

Exhibit No.: **KCP&L-61**
Issue: Depreciation
Witness: John J. Spanos
Type of Exhibit: Surrebuttal Testimony
Sponsoring Party: Kansas City Power & Light Company
Case No.: ER-2010-0355
Date Testimony Prepared: January 5, 2011

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO.: ER-2010-0355

SURREBUTTAL TESTIMONY

OF

JOHN J. SPANOS

ON BEHALF OF

KANSAS CITY POWER & LIGHTCOMPANY

**Kansas City, Missouri
January 2011**

**KCP&L Exhibit No. KCP&L 60
Date 2/4/11 Reporter LMB
File No. ER-2010-0355**

SURREBUTTAL TESTIMONY

OF

JOHN J. SPANOS

Case No. ER-2010-0355

1 **Q: Please state your name and business address.**

2 A: John J. Spanos, 207 Senate Avenue, Camp Hill, Pennsylvania, 17011.

3 **Q: Are you the same John J. Spanos who prefiled direct and rebuttal testimony in this**
4 **matter?**

5 A: Yes.

6 **Q: What is the purpose of your surrebuttal testimony?**

7 A: The purpose of my surrebuttal testimony is to address the rebuttal testimony of Missouri
8 Public Service Commission Staff witness, Arthur W. Rice. The specific issues relate to
9 the utilization of the life span methodology for production accounts, the most reasonable
10 and fair approach to the regulatory depreciation amortization, the implementation of
11 general plant amortization, and a few other rate issues that need to be addressed.

12

13 **Life Span Methodology for Production Plant**

14 **Q: Does the use of the life span methodology best represent the life characteristics of**
15 **production plants?**

16 A: Yes, it does. The use of an interim survivor curve combined with a probable retirement
17 date for each facility matches the complete life characteristics of a production facility.
18 The interim survivor curve represents the dispersion patterns of the assets which are
19 replaced each year during the life span of the facility. The probable retirement date sets
20 forth the best estimate of the date of concurrent final retirement of the facility.

1 Q: Does the methodology of the MPSC Staff properly represent the life characteristics
2 of production facilities?

3 A: No, it does not. Each production facility will not have life characteristics similar to a
4 mass property account, such as poles. A production facility will not be able to operate
5 with small percentages of assets being retired each year until there is nothing left. There
6 is a point in time for a production plant when it is no longer efficient or used and useful
7 which requires a large percentage of survivors to be retired concurrently. In the manner
8 in which the MPSC Staff has decided to represent the life characteristics, there is no
9 concurrent final date of retirement. Thus, MPSC Staff assumes that small percentages of
10 surviving plant will be retired at each age until zero percent is remaining. This is not
11 reasonable.

12 Q: Are there other states that realize the life span methodology?

13 A: Yes. The life characteristics of generation units are represented by the life span
14 methodology in the other 49 states as well as in the Canadian provinces. Additionally, in
15 the recent AmerenUE case, the Missouri Commission approved the utilization of the life
16 span methodology.

17 Q: Has a recent survey supporting the life span methodology been presented to the
18 Missouri Commission?

19 A: Yes. In the AmerenUE case, Concentric Energy Advisors conducted a survey which sets
20 forth the various examples of other states utilizing the life span methodology. There are
21 some states that currently have non-regulated generation, so past experiences of Gannett
22 Fleming depreciation studies or other depreciation consultants can support the use of the
23 life span approach.

1 **Q: Has the MPSC Staff recognized that the life span methodology has been approved**
2 **by the Missouri Commission?**

3 A: Yes. In Mr. Rice's rebuttal testimony, page 5, he discusses his opinion of an appropriate
4 life span for Iatan Unit 2. Although I do not agree with his support of Industrial witness
5 Mr. Greg Meyer's life span of 60 for the initial life span of Iatan Unit 2, Mr. Rice's
6 rebuttal recognizes that the life span methodology has been recently approved in
7 Missouri.

8 **Q: Has the MPSC Staff recognized the benefits of the life span methodology for**
9 **depreciation expense over the total life of the plant?**

10 A: Yes. On page 5 of Mr. Rice's rebuttal testimony, he discusses that the shorter initial life
11 span tends to smooth the depreciation expense over the total life of the plant. However,
12 Mr. Rice continues in his rebuttal by stating that the initial users are not the ones driving
13 the additional demands and requirements on the plant in the future which causes future
14 additions and retirements. This is not correct given that the Iatan Unit 2 is a base load
15 unit so all generations of users equally cause demands and requirements of the unit.
16 Consequently, all users equally drive the demands of the unit so they should equally pay
17 for the unit through annual depreciation expense.

