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Issue(s):	Depreciation, Plant Records
Witness:	Laura M. Moore
Sponsoring Party:	Union Electric Company
Type of Exhibit:	Surrebuttal Testimony
Case No.:	ER-2012-0166
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MISSOURI PUBLIC SERVICE COMMISSION

Case No. ER-2012-0166

SURREBUTTAL TESTIMONY

OF

LAURA M. MOORE

ON

BEHALF OF

UNION ELECTRIC COMPANY
d/b/a Ameren Missouri

St. Louis, Missouri
September, 2012

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OF

LAURA M. MOORE

CASE NO. ER-2012-0166

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Laura M. Moore. My business address is One Ameren Plaza, 1901 Chouteau Avenue, St. Louis, Missouri 63103.

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

A. I am employed by Union Electric Company d/b/a Ameren Missouri ("Ameren Missouri" or "Company") as Managing Supervisor of Regulatory Accounting.

Q. Are you the same Laura M. Moore who filed rebuttal testimony in this case?

A. Yes, I am.

Q. What is the purpose of your surrebuttal testimony?

A. The purpose of my surrebuttal testimony is to respond to the rebuttal testimony of Missouri Public Service Commission Staff ("Staff") witness Guy C. Gilbert. More specifically, I rebut Mr. Gilbert's mischaracterization of the accruals for net salvage expense included in the Company's Commission-approved depreciation rates, and his contention that the net salvage accruals somehow undermine the Company's request for Plant-in-Service Accounting, which is discussed in the testimonies of Ameren Missouri witness Lynn M. Barnes. I also demonstrate that Mr. Gilbert's contention that if Plant-in-Service Accounting were adopted there should be an amortization of a portion of the Company's depreciation reserve is improper and unwarranted.

Finally, I again briefly address issues raised by Mr. Gilbert related to plant records (that I have previously addressed in my rebuttal testimony) and that he again raised in his rebuttal testimony.

II. NET SALVAGE ACCRUALS

Q. Mr. Gilbert characterizes the inclusion in depreciation rates of accruals for net salvage associated with plant that is in service today but which will not be retired until some future date as a reason to deny Ameren Missouri's Plant-in-Service Accounting request.[1] Is the recovery of depreciation expense associated with net salvage for plant serving customers today and which will be retired in the future a "pre-collection" as suggested by Mr. Gilbert?

A. No, it is not. Mr. Gilbert's characterization of the recovery of net salvage as a "pre-collection" through depreciation rates is inaccurate and misleading. The amount cited by Mr. Gilbert on page 2, line 10 of his testimony, of $76,203,396, represents the net salvage accrual related to electric plant *that is serving customers today*. This amount was determined using Commission-approved depreciation rates established just over two years ago in Case No. ER-2010-0036. The net salvage cost estimates underlying the approved depreciation rates were based on a depreciation study performed by Gannett Fleming, Inc.[2] Staff performed its own net salvage cost analyses in Case No. ER-2010-0036 and submitted net salvage estimates that were *nearly identical* to the Company's proposed net salvage parameters, especially for the Transmission and Distribution accounts.

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[1] Gilbert Rebuttal, p. 2, l. 16-19.

[2] The Commission approved those depreciation rates, including the net salvage parameters, in its June 16, 2010 *Order Approving Compliance Tariff Sheets and Depreciation Rates.*

Q. What does this suggest?

A. This suggests that Staff recommended to the Commission that accrual for net salvage designed to cover the future cost of removal of plant that is in service today, at the rates (and thus the amounts) at which the Company is actually collecting those sums, is appropriate and reasonable. Mr. Gilbert, just over two years later and without performing a depreciation study, is, in effect, attempting to disavow Staff's recommendation, and the Commission's order implementing that recommendation, under the guise of opposing the Company's Plant-in-Service Accounting proposal.

Q. Mr. Gilbert, in effect, is recommending that the depreciation expense for one group of assets (those in service today) be used to offset depreciation expense for another group of assets (plant to be placed in service in the future). Is this appropriate?

