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| *Exhibit No.:* | |
| *Issue:* | *Depreciation* |
| *Witness:* | *Guy C. Gilbert, PE, RG* |
| *Sponsoring Party:* | *MoPSC Staff* |
| *Type of Exhibit:* | *Surrebuttal Testimony* |
| *Case No.:* | *WR-2010-0131* |
| *Date Testimony Prepared:* | *May 6, 2010* |

**MISSOURI PUBLIC SERVICE COMMISSION**

**UTILITY SERVICES DIVISION**

# SURREBUTTAL TESTIMONY

# OF

# GUY C. GILBERT, PE, RG

**MISSOURI-AMERICAN WATER COMPANY**

**CASE NO. WR-2010-0131**

*Jefferson City, Missouri*
*May 2010*

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**OF**

**GUY C. GILBERT, PE, RG**

**MISSOURI-AMERICAN WATER COMPANY**

**CASE NO. WR-2010-0131**

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**GUY C. GILBERT, PE, RG**

**MISSOURI-AMERICAN WATER COMPANY**

**CASE NO. WR-2010-0131**

Q. Would you please state your name and business address?

A. Guy C. Gilbert, 200 Madison Street, Jefferson City, Missouri, 65102.

Q. By whom are you employed and in what capacity?

A. I am employed by the Missouri Public Service Commission (PSC or Commission) as a Utility Regulatory Engineer II in the Engineering and Management Services Department.

Q. Would you please describe your work experience and educational background?

A. A copy of my work and educational experience was provided in Appendix 1, pages 10 to 13 of the Staff Report in this case.

Q. Have you previously testified before the Commission?

A. Yes. The cases in which I have filed testimony before the Commission are listed in Appendix 1, pages 8 and 9 of the Staff Report in this case.

Q. And are you the same Guy Gilbert that caused portions of the Staff's Cost of Service Report and Rebuttal Testimony to be filed in this case?

A. Yes I am.

**EXECUTIVE SUMMARY**

Q. Please state the purpose of your testimony?

A. The purpose of this Surrebuttal Testimony is to address Company witness Mr. Spanos' Rebuttal Testimony and the Company's seemingly disregard for Commission rules; an inaccurate, inappropriate and myopic view of depreciation; the inappropriate recording of transaction codes to be used in the determination of depreciation rates; the flawed use of the life span approach to determine depreciation rates; the use of remaining life depreciation rates; and either a failure to adequately use Commission implied resources or a disregard of Commission rules regarding the amortization of general plant accounts.

**COMMISSION RULES AND DEPRECIATION**

Q. Is the description of the term "depreciation" as put forth by Mr. Spanos in his surrebuttal testimony at page 5, lines 20 through 24, and page 6, lines 1 through 8, inaccurate of the Commission's definition and inappropriate?

A. Yes. The Commission rules state:

> **4 CSR 240-50.030 Uniform Systems of Accounts. Water Companies**
> *PURPOSE: This rule prescribes uniform systems of accounts for and the filing of annual reports by all classes of water companies.*
> (1) The uniform systems of accounts for Class A and B and for Class C and D water companies, issued by the National Association of Regulatory Utility Commissioners in 1973, as revised July 1976, are adopted and prescribed for use by all water companies under the jurisdiction of the Public Service Commission.
> (2) For the purpose of this rule, the four (4) classes of water companies have annual water operating revenues as follows:
> (A) Class A. $500,000 or more;
> (B) Class B. $250,000 to $500,000;
> (C) Class C. $50,000 to $250,000; and
> (D) Class D. Less than $50,000.

And the correct definition is:

> 11. "Depreciation." as applied to depreciable utility plant. means the loss in service value not restored by current maintenance. incurred in connection with the consumption or prospective retirement of utility plant in the course of service from causes which are known to be in current operation and against which the utility is not protected by insurance. Among the causes to be given consideration are wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand and requirements of public authorities.

Mr. Spanos has replaced the clause: "which are known to be in current operation and", with the clause: "which can be reasonably anticipated or contemplated." This completely alters the meaning of depreciation from the standard objective viewing of the events that may happen, to a subjective approach of predetermining scenarios, which then require depreciating.