18 **Q: Can you elaborate on why the life span for Iatan Unit 2 is best represented by 50**
19 **years?**

20 A: First, Mr. Meyer performs a comparison of units that have been in service for many years
21 and their current life span is quite different than their initial life span. Each of the units
22 described in Mr. Meyer's examples have had many major upgrades which has allowed
23 those units to establish a new life span beyond 40 or 50 years. Therefore, the initial life

1 span for Iatan Unit 1 was actually shorter than the proposed life span to Iatan Unit 2 as
2 implied by Mr. Meyer and Mr. Rice.

3 **Q: Can you supply examples of life spans for comparable units recently constructed?**

4 A: There are five units that have recently been placed in service that I have a good
5 understanding of all the factors included in establishing the appropriate life span. Below
6 is the list of units, their initial date of operation and the currently approved life span date.

<u>Unit</u>	<u>Initial Date of Operation</u>	<u>Life Span Date</u>
Nebraska City Unit 2	2009	2069
Spurlock Unit 3	2005	2045
Trimble County Unit 2	2008	2063
Council Bluffs Unit 4	2005	2049
Weston Unit 4	2008	2046

7

8 The aggregate life span of these five units is 47.4 years and the composite depreciation
9 rate for each of these units is higher than that recommended by Staff for Iatan Unit 2.
10 This was a factor when recommending 50 years for Iatan Unit 2. The life spans for each
11 of these units were determined based on physical life, efficiency, energy demands and the
12 current regulatory arena which considers potential future environmental regulations.
13 Each of these factors were discussed with Company engineering to determine the
14 appropriate life span for Iatan Unit 2.

15 **Q: Should the life span methodology be limited to just steam production plant?**

16 A: No. The life characteristics of combustion turbines are similar to steam production
17 facilities in that there are many smaller interim retirements over the life of the facility and
18 then one concurrent final retirement. The combustion turbines are not comparable to the
19 size of the steam units, but their life characteristics are similar. There are few locations
20 or units which have small components that get retired over the years with one eventual

1 date when the facility is shut down. Thus, recovery of the capital investment through
2 depreciation should have the same methodology.

3
4 **Depreciation Reserves and Regulatory Amortizations**

5 **Q: Can you explain the issue related to the Depreciation Reserve?**

6 A: There is a \$169,000,000 amount that KCPL has received from the ratepayers which
7 should reduce rate base. The funds were not designated to specific assets; therefore, the
8 depreciation study included an allocation of these funds to each account. This allocation
9 increased the December 31, 2008 book reserve for each account which in turn reduces the
10 amount to be collected in future rates. Additionally, the reduced recovery amount will be
11 spread over the remaining life equally, so as not to artificially reduce future costs for one
12 small generation of ratepayers, and to make sure all assets are treated equally.

13 **Q: Does this allocation address the concerns of the MPSC Staff?**

14 A: Yes. On page 12 of Arthur Rice's rebuttal testimony, he makes a recommendation that
15 the \$169,000,000 be used to reduce the amount of dollars that current rates collect to
16 cover future costs. That is exactly what has been done in the depreciation study. The
17 overall accumulated depreciation was \$1,348,972,461. After the allocation of the
18 \$169,000,000, the amount utilized to determine remaining life depreciation rates is
19 \$1,517,868,250. The actual regulatory amortization has two components. One
20 established in 2005 for \$132,221,058 and the other from 1994 of \$36,674,731 for a total
21 amount of \$168,895,789.

22 **Q: On Page 12 of Mr. Rice's rebuttal testimony, he suggests that my recommendation**
23 **is premature. Do you agree?**

1 A: No. In the previous proceedings concerning the allocation, KCPL was required to
2 develop a methodology for allocating to accounts for use in the fourth rate case. This
3 methodology addresses the allocation at the most appropriate time.

