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Witness: Gregory E. Macias
Sponsoring Party: MoPSC Staff
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

GREGORY E. MACIAS

FILED²

FEB 07 2007

**Missouri Public
Service Commission**

MISSOURI GAS ENERGY

CASE NO. GR-2006-0422

Jefferson City, Missouri
December 2006

~~Staff~~ Exhibit No. 117
Case No(s). GR-2006-0422
Date 1-17-07 Rptr RF

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

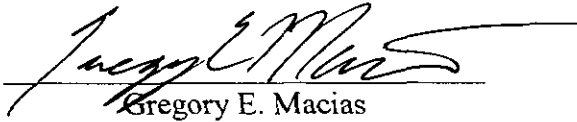
In the Matter of Missouri Gas Energy's Tariff)
Sheets Designed to Increase Rates for Gas Service)
in the Company's Missouri Service Area)

Case No. GR-2006-0422

AFFIDAVIT OF GREGORY E. MACIAS

STATE OF MISSOURI)
)
COUNTY OF COLE) ss.

Gregory E. Macias, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Surrebuttal Testimony in question and answer form, consisting of 12 pages to be presented in the above case; that the answers in the foregoing Surrebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

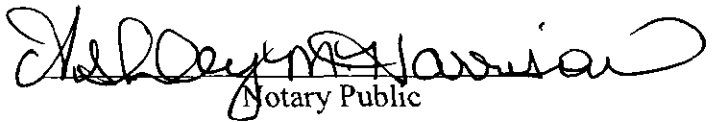


Gregory E. Macias

Subscribed and sworn to before me this 8th day of December 2006.



ASHLEY M. HARRISON
My Commission Expires
August 31, 2010
Cole County
Commission #06898978



Notary Public

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OF
GREGORY E. MACIAS
MISSOURI GAS ENERGY
CASE NO. GR-2006-0422

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1 Account 380 - Services. Fourth, I will address the Staff's net salvage recommendation for
2 Account 376 - Mains.

3 Q. Do you sponsor any schedules with your surrebuttal testimony?

4 A. Yes. Schedule 1 is a comparison of Staff's depreciation recommendation and
5 MGE's depreciation recommendation.

6 **EXECUTIVE SUMMARY**

7 Q. Please summarize your surrebuttal testimony.

8 A. The Commission should reject the Company's proposed adjustment to the
9 accumulated reserve for depreciation because it is unnecessary. The Company's depreciation
10 reserve deficiency is greatly inflated by the Company's proposal to shorten the average
11 service life for Account 380 - Services.

12 The Commission should adopt Staff's recommended surrogate average service life of
13 42 years for Account 380 - Services. MGE is a natural gas local distribution company
14 comparable to the Missouri jurisdictional companies used as Staff's surrogate. MGE's
15 recommend average service life of 32 years for Account 380 - Services should be rejected
16 because it is based on a simulated plant balance analysis that "... may not reflect the life
17 characteristics of the majority of the plant recorded in the account ...".¹

18 The Commission should adopt Staff's recommended five percent net salvage
19 allowance for Account 376 - Mains because it relieves customers from paying for plant that
20 has been reimbursed to the Company. The Commission should reject Mr. Sullivan's proposal
21 to alter the Staff's recommendation to include a negative 15 percent net salvage allowance for
22 Account 376 - Mains because it clearly overstates the Company's cost of service.

¹ Sullivan direct testimony, schedule TJS-2, page 9

CHANGE IN MGE'S DEPRECIATION RECOMMENDATION

Q. What is the significant change in the Company's depreciation recommendation presented in Mr. Sullivan's prefiled rebuttal testimony versus the depreciation recommendation presented in Mr. Sullivan's prefiled direct testimony?

A. Mr. Sullivan has changed his depreciation recommendation to include an adjustment to the accumulated reserve for depreciation resulting in a \$618,848 increase to annual depreciation expense. In his direct testimony at page 3, lines 1-11, Mr. Sullivan states:

Q. In your report, what are your recommendations with regard to the depreciation accrual rates for the Company?

A. In my report, I recommend the Company implement the depreciation expense rates contained in column (H) of Table 4-2, which are based on the remaining life methodology.

