





Cases 08-E-0887 & 08-G-0888- Central Hudson RatesStaff Response to Interrogatory/Document Request

Request No.: CH-201
Date of Request: 12/09/08
Reply Date: 12/10/08
Responding Witness: Depreciation Panel
Subject: Depreciation

Q.201) Referring to Staff's response to Central Hudson IR 75, please identify the Commissions that have "abandoned the traditional method and moved to current-period accounting for gross salvage and or cost of removal," including the relevant circumstances surrounding such actions and provide a citation to the Commission action/decision reflecting such abandonment.

A. Staff does not know which Commissions have abandoned the traditional method and moved to current-period accounting for gross salvage and or cost of removal. Staff paraphrased the following quote from page 157 from Public Utility Depreciation Practices by NARUC; "Some Commissions have abandoned the above procedure and moved to current-period accounting for gross salvage and/or cost of removal." The "above procedure" describes the traditional method. The current-period method is essentially referring to expensing the cost of removal and salvage being considered revenue. Staff is not proposing that specific method for electric, but is realizing more current costs via the traditional method of reflecting these costs and revenues through the deprecation rate.

CHAPTER XI

ESTIMATING SALVAGE AND COST OF REMOVAL

General

A general discussion of salvage and cost of removal is presented in Chapter III. Before discussing the process of analyzing and estimating these factors, a review of definitions and discussion of general principles is presented below.

When depreciable plant facilities are retired from service and physically removed, costs may be incurred and/or cash or other value may be realized if they are sold or retained for reuse. The abandonment of utility property in place can also cause costs to be incurred, (e.g., the cost of filling an abandoned gas pipe line with an inert gas). The term gross salvage refers to the amount received for retired property sold or junked, reimbursement received from insurance or other sources, or the amount at which reusable material is charged to a utility's Material and Supplies Account.¹ Cost of removal is the expenditure incurred in connection with retiring, removing, and dispersing of property. Net salvage is the difference between gross salvage and cost of removal.

Historically, most regulatory commissions have required that both gross salvage and cost of removal be reflected in depreciation rates. The theory behind this requirement is that, since most physical plant placed in service will have some residual value at the time of its retirement, the original cost recovered through depreciation should be reduced by that amount. Closely associated with this reasoning are the accounting principle that revenues be matched with costs and the regulatory principle that utility customers who benefit from the consumption of plant pay for the cost of that plant, no more, no less. The application of the latter principle also requires that the estimated cost of removal of plant be recovered over its life.

Some commissions have abandoned the above procedure and moved to current-period accounting for gross salvage and/or cost of removal. In some jurisdictions gross salvage and cost of removal are accounted for as income and expense, respectively, when they are realized. Other jurisdictions consider only gross salvage in depreciation rates, with the cost of removal being expensed in the year incurred.

Determining a reasonably accurate estimate of the average or future net salvage is not an easy task; estimates can be the subject of considerable discussion and controversy between regulators and utility personnel. This is one of the reasons advanced in support of current-period accounting for these items. When estimating future net salvage, every effort should be made to ensure that the estimate is as accurate as possible. Normally, the process should start by

¹ Regulatory agencies generally require that reusable material consisting of retirement units be salvaged at original cost, while minor items may be salvaged at current prices new. Some regulatory agencies take into consideration the fact that depreciation has been sustained.

Cases 08-E-0887 & 08-G-0888- Central Hudson Rates

Staff Response to Interrogatory/Document Request

Request No.: CH-77
Date of Request: 11/26/08
Reply Date: 12/04/08
Responding Witness: Depreciation Panel
Subject: Depreciation

Q.77) Referring to Staff Depreciation Panel testimony on Page 15, lines 5-14. Please describe the manner in which Staff's salvage proposal has been "accepted" in other rate cases, including the relevant circumstances surrounding any such acceptance.

A. Staff's salvage proposal was basically accepted by Central Hudson in a Joint Proposal in the last rate case 05-E-0934 & 05-E-0935. In the NYSEG rate case, Case 05-E-1222, the ALJ accepted all of Staff's adjustments and the Commission agreed with the ALJ.

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 05-E-1222 - Proceeding on Motion of the Commission as to
the Rates, Charges, Rules and Regulations of
New York State Electric & Gas Corporation for
Electric Service.

RECOMMENDED DECISION

BY

ADMINISTRATIVE LAW JUDGES
WILLIAM BOUTELILLER AND ELIZABETH H. LIEBSCHUTZ

CASE 05-E-1222

depreciation rates presume. Here too, we recommend the DPS Staff-proposed average service lives.

3. Net Salvage

Two net salvage issues have been presented. The first concerns five accounts for which there are no historical, salvage data.⁹ Rather than apply a negative salvage value to these accounts, DPS Staff has proposed that a zero net salvage factor be used.

The second applies to transmission poles (account 355) and distribution services (account 369) where both NYSEG and Staff agree that substantial negative salvage rates should apply. NYSEG has proposed a negative 70% rate for transmission poles and a negative 90% rate for distribution services. Staff has proposed a negative 50% and a negative 60%, respectively.

Staff points out that the rates NYSEG has proposed will produce annual accruals significantly greater than the net salvage amounts the Company has incurred, on average, over the last ten years. In response, NYSEG observes that its depreciation rates must adequately anticipate the future removal and retirement costs and they cannot be set simply or solely on the basis of the historical information.

Nucor also addresses net salvage and opposes the inflation factor the Company applied to the historical net salvage data. Nucor believes that the construction costs included in the plant accounts sufficiently capture the effects of inflation and net salvage need not be adjusted. Nucor states that inflation is reflected adequately in the historic data that spans substantial periods, in some cases 30 to 40 years. It also believes that the same data that is used to establish the service lives should also be used for net salvage purposes.

We find that NYSEG has projected negative net salvage for five accounts that entirely lack any historical information.

⁹ The five accounts are 335 (hydro) and 341, 342, 343 and 345 (production).

CASE 05-E-1222

Inasmuch as these accounts have not experienced any final retirements, we believe it would be premature for the Commission to set any negative salvage values for the retirement of the entire facilities that are included in these plant accounts.

We also find, with respect to the transmission pole and distribution service accounts, that the parties do not dispute the need for substantial negative salvage rates in these instances. They differ on the accrual rate that should be established now given past trends and future cost expectations. For now, we recommend that the Commission accept and adopt the DPS Staff-proposed negative salvage rates and that these accounts be re-examined the next time that the Company reviews its applicable depreciation rates for their adequacy and for potential changes.

Rate Base

1. Capital Expenditures - Computer Software
 - a. Integrated Back Office Program and Work Management System - Costs to Achieve

According to DPS Staff, the current rate plan requires NYSEG to expense, during its term, the costs incurred by the Company to achieve its merged operations, including the software costs for the Integrated Back Office Program. Staff has proposed to disallow NYSEG's remaining costs for achieving the Integrated Back Office Program that consist of a \$419,000 expense item and a \$2.7 million rate base item.

Similarly, Staff has proposed that the remaining costs to achieve the Work Management System also be disallowed, consisting of a \$765,000 expense item and a \$5.9 million rate base item. According to DPS Staff, the prevailing rate plan does not provide NYSEG any discretion to amortize these costs beyond the plan's five-year period. Staff supports its position