Q. Are there other inaccuracies or misrepresentations in Mr. Spanos' testimony?

A. Yes. Please see Mr. Spanos' rebuttal testimony at page 6, lines 9 through 17, where definitions for the Uniform System of Accounts General Instructions 11 and 22 appear. Upon close review of the USOA, the following definition appears in General Instruction 11, and General Instruction 22 does not exist.

> Uniform System of Accounts Class A & B Water - 1973
> Page 18 GENERAL INSTRUCTIONS
>
> 11. Payroll Distribution.
> Underlying accounting data shall be maintained so that the distribution of the cost of labor charged direct to the various accounts will be readily available. Such underlying data shall permit a reasonably accurate distribution to be made of the cost of labor charged initially to clearing accounts so that the total labor cost may be classified between construction, cost of removal, utility operating functions (source of supply, pumping, transmission and distribution. etc.) and nonutility operations.

**TRANSACTION CODES**

Q. How does Mr. Spanos' interpretation of depreciation lead to a myopic view?

A. There are two basics contributing to the near-sighted approach in Mr. Spanos' depreciation study. While the Company has Commission ordered depreciation rates assigned according to the USOA by account, Mr. Spanos has chosen to further segregate these accounts by production site, and then subjectively determine what hazard may fall upon them, such as a lifespan driven retirement.

While we all agree that utility plant and equipment have some definite useful service life, Mr. Spanos' approach would plan for no replacement of the retired production facility. Paris, France has had a water system for over four hundred years. The Roman ducted system has largely been replaced with pipes. Production does not cease; it is replaced. Utilities, whether water, sewer, gas or electric companies all provide on-going utility services. Unless a new technology replaces the service the water utility provides, or technology replaces moving fluids through pipes, the current utility system will be replaced to maintain on-going service.

The second approach that Mr. Spanos uses is flawed by what appears to be a failure to recognize that these retirements are expected. Instead, Mr. Spanos has chosen to label retirements related to his life spanned accounts as outliers. The definition for an outlier retirement in the instructions provided by Mr. Spanos' firm, Gannett-Fleming, defines outlier retirement as follows:

> "Outlier Retirement: A retirement that occurs under unusual circumstances such that the analyst deems it appropriate that it be excluded from the retirements used in the service life or salvage study."

In other words, the subjective definition implies this kind of retirement has not occurred before and will not happen again, and should therefore be excluded from the analysis. In reality, this would predicate that the production facility for potable water is a singular facility and is not going to be replaced.

**LIFE SPAN**

Q. Does the subjective use of life span cause apparent self-imposed under recovery of depreciable amounts?

A. Yes. This is a subjectively self-inflicted perspective of what may happen. The Company has this one production plant, and when it is retired the Company will not have in this subjective singularity an opportunity to recover all of the investment in that plant.

Following the Commission's order where it provides a depreciation rate for a whole account, the Company is instantly made whole for the retired amounts. It is only by refusing to look at the entire account that any perception of under accrual for depreciation can be made. Furthermore, using the experience and information given from the entire account can then be used to determine whether the Company needs an adjustment to the depreciation rates based upon this objective experience.

Q. Do the authoritative texts cited in Mr. Spanos' rebuttal testimony specifically refer to water treatment facilities?

A. No. The citations of authoritative texts by Mr. Spanos in his rebuttal testimony at page 6, lines 6 through 32, and page 7, lines 1 through 5, only refer to plant accounting data related to electric production.

**REMAINING LIFE**

Q. Has the Company followed the Commission's guidance as discussed in your rebuttal testimony?

A. No. The method for determining the depreciation rates, as stated by the Commission in ER-2004-0570, is straightforward and relies on two numbers developed from data captured in the Company's continuing property record (CPR). The first number is the average service life (ASL) that results from an actuarial analysis of the recorded data. The second number, net salvage percent (NS), is based upon a near term historical review of retirements and their associated salvage and cost of removal.

Q. Please explain in layman's terms the Company's remaining life method for determining depreciation rates.

A. First, the Company's remaining life method is predicated on always looking forward to when the account by vintage will come to an end. There is not a general implication that the account will keep growing.