Q. Are you recommending that the Company implement these same depreciation expense rates for this case?

A. No, I am not. Based on the Commission and Staff's historical use of the whole life methodology, the Company is proposing the whole life rates developed in my Report. Therefore, for the purposes of this case, I recommend that the Company implement the whole life rates contained in column (J) of Table 4-1.

In the filed rebuttal testimony of MGE witness Sullivan at page 4, lines 3-12, he states:

Q. Is there another difference between the depreciation rates you are recommending in your rebuttal testimony and your recommendation on Page 3, Lines 1-11 of your direct testimony?

A. Yes, I misspoke on Page 3, Lines 3-5 of my direct testimony when I referred to the depreciation rates in Column H of Table 4-2 as remaining life rates. The depreciation rates in Column H of Table 4-2 are not remaining life rates but rather whole life rates reflecting a reserve adjustment. As such, I should have recommended the depreciation rates in Column H of Table 4-2, not the depreciation rates shown in Column J of Table 4-1 as stated on Page 3, Line 11 of my direct testimony.

1 In his direct testimony Mr. Sullivan recommended whole life depreciation rates
2 without an adjustment for the depreciation reserve. However, in his rebuttal testimony he
3 recommends whole life depreciation rates with an adjustment to amortize the depreciation
4 reserve imbalance. This is a significant change between MGE's direct and rebuttal cases.

5 **ACCUMULATED RESERVE FOR DEPRECIATION**

6 Q. Briefly summarize the Company's accumulated reserve for depreciation
7 redistribution and amortization.

8 A. In his rebuttal testimony, Mr. Sullivan recommends an adjustment to the
9 accumulated reserve for depreciation. Mr. Sullivan calculates an over accrual in
10 Account 380 – Services of approximately \$29 million, and net depreciation reserve deficiency
11 of approximately \$15.7 million. In Mr. Sullivan's Direct Testimony, Schedule TJS-2, page
12 19, he recommends "a redistribution of the excess depreciation reserve of Account 380 . . . to
13 other accounts so that the net redistribution is zero". After the redistribution, "[a]ny amounts
14 that have been over- or under-recovered should be amortized over the remaining life of the
15 asset group."

16 Q. Does Staff agree with the Company's depreciation reserve amortization?

17 A. No. Mr. Sullivan's depreciation reserve over-accrual is a result of the
18 theoretical depreciation reserve calculated using the Company's selected average service
19 lives. Staff does not agree with the Company's recommended average service lives as they
20 generally overstate the Company's cost of service. Using Mr. Sullivan's formulas and the
21 currently ordered average service lives, the net depreciation reserve deficiency drops to less
22 than \$2 million. Substitute Staff's recommended average service lives into the equation, and
23 the depreciation reserve is *over*-accrued by approximately \$14.6 million.

1 Q. Does Staff agree with the Company's depreciation reserve redistribution?

2 A. No. Staff believes that redistributing the depreciation reserve over-accrual for
3 Account 380 – Services, estimated at \$29 million by Mr. Sullivan, is unnecessary and
4 potentially confusing. By redistributing the accumulated reserve for depreciation for the
5 services account, the effects of years of excessive depreciation are masked, and any previous
6 collection for future costs of removal in Account 380 is negated. Instantaneous elimination of
7 the excess depreciation reserve accrual in Account 380 allows the Company to falsely justify
8 accelerated depreciation for the services account by recommending an unreasonably short
9 average service life of 32 years.

10 Q. What is Staff's recommendation for accumulated reserve for depreciation
11 redistribution and amortization?

12 A. Staff recommends no adjustment to MGE's accumulated reserve for
13 depreciation at this time. As stated in my direct testimony, Staff believes that MGE's reserve
14 ratio of approximately 33% is adequate at this time.

