 makes no sense for a number of other reasons. Imagine,
5 for example, if the Country's nuclear units were not on
6 a "pre-funding" basis (as Mr. Arnett refers to the
7 method used by the Company). Decommissioning a nuclear
8 facility often results in an outlay of billions of
9 dollars in a short period of time. Customers being
10 forced to pay those costs after they are incurred and
11 over a short period might not be able to afford to do
12 so and such a policy would result in a significant rate
13 spike. Regulators agree in that they require pre-
14 funding in a segregated decommissioning fund in order
15 to avoid these long-term cost issues. If it is unfair
16 and unwise for both the utility and for customers for
17 decommissioning, then it is similarly unfair for
18 removal costs as such costs are no different from
19 decommissioning costs. The cash basis method simply
20 means that net salvage cannot be recovered until after
21 it is spent, which presumes that the utility has the
22 money and the ability to fund its removal cost (or
23 decommissioning) programs. In cases where the cash
24 basis method has been proposed, recovery is not

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1 realized until after the money has been spent, which
2 may take several more years. Such recovery is based on
3 averages of past experience, and is often recovered
4 through forward-looking amortizations.

5 The cash basis method makes customers who did not
6 receive the benefit of the asset pay the costs to
7 remove the asset many years after asset retirement, and
8 increases the risk of having costs spread out even
9 further because of the enormous rate spike that would
10 occur when the costs actually are incurred and need to
11 be collected.

12 Q. Please continue.

13 A. The goal of the Company's proper method of recovering
14 net salvage is to have an adequate amount recovered
15 from the customers who benefited from the asset's use
16 by the time the asset is retired. At the time of the
17 future retirement/removal, the costs for removal will
18 likely be higher than what the Company would pay to
19 remove the same asset today because of inflation in
20 connection with labor costs. The cash basis method
21 essentially does not provide a proper allowance for
22 future net salvage. Although using an average based on
23 some number of past years may have some relationship to
24 today's cash outlays for negative salvage, such an

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1 average surely does not provide for the higher future
2 costs that will be required to remove the plant that is
3 currently on the system. The cash basis method will
4 therefore mismatch and back-load net salvage costs
5 relating to current plant in service and burden future
6 customers with those costs that should have been paid
7 earlier.

8 Q. Please provide an example.

9 A. Assume an asset with a \$100 original book cost, a five-
10 year average service life, and a 20% negative net
11 salvage factor (or \$20 for net negative salvage at
12 retirement, based on the historic relationship of
13 salvage costs to original cost). Assume also that the
14 asset survives exactly five years and the net negative
15 salvage at the end of that time will equal exactly 20%
16 of the asset cost, or \$20. The Company will depreciate
17 this asset for five years with annual depreciation
18 expense amounting to \$24, based on a computed
19 depreciation rate of 24%¹. As of the retirement date,
20 the Company will have recovered a total of \$120 from
21 ratepayers (\$100 of the original cost and \$20 for the

¹The 24% annual depreciation rate is derived by taking 100% and subtracting the 20% negative net salvage factor and dividing by the life of 5 years $((100\% - (-20\%)) / 5)$.

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1 net negative salvage). After retirement and removal of
2 this asset, the net unrecovered book cost of the asset
3 will be zero and the Company will have recovered the
4 full amount of net salvage needed to remove the asset.
5 It is also important to note that the recovery of the
6 asset's full costs will have been accomplished over the
7 time that the asset was providing service to customers.
8 That is, each year customers that were benefiting from
9 the plant provided \$4 towards its net negative salvage.
10 Assuming the same facts, under the cash basis method
11 being advanced, at the time of the asset retirement,
12 the Company will have not yet recovered any of the
13 costs necessary to remove the asset since the ten-year
14 average of actual dollars spent on net removal costs
15 for this asset will always be zero until the year after
16 retirement. This will always be the case because there
17 can be no net salvage charged to an asset before it has
18 been retired. Notwithstanding the lack of rate
19 recovery, the Company will still need to expend and
20 collect the \$20 for salvage. Under proposals like
21 these, the Company will have to wait at least twice as
22 long as the averaging period for full recovery of this
23 asset's total cost since these methods require ten
24 additional years after retirement for the amortization

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1 to be fully realized to accumulate to the total \$20
2 requirement. The cash basis method also requires the
3 Company to secure funds from an external source since
4 the costs have not been recovered from customers. Such
5 proposals are both inconsistent with the New York
6 Commission's depreciation policy and an incorrect
7 application of depreciation theory.

