

ORANGE AND ROCKLAND UTILITIES, INC.

DEPRECIATION PANEL  
UPDATE/REBUTTAL - ELECTRIC & GAS

1 Q. Please state your names.

2 A. Matthew Kahn and Ned Allis.

3 Q. Have you previously submitted testimony in this  
4 proceeding?

5 A. Yes. We previously submitted direct testimony on  
6 behalf of Orange and Rockland Utilities, Inc. ("Orange  
7 and Rockland," "O&R" or the "Company") as the  
8 Depreciation Panel ("Panel") as part of the Company's  
9 January 2018 initial base rate filing.

10 Q. What is the purpose of the Panel's update and rebuttal  
11 testimony?

12 A. First, we are updating certain pages of the gas  
13 depreciation study, filed as Exhibit \_\_DP-G1, which  
14 Exhibit we are sponsoring in this proceeding. These  
15 revisions do not have an impact on either the results  
16 of the gas depreciation study or on the  
17 recommendations set forth in our direct testimony.  
18 Second, we are responding to the direct testimony of  
19 the following parties:

20 • The Staff Depreciation Panel ("SDP"); and

21 • Robert Wyman.

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1 **UPDATE**

2 Q. Please describe the revisions to the Company's gas  
3 depreciation study.

4 A. Section VII of the gas depreciation study includes a  
5 discussion of the process of estimating net salvage  
6 for gas mains. This discussion contains several  
7 incorrect citations to existing and proposed net  
8 salvage percentages and to the historical data. These  
9 were inadvertent typographical errors, and did not  
10 impact the net salvage analyses or recommendations in  
11 the gas depreciation study. Specifically, the  
12 following changes should be made to the gas  
13 depreciation study:

- 14 • Page 43 of Exhibit\_\_\_DP-G1:
  - 15 o Line 3 of the first full paragraph - replace
  - 16 "negative 80 percent" with "negative 50
  - 17 percent".
  - 18 o Line 7 of the first full paragraph - replace
  - 19 "historical indication for the period 1983
  - 20 through 2013 is negative 22 percent" with

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1 "historical indication for the period 1983  
2 through 2016 is negative 63 percent".

3 o Line 8 of the first full paragraph - replace  
4 "negative 20 percent" with "negative 50  
5 percent".

6 • Page 44 of Exhibit\_\_\_DP-G1:

7 o Line 1 - replace "negative 80 percent" with  
8 "negative 50 percent".

9 o Line 4 - replace "negative 70 percent" with  
10 "negative 30 percent".

11 Q. Do these changes affect any of your recommended  
12 depreciation parameters, rates or theoretical  
13 reserves, set forth in your direct testimony or the  
14 exhibits you are sponsoring?

15 A. No. These changes do not have any effect on the  
16 recommendations in our direct testimony or the  
17 exhibits we are sponsoring.

18 **REBUTTAL**

19 Q. Please summarize your rebuttal testimony.

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1 A. Our rebuttal testimony responds to the depreciation-  
2 related testimony submitted by the SDP and Mr. Wyman.  
3 As to the SDP's depreciation related recommendations:  
4           • We disagree with the average service  
5           life and survivor curve recommendations  
6           made by the SDP. Based on their  
7           testimony, the primary reasons for  
8           their proposals are visual comparisons  
9           to the Company's historical data.  
10          However, in some instances their  
11          approach results in estimates that  
12          represent what are, in our judgement,  
13          unrealistically long service lives for  
14          the property studied. Service life  
15          estimates (*i.e.*, average service life  
16          and survivor curves) should be based on  
17          more than mathematical or visual  
18          analysis, and should represent the  
19          mortality characteristics of the  
20          property studied. In our view, the

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1 SDP's recommendations do not meet these  
2 criteria.

3 • We disagree with the SDP's net salvage  
4 recommendations. While it is unclear  
5 from the SDP's testimony what forms the  
6 basis for their estimates, they have  
7 not fully recognized trends to more  
8 negative net salvage for several  
9 accounts. In some instances, their  
10 recommendations appear to move in the  
11 opposite direction of trends in the  
12 data. As a result, the SDP's net  
13 salvage recommendations are  
14 insufficient to cover the Company's  
15 future net salvage costs.

16 • We disagree with the SDP's opposition  
17 to the Company's recovery of the  
18 stranded costs of legacy electric  
19 meters that result from AMI  
20 implementation. The SDP's  
21 recommendation is predicated on the

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1 SDP's contention that there is a large  
2 theoretical reserve "surplus" for  
3 electric plant. We believe the SDP's  
4 logic is based on flawed premises,  
5 specifically: (1) we disagree that  
6 there is even a theoretical reserve  
7 "surplus," much less a large "surplus,"  
8 as our study estimates a reserve  
9 "deficiency;" (2) the theoretical  
10 reserve "surplus" calculated by Staff  
11 should not be considered "large," as  
12 the SDP's testimony acknowledges that  
13 it is less than the 10% tolerance band  
14 that has traditionally been considered  
15 in New York; and (3) Staff's calculated  
16 "surplus" is a theoretical number,  
17 based on estimates of the future, and  
18 (as the SDP acknowledges) the  
19 theoretical reserve imbalance will  
20 change each time a study is performed.  
21 In contrast, it is known (and not

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1                   theoretical) that a deficiency will  
2                   result from stranded legacy meter  
3                   costs. By disallowing the recovery of  
4                   the stranded meter costs due to a  
5                   perceived theoretical "surplus," the  
6                   SDP's proposal will push out the  
7                   recovery of these costs well beyond the  
8                   time during which these legacy meters  
9                   provided service. Therefore, the SDP's  
10                  proposal will result in  
11                  intergenerational inequity.

12                 Mr. Wyman makes two depreciation-related proposals:

- 13                     • He argues that the average service life for
- 14                     gas services should be shorter, due to
- 15                     statewide emissions goals; and
- 16                     • He asserts that the net salvage estimate
- 17                     for gas services should be more negative.

18                 As an initial matter, we would note that Mr. Wyman is  
19                 not a depreciation expert. He has not presented any  
20                 formal depreciation studies in support of either of  
21                 his proposals. We view his proposals as

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1 unsubstantiated and speculative. Accordingly, they  
2 should not be adopted at this time.