15 **AVERAGE SERVICE LIFE OF ACCOUNT 380 – SERVICES**

16 Q. Briefly summarize why Mr. Sullivan believes his recommendation for a
17 32 year average service life for Account 380 – Services is more appropriate than your
18 recommendation of a 42 year average service life.

19 A. Mr. Sullivan states in his rebuttal testimony at page 33, lines 11-12, that his
20 simulated plant balance analysis "indicated a service life reasonably in line with what I
21 expected based on my experience and other available information." However, in the
22 June 2005 Black & Veatch report attached as Schedule TJS-2 to Mr. Sullivan's direct
23 testimony he admits that there are problems with the simulated analysis. In Schedule TJS-2,

1 at page 9, Mr. Sullivan explains the three problems with the Account 380 – Services analysis.
2 First, the results “...may not reflect the life characteristics of the majority of the plant
3 recorded in the account since it has only recently been placed in service...”. Second, “[t]he
4 use of simulated plant balance analysis results in an aggregate service life that may not be
5 indicative of the account, especially of the property currently in service”. “Third, the services
6 account has a relatively high retirements index...” which “...merely substantiates that the
7 majority of the account consists of relatively new property.”

8 Q. Does Mr. Sullivan agree with Staff’s comparison to Ameren UE, Aquila Inc.
9 and Laclede Gas Co. with respect to Account 380 – Services?

10 A. No. Mr. Sullivan believes that, among other things, MGE’s service line
11 replacement program distinguishes the Company so much as to be incomparable to any of the
12 comparison companies used to determine Staff’s surrogate average service life. Mr. Sullivan
13 contends that MGE’s limited continuing property record indicates such by the results of his
14 simulated plant balance analysis.

15 The Company requested that the Commission relieve MGE from the burden of
16 reconstructing its plant mortality data. The Commission granted this relief to the company in
17 Case No. GR-98-140:

18 . . . it would not be appropriate to require the reconstruction or re-
19 creation of records that apparently do not exist or cannot be completed
20 by any reasonable efforts of MGE.

21 Now the Company proclaims that if they had the data that they failed to obtain and
22 refused to reconstruct, it would show that MGE is substantially different from the other
23 natural gas operations in the State of Missouri.

1 Q. At page 11, line 9, Mr. Sullivan quotes Staff witness David Murray, and infers
2 that Mr. Murray believes that Laclede Gas Company is not comparable to MGE. Do you
3 believe the Mr. Sullivan accurately characterizes Mr. Murray's statement?

4 A. No, he does not. Mr. Sullivan is so selective in choosing his excerpt as to be
5 misleading. Mr. Murray's actual statement in direct testimony at page 24, lines 1-4, is:

6 Although I did not give any weight to my Laclede DCF cost of
7 common equity estimates shown on Schedule 18, I do believe that
8 Laclede's cost of common [equity] estimation can be informative
9 because most of its operations are confined to Missouri and are
10 regulated by the Missouri PSC.

11 Q. In Mr. Sullivan's rebuttal testimony at page 37, lines 13-15, he states: "In
12 Rebuttal Schedule TJS-4, I clearly demonstrate that R1.5 42-year Iowa Curve does not
13 reasonably predict actual survivors reported on the books and records of MGE." Did you
14 recommend the use of R1.5 42-year Iowa Curve for Account 380 – Services?

15 A. No, I did not specify any Iowa type curve. As explained in my direct
16 testimony, I am recommending a 42 year average service life for Account 380 – Services
17 based on an average of the results of recent Staff-performed depreciation studies of Missouri
18 jurisdictional natural gas local distribution companies.

19 Q. In Mr. Sullivan's Rebuttal Schedule TJS-4 and Rebuttal Schedule TJS-5 he
20 claims to present a "Comparison of Predicted and Actual Survivor Curves" that shows a plot
21 of the "actual" percent surviving of each vintage of Account 380 – Services. Does the
22 Company know the original vintage balances for this account?