8 Q. Please specifically discuss Mr. Arnett's proposal.

9 A. Mr. Arnett has proposed a cash basis method. He
10 proposes to remove all negative net salvage from
11 depreciation rates for Electric Transmission and
12 Distribution, and replace it with a 10-year
13 amortization of the costs after they are incurred,
14 beginning with a rate year 1 amortization of \$50
15 million per year. His amount to be amortized is based
16 on a 10-year rolling average of past actual experience.
17 His proposal results in the elimination of the \$42
18 million reserve variation amortization proposed by me
19 and further reduces the rate year 1 revenue requirement
20 by an additional \$78 million.

21 Q. Is there anything specific to Mr. Arnett's proposal
22 that causes additional concerns that you have not
23 already addressed above in your general comments on
24 cash basis methods?

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1 A. I would note that Mr. Arnett has based his proposal on
2 an unreasonably long 10-year average, meaning that
3 because of inflation, the average so developed will be
4 relatively low in relation to the amount spent on net
5 salvage in the most recent year. Said another way, a
6 10-year average is far too long because it really does
7 not account for the Company's current costs since, over
8 such a long period of time, the cost of labor can rise
9 significantly. For instance, for total Electric
10 Transmission and Distribution Plant, the 10-year
11 average net salvage costs based on the period 1997-2006
12 equal \$83.9 million while a more reasonable three-year
13 average amounts to \$119.4 million. Going one step
14 further, the 2006 total amount actually spent on net
15 salvage is even higher, amounting to \$134.7 million.
16 It is evident by the numbers that using a 10-year
17 average to compute an allowance which generally
18 increases with time is not fairly measuring the true
19 recent costs being experienced by the Company.
20 In addition, Mr. Arnett arrives at a \$50 million
21 amortization, or allowance, for net salvage in lieu of
22 recovery through depreciation that is simply
23 unreasonable. He has computed both a five and a 10-
24 year average and picked \$100 million as representative

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1 of the Company's past spending. He then opts for half
2 of that level, or \$50 million, as the appropriate level
3 to include as his net salvage allowance. He claims
4 that an allowance of \$50 million would avoid the need
5 for a rate increase in the next rate plan as well as
6 the one after that. His logic is not properly
7 explained and, at any rate, cannot be true because, as
8 I indicated above, the Company spends well over the \$50
9 million allowance for Electric Transmission and
10 Distribution plant. Mr. Arnett's testimony does not
11 justify his decision to use \$50 million for his
12 allowance and it clearly does not cover the Company's
13 current costs nor will it cover future costs that
14 should be recovered upon retirement.

15 Q. Do you have any other concerns with Mr. Arnett's
16 proposal?

17 A. Yes. Mr. Arnett explains the intergenerational
18 inequity argument in his testimony by describing the
19 method used by the Company and stating (at 22),
20 "ratepayers who are served by that item of plant are
21 said to contribute to the full cost associated with
22 that asset incurred both before it enters service and
23 after that asset is retired". He has misspoken in
24 stating that ratepayers contribute to the cost of

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1 assets before they are placed in service as he has
2 clarified the statement in response to a discovery
3 request (Con Edison Set No. 1-1) and states that the
4 sentence was "not meant to suggest that ratepayers were
5 paying rates that reflected the costs of the asset
6 before the asset was placed in service" (MARK FOR
7 IDENTIFICATION AS EXHIBIT ____ (CH-4)).
8 Referring again to his testimony, he describes the
9 Company method as an argument supporting
10 intergenerational "equity" (at 22) and I certainly
11 would agree with his conclusion that the Company's
12 method supports this important principle. The
13 troubling part is that he is aware of this principle,
14 mentions it in his testimony as if he supports this
15 principle, but makes no attempt to demonstrate that the
16 cash basis method he has proposed supports this
17 principle.