3 **I. The Staff Depreciation Panel's Proposals**  
4

5 A. Service Lives  
6

7 Q. Please summarize your disagreements with Staff's  
8 service life (*i.e.*, average service life and survivor  
9 curve) proposals.

10 A. Based on the SDP's testimony, their process for  
11 estimating service lives was primarily based on visual  
12 comparisons of survivor curves to the Company's data.  
13 When estimating service lives, it is important to  
14 consider factors beyond just the statistical life  
15 analysis results so that the recommended estimates are  
16 consistent with reasonable expectations of the  
17 mortality characteristics of the property studied. In  
18 our view, Staff's approach to estimating service lives  
19 has, in certain instances, produced results that are  
20 unrealistic.

21 Q. Please explain.



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1 A. For some accounts, Staff's estimates forecast service  
2 lives that are longer than any realistic experience  
3 would indicate. For example, referring to Staff's  
4 Exhibit \_\_\_\_ (SDP-3), page 6 of 13 for electric Account  
5 365, Overhead Conductors and Devices, Staff's proposal  
6 assumes a very long average service life of 75 years.  
7 Staff's estimate also implies that close to 30% of the  
8 assets will be in service for more than 100 years and  
9 about 10% will be in service more than 120 years.  
10 Based on our experience, as well as the experience of  
11 other electric utilities, it is not a reasonable  
12 expectation that more than a quarter of the Company's  
13 overhead electric lines will remain in service for 100  
14 years or more.

15 Q. How will you address Staff's service life proposals?

16 A. First, we will discuss the recommendations in the  
17 Company's depreciation study and demonstrate that the  
18 currently effective average service lives for O&R are  
19 already near or beyond the upper end of the range of  
20 experience for similar assets for other companies.

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1 Our recommendations in many instances will bring the  
2 Company's estimates more in line with those of other  
3 similarly situated electric and gas utilities.

4 Staff's recommendations for longer service lives are,  
5 for many accounts, outliers in the industry. We will  
6 then discuss the importance of informed judgment in  
7 service life estimation and explain that Staff's  
8 approach has resulted in unreasonable and unrealistic  
9 proposals.

10

11 *i. Comparison of Orange and Rockland and Staff's*  
12 *Service Life Estimates*

13

14 Q. Has the Company presented a reasonable study of the  
15 service lives of its assets?

16 A. Yes. The Company's depreciation study is consistent  
17 with the traditional methods used for life analysis  
18 and life estimation throughout the utility industry  
19 and across the country and results in reasonable  
20 estimates of service lives.

21 Q. In general, how would you characterize the service  
22 life estimates in the Company's study compared to the  
23 estimates of other companies?

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1 A. The estimates recommended in the Company's study are,  
2 for many plant accounts, as long as or longer than the  
3 estimates for other utilities.

4 Q. Please illustrate this point.

5 A. Gannett Fleming has performed depreciation studies in  
6 almost all 50 states, as well as all ten Canadian  
7 provinces and each of the three Canadian territories.  
8 Based on that experience, we can provide typical  
9 ranges of service lives experienced by others in the  
10 industry for each property account.

11 For the accounts for which Staff has proposed an  
12 adjustment, Table 1 below compares O&R's currently  
13 effective service life estimates, those proposed by  
14 the Company, those proposed by Staff, and the range of  
15 estimates typically made for each of the presented  
16 electric, gas and common plant accounts. As the table  
17 shows, many of the currently effective estimates and  
18 the estimates presented by the Company are at least as  
19 long as the longest life in the typical industry  
20 range. The table also shows that our proposals will  
21 result in the Company's estimates being more in line

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1 with those typical of other utilities, particularly  
2 for the electric accounts.

3

4 **Table 1: Comparison of Average Service Life Estimates**

<u>Account</u>		<u>Current</u>	<u>Company Study</u>	<u>Staff Proposed</u>	<u>Typical Industry Range</u>
<b><u>Electric Plant</u></b>					
352	Structures and Improvements	60	60	65	55-70
354	Towers and Fixtures	75	70	75	60-75
356	Overhead Conductors and Devices	65	65	67	45-65
356.1	Overhead Conductors and Devices - Clearing	65	65	67	60-75
359	Roads and Trails	70	65	70	50-75
364	Poles, Towers and Fixtures	60	55	60	40-65
365	Overhead Conductors and Devices	75	65	75	40-65
365.1	Overhead Conductors and Devices – Capacitors	35	30	35	--
369.2	Services – Underground	65	65	75	40-65
371	Installations on Customers' Premises	40	35	50	20-40
392.1	Passenger Cars	8	9	12	5-13
392.3	Heavy Trucks	12	12	13	8-16
<b><u>Gas Plant</u></b>					
367	Mains	70	70	72	55-75
376	Mains	70	70	72	55-75
392.1	Passenger Cars	8	9	12	5-13
392.3	Heavy Trucks	12	12	13	8-16
<b><u>Common Plant</u></b>					
392.1	Passenger Cars	8	9	12	5-13
392.3	Heavy Trucks	12	12	13	8-16

5

6 Q. How would you characterize the service life estimates  
7 proposed by Staff?

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1 A. In general, the average service life estimates  
2 proposed by Staff are too long for the assets studied.  
3 As Table 1 shows, for many accounts the SDP's  
4 estimates are as long as, or longer than, the longest  
5 average service lives in the industry. For example,  
6 of the electric accounts, six of the 13 estimates  
7 Staff has proposed are longer than the typical  
8 industry range, and an additional one is at the upper  
9 end of the range.

10 Q. How does the Company's study differ from Staff's  
11 approach?

12 A. Many factors were considered in the Company's study in  
13 addition to the statistical analysis. Based on these  
14 factors, as well as knowledge of the property being  
15 studied, it would be inappropriate to simply select  
16 survivor curves based on how well the curve matches  
17 the available data. Using informed judgment, the  
18 Company's studies have produced service lives that are  
19 reasonable estimates of the future experience for each  
20 account studied and the Company's estimates are better

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1 aligned with estimates in use throughout the utility  
2 industry.