23 A. No, MGE does not know the original investment for pre-1994 vintages for any
24 account. In his rebuttal testimony at page 35, lines 5-7, Mr. Sullivan admits that "We cannot
25 perform retirement analysis on retirements made subsequent to 1994 on property installed

1 prior to 1994 because the continuing property record contains no information with regard to
2 the original investment.”

3 I do not understand why Mr. Sullivan makes reference to “actual” survivor curves and
4 “actual” retirements when the “actual” points on the plots are calculated from the 1994 plant
5 balances (Mr. Sullivan describes this process at page 36, lines 1-11, of his rebuttal testimony).
6 These “actual” survivors are dependent on Mr. Sullivan’s selection of Iowa type curve and
7 average service life in all five of the graphs presented in Rebuttal Schedules TJS-4 and TJS-5,
8 not history or MGE’s record of original investment.

9 Q. Mr. Sullivan discusses census data relating to Jackson County housing stock at
10 page 42, lines 1-22 of his rebuttal testimony. Mr. Sullivan contends that for Staff to support a
11 42-year ASL, Staff must assume that 63,000 housing units that are either vacant or over 60
12 years old will remain in service on average for 42 years. Is this Staff’s assumption?

13 A. No, it’s not. Staff assumes that the potentially shortened lives of the service
14 lines to the 63,000 housing units will be offset by the longer lives of service lines to newer
15 housing units, including the nearly 4,000 new homes built in Jackson County annually. Staff
16 assumes that the average service life of all short lived, long lived and in-between lived service
17 lines will be around 42 years.

18 **NET SALVAGE ALLOWANCE FOR ACCOUNT 376 – MAINS**

19 Q. How did you calculate net salvage percent for Account 376 – Mains?

20 A. The formula I used to calculate net salvage percent is:

21 *Net Salvage % = (Gross Salvage – Cost of Removal) ÷ Original Cost of Plant Retired*

1 The National Association of Regulatory Utility Commissioners (NARUC)² defines
2 "net salvage" as "[t]he gross salvage for the property retired less its cost of removal." "Gross
3 salvage" is defined by NARUC as "[t]he amount recorded for the property retired due to the
4 sale, reimbursement, or reuse of the property." "Cost of removal" is defined by NARUC as
5 "[t]he costs incurred in connection with the retirement from service and the disposition of
6 depreciable plant." "Original Cost" is defined by NARUC as "[t]he cost of property when
7 first placed in service."

8 Q. Mr. Sullivan states in his rebuttal testimony at page 50, lines 3-5, that you
9 "grossly overstated the net salvage allowance that should be used for Mains because he has
10 misapplied the reimbursements that were received by MGE in the past." Would you explain
11 why you included reimbursements in your calculation of net salvage percentage for
12 Account 376 – Mains?

13 A. Yes. Including reimbursements in the net salvage allowance relieves
14 customers from paying for plant that has already been reimbursed to the Company. I will
15 illustrate how this happens with an example.

16 Mr. Sullivan provides an example of how a reimbursement is booked at page 46, line
17 17 through page 47, line 5 of his rebuttal testimony. His example follows:

- 18 1. MGE has to remove certain facilities, let's say a Main. This
19 results in a retirement of say \$100,000 (the original cost of main
20 removed).
- 21 2. MGE has to construct the new Main for a cost of \$500,000. An
22 addition is made to plant for the \$500,000.

² Staff Subcommittee on Depreciation of The Finance and Technology Committee of the National Association of Regulatory Utility Commissioners, *Public Utility Depreciation Practices*, National Association of Regulatory Utility Commissioners, August 1996, pp. 317, 320, 322.

1 3. The Missouri Department of Transportation reimburses MGE
2 for the cost of the new mains, i.e. \$500,000. MGE credits (increases)
3 reserve to reflect this reimbursement.

4 4. Net plant is unchanged by the sum of these three accounting
5 entries.

