Exhibit No.:
Issues: Cost of Removal/Savage
Net Salvage
Witness: Paul W. Adam
Sponsoring Party: MoPSC Staff
Type of Exhibit: Direct Testimony
Case No.: GR-2000-512

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

PAUL W. ADAM

UNION ELECTRIC COMPANY
d/b/a AMERENUE

CASE NO. GR-2000-512

Jefferson City, Missouri
August 2000

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Q. Please state your name and business address.

A. Paul W. Adam, P.O. Box 360, Jefferson City, MO 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 an Engineer IV in the Engineering and Management Services Department.

Q. What are your duties as an engineer in the Engineering and Management Services Department?

A. I am responsible for depreciation calculations and studies of companies regulated by the Commission.

Q. Would you please state briefly your qualifications, educational background and experience?

A. I am a Registered Professional Engineer in Missouri and Colorado. In 1967, I earned a Bachelor of Science degree in Chemical Engineering from the University of Missouri–Columbia. I served in the U.S. Army after graduating and

subsequently was employed in the oil industry from 1969 until 1991 as an engineer in various capacities, with the exception of a brief period from 1971 to 1974 when I completed a Masters Degree in Business Administration at the University of Missouri and also built single family homes.

From 1991 to 1993 I managed a concrete products plant in Northwest Missouri. In 1994, I accepted my current position.

Q. Have you ever testified before the Commission?

A. Yes.

Q. Please state the purpose of your testimony in this case.

A. The purpose of my testimony in this case is to present the benefits of separating net salvage calculations from the life calculation in depreciation calculations.

Q. Would you clarify what depreciation is considered to be?

A. Yes. The Supreme Court of the United States stated:

> Broadly speaking, depreciation is the loss, not restored by current maintenance, which is due to all the factors causing the ultimate retirement of the property. These factors embrace wear and tear, decay, inadequacy and obsolescence. Annual depreciation is the loss which takes place in a year.

In Re: Lindheimer v. Illinois Bell Telephone Company, 292 U.S. 151, 167 (1934).

Q. Can you give your position on this definition?

A. The ". . . loss, not restored by current maintenance . . . which cause(s) the ultimate (final) retirement of property", as stated by the Supreme Court, is the original capital cost of the plant that must be recovered over the property's used and useful life. To calculate a depreciation rate, an average service life is determined by Staff from historical retirements along with information learned from company engineers and

operations personnel. The depreciation rate determined by Staff allows the company to collect, from customers, the original capital cost of the plant in equal amounts over the average service life (the used and useful life) of the plant as wear and tear, decay, inadequacy and obsolescence take their toll leading to final retirement.

Q. Are there other components that have been addressed by depreciation?

A. Yes. The other component that has been addressed by depreciation calculations is net salvage which I will call net salvage cost in this testimony. Net salvage cost includes the cost to remove plant at interim and/or final retirement points in time and the collection of any scrap value or disposition of the retired plant. For most companies, the cost to remove plant exceeds the scrap value of the same plant when all accounts are combined. Therefore, it is reasonable to consider net salvage a cost. It is Staff's proposal that net salvage cost be separated into two parts, as has been historically done by the Commission.

Q. Can you explain the two parts of net salvage cost recognized, in the past, by the Commission?

A. The Commission has historically recognized both "final net salvage cost" and "interim net salvage cost" of life span property. Examples of life span property subject to "final net salvage cost" and "interim net salvage cost" would be plant, such as buildings, gas holders and power plants. "Final net salvage cost" occurs when all units of life span property, regardless of age, are retired. "Interim net salvage cost" is the retirement of units of plant during the life of the life span type property, as will be explained later.

The final retirements of the plant in mass property accounts (i.e., mains, services, poles, etc.) occur frequently, usually there are many retirements each year. These mass property retirements cause a "final net salvage cost." Both the interim retirements of life span property and the final retirements of mass property accounts can be evaluated using the same methodology. Staff propose that the auditors can evaluate the net salvage cost of these retirements as a recurring expense with benefits to the regulated utility companies and their customers, this will be discussed later.

Q. How would Staff make this separation of net salvage cost into two parts?

A. The final retirement of a life span property frequently includes a major demolition project and a rehabilitation of the site where the plant was located. These projects do not occur frequently and are normally after a long 'in service' period. For example, the Laclede gas holders in St. Louis are in the range of 100 years old and are still in use. Their removal will be the final retirement of a life span property. This would be the part of net salvage cost that would remain the responsibility of depreciation engineers, due to the need to evaluate demolition projects.

Conversely, during the life of a life span property, units of plant may be retired and replaced several times. For example, if the roof on a building is considered a unit of plant, it may need to be retired and replaced every 20 years, while the building will remain in service for 100 years or more. Therefore, the roof may be replaced four or five times during the life span of the building. These retirements are interim retirements and occur repeatedly, and with a reasonable frequency. Also, the final retirements of plant in the mass property accounts, like mains for gas or poles for electric, occur with a reasonable frequency. The frequency of retirements in mass property accounts is

normally at a higher rate of events per unit of time than the interim retirements of a life span account. Retirements from large accounts such as mains, services and meters tend to be relatively constant from year to year with some trends due to growth of the account or other events such as regulatory requirements to replace old services. This would be the second part of net salvage cost. It will be the responsibility of auditors because it is easily evaluated as an expense item by them.