3 In contrast, Staff has recommended estimates that  
4 are in some instances unrealistic. We believe that  
5 this occurs because the SDP has not incorporated the  
6 proper judgment required to perform a depreciation  
7 study. Instead, the SDP focused (p. 10) on the  
8 results of statistical analyses of historical data and  
9 has not adequately considered other factors that  
10 should be used to interpret the statistical studies  
11 properly. We will discuss the differences between our  
12 study and Staff's proposals in more detail in the next  
13 section.

14 *ii. Informed Judgment*

15  
16 Q. Please explain the proper process used for life  
17 estimation in the Company's depreciation study.

18 A. The estimates made for the depreciation study are  
19 based on informed judgment that incorporates  
20 statistical analysis of the Company's historical data,  
21 as well as other factors. The statistical analysis

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1 used for the study is the retirement rate method,<sup>1</sup>  
2 which is the most commonly used and widely accepted  
3 statistical analysis of aged retirements.

4 Q. Is the statistical analysis the only basis for the  
5 service life estimates in the depreciation study?

6 A. No. While the statistical analysis is an important  
7 component of the "life analysis" process of  
8 depreciation studies, it is only a tool in determining  
9 the life characteristics that a utility's assets have  
10 experienced historically. The goal of the  
11 depreciation study is to estimate the service lives of  
12 the assets that are currently in service, not those  
13 that were retired in the past. Thus, the process is  
14 to develop informed estimates of what will occur in  
15 the future, not simply to determine what has occurred  
16 in the past and assume it will recur.

17 Q. Please continue.

18 A. The full process of determining the service life  
19 estimates is referred to as "life estimation."

---

<sup>1</sup> The retirement rate method is described in more detail in the Company Depreciation Panel's direct testimony and in the depreciation studies filed as Exhibit \_\_\_\_ (DP-E1) and Exhibit \_\_\_\_ (DP-G1).

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1 Factors other than the statistical analysis should be  
2 considered, both because the historical statistical  
3 data are not always definitive (*i.e.*, often more than  
4 one survivor curve will represent a similar fit to an  
5 original life table, as usually only a "stub curve"<sup>2</sup> is  
6 available for the analysis) and because the historical  
7 data may not be reflective of future experience (*e.g.*,  
8 if the Company were planning to replace more assets in  
9 the future than it has historically).

10 Q. Please provide an example of how the service life  
11 estimates were made in the Gannett Fleming  
12 depreciation study.

13 A. Electric Account 365 - Overhead Conductors and Devices  
14 provides a good example of how informed judgment can  
15 produce more realistic service life estimates. This  
16 account includes the cable for overhead distribution  
17 lines as well as other devices on the lines, such as  
18 insulators and reclosers. The currently effective

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<sup>2</sup> A "stub curve" means that the original life table developed from the historical data is not a complete curve, *i.e.* it does not reach 0% surviving. Because the retirement rate method generally will only produce stub curves for many accounts, there is typically an aspect of forecasting or projecting future experience in the statistical analysis (even if no other factors are considered).



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1 average service life estimate for this account is 75  
2 years (the 75-h1.5 survivor curve is currently used).  
3 However, this estimate was based on a settlement in  
4 the Company's 2014 rate case. The typical industry  
5 range of average service lives for this account is 40  
6 to 65 years. Thus, the current use of a 75-year  
7 average service life is already beyond the upper end  
8 of the typical range estimated for this type of  
9 property by other electric utilities.

10 Based on discussions with O&R engineering  
11 personnel, and consistent with Gannett Fleming's  
12 industry knowledge, retirements in this account  
13 typically occur due to upgrades for capacity reasons,  
14 storm hardening, conversions (e.g., single phase to  
15 three-phase), line relocations, equipment failure, and  
16 damage to facilities due to factors such as storms.  
17 In addition, the Company has strategically replaced  
18 smaller voltage lines (e.g., 4 kV and less) over time.  
19 In general, the Company provided no reason to expect  
20 that its assets would last much longer than similar  
21 assets for other electric utilities.

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1           Many of the causes of retirement for this account  
2           tend to increase as assets age. For example, lines  
3           that are upgraded for capacity reasons are often older  
4           lines. The same is true of the smaller voltage  
5           systems. For these reasons, the expectation for this  
6           account is that the probability of retirement will  
7           tend to increase as the property ages. In addition,  
8           it is expected that most assets will not reach ages  
9           of 100 years or more. These factors suggest that a  
10          mid-mode survivor curve would be appropriate for this  
11          account and that the maximum life should not be  
12          inordinately long.

13          The statistical life analysis was performed using  
14          the retirement rate method. While the statistical  
15          analysis alone indicated relatively long service lives  
16          and lower mode curves for this account, the best  
17          fitting results of the statistical analysis were  
18          outside of a typical industry range for this account  
19          and are not considered to be indicative of the future  
20          experience. The best fitting curves also indicated  
21          very long lives for a significant portion of the

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1 assets in this account (e.g., a high percentage of the  
2 assets would be in service for over 100 years based on  
3 the best fitting curves). Further, as can be seen on  
4 page VII-53 of Exhibit \_\_\_\_ (DP-E1), the most  
5 representative points of the original life table  
6 (which are plotted on page VII-53) do not even extend  
7 to 50% surviving. As a result, the statistical  
8 analysis alone requires the projection of much of the  
9 life cycle for this account.

10 Based on the factors discussed with the Company's  
11 engineering personnel, as well as Gannett Fleming's  
12 knowledge of the assets in this account (based on  
13 performing hundreds of studies for other electric  
14 utilities), it would be inappropriate to use the  
15 mathematically best fitting curves, as these curves  
16 forecast lives that are too long for the property  
17 being studied. Instead, curves with a higher mode  
18 than the best fitting curves and with a more  
19 reasonable 65-year average service life are a better  
20 representation of the expected future mortality  
21 characteristics for this account. For these reasons,

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1 the 65-R1.5 survivor curve has been recommended in the  
2 depreciation study.