Second, because of this assumption of the account ending, certain assumptions need to be developed based upon the ASL and NS developed above. The depreciation engineer next determines the remaining life for the account. This is done by matching a stub curve, depicting composite (by vintage) actual additions and retirements, with an Iowa curve as discussed in my direct testimony. Once the desired curve has been selected, a remaining life (RL) can be determined. Given the RL, one can determine how much time is available to recoup the undepreciated investment, plus any NS associated with those amounts. This results in a first pass depreciation rate that is used to determine what the theoretical reserve for depreciation should be, had that depreciation rate been in use up to this point in time. Now the amount of reserve imbalance can be determined, and whether the account is over or under accrued. The amount of reserve imbalance is then depreciated over the remaining life of the account and added back into the depreciation rate.

**GENERAL PLANT ACCOUNTS**

Q. Do the Commission rules contemplate amortization of general plant accounts?

A. No. First of all, amortization does not depreciate the asset over its service life. Amortization in this manner is simply a matter of convenience for the Company and does not benefit the rate payer. Accordingly, it does not meet the Commission's definition of depreciation. The Commission rules also take into account the supporting record keeping through the CPR, USOA and the Property Unit Catalog.

Q. Will the accrual rate remain constant over time and will the annual expense remain constant?

A. No. This rate may change when the Commission is asked to change the depreciation rates and decides to do so. The annual expense, however, will likely increase. The Company is increasing ownership of their transportation fleet and is likely to increase those amounts in the pendency of this case. Due to plant additions, annual expense will likely increase in the next case. All of the Company's accounts for which the Commission has assigned depreciation rates appear to still be growing. The amortization rate proposed by the Company is equal to the depreciation rate proposed by Staff.

Q. Will the need for continual asset inventories and extensive record keeping disappear?

A. No. The Company will still be required to keep records for property tax purposes and should for other items that fall below the capitalization limit, such as computers, transportation, power operated equipment, and technology based equipment.

Q. Has the Staff suggested remedies to this perceived problem in the past?

A. Yes. The Staff has recommended that the Company be allowed to remove all items below their capitalization limit in the General Plant Accounts category and then amortize those dollars over some Commission designated or approved time period.

Q. Is there a concern that the Company is not or may not be willing or able to comply with the Commission's rules regarding amortization of General Plant accounts?

A. Yes. At page 13, lines 18 through 21, Mr. Spanos, the management approved Company representative regarding depreciation issues, states that this amortization of General Plant issues is of such a necessity, because the Company cannot accurately keep the required records. Conversely, if this matter is truly a great burden, one would expect a cost savings tied to the Commission granting a waiver of its rules for this Company.

**<u>SUMMARY</u>**

Q. What is Staff's recommendation in this case?

A. Staff recommends that the Commission adopt its depreciation rates as put forth in Schedule GCG-1 of the Staff Cost of Service Report Appendices. The Staff's depreciation rates do not include use of lifespan, a remaining life adjustment, nor do they include any amortization for depreciable plant. Staff further recommends that the Company follow the Commission's rules as they pertain to depreciation and record keeping.

Q. Does this conclude your prepared Surrebuttal Testimony?

A. Yes, it does.

**BEFORE THE PUBLIC SERVICE COMMISSION**

**OF THE STATE OF MISSOURI**

| | | |
|---|---|---|
| In the Matter of Missouri-American Water Company's Request for Authority to Implement a General Rate Increase for Water and Sewer Services Provided in Missouri Service Areas | ) ) ) ) | Case No. WR-2010-0131 |

AFFIDAVIT OF GUY C. GILBERT MS, PE, RG

STATE OF MISSOURI )
) ss.
COUNTY OF COLE )

Guy C. Gilbert, 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 8 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.

Guy Gilbert

Guy C. Gilbert MS, PE, RG

Subscribed and sworn to before me this 6th day of May, 2010.

Nikki Senn

Notary Public

NIKKI SENN
Notary Public - Notary Seal
State of Missouri
Commissioned for Osage County
My Commission Expires: October 01, 2011
Commission Number: 07287016