Q. How have these two different parts of net salvage cost been addressed by the Commission in the past?

A. From my experience, the Commission has not allowed a regulated utility company to include the 'final net salvage cost' of life span plant into customer rates until the removal activity is certain. On the other hand, the Commission has allowed an annual accrual of net salvage cost for interim retirements of life span plant and for final retirement of mass property accounts, even though the accrued amount did not tie to actual amounts spent for these retirements.

Q. Going back to the purpose of this testimony, which is to separate net salvage calculations from life calculations and to give benefits that the regulated utility and its customers can expect, can you now explain the proposed separation?

A. The separation would leave the calculations and determination of plant life and the final retirement cost of life span property with the engineers of the Engineering and Management Services Department. Also, the separation gives the auditors the annual recurring net salvage cost, which is: 1) the interim retirements of life span properties; and 2) all retirements of the mass property properties.

Q. How would you describe the separation of life and final net salvage cost of life span properties from the interim retirements of life span properties and final retirement of mass property calculations?

A. The calculations become two separate, clear and traceable calculations that will define the separate amounts of (A) the depreciation accrual and final net salvage cost of life span property, calculated by the engineers, from (B) the interim retirements of life span properties and the final retirements of mass property, calculated by the auditors. The original capital cost of the plant in each account will be recovered in equal increments over the average service life of the plant in each account, this is the depreciation accrual calculation. Also, the final retirement cost of life span plant would be calculated and determined by the engineers in the Engineering and Management Services Department and an amortization, that preferably would not induce rate shock, would be proposed to allow the regulated utility company to recover this final cost of removal. This is not a change from previous Commission decisions.

In separate calculations, the Accounting Department would determine, from data submitted by the regulated utility company, the annual expense amount of the net salvage cost of all accounts. For life span accounts, this would be interim net salvage cost and for mass property accounts this would be all net salvage cost.

Q. Have other states separated the net salvage cost that will be determined by the auditors in Staff's proposal from the depreciation accrual calculation?

A. Yes. In the words of Pat Lee, who is Manager of Depreciation for the Florida Public Service Commission Staff, "This debate about net salvage (cost) has gone on for ages." Florida separated the net salvage cost as described in this testimony in

1983. In an earlier case, the state of Pennsylvania removed net salvage (cost) from their depreciation rates in 1962 (see Penn Sheraton Hotel v. Pennsylvania Public Utility Commission, 198 Pa.Super. 618, 184 A.2d 324, 45 P.U.R.3d 353 (1962).

It should be realized that the long-term debate concerning net salvage cost would not exist unless there was truly a problem with some of the methods of calculating net salvage cost. The dollars spent, as net salvage cost by the regulated utility, should be traceable to their inclusion in customer rates.

Q. How would the separation of life and net salvage cost calculations be a benefit to utility companies and their customers?

A. The customers of each Commission regulated utility company will be certain they are not paying to the regulated utility company funds that are not defined for a specific purpose and the regulated utility will be certain that they are collecting in customer rates what the regulated utility company is spending, or has spent for capital investment and all net salvage cost. Separation of the duties of calculating and determining the life of plant from net salvage cost will: 1) allow for the recovery of the original investment through depreciation rates; 2) provide a calculation and determination to recover the final removal cost of life span plant through an amortization; and 3) will give a calculation and determination of the net salvage cost of interim retirements on life span accounts and final retirements on mass property accounts through expenses. These three calculations and determinations, numbers one and two done by engineers and number three done by auditors, can be tracked to amounts actually spent by the regulated utility company. This ability to track amounts actually spent by the regulated utility

company through to customer rates is a benefit to both the customers and the regulated utility, in that it lets both parties know that each is being treated fairly.

Q. Does this conclude your testimony?

A. Yes.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In The Matter Of Union Electric Company d/b/a AmerenUE, For Authority To File Tariffs Increasing Rates For Gas Service Provided To Customers In The Company's Missouri Service Area	)))))	Case No. GR-2000-512

AFFIDAVIT OF PAUL W. ADAM

STATE OF MISSOURI)
) **ss**
COUNTY OF COLE)

Paul W. Adam, of lawful age, on his oath states: that he has participated in the preparation of the foregoing written testimony in question and answer form, consisting of 8 pages of testimony to be presented in the above case, that the answers in the attached written testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true to the best of his knowledge and belief.

Paul W. Adam

Subscribed and sworn to before me this 4th day of August, 2000.

Notary Public

My commission expires_____

SHARON S WILES
NOTARY PUBLIC STATE OF MISSOURI
COLE COUNTY
MY COMMISSION EXP. AUG. 23,2002