3 Q. How does Staff's analysis differ from Gannett  
4 Fleming's?

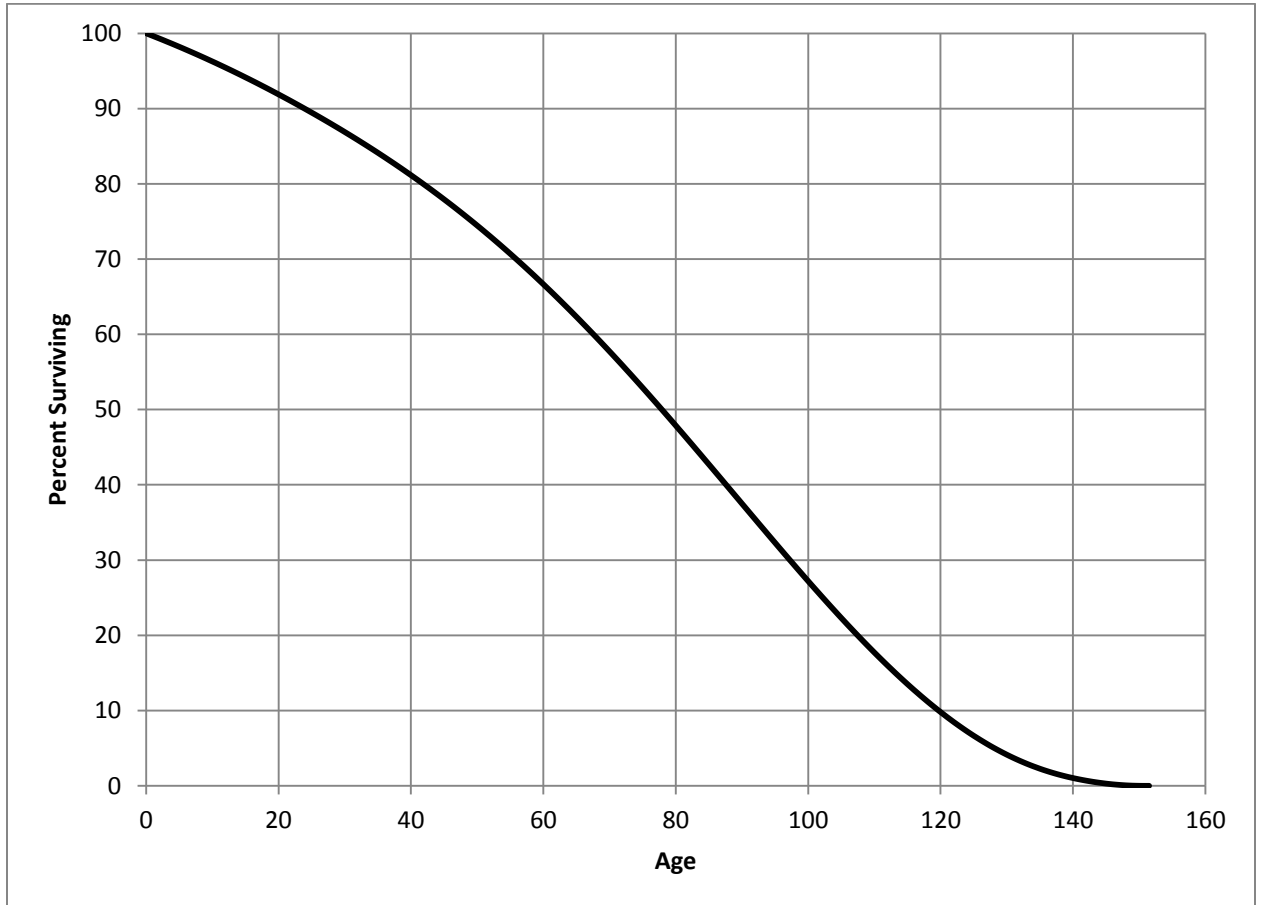
5 A. In our view, the SDP did not give adequate  
6 consideration to the factors discussed above. The  
7 result is a service life estimate that is too long for  
8 the property studied. A graph of the survivor curve  
9 chosen by Staff provides evidence that Staff's  
10 estimate of a 75-R1 estimate for this account is not  
11 reasonable. Figure 1 below shows a graph of the 75-R1  
12 survivor curve chosen by Staff for overhead conductors  
13 and devices.

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1

**Figure 1: 75-R1 Survivor Curve**



2

3

4 Figure 1 shows the percent of plant that is expected  
5 to last to each age. For example, approximately 80%  
6 of plant would be expected to last until age 40 and  
7 slightly more than 60% would be expected to last until  
8 age 60.

9

10

As Figure 1 shows, Staff's estimate predicts that  
approximately half of the Company's assets in this

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1 account will last more than 75 years and more than a  
2 quarter of the assets will last over 100 years.  
3 Staff's estimate further predicts that about 10% of  
4 the account will last for 120 years, and a portion  
5 will last longer than 140 years. These expectations  
6 implied by Staff's estimates are not realistic. As  
7 discussed previously, the representative data points  
8 from the original life table for this account do not  
9 reach 50% surviving. Thus, Staff's estimate of these  
10 very long service lives for a significant portion of  
11 the account are based solely on the forecast made by  
12 Staff's estimate - they are not based on the Company's  
13 actual experience.

14 Q. Does Staff's analysis for other accounts also produce  
15 unrealistic results?

16 A. Yes. Staff's approach was similar for each account,  
17 and as a result, similar issues are apparent for other  
18 accounts. However, the differences between Staff's  
19 estimates and ours are not as significant for every  
20 account for which Staff has proposed a different  
21 estimate.

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1 Q. Do any authoritative depreciation texts support your  
2 assertion that a comprehensive depreciation study  
3 should incorporate factors other than statistical  
4 analysis?

5 A. Yes, all depreciation texts are clear that service  
6 life estimates are forecasts of future expectations.  
7 It is widely understood by depreciation professionals  
8 that sole reliance on the statistical analysis of  
9 historical data is inappropriate for life estimation.

10 For example, the National Association of  
11 Regulatory Utility Commissioners' ("NARUC") *Public*  
12 *Utility Depreciation Practices* manual ("NARUC Manual")  
13 is one of the most widely recognized authoritative  
14 depreciation texts. Chapter VIII of NARUC Manual  
15 discusses life analysis.