A. No, it is not appropriate. The depreciation expense related to net salvage of $76,203,396 was the actual net salvage expense (based on, as noted, Commission-approved depreciation rates including net salvage parameters) associated with plant-in-service as of the true-up cutoff date (March 31, 2011) in the Company's last rate case (Case No. ER-2011-0028). The $9,772,000 amount cited by Mr. Gilbert on page 2, line 2 of his rebuttal testimony represents the depreciation expense on certain non-revenue producing plant additions (net of retirements) made *subsequent* to the true-up cutoff date in that case. To suggest one could use the depreciation expense calculated for one group of assets to offset the depreciation expense for another group is illogical. It is illogical since the reduction in depreciation expense related to the first group of assets that would be used to offset depreciation expense related to the second group of assets would ultimately leave the first group short by an amount equal to the offset. Put another way, the $76,203,396 is the net salvage it was agreed was part of the *cost* of those assets that were in-service as of March 31, 2011. If we now reduce that sum to $66,431,396, we have, in effect, reduced the depreciation rate for those assets (by reducing the net salvage percentage). Underlying such an approach would have to be the conclusion, which is not supported by evidence of any kind, let alone a proper depreciation study, that the depreciation rates approved by the Commission in Case No. ER-2010-0036 were too high. This is clearly not the case as the Company and Staff recommended net salvage rates that were very close to each other and, more importantly, the Commission approved depreciation rates reflecting those net salvage rates. Additionally, the composite depreciation rates used by Ameren Missouri are lower than most other electric utilities in the United States, which provides further evidence that the depreciation expense being collected by Ameren Missouri is not too high, as Mr. Gilbert suggests.[3]

Q. Why do you believe it is inaccurate and misleading to describe the portion of depreciation expense related to the recovery of future net salvage as a "pre-collection?"

A. This very argument was rejected by the Commission in its January 11, 2005, *Third Report and Order* in a case involving Laclede Gas Company (Case No. GR-99-315), and it is completely at odds with the overwhelming weight of authority related to the proper accounting for depreciation expense (and in particular net salvage), including the Uniform System of Accounts ("USoA").

Q. Please explain.

A. Despite decades of estimating net salvage for depreciation purposes using the "accrual" approach, in the late 1990s the Staff attempted to change that approach by, in effect, not accruing for net salvage costs designed to cover the future cost of removal associated with plant-in-service today. This was an argument against "pre-collection" because it was based on the theory that net salvage expense in depreciation rates should match the actual, historical cash

[3] Case No. ER-2010-0036, Ex. 105 (Rebuttal Testimony of John F. Wiedmayer, Jr., Schedule JFW-ER8, p. 1.)

outlays for cost of removal. The problem with this approach, as the Commission found in its Laclede Report and Order, was that it failed to recognize the growth in the size of the utilities' systems and failed to recognize the reality of inflation. In summary, the Laclede Report and Order, which has been consistently followed by the Company and Staff (including when Staff recommended depreciation rates and net salvage percentages in Case No. ER-2010-0036), does not support Mr. Gilbert's characterization of the net salvage accrual as a pre-collected expense, and in fact contradicts Mr. Gilbert's argument.

Q. Please describe what you mean by the term "depreciation."

A. "Depreciation," as defined in the USoA, refers to 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 can be reasonably anticipated or contemplated, against which the Company 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 the requirements of public authorities.

Depreciation accrual rates (a/k/a depreciation rates) are used to allocate, for accounting and ratemaking purposes, the ***service value*** of assets over their service lives. As a result, each year of service and each generation of customers are charged with the portion of the asset that it or they consume or use.

Q. You referred to depreciation as the "loss in service value" in your definition. What is service value?

A. Service value, as defined in the USoA, is "the difference between original cost and net salvage value of electric plant."[4]

[4] 18 CFR Part 101 Uniform System of Accounts Prescribed for Public Utilities and Licensees Subject to the Provisions of the Federal Power Act. Definition 37.

Q. Does the Uniform System of Accounts also define what it means by "net salvage value?"

A. Yes, it does. "'Net salvage value' means the salvage value of property retired less the cost of removal."[5] Net salvage can be either positive or negative. Net salvage is positive when gross salvage is greater than the costs of retiring the asset. Net salvage is negative when removal costs exceed gross salvage. Net salvage is often negative for utility assets as it often costs more to remove them than can be realized from salvaging the removed item.