6 Q. Does this end the depreciation cycle?

7 A. No. Let's say the new main is depreciated over 45 years (in other words, the
8 average service life is 45 years), and is retired after 45 years. Mr. Sullivan's example would
9 continue as follows:

10 5. Although net plant is unchanged, depreciable plant has increased by \$500,000
11 (the original cost of the new main). MGE collects through depreciation expense $1/45^{\text{th}}$ of
12 \$500,000 annually for 45 years and accrues \$500,000 to the depreciation reserve at the end of
13 the 45th year. MGE has now increased the depreciation reserve by the original cost of the new
14 main.

15 6. Net plant has been reduced by \$500,000 over the course of 45 years because
16 customers have repaid MGE for the new main.

17 7. After 45 years the main is taken out of service. This results in a retirement of
18 \$500,000. MGE reduces plant and reduces depreciation reserve by \$500,000 each. Net plant
19 is unchanged by the retirement of the main.

20 8. Now that our main is retired, the sum of the accounting entries is a net
21 reduction in plant of \$500,000 (the depreciation reserve is \$500,000 over-accrued). This is
22 money that customers paid in depreciation expense that must now be given back.

23 Q. How did the Company end up over collecting the entire \$500,000 cost of the
24 main from customers?

1 A. Because Mr. Sullivan did not consider the reimbursement, the new main that
2 was initially paid for by the Missouri Department of Transportation was also paid for by
3 customers in depreciation expense. Not recognizing the reimbursement resulted in
4 overstating the Company's cost of serving its customers.

5 Q. Is this an extraordinary occurrence?

6 A. No, MGE receives reimbursement for relocating facilities year after year.
7 Mr. Sullivan's example is, however, "extreme".

8 Q. In Mr. Sullivan's rebuttal testimony at page 47, line 20-21, he states "Prior to
9 1994, the reimbursements were lower than they were during the period 1994 through 2002."
10 Is this correct?

11 A. No, not entirely. The total dollar amount of reimbursement was lower, but the
12 level of reimbursement relative to retirements was actually higher. For the period 1994
13 through 2002 the level of reimbursements relative to retirements was approximately 51%.
14 Prior to 1994, the level of reimbursements relative to retirements was approximately 70%
15 (1978 through 1993).

16 Q. Mr. Sullivan points out that reimbursement for 2003 and 2004 have been
17 \$89,000 and \$69,000 respectively. Is your recommendation for including reimbursements in
18 the net salvage calculation wrong?

19 A. No. For the past five years, MGE has received almost \$2.5 million, or nearly
20 \$500,000 a year on average. Large relocation projects do not occur every year, but they do
21 happen regularly which is why we consider averages instead of only the test year.

22 Q. Please summarize your surrebuttal testimony recommendation.

Surrebuttal Testimony of
Gregory E. Macias

1 A. I recommend that the Commission order the depreciation rates, associated
2 average service lives and net salvage allowances proposed in my direct testimony Schedule 2.