16 Q. Does the NARUC Manual caution against relying solely  
17 on the statistical life analysis?

18 A. Yes. The NARUC Manual (p. 126) states as follows:

19 Depreciation analysts should avoid becoming  
20 ensnared in the mechanics of the historical  
21 life study and relying solely on  
22 mathematical solutions. The reason for  
23 making an historical life analysis is to  
24 develop a sufficient understanding of

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1 history in order to evaluate whether it is a  
2 reasonable predictor of the future. The  
3 importance of being aware of circumstances  
4 having direct bearing on the reason for  
5 making an historical life analysis cannot be  
6 understated. These circumstances, when  
7 factored into the analysis, determine the  
8 application and limitations of an historical  
9 life analysis.

10 Q. You have also referred to "judgment" or "informed  
11 judgment" as being necessary to a proper depreciation  
12 study. Does the NARUC Manual discuss that subject?

13 A. Yes, it does. The NARUC Manual (p. 128) discusses the  
14 use of "informed judgment" in detail, explaining that  
15 "the use of informed judgment can be a major factor in  
16 forecasting." It goes on to explain that:

17 Judgment is not necessarily limited to  
18 forecasting and is used in situations  
19 where little current data are  
20 available. The analysis gathers what  
21 is known about a particular situation  
22 and modifies and refines the data to  
23 reflect the actual circumstances. The  
24 analyst's role in performing the study  
25 is to review the results and determine  
26 if they represent the mortality  
27 characteristics of the property. Using  
28 judgment, the analyst considers such  
29 things as personal experience,  
30 maintenance policies, past company  
31 studies, and other company owned  
32 equipment to determine if the stub  
33 curve represents this class of  
34 property.



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1

2

The NARUC Manual makes clear that the role of the

3

analyst is to make service life estimates that

4

represent "the mortality characteristics of the

5

property." This term refers to reasonable life

6

expectations for the specific assets included in each

7

account studied. As we discussed for Account 365, our

8

estimate is more representative of reasonable

9

expectations for the overhead conductors and devices

10

in that account, whereas Staff's estimate does not

11

result in reasonable expectations for the property

12

studied.

13

14

B. Net Salvage

15

16

Q. Please summarize your disagreements with the SDP's net salvage proposals.

17

18

A. There are two primary areas of disagreement with the

19

SDP's net salvage proposals. First, in instances in

20

which the net salvage data supports a more negative

21

net salvage estimate, the SDP's recommended changes to

22

the current net salvage estimates are too gradual and

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1 do not sufficiently incorporate trends to more  
2 negative net salvage estimates. In each instance in  
3 which the SDP recommends a net salvage estimate that  
4 is more negative than the current estimate, it appears  
5 that the SDP only changed net salvage estimates by  
6 five percentage points, even when the historical data  
7 support a larger change. However, in instances in  
8 which the SDP recommended less negative net salvage  
9 estimates from the current estimates, the SDP was  
10 willing to make changes of more than five percentage  
11 points - even if the data did not support a less  
12 negative net salvage estimate.

13 Second, the SDP (p. 14) appears to have given  
14 undue consideration to the "absolute net salvage  
15 dollars expended." It appears that the SDP believes  
16 that the depreciation accruals related to net salvage  
17 should have a relationship to the dollar level of net  
18 salvage costs. As we will explain, this impression is  
19 incorrect and is inconsistent with accepted and  
20 appropriate methods of forecasting net salvage.

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1 Q. Please provide a comparison of the net salvage  
2 estimates of each party to the Company's historical  
3 data.

4 A. For the accounts for which the SDP has recommended a  
5 different net salvage estimate from the Company's,  
6 Table 2 below provides a comparison of the current net  
7 salvage estimates, the Company's proposed estimates,  
8 the SDP's proposed estimates, and the overall and most  
9 recent five-year average net salvage estimates from  
10 the Company's historical data.

11 **Table 2: Comparison of Net Salvage Estimates to Company**  
12 **Data**

<u>Account</u>	<u>Current</u>	<u>Company Estimate</u>	<u>Staff Estimate</u>	<u>Overall Avg.</u>	<u>5-Year Avg.</u>
<b>Electric</b>					
352 Structures and Improvements	(5)	(15)	(5)	(19)	(9)
354 Towers and Fixtures	(30)	(30)	(20)	(59)	(53)
355 Poles and Fixtures - Wood	(40)	(50)	(30)	(63)	(91)
355.1 Poles and Fixtures - Steel	(40)	(50)	(30)	(63)	(91)
356 Overhead Conductors and Devices	(10)	(20)	(10)	(23)	(29)
356.1 Overhead Conductors and Devices - Clearing	(10)	0	(10)	(23)	(29)
358 Underground Conductors and Devices	0	(5)	0	(4)	0
362 Station Equipment	(5)	(15)	(10)	(12)	(30)
364 Poles, Towers and Fixtures	(90)	(100)	(95)	(119)	(114)
365 Overhead Conductors and Devices	(80)	(100)	(85)	(125)	(179)
Overhead Conductors and Devices -					
365.1 Capacitors	(30)	(40)	(25)	(41)	(28)
366 Underground Conduit	(40)	(50)	(30)	(119)	(2542)
368.1 Line Transformers - Overhead	(30)	(15)	(20)	(19)	(30)
368.2 Line Transformers - Overhead Installations	(30)	(15)	(20)	(19)	(30)
368.3 Line Transformers - Underground	(30)	(15)	(20)	(19)	(30)
368.4 Line Transformers - Underground	(30)	(15)	(20)	(19)	(30)

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Installations						
369.1	Services - Overhead	(95)	(110)	(95)	(250)	(524)
369.2	Services - Underground	(95)	(110)	(95)	(250)	(524)
390	Structures and Improvements	(35)	(30)	(40)	(32)	(55)
<b>Gas</b>						
367	Mains	(30)	(50)	(30)	(63)	(33)
376	Mains	(30)	(50)	(30)	(63)	(33)
382	Meter Installs	(20)	(20)	(15)	(61)	(9)
382.1	Meter Installs - Special Types	(20)	(20)	(15)	(61)	(9)
382.4	Meter Bar Installs	(15)	(20)	(15)	(61)	(9)
384	House Regulators - Installs	(15)	(20)	(15)	(61)	(9)
390	Structures and Improvements	(40)	(30)	(40)	(32)	(55)
<b>Common</b>						
390	Structures and Improvements	(40)	(30)	(40) <sup>3</sup>	(32)	(55)