18 Q. Mr. Arnett claims four reasons why recovering negative
19 net salvage through depreciation rates is incorrect.
20 Do you agree with him?

21 A. No. For his first reason he states (at 22) that, "in
22 the case of an electric utility, negative net salvage
23 is almost always incurred to allow the installation of
24 a new asset to serve the greater needs of the future

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1 ratepayers". He then explains (at 23) that the
2 Company's current "practice is akin to requiring
3 homeowners to cover through their mortgage payments the
4 eventual demolition of their new house when it becomes
5 inadequate for the needs of the then current owners".
6 Mr. Arnett is trying in some way to make removal costs
7 a part of the cost of the new asset. This is a
8 violation of the Uniform System of Accounts which
9 states the cost of removal and salvage shall be charged
10 to the depreciation reserve account. It is also at
11 odds with the accounting profession. The American
12 Institute of Certified Public Accountants defines
13 depreciation accounting as follows:

14 "Depreciation accounting is a system of
15 accounting which aims to distribute the
16 cost or other basic value of tangible
17 capital assets, less salvage (if any),
18 over the estimated useful life of the
19 unit (which may be a group of assets) in
20 a systematic and rational manner" (An
21 Introduction to Depreciation of Public
22 Utility Plant and Plant of Other
23 Industries, AGA Depreciation Committee

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1 and EEI Depreciation Accounting
2 Committee, page 8).

3 From that definition, it is clear that the accounting
4 concept of depreciation includes the original cost
5 adjusted for net salvage over the estimated useful life
6 and not over a period after the asset is already
7 retired from service.

8 His second reason is that it requires the Commission to
9 predict removal costs far into the future. I disagree.
10 Although it is certainly true that the current method
11 attempts to provide an adequate recovery for a cost
12 that will ultimately occur in the future, it does not
13 require unreasonable predictions. In his example using
14 PSC No. 366 - Underground Conduit (Distribution),
15 arguing against the Company methodology that requires
16 customers to pay for removal costs over 80 years, he
17 fails to mention that the estimate can be reviewed and
18 changed periodically over the course of that service
19 life. The number of times the estimate is reviewed
20 depends on the number of rate proceedings over the
21 course of that 80-year life. The Company method also
22 spreads out that significant cost over a full 80-year
23 life instead of burdening customers with that cost over
24 just 10 years because the longer time is a much fairer

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1 way. He concludes his argument by stating (at 25),
2 "charging today's ratepayers based on a forecast of the
3 removal costs of conduits that far out in the future is
4 hard to defend." I think it would be far harder to
5 defend requiring customers starting in year 81 to pay
6 for the entire cost to remove plant that served
7 customers for 80 years.
8 His third reason claims ratepayers are penalized in the
9 early years of an asset's life for capital recovery in
10 general, and that they are further penalized when net
11 salvage is added into that capital recovery. His own
12 exhibit contradicts his argument. Referring to Exhibit
13 ___ (HA-3), all four of the totals under columns 3 and
14 4 result in higher revenue requirements over the
15 twenty-year period he has chosen. Columns 3 and 4
16 include his example of revenue requirements with
17 negative salvage paid at retirement. He explains in
18 his direct testimony the reason why columns 3 and 4
19 have higher revenue requirements by stating (at 27) "so
20 long as the utility pre-tax cost of capital is higher
21 than the discount rate, calculations like these will
22 generally show that the ratepayer is worse off whenever
23 the utility has an opportunity to earn a return on its
24 investment." However, in response to a discovery