3 Q. Does this conclude your surrebuttal testimony?

4 A. Yes, it does.

GR-2008-0422
Missouri Gas Energy
Surrebuttal Schedule 1. Depreciation Comparison

Account Number	Description	Original Cost 6/30/2006	Staff Proposal					Company Proposal					Difference Between Staff & MGE				
			ASL	\$ Life	Net Svlg	\$ Salvage	\$ Amort.	Dep. Rate	Annual Accrual	ASL	\$ Life	Net Svlg		\$ Salvage	\$ Amort.	Dep. Rate	Annual Accrual
DISTRIBUTION																	
375.00	Structures and Improvements	5,584,958	45	123,986	10%	(12,287)	-	2.00%	111,699	45	123,986	-	-0.03%	(1,675)	2.19%	122,311	10,612
376.00	Mains	339,884,706	45	7,545,440	5%	(373,873)	-	2.11%	7,171,567	44	7,715,383	-	0.16%	543,816	2.43%	8,259,198	1,087,631
378.00	Measuring and Regulating Equip.	11,634,249	41	283,876	0%	-	-	2.44%	283,876	35	332,740	-	0.03%	3,490	2.89%	336,230	52,354
379.00	Meas & Reg Equip - City Gate	3,058,251	41	74,621	0%	-	-	2.44%	74,621	40	76,456	-	0.14%	4,282	2.64%	80,738	6,117
380.00	Services	284,362,067	42	7,005,817	-28%	1,972,226	-	3.05%	8,978,043	32	9,213,533	-9.00%	824,214	-	3.41%	10,037,746	1,059,703
381.00	Meters	31,036,775	41	757,297	-1%	6,207	-	2.46%	763,505	35	887,652	-	0.10%	31,037	2.96%	918,689	155,184
382.00	Meter Installations	68,835,673	41	1,679,590	0%	-	-	2.44%	1,679,590	35	1,968,700	-	0.06%	41,301	2.92%	2,010,002	330,412
383.00	House Regulators	11,558,045	45	256,588	0%	-	-	2.22%	256,588	42	275,081	-	-0.04%	(4,623)	2.34%	270,458	13,869
385.00	Industrial Meas and Reg Equip.	372,505	43	8,679	0%	-	-	2.33%	8,679	30	12,404	-	-0.04%	(149)	3.29%	12,255	3,576
	TOTAL DISTRIBUTION	766,327,228		17,735,895		1,592,273	-		19,328,169		20,605,935		824,214		617,479	22,047,627	2,719,458
DIFFERENCE - DISTRIBUTION																	
				(2,870,040)		768,069	(617,479)		(2,719,458)		2,870,040		(768,069)		617,479	2,719,458	
GENERAL																	
390.00	Structures and Improvements	661,193	41	16,133	0%	-	-	2.44%	16,133	45	14,678	40.00%	(5,885)	(850)	1.21%	8,000	(8,133)
391.00	Office Furniture and Equipment	6,970,421	11	633,611	0%	-	-	9.09%	633,611	11	633,611	-	0.01%	697	9.10%	634,308	697
392.00	Transportation Equipment	5,043,979	12	420,163	10%	(41,865)	-	7.50%	378,298	11	458,498	10.00%	(45,900)	504	8.19%	413,102	34,804
393.00	Stores Equipment	538,350	32	16,850	0%	-	-	3.13%	16,850	30	17,927	-	0.02%	108	3.35%	18,035	1,185
394.00	Tool, Shop, and Garage Equip.	5,154,470	27	190,715	0%	-	-	3.70%	190,715	20	257,724	-	0.01%	515	5.01%	258,239	67,524
396.00	Power Operated Equipment	243,807	17	14,336	25%	(3,584)	-	4.41%	10,752	15	16,262	20.00%	(3,243)	49	5.36%	13,068	2,316
397.10	Electronic Reading - ERT	36,324,861	20	1,816,243	0%	-	-	5.00%	1,816,243	20	1,816,243	-	0.00%	-	5.00%	1,816,243	-
397.20	Communication Equipment	3,289,347	21	156,573	0%	-	-	4.76%	156,573	16	205,584	-	0.02%	658	6.27%	206,242	49,669
398.00	Miscellaneous Equipment	431,485	26	16,612	0%	-	-	3.85%	16,612	20	21,574	-	-0.07%	(302)	4.93%	21,272	4,680
	TOTAL GENERAL	58,857,913		3,281,236		(45,449)	-		3,235,787		3,442,101		(55,028)		1,369	3,388,509	152,722
DIFFERENCE - GENERAL																	
				(160,865)		9,579	(1,369)		(152,722)		160,865		(9,579)		1,369	152,722	
	GRAND TOTAL	824,985,141		21,017,131		1,546,824	-		22,563,956		24,048,036		769,166		618,848	25,436,136	2,872,180
DIFFERENCE - TOTAL																	
				(3,030,905)		777,638	(618,848)		(2,872,180)		3,030,905		(777,638)		618,848	2,872,180	