1 As can be seen in the table, for each of these  
2 accounts, our estimates tend to move the estimates in  
3 the same direction as represented by the historical  
4 data. For example, for Account 364, Poles, Towers and  
5 Fixtures, the current estimate is negative 90 percent.  
6 However, the overall average and most recent five-year  
7 average are both more negative (at negative 119 and  
8 negative 114 percent, respectively). Accordingly, we

---

<sup>3</sup> In response to O&R-14, the SDP confirmed that their net salvage estimate for Common Plant Account 390 is (40) percent, the same as for Electric and Gas Plant Accounts 390. The SDP indicated this was a "typographical error." However, this also appears to impact the depreciation rate for Common Plant Account 390 shown on page 4 of Exhibit \_\_\_\_ (SDP-2). Based on the SDP's response to O&R-14, proposed depreciation rate for Common Plant Account 390 should be 3.11% instead of 2.89%.

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1 propose an estimate of negative 100 percent, which is  
2 consistent with the indications in the historical data  
3 for a more negative net salvage estimate than the  
4 current estimate.

5

6 *i. The SDP's Net Salvage Estimates Do Not Fully*  
7 *Recognize Trends in the Historical Net Salvage Data*  
8

9 Q. Has the SDP properly incorporated the trends in the  
10 historical data?

11 A. No. While the SDP's testimony states that their  
12 estimates consider trends in the historical net  
13 salvage data,<sup>4</sup> they do not sufficiently incorporate  
14 these trends - particularly when the result would be a  
15 more negative net salvage estimate. For example, for  
16 Account 364 discussed above, Staff has only  
17 recommended a change of five percentage points. That  
18 is, although the data support a more negative estimate  
19 than even the one we have proposed, Staff has limited  
20 the change to only five percentage points.

---

<sup>4</sup> For example, on page 14 of their testimony, the SDP states that "[w]here it is apparent that trends indicate that net salvage is becoming more negative, we are recommending the net salvage factors be made more negative from the current factors."

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1 Q. Is Staff consistent with how they have incorporated  
2 trends in the historical data?

3 A. No. As can be seen in Table 2, in each instance in  
4 which Staff has recommended a net salvage estimate  
5 that is more negative than the current estimate, Staff  
6 has elected to only change the net salvage estimate by  
7 five percentage points. However, the same is not true  
8 when Staff has proposed a less negative net salvage  
9 estimate than the current estimate. In many of these  
10 instances, Staff has recommended larger changes of 10  
11 percentage points. In our view, this is neither a  
12 consistent approach nor one for which the SDP has  
13 adequately explained its reasoning. Staff has made  
14 larger changes when the result would reduce  
15 depreciation expense, but smaller changes when the  
16 result would increase depreciation expense.

17 Q. Are there any other ways in which Staff does not  
18 incorporate trends?

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1 A. Yes. For Accounts 355 and 355.1, while the data  
2 indicate a more negative net salvage estimate,<sup>5</sup> Staff  
3 has proposed the opposite and recommends a less  
4 negative net salvage estimate. Similarly, there are  
5 some accounts where the data indicate a more negative  
6 net salvage estimate but Staff recommends no change.  
7 Based on Staff's testimony, as well as the SDP's  
8 response in discovery to O&R-11, this appears to be due  
9 to the SDP's incorrect impression that net salvage  
10 costs and net salvage accruals should be similar, if  
11 not the same. This impression is incorrect, as we  
12 will discuss in more detail in the next section.

13

14 *ii. Net Salvage Accruals and Net Salvage Costs Should*  
15 *Not Be Expected to Be the Same*  
16

17 Q. Please explain the distinction between net salvage  
18 costs and net salvage accruals.

19 A. Net salvage costs represent the dollars that the  
20 Company has expended on net salvage (i.e., gross

---

<sup>5</sup> As can be seen in Table 2, both the overall average of (63) percent and the most recent five-year average of (91) percent are more negative than the currently effective estimate of (40) percent.

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1 salvage received less cost of removal expended).  
2 These costs are related to assets that have already  
3 been retired and are no longer in service. In  
4 contrast, the depreciation accruals for net salvage  
5 are accruals related to costs that have not yet been  
6 incurred. These accruals are for the future net  
7 salvage costs for assets that are currently in  
8 service. Because net salvage accruals relate to the  
9 assets currently in service, whereas net salvage costs  
10 are for assets that have been retired and are no  
11 longer providing service, net salvage accruals and net  
12 salvage costs should not be expected to be the same or  
13 even be of a similar dollar level to one another.

14 Q. Please provide an example to demonstrate that net  
15 salvage accruals and net salvage costs should not be  
16 expected to be the same.

17 A. Consider a single asset that has a ten-year service  
18 life. When the asset will be retired, it will cost  
19 \$1,000 to remove from service and there will be no  
20 gross salvage. The net salvage is, therefore,  
21 negative \$1,000 (\$0 in gross salvage less \$1,000 in



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1 cost of removal). The net salvage accruals for this  
2 asset will be \$100 in each of the ten years the asset  
3 will be in service (*i.e.*, the \$1,000 net salvage cost  
4 divided by ten years). However, the net salvage cost  
5 will not be incurred until year ten, at which time the  
6 entire \$1,000 is expended. Thus, for years one  
7 through nine, the net salvage accruals will be larger  
8 than any net salvage costs (\$100 compared to \$0 in net  
9 salvage costs), but in year ten the net salvage costs  
10 will be higher than the net salvage accruals (\$1,000  
11 compared to \$100 in net salvage accruals). Over the  
12 full ten-year period, the net salvage accruals will  
13 sum to the net salvage cost, fully recovering this  
14 cost over the life of the asset. However, by  
15 allocating the net salvage costs over the life of the  
16 asset, customers pay an equitable portion of the cost  
17 of the asset in each year of its service life.