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1 request (Con Edison Set No. 1-8), Mr. Arnett responds
2 that in his opinion, the utility pre-tax cost of
3 capital is normally higher than the discount rate,
4 thereby nullifying his own explanation (MARK FOR
5 IDENTIFICATION AS EXHIBIT ____ (CH-5)).
6 At this point, Mr. Arnett confuses the issue by adding
7 another example having additional plant increases over
8 the next 40 years and even another which uses a 14%
9 growth rate for that 40-year investment. It is
10 unrealistic to believe the Company could sustain a 14%
11 growth rate over 40 years. In addition, it appears
12 that the selection of the 14% growth rate was (at 29)
13 "because [he] wanted to show that in a case where plant
14 balances are growing rapidly over many years, the
15 general rule that the ratepayer pays a lower net
16 present value by pre-funding negative net salvage does
17 not apply." He states (at 29) "the 14 percent growth
18 rate was the lowest whole number percentage that, under
19 the assumptions used on Schedule 3, showed that the net
20 present value of revenue requirements for the 20 year
21 window was lower with negative net salvage amortized
22 over ten years after it was incurred than it was with
23 the current utility treatment of recovering negative
24 net salvage in depreciation rates of the assets life."

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1 It certainly appears that Mr. Arnett has gone to great
2 lengths to find a scenario where his exhibit proves his
3 point that adding net salvage to the depreciation rate
4 increases customer costs.

5 For his fourth and final argument, he claims that
6 Schedule 3 of Exhibit ___ (HA-3) is the basis of his
7 last objection to the Company's current treatment of
8 negative net salvage which says (at 23), "prepaying in
9 a situation where plant balances are growing rapidly
10 can be a losing situation for ratepayers." I fail to
11 see how this is applicable since it is based on a
12 single growth rate that is not even realistic.

13 Q. Turning to another set of testimony, please discuss the
14 proposals advanced by the Westchester Panel.

15 A. The Westchester Panel's proposal is virtually identical
16 to Mr. Arnett's approach in that they propose to remove
17 negative net salvage from the depreciation rate and
18 implement the practice of expensing negative net
19 salvage for Transmission and Distribution accounts.
20 The amortization would be computed over a 10-year
21 averaging period and would be trued-up when rates are
22 re-set. In addition, according to the Panel's
23 testimony, the reserve variation that I have computed
24 would change from the \$627 million deficiency using my

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1 proposals to a surplus. The Panel claims a \$129
2 million reduction to the revenue requirement. My
3 rebuttal to Mr. Arnett addresses most, if not all, of
4 these claims.

5 Q. Is the Panel's illustration regarding the amount of
6 money related to negative net salvage on point?

7 A. All of the facts are correct, and the Panel computes
8 that the Company recovered \$39.1 million of net salvage
9 in the past year for PSC Account 367 - Underground
10 Conductors. However, that amount is far from adequate
11 to reimburse the Company for what it spent on net
12 salvage in the recent past. What the Panel does not
13 say is that in 2006, the Company actually spent \$66.5
14 million in net salvage costs for this account. Looking
15 at recent history, the Company spent \$62.9 million in
16 2005 and \$46.9 million in 2004. Even using a three-
17 year average of these costs results in an average of
18 \$58.7 million spent annually just for this one account.
19 All of these recent amounts, as well as the three-year
20 average, are well above the \$39.1 million that the
21 Panel claims is too high an amount to be recovered
22 through depreciation. The same is true when looking at
23 a five-year average (which is too long a period to
24 compute the average). A five-year average results in

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1 an amount totaling \$50.4 million, still above the \$39.1
2 being recovered through the depreciation rate. Only by
3 looking at a ten-year average will the Panel's proposal
4 get low enough to approach the amount that is near what
5 is being recovered in the annual rate. For instance,
6 over ten years, the average drops to \$40.3 million,
7 very close to the \$39.1 million recovered under the
8 Company's methodology. The obvious conclusion is that
9 the Company spends more in actual net salvage than is
10 recovered through the depreciation rate. This is
11 exactly the opposite of what the Panel's premise is -
12 they claim the Company recovers too much through the
13 annual rate which is simply incorrect. In fact, it is
14 precisely the lack of adequate net salvage recovery
15 through depreciation rates that contributes to the
16 reserve variation I proposed.

