

*Exhibit No.:*  
*Issue:* Depreciation  
*Witness:* Gregory E. Macias  
*Sponsoring Party:* MoPSC Staff  
*Type of Exhibit:* Surrebuttal Testimony  
*Case No.:* GR-2006-0422  
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**MISSOURI PUBLIC SERVICE COMMISSION**

**UTILITY SERVICES DIVISION**

**SURREBUTTAL TESTIMONY**

**OF**

**GREGORY E. MACIAS**

**MISSOURI GAS ENERGY**

**CASE NO. GR-2006-0422**

Jefferson City, Missouri  
December 2006

**BEFORE THE PUBLIC SERVICE COMMISSION**

**OF THE STATE OF MISSOURI**

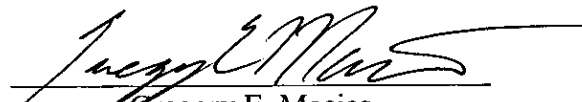
In the Matter of Missouri Gas Energy's Tariff )  
Sheets Designed to Increase Rates for Gas Service )  
in the Company's Missouri Service Area )

Case No. GR-2006-0422

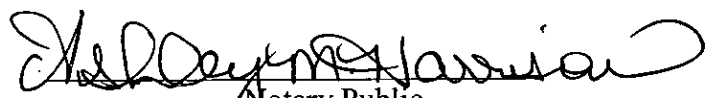
**AFFIDAVIT OF GREGORY E. MACIAS**

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.

  
\_\_\_\_\_  
Notary Public



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

**TABLE OF CONTENTS**  
**SURREBUTTAL TESTIMONY**  
**OF**  
**GREGORY E. MACIAS**  
**MISSOURI GAS ENERGY**  
**CASE NO. GR-2006-0422**

EXECUTIVE SUMMARY ..... 2

CHANGE IN MGE’S DEPRECIATION RECOMMENDATION..... 3

ACCUMULATED RESERVE FOR DEPRECIATION ..... 4

AVERAGE SERVICE LIFE OF ACCOUNT 380 – SERVICES ..... 5

NET SALVAGE ALLOWANCE FOR ACCOUNT 376 – MAINS ..... 8

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

Q. Please state your name and business address.

A. Gregory E. Macias, 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 a Utility Engineering Specialist II in the Engineering and Management Services Department.

Q. Are you the same Gregory E. Macias who has previously filed direct and rebuttal testimonies on behalf of the Staff of the Commission (Staff) in this proceeding?

A. Yes, I am.

Q. What is the purpose of your surrebuttal testimony?

A. I will respond to the rebuttal testimony of Missouri Gas Energy (MGE or Company) witness Thomas J. Sullivan.

Q. What issues will you address?

A. First I will address a significant change that the Company made to its depreciation expense recommendation from its direct case to rebuttal testimony. Second, I will address the Company's proposed adjustment to the accumulated reserve for depreciation. Third, I will address the Staff's recommended 42 year average service life for

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 . . .”.<sup>1</sup>

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.

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<sup>1</sup> 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)<sup>2</sup> 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.

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<sup>2</sup> 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  $45^{\text{th}}$  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.

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.