Q. Does the USoA prescribe a method of Depreciation Accounting?

A. Yes. The USoA for electric utilities includes General Instruction 11 (Accounting to be on Accrual Basis), which states: "The utility is required to keep its accounts on the accrual basis." Further, General Instruction 22 (Depreciation Accounting) of the USoA for electric utilities states: "Utilities must use a method of depreciation that allocates in a systematic and rational manner the service value of depreciable property over the service life of the property."

Q. Based on the definitions and instructions in the USoA, what do you conclude that it requires regarding net salvage?

A. The USoA requires that net salvage, as a component of service value, must also be allocated or accrued over the service life of the property in a systematic and rational manner. Put another way, the USoA recognizes that accrual for net salvage is not a "pre-collection," but rather is the ongoing recovery of part of the expense of the assets serving customers today.

Q. Do authoritative texts on depreciation support your conclusion that net salvage should be accrued during the life of the related plant?

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[5] *Ibid*. Definition 19.

A. Yes, they do. Every authoritative text on the subject of depreciation supports the ratable accrual of net salvage during the life of the related property. Public Utility Depreciation Practices, published in 1996 by the National Association of Regulatory Utility Commissioners states:

> Closely associated with this reasoning are the accounting principles that revenues be matched with costs and the regulatory principle that utility customers who benefit from the consumption of plant pay for the cost of that plant, no more, no less. The application of the latter principle also requires that the estimated cost of removal of plant be recovered over its life.[6]

Depreciation Systems, a widely used reference book on depreciation, states the concept in this manner:

> The matching principle specifies that all costs incurred to produce a service should be matched against the revenue produced. Estimated future costs of retiring of an asset currently in service must be accrued and allocated as part of the current expenses.[7]

Q. You mentioned the Report and Order in the Laclede case. What did it have to say on these points?

A. It provides that:

- "It is undisputed that the accrual method . . . is supported by the overwhelming weight of authority on such matters . . . and [that there is] widespread support among depreciation professionals and authoritative texts for the traditional, accrual method of treating net salvage."[8]
- "[The] method is consistent with the requirement of the Uniform System of Accounts that this Commission has adopted, and depreciation practices

[6] Public Utility Depreciation Practices. Page 157. National Association of Regulatory Utility Commissioners. 1996.
[7] Depreciation Systems, Wolf, Frank K. and W. Chester Fitch. Page 7. Iowa State University Press. 1994.
[8] Laclede Report and Order, p. 8

recognized and followed in all but a few regulatory jurisdictions in the United States."[9]

- "The Commission finds that the fundamental goal of depreciation accounting is to allocate the full cost of an asset, *including its net salvage cost*, over its economic or service life so that utility customers will be charged for the cost of an asset in proportion to the benefit they receive from its consumption."[10]
- "The Commission's rule requiring submission of depreciation studies no less frequently than every five years provides a mechanism for monitoring the depreciation reserve so that . . ." adjustments can be made if necessary to account for necessary changes in the net salvage parameters used in the depreciation rates.[11]
- "[A]ny temporary difference between the estimated and actual net salvage costs is reflected in the depreciation reserve that, in turn, is deducted from the utility's rate base . . . [and] [a]s a result, ratepayers are compensated at the utility's overall rate of return for the 'use' of their money."[12]

Q. Can you apply the Commission's conclusions in the Laclede Report and Order to Mr. Gilbert's characterization of the net salvage accrual as a "pre-collected" expense?

A. Yes, I can. The notion that depreciation expense (or the net salvage component of it) is a "pre-collection" is at odds with (and arguably suggests a fundamental misunderstanding of) accrual accounting and of the purpose of including net salvage accruals as part of

[9] *Id.*, p. 9.
[10] *Id.* (emphasis added). If the net salvage is part of the asset's cost, then it is not a "pre-collection."
[11] *Id.*, p. 13.
[12] *Id.*

depreciation expense. As the Laclede Report and Order indicates, the net salvage accruals are collections for *part of the cost of the asset*; i.e., the asset cost $X to install, which is part of the depreciation rate, and it will cost $Y to remove, which is also part of the depreciation rate, and what we are doing is collecting the sum of X and Y ratably *over the service life of the asset.* What Mr. Gilbert is suggesting is that the net salvage costs are future costs and thus there is a "pre-collection." There is not. The net salvage costs associated with assets that are serving customers today are appropriately reflected on our books and records today. It is true that a cash outlay will not be made for an asset that is in service today until it is later actually removed but, as the Commission recognized, it is appropriate for customers who are benefitting from the use of that asset to pay for its full cost over its life, including net salvage costs.