4 **Q: Does Staff handle the \$169,000,000 regulatory amortization correctly?**

5 A: No. Staff attempts to address the \$169,000,000 regulatory amortization by offsetting
6 amounts of recent cost of removal averages in order to reduce the revenue requirement.
7 This practice does not establish a systematic and rational manner to offset future rate base
8 and requires a significant tracking of these amounts which will inevitably create issues in
9 future cases. The attempts to utilize the amortization amount as an offset to incurred cost
10 of removal and eliminating the cost of removal accrual is not fair and reasonable to all
11 generations of ratepayers. Additionally, this adjustment does not follow the meaning of
12 the Uniform System of Accounts which requires a systematic and rational manner. An
13 undefined amortization specifically designed to offset well supported net salvage accruals
14 does not make any sense. Mr. Rice is attempting to manufacture depreciation expense
15 without proper recovery patterns.

16

17

Amortization of General Plant

18 **Q: Is general plant amortization widely utilized across the United States and Canada**
19 **by other utilities?**

20 A: Yes. Almost all the other states and Canadian provinces have widely accepted the use of
21 amortization accounting for general plant since the early 1990s.

22 **Q: Has the Federal Energy Regulatory Commission (FERC) approved the use of**
23 **general plant amortization?**

1 A: Yes. The FERC established Accounting Release No. 15 in April 1997 to address general
2 plant amortization for utility companies. Thus, in addition to the state commissions, the
3 FERC has approved of the merits of amortization accounting.

4 **Q: Has the MPSC Staff set forth some concerns with your recommendations?**

5 A: Yes, however each of the concerns will be eliminated with the proper implementation of
6 general plant amortization over time. Thus, Staff's reasons for not implementing general
7 plant amortization are addressed throughout this proceeding, such as; the concern for
8 appropriate plant balances as of December 31, 2008; the concern for not consistently
9 following Rule 4 CSR240-20.030; and the concern that assets are not properly recorded
10 in the correct accounts. The discussion below addresses each of these concerns and
11 eliminates Staff's continual opposition to the commonly used accounting of amortization
12 for certain general plant accounts.

13 Staff's first concern related to an imbalance of the plant and reserve amounts as of
14 December 31, 2008 which has been resolved. Through discussions with Art Rice, the
15 plant and reserve balances for each account were reconciled which eliminated his
16 opposition to inaccurate records as of December 31, 2008.

17 Staff's second concern is to address assets that are still on the books which may no longer
18 be used and useful. This is the biggest challenge of general plant assets because there are
19 so many assets with little individual value. Consequently, it is difficult for accounting
20 departments to keep track of all these assets, especially the assets that have the ability to
21 change locations easily. An extensive inventory of all of these assets could be performed
22 which will take numerous man-hours, add little value of resources and, most importantly,
23 not truly improve the future practices of asset retention, which will leave KCPL in this
24 same position in a few years. Additionally, Staff raised concerns that some assets were

1 not properly categorized by account. However, a thorough review of the classification in
2 the Uniform System of Accounts and the Company's plant catalog which the
3 Commission has a copy confirms the appropriate classification. Consequently,
4 establishing a reasonable useful life of each general plant account that falls into the
5 amortization criteria and retiring all assets that were installed prior to that period will
6 eliminate almost all concerns that assets not used and useful will be taken off the books.
7 This can be done with limited man-hours and will establish an improved practice for
8 future recovery, all at the same time of stabilizing depreciation rates.

9 Staff's third concern is the appropriate useful life of each asset category. I have reviewed
10 the various asset types in each account or subaccount and compared them to other utilities
11 across the country to determine the most reasonable useful life to be utilized. Staff has
12 attempted to conduct life analyses from retirement history of KCPL assets which we
13 know include assets that will be retired as soon as this case is finalized and amortization
14 accounting is implemented. Therefore, there is little value in utilizing this data for
15 establishing current and future life characteristics when it is known that the historical life
16 characteristics are not a true indication of future characteristics. An understanding of the
17 assets in each plant account and determination of their useful life must be the dominant
18 factor in establishing a reasonable amortization period.

19 **Q: Are there other issues Staff cites for opposing general plant amortization?**

20 A: Yes. The MPSC Staff also attempts to utilize FERC rulings as a reason for not using
21 general plant amortization, but Accounting Release No. 15 clearly supports the concept.