17 Q. Can a similar argument be made for total Electric
18 Transmission and Distribution Plant?

19 A. Yes. The Company spent far more on net salvage costs
20 in 2006 than it recovered through annual depreciation
21 expense for net salvage. For instance, net salvage
22 costs spent for Electric Transmission and Distribution
23 plant in 2006 totaled \$134.7 million compared to \$110.1
24 million recovered through annual depreciation expense.

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1 I have included Exhibit ___ (CH-6) to compare the
2 computation of depreciation expense based on my
3 proposed rates including net salvage verses a
4 computation without net salvage (MARK FOR
5 IDENTIFICATION AS EXHIBIT ___ (CH-6)). The difference
6 between the two amounts (\$110.1 million) for total
7 Transmission and Distribution would represent the
8 amount of net salvage costs being recovered through
9 annual depreciation rates. The amount actually spent
10 on net salvage (\$134.7 million) is then compared to the
11 amount being recovered through depreciation rates
12 demonstrating that the Company is actually not
13 recovering enough from customers through the annual
14 depreciation rate to pay for net salvage costs actually
15 being spent during 2006. The shortfall amounts to
16 \$24.6 million annually.

17 Q. Please discuss the proposals advanced by the NYPA
18 Panel.

19 A. The NYPA Panel recommends that the Company's entire
20 proposed increase in depreciation be eliminated.
21 Before arriving at that conclusion, the Panel
22 acknowledges (at 30), "removal costs could be higher
23 than they have been historically" but that (at 30) "it
24 is probably unrealistic to even guess at what residual

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1 values or removal costs might be when the equipment
2 finally does reach the end of its useful life." The
3 Panel also states (at 30) their "suggestion for removal
4 costs would be to capitalize them as incurred - and
5 recover those costs when they are known and
6 verifiable."

7 I am unclear as to exactly what the Panel proposes. If
8 they are proposing that removal costs are to be
9 recovered at some period after they are spent, such
10 proposal should be rejected for the reasons I have
11 discussed above in connection with the cash basis
12 method. If their proposal is to capitalize removal
13 costs and add them to the cost of the replacement asset
14 (if any), such proposal should be rejected since it
15 violates the Uniform System of Accounts. Lastly, if
16 they are proposing that all depreciation changes should
17 be rejected, they have failed to provide a basis for
18 such a proposal.

19 Q. Please now discuss the testimony of Mr. Elfner.

20 A. Mr. Elfner recommends that no changes be made in
21 depreciation rates. He recommends (at 14), "the
22 Company's proposed methodological and procedural
23 changes should only be approved upon a finding that
24 current service lives and net salvage estimates are

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1 inadequate to provide for the Company's recovery of its
2 capital costs."

3 Q. Do you agree with Mr. Elfner's proposal?

4 A. No. The submissions of the studies I have performed
5 support the need to increase depreciation rates in this
6 proceeding. The fact that the revenue requirement may
7 be above what Mr. Elfner considers reasonable provides
8 no basis for disallowing my proposed depreciation rate
9 changes. In addition, Mr. Elfner has missed the point
10 by stating that current rates are adequate. In fact,
11 just the opposite is true - the studies I have filed in
12 this case support a finding that current service lives
13 and net salvage factors are not adequately providing
14 for the proper levels of depreciation expense. Those
15 studies provide a sound and reasonable basis for the
16 Commission to approve the depreciation changes I have
17 proposed.

18 Q. Does that conclude your update and rebuttal testimony?

19 A. Yes, it does.

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding on Motion of the Commission as to the Rates,
Charges, Rules and Regulations of Consolidated Edison
Company of New York, Inc. for Electric Service

Case 07-E-0523

NEW YORK CITY RESPONSES TO INFORMATION REQUESTS
CON EDISON SET NO. 1

1. Request:

Mr. Arnett states on p 22, lines 8-11, that ratepayers who are served by that item of plant are said to contribute to the full cost associated with that asset incurred both before it enters service and after that asset is retired. Please explain how ratepayers contribute to the cost of an asset before it enters service.