18 Depreciation accounting is intended to equitably  
19 spread the costs of an asset, including net salvage,  
20 over the period of time the asset will be in service.  
21 Because net salvage costs are only expended at the end

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1 of the asset's life, but net salvage accruals are  
2 spread evenly over the asset's life, the timing of net  
3 salvage accruals and net salvage costs should be  
4 expected to be different.

5 Q. Please explain how Staff's analysis fails to recognize  
6 this relationship between net salvage accruals and net  
7 salvage costs.

8 A. The SDP's testimony (p. 15) states the following:

9 In instances where it is apparent the  
10 Company is accruing significantly more than  
11 what is presently needed for net salvage  
12 cost, or the trend indicates that the  
13 Company is experiencing less negative net  
14 salvage, we recommend less negative net  
15 salvage factors.

16 Based on the underlined portions of this testimony, it  
17 appears that the SDP believes the net salvage accruals  
18 should be the same as, or at least similar to, current  
19 net salvage costs. At a minimum, the SDP believes  
20 that net salvage accruals should not be "significantly  
21 more" than current (or present) net salvage costs. As  
22 discussed above, this belief is misguided. Net  
23 salvage accruals will be different from net salvage  
24 costs, and the difference between the two at a given

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1 point in time does not have any bearing on whether a  
2 net salvage estimate is appropriate. In our example  
3 above, the net salvage costs were \$0 from years one  
4 through nine, but net salvage accruals were  
5 significantly greater, at \$100. That is, the net  
6 salvage accruals were significantly more than the net  
7 salvage costs in these years, but this was appropriate  
8 and necessary in order to recover the net salvage  
9 costs equitably over the life of the asset.

10 Q. Please provide an example of an account for which this  
11 reasoning impacted the SDP's net salvage proposal.

12 A. The accounts for which this consideration appears to  
13 have most materially affected the SDP's net salvage  
14 proposal are Accounts 355 and 355.1, which are studied  
15 together and include the Company's transmission poles.  
16 The table below provides a comparison of the estimates  
17 for these accounts and the net salvage percentages  
18 from the statistical net salvage analysis.

19 **Table 3: Comparison of Net Salvage Estimates to Historical**  
20 **Data for Accounts 355 and 355.1**

	<b>Net Salvage Percent</b>
Current Estimate	(40)

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Overall Average	(63)
Five-Year Average	(91)
Company Estimate	(50)
Staff Estimate	(30)

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As the table illustrates, both the overall average net salvage and the most recent five-year average are more negative than the current estimate of negative 40 percent. Staff's testimony states (p. 14) that "[w]here it is apparent that net salvage is becoming more negative, we are recommending net salvage factors be made more negative from current factors." Given this statement and that the historical data indicate that net salvage has become more negative than the current estimate, we would have expected that Staff would propose a more negative net salvage estimate for this account (such as the negative 50 percent estimate we have proposed). However, the SDP has done the opposite and has proposed a less negative 30 percent net salvage estimate.

It appears that Staff has made this counterintuitive estimate because of a comparison of the net salvage accruals to the present net salvage

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1 costs (see Staff's response to O&R-11). As we have  
2 explained, this is not a reasonable comparison, and in  
3 this instance, it results in Staff making a  
4 counterintuitive proposal for this account.

5 Q. Are there any specific reasons why one would expect  
6 net salvage accruals to be greater than present net  
7 salvage costs for this account?

8 A. Yes. A large portion of this account is relatively  
9 new, as the Company has constructed several new  
10 transmission lines in recent years.

11 To recover the net salvage costs for these newer  
12 assets, and because these newer assets have not  
13 experienced any retirements (and, therefore, have not  
14 experienced any net salvage), the net salvage accruals  
15 must be higher than present net salvage costs. The  
16 SDP's decision to reduce the net salvage estimate for  
17 this account because net salvage accruals exceed net  
18 salvage costs will result in an under-recovery of the  
19 net salvage costs for the assets in this account.

20 Q. Does similar analysis impact the SDP's other  
21 proposals?

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1 A. It is not clear from the SDP's testimony the extent to  
2 which the improper comparison of net salvage accruals  
3 and costs has impacted each of the SDP's proposals.  
4 However, given that this portion of the SDP's analysis  
5 is not appropriate or meaningful, we disagree with  
6 each of the SDP's net salvage recommendations.

7 We also note that the SDP more explicitly  
8 proposed to align net salvage accruals and costs in  
9 O&R's 2013 rate case. The Company addressed this  
10 issue in more detail in our direct and rebuttal  
11 testimonies in that case. In particular, we explained  
12 that Staff's proposal was functionally equivalent to a  
13 method referred to as "PAYGO," in which net salvage  
14 costs are paid for as they are incurred, rather than  
15 equitably recovered over the service lives of the  
16 related assets. In part for this reason, the  
17 Commission has previously rejected the "PAYGO" method  
18 (see the 2009 Order in Case 08-E-0539 at 111).

19 While we agree with Staff's decision to move away  
20 from explicitly trying to align net salvage accruals  
21 with net salvage costs, we are concerned that the SDP

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1 continues to use this type of analysis to inform its  
2 net salvage proposals. To the extent this type of  
3 analysis has informed Staff's proposals, their  
4 proposals are unreasonable and will fail to equitably  
5 recover the Company's net salvage costs over the  
6 service lives of its assets.

7 C. Legacy Meter Costs  
8

9 Q. What has the SDP proposed regarding the unrecovered  
10 costs of legacy meters that will be replaced with  
11 Advanced Metering Infrastructure ("AMI") meters?

12 A. The SDP acknowledges in its direct testimony (p. 20)  
13 that the AMI deployment will result in stranded costs  
14 for the Company's legacy meters, and also acknowledges  
15 that the amortization of these stranded costs will  
16 "shorten the length of time intergenerational  
17 inequities exist, and will make the amount to be  
18 recovered from customers less costly in the long-run  
19 through reduced return on rate base." It is,  
20 therefore, unreasonable that the SDP proposes that the  
21 Company not be allowed to amortize these stranded  
22 costs at this time.

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1 Q. What is the basis for the SDP's proposal for legacy  
2 meter costs?