Q. Is there any other aspect of Mr. Gilbert's testimony that you would like to comment on?

A. Yes, there is. On pages 3 through 5 of his rebuttal testimony, Mr. Gilbert discusses existing "over-accruals" already on Ameren Missouri's books and suggests they be used to offset any additional depreciation expense arising from the Company's Plant-in-Service Accounting proposal.

Q. To what over-accruals is Mr. Gilbert referring?

A. The over-accruals that Mr. Gilbert is referencing are the difference between the Company's accumulated depreciation amount (a.k.a. its depreciation or book reserve) and the "theoretical reserve." The "theoretical reserve" is the amount the depreciation reserve would have been had current depreciation rates (in this case, those adopted in Case No. ER-2010-0036) been in place throughout the assets' lives. There is often a difference between the theoretical and book reserves because depreciation rates change from time-to-time. The difference between the book reserve and theoretical reserve is called the reserve variance. Mr. Gilbert calls this an "over-accrual."

Q. Does Mr. Gilbert make a determination of the reserve variance?

A. Mr. Gilbert makes a very quick and cursory estimate of the reserve variance. His back-of-the-envelope calculation leads him to estimate that the reserve variance ranges from $400 million to $1 billion. He arrived at his estimate using what he describes as a "rule of thumb" that reserve ratios for electric utilities should generally range from 30% to 40%. Since he calculates the Company's reserve ratio to be 43%, he concludes that Ameren Missouri is significantly over-accrued based on his cursory review.

Q. What recommendations does Mr. Gilbert make concerning the over-accruals?

A. Mr. Gilbert recommends that if the Company's Plant-in-Service Accounting proposal is adopted, that the Commission require the Company to amortize the reserve variance over 10 years (at $40 million per year).[13]

Q. Is Mr. Gilbert's recommended condition appropriate?

A. No, it is not. In reading Mr. Gilbert's rebuttal testimony on pages 3 through 5, it is apparent that Mr. Gilbert has overlooked the fact that the Company is already amortizing the difference between the book and theoretical reserves (i.e. the "over-accruals"). In Case No. ER-2010-0036, the Commission-approved depreciation rates that included a $24 million per year adjustment to reflect (i.e. to start amortizing back) the over-accruals. The over-accruals that were adjusted were based on the reserve variance, as defined above, calculated during the depreciation study. For the reasons discussed earlier, the net salvage accruals have nothing to do

[13] Gilbert Rebuttal, p. 4, l. 17-21.

with the Company's Plant-in-Service Accounting proposal but, in any event, one of the "conditions" recommended by Mr. Gilbert regarding adopting the Company's Plant-in-Service Accounting proposal has already been satisfied. A further amortization would inappropriately amortize the same reserve variance twice. Moreover, it would be inappropriate to change the already-in-place adjustment based upon Mr. Gilbert's back-of-the-envelope estimates and his "rule of thumb" without conducting a proper depreciation study. To do so is to, in effect, "guess" at what the answer should be.

III. <u>OTHER ISSUES</u>

Q. Mr. Gilbert states in his rebuttal testimony that the rate base inflation discussed in Staff's Cost of Service Report is of a significantly greater magnitude than the perceived regulatory lag discussed in connection with Ameren Missouri's Plant-in-Service Accounting proposal. Is he correct?

A. No, he is not. As I explained in my rebuttal testimony, there is no rate base "overstatement" at all. Mr. Gilbert was wrong about the Labadie burners, which were correctly retired from the Company's books without the use of any estimates. Mr. Gilbert was also wrong about the induced fan motors at the Sioux Plant. There was also no overstatement of rate base in the case of the induced fan motors because the one motor that was transferred (that Mr. Gilbert assumed was a "