Response:

The sentence in question was intended to say that under the utility approach ratepayers, over the time that asset was in service, would be paying for costs incurred before the asset was in service, which would be the costs incurred to place that unit in service, as well as the costs incurred after it was taken out of service, which would be any net negative salvage. It was not meant to suggest that ratepayers were paying rates that reflected the costs of the asset before the asset was placed in service.

Prepared by: Harvey Arnett

Dated: September 17, 2007

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding on Motion of the Commission as to the Rates,
Charges, Rules and Regulations of Consolidated Edison
Company of New York, Inc. for Electric Service

Case 07-E-0523

NEW YORK CITY RESPONSES TO INFORMATION REQUESTS
CON EDISON SET NO. 1

8. Request:

On page 27, Mr. Arnett testifies: "So long as the utility pre-tax cost of capital is higher than the discount rate, calculations like these (*those on Schedule 1 of Exhibit ____ (HA-3)*) will generally show that the ratepayer is worse off whenever the utility has an opportunity to earn a return on its investment. In Mr. Arnett's opinion, are discount rates normally higher than the utility pre-tax cost of capital?"

Response:

No.

Prepared by: Harvey Arnett

Dated: September 17, 2007

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.
PROPOSED DEPRECIATION RATE CHANGES WITH AND WITHOUT NET SALVAGE FOR ELECTRIC TRANSMISSION AND DISTRIBUTION
AT DECEMBER 31, 2006