22 **Q: Does Staff propose any other alternatives in their attempt to avoid general plant**
23 **amortization?**

1 A: Yes. Staff proposes to raise the capitalization threshold for many of the asset classes.
2 Higher capitalization thresholds may reduce some of the assets being misidentified, but it
3 will not reduce the man-hours needed to keep track of small dollar items as compared to
4 production, transmission and distribution assets. We must not forget that the accounts
5 recommended for general plant amortization represents slightly more than 2 percent of
6 the depreciable assets, yet requires an equal amount of time to monitor as compared to
7 the other asset classes. Thus, conducting physical inventories for general plant
8 unnecessarily increases costs of doing business without providing any long range benefit.
9 General plant amortization creates improved accounting processes and minimizes heavy
10 costs for a small percentage of the capital investment. Also, the higher capitalization
11 thresholds reduce the number of assets being capitalized, but it also increases the amount
12 of dollars being expensed. Therefore, revenue requirements would increase because
13 annual O&M expenses will increase instead of the current practice of capitalizing the
14 smaller assets and recovering over 5, 10 or 20 years.

15 **Q: Has Staff determined how life characteristics of 30 years for assets such as**
16 **Communication Equipment are better than 15 years, as I recommend?**

17 A: No. On page 15 of Mr. Rice's rebuttal testimony, he indicates the life characteristics of
18 Communication Equipment for KCPL is best represented by a 35-L0 survivor curve. In
19 other words, Mr. Rice would consider a 35-year average service life and 115-year
20 maximum life to be reasonable for telephones, radios, automatic meter reading
21 equipment, video conferencing equipment, microwave equipment, flat screen TVs and
22 security cameras. Mr. Rice does show on his table, page 15 of his rebuttal, that he would
23 recommend a 30-year amortization to correlate to the life analyses. Even the 30-year
24 amortization level seems extremely long for the types of assets in this account and that

1 would even apply if we excluded some of the assets he feels are misclassified. However,
2 I think anyone would agree that of all the assets listed in Account 397, Communication
3 Equipment, there is very little that would stay in service and be useful beyond 15 years.
4 Therefore, there is little support for Mr. Rice's opposition of general plant amortization
5 due to improper classifications. After reviewing the Uniform System of Accounts, there
6 is justification for proper recording of all assets within the current asset class.

7
8 **Other Depreciation Issues**

9 **Q: Are there any other depreciation issues that need to be addressed?**

10 A: Yes. On Page 7, lines 4 through 23, of Mr Rice's rebuttal testimony he identifies
11 Accounts 312.02, 353.03, 362.03 and 391.02 as having excessive or abnormal differences
12 between Staff's proposal and KCPL's proposal.

13 **Q: Can you address the suggested excessive or abnormal difference for Account**
14 **312.02?**

15 A: Yes. KCPL has assigned a depreciation rate of 0 percent because past recovery rates has
16 already fully recovered the service value of the asset. This is known as fully depreciated
17 or fully accrued. Staff has recommended a 2.33 percent. Therefore, Staff recommends
18 that KCPL should continue to depreciate the assets in Account 312.02 even though full
19 recovery has already been achieved. Not only is the 0 percent appropriate for this
20 account but this is a perfect illustration as to why the remaining life is superior to the
21 whole life methodology.

22 **Q: Are the depreciation rates for 353.03 and 362.03 excessive or abnormal?**

23 A: No. These accounts represent communication equipment at substations which has a
24 much shorter life than the other assets at the substation. Therefore, the 15 year life I

1 recommend is much more appropriate for these assets than the 30 year life recommended
2 by Staff. The actual rate difference is due to the underrecovered situation in these assets.

3 **Q: Is the difference for Account 391.02 excessive or abnormal?**

4 A: No. This account consists of computer equipment which has a considerably shorter life
5 than office furniture and equipment such as desks and chairs. Mr. Rice recommends
6 maintaining a life close to 20 years as compared to the KCPL proposal of 5 years. Mr.
7 Rice rationalizes in his rebuttal testimony that maintaining the current rate is appropriate
8 because he cannot understand the changes in plant balance from December 31, 2008 to
9 July 2010. This information was provided in the response to Data Request 310. The data
10 request asked for plant additions for years 2009 and 2010 which was supplied, however,
11 the increased plant balance during those years was due to a \$789,124 transfer that Mr.
12 Rice did not consider. There were no plant additions during the years 2009 and 2010.

13 **Q: Did Mr. Rice request further explanation for the balance differences?**

14 A: No. I can only presume that Mr. Rice could not find any additional reasons for not
15 accepting general plant amortization or a more appropriate rate for Account 391.02 than
16 the current 5.40% rate so he attempted to leave the topic outstanding.

17 **Q: Does that conclude your testimony?**

18 A: Yes, it does.