3 A. The SDP's proposal is predicated on the SDP's belief  
4 (p. 21) that there is a "large book reserve surplus  
5 that presently exists" for electric plant.

6 Q. What is a theoretical reserve "surplus"?

7 A. A theoretical reserve "surplus" is a term that is  
8 sometimes used to refer to a situation in which the  
9 book depreciation reserve exceeds the theoretical  
10 depreciation reserve calculated based on the  
11 depreciation parameters (average service lives,  
12 survivor curves and net salvage) in a depreciation  
13 study. If the theoretical reserve exceeds the book  
14 reserve, then this situation may be referred to as a  
15 theoretical reserve "deficiency".

16 However, in our view these terms can be  
17 misleading, as the usage of the words "surplus" or  
18 "deficiency" implies that too much or too little  
19 depreciation has been collected. This is not  
20 necessarily the case. The theoretical reserve is, as  
21 the name implies, a strictly theoretical amount based



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1 on the current estimates. These estimates change in  
2 each study, and accordingly, so does the theoretical  
3 reserve. For this reason, we prefer the terms  
4 "theoretical reserve imbalance" or "reserve  
5 variation," as they do not imply the degree of  
6 certainty that terms such as "surplus" or "deficiency"  
7 can imply.

8 Q. Do you agree with the SDP's proposal?

9 A. No. There are three primary reasons for our  
10 disagreement. First, we disagree that a reserve  
11 "surplus" even exists, as our depreciation study  
12 results in a theoretical reserve "deficiency" for  
13 electric plant. We have explained the problems with  
14 Staff's service life and net salvage estimates, and  
15 accordingly, we do not think it is appropriate to base  
16 the decision to recover the Company's stranded meter  
17 costs on their depreciation recommendations.

18 Second, even if one were to agree with Staff's  
19 calculated theoretical reserve imbalance, it is  
20 incorrect and inconsistent with Staff's testimony to  
21 refer to the resulting theoretical reserve imbalance

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1 as "large." As Staff acknowledges (p. 22), the SDP's  
2 theoretical reserve imbalance is "below the 10 percent  
3 tolerance band that is generally accepted by the  
4 Commission." Given this fact, it is incorrect to  
5 characterize Staff's estimated theoretical reserve  
6 imbalance as large. Further, since our study  
7 estimates a reserve "deficiency," this provides  
8 further support that no matter the estimates  
9 ultimately adopted by the Commission, the theoretical  
10 reserve imbalance is not large.

11 Third, and perhaps most important, is that the  
12 theoretical reserve imbalance is a purely theoretical  
13 number. It is, therefore, quite different from the  
14 stranded costs for legacy electric meters.

15 Q. Please explain further why the theoretical reserve  
16 imbalance for most accounts is different from the  
17 stranded legacy meters costs.

18 A. The theoretical reserve is based on the current  
19 estimates of service lives and net salvage. Because  
20 many accounts have relatively long lives, these  
21 estimates are forecasts of what will occur over many

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1 decades in the future. For this reason, the  
2 theoretical reserve is a purely theoretical number, as  
3 the actual lives and net salvage over the next several  
4 decades may end up being different from current  
5 forecasts. The NARUC manual (p. 189) addresses this  
6 point:

7           When a depreciation reserve imbalance  
8           exists, one should investigate why past  
9           depreciation rates, average service lives,  
10          salvage, or cost of removal amounts differ  
11          from the current estimates. Care should be  
12          taken to analyze these effects before  
13          correcting for the reserve imbalances.  
14          Instances occur where subsequent experience  
15          shows the original estimates no longer to be  
16          appropriate. It should be noted that only  
17          after plant has lived its entire useful life  
18          will the true depreciation parameters become  
19          known.

20 The last sentence in this passage underscores our  
21 point. The theoretical reserve imbalance, whether  
22 based on Staff's proposals or the Company's, is a  
23 theoretical number, and the true value will not be  
24 known for many decades, once all assets currently have  
25 reached the end of their useful lives.

26 Q. Is the same true of the stranded costs for legacy  
27 meters?

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1 A. No. The Company's plans for AMI implementation are  
2 known, and the SDP does not challenge any of the  
3 specifics of the Company plans for AMI. Thus, the  
4 reserve "deficiency" for legacy meters is not a  
5 theoretical concept. Instead, it is known that these  
6 assets will be retired and, based on current  
7 depreciation rates, their costs will not be fully  
8 recovered by the end of their service lives. For this  
9 reason, an amortization of these costs is appropriate  
10 and necessary to mitigate intergenerational inequity.  
11 Staff's proposal, in contrast, will defer the recovery  
12 of these costs to some future date - if they are  
13 recovered at all. The SDP's proposal is, therefore,  
14 both inequitable and inappropriate.

15

16 **II. Mr. Wyman's Depreciation Proposals**

17 Q. What is the basis for Mr. Wyman's proposal to  
18 significantly shorten the average service life for gas  
19 services?

20 A. Mr. Wyman's average service life proposal is based on  
21 his expectations for the impact of the State's Carbon

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1 Reduction goals. For example, he provides a graph on  
2 page 47 of his testimony setting forth how he believes  
3 the State's Carbon Reduction goals will reduce gas  
4 revenues, and he argues that depreciation should  
5 follow a similar pattern.

6 Q. Do you agree with Mr. Wyman's proposal?

7 A. We do believe it is important to consider how external  
8 factors such as regulations and state goals, as well  
9 as forces of retirement such as obsolescence, will  
10 impact both the service lives and net salvage of the  
11 Company's assets. In general, these factors favor  
12 conservatism regarding service lives and are one  
13 reason why we believe adopting the longer lives Staff  
14 has proposed for many accounts is not appropriate.

15 However, as discussed in the Policy Panel  
16 rebuttal testimony, the precise path the State will  
17 take to achieve 80x50 is not clear at this time.  
18 Accordingly, it is also not clear at this time that  
19 the State's Carbon Reduction goals will have the  
20 effect that Mr. Wyman predicts in his testimony.

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1           Accordingly, there is no basis at this time to adopt  
2           his proposal.

3    Q.    Does this conclude your rebuttal and update testimony?

4    A.    Yes, it does.