P.S.C. ACCT. NO.	ACCOUNT TITLE	CO. ACCT.	BOOK COST	COMPANY PROPOSED BASIS				COMPANY PROPOSED WITHOUT NET SALVAGE				ANNUAL NET SALVAGE IN THE DEPRECIATION RATE
				AVERAGE SERVICE LIFE	NET SALVAGE	DEPR. RATE IN %	ANNUAL DEPREC. EXPENSE	AVERAGE SERVICE LIFE	NET SALVAGE	DEPR. RATE IN %	ANNUAL DEPREC. EXPENSE	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
	<u>ELECTRIC PLANT IN SERVICE</u>											
	<u>TRANSMISSION PLANT</u>											
350	LAND AND LAND RIGHTS	9530	36,875,022	-	-	-	-	-	-	-	-	-
352	STRUCTURES AND IMPROVEMENTS	9532	140,377,580	70	(35)	1.93	2,709,287	70	-	1.43	2,007,399	701,888
353	STATION EQUIPMENT	9534	1,140,021,993	45	(30)	2.89	32,946,636	45	-	2.22	25,308,488	7,638,147
354	TOWERS AND FIXTURES	9536	142,094,886	45	(40)	3.11	4,419,151	45	-	2.22	3,154,506	1,264,644
356	OVERHEAD CONDUCTORS AND DEVICES	9540	82,029,638	35	(35)	3.86	3,166,344	35	-	2.86	2,346,048	820,296
	UNDERGROUND CONDUIT - CAPITAL LEASES	9543	6,989,000	-	-	-	-	-	-	-	-	-
357	UNDERGROUND CONDUIT	9544	244,116,392	55	(20)	2.18	5,321,737	55	-	1.82	4,442,918	878,819
357	UNDERGROUND CONDUIT - MAN. & BRONX	9545	122,472,519	55	(20)	2.18	2,669,901	55	-	1.82	2,229,000	440,901
358	UNDERGROUND CONDUCTORS & DEVICES	9546	<u>340,584,933</u>	50	(25)	2.50	<u>8,514,623</u>	50	-	2.00	<u>6,811,699</u>	<u>1,702,925</u>
	TOTAL TRANSMISSION PLANT		<u>2,255,561,963</u>				<u>59,747,679</u>				<u>46,300,059</u>	<u>13,447,621</u>
	<u>DISTRIBUTION PLANT</u>											
360	LAND AND LAND RIGHTS	9550	153,493,383	-	-	-	-	-	-	-	-	-
361	STRUCTURES AND IMPROVEMENTS	9552	239,991,626	50	(35)	2.70	6,479,774	50	-	2.00	4,799,833	1,679,941
362	STATION EQUIPMENT	9554	1,357,885,787	45	(30)	2.89	39,242,899	45	-	2.22	30,145,064	9,097,835
364	POLES, TOWERS AND FIXTURES	9556	291,586,279	50	(100)	4.00	11,663,451	50	-	2.00	5,831,726	5,831,726
303	CAPITALIZED SOFTWARE	9557	-	5	-	20.00	-	5	-	20.00	-	-
365	OVERHEAD CONDUCTORS AND DEVICES	9558	495,481,252	60	(55)	2.58	12,783,416	60	-	1.67	8,274,537	4,508,879
366	UNDERGROUND CONDUIT	9560	1,031,252,080	80	(40)	1.75	18,046,911	80	-	1.25	12,890,651	5,156,260
366	UNDERGROUND CONDUIT - MAN. & BRONX	9561	1,131,305,001	80	(40)	1.75	19,797,838	80	-	1.25	14,141,313	5,656,525
367	UNDERGROUND CONDUCTORS & DEVICES	9562	3,199,081,426	45	(55)	3.44	110,048,401	45	-	2.22	71,019,608	39,028,793
368	LINE TRANSFORMERS	9565										
	OVERHEAD TRANSFORMERS		186,233,641	30	(5)	3.50	6,518,177	30	-	3.33	6,201,580	316,597
	UNDERGROUND TRANSFORMERS		<u>1,638,440,798</u>	40	(5)	2.63	<u>43,090,993</u>	40	-	2.50	<u>40,961,020</u>	<u>2,129,973</u>
	TOTAL LINE TRANSFORMERS		<u>1,824,674,438</u>				<u>49,609,170</u>				<u>47,162,600</u>	<u>2,446,570</u>
369	SERVICES - OVERHEAD	9566	98,024,567	60	(175)	4.58	4,489,525	60	-	1.67	1,637,010	2,852,515
369	SERVICES - UNDERGROUND	9567	860,033,505	70	(150)	3.57	30,703,196	70	-	1.43	12,298,479	18,404,717
370	METERS											
	ELECTRO MECHANICAL	9569	207,685,333	35	-	2.86	5,939,801	35	-	2.86	5,939,801	-
	SOLID STATE	NEW	<u>35,970,380</u>	20	-	5.00	<u>1,798,519</u>	20	-	5.00	<u>1,798,519</u>	-
			<u>243,655,713</u>				<u>7,738,320</u>				<u>7,738,320</u>	-
370	METER INSTALLATIONS											
	ELECTRO MECHANICAL	9571	100,384,253	35	-	2.86	2,870,990	35	-	2.86	2,870,990	-
	SOLID STATE	NEW	<u>45,930,756</u>	20	-	5.00	<u>2,296,538</u>	20	-	5.00	<u>2,296,538</u>	-
			<u>146,315,009</u>				<u>5,167,527</u>				<u>5,167,527</u>	-
371	INSTALLATION ON CUSTOMERS' PREMISES	9573	4,448,190	60	-	1.67	74,285	60	-	1.67	74,285	-
373	O.H. STREET LIGHTING & SIGNAL SYS.	9575	20,544,378	45	(100)	4.44	912,170	45	-	2.22	456,085	456,085
373	U.G. STREET LIGHTING & SIGNAL SYS.	9576	<u>131,387,161</u>	65	(75)	2.69	<u>3,534,315</u>	65	-	1.54	<u>2,023,362</u>	<u>1,510,952</u>
	TOTAL DISTRIBUTION PLANT		<u>11,229,159,795</u>				<u>320,291,199</u>				<u>223,660,399</u>	<u>96,630,800</u>
	TOTAL TRANS. & DIST. PLANT		<u>13,484,721,758</u>				<u>380,038,878</u>				<u>269,960,458</u>	<u>110,078,420</u>
	ACTUAL NET SALVAGE - T&D - Year 2006											<u>134,720,409</u>
	SHORTFALL RECOVERED THROUGH DEPRECIATION RATES											<u>(24,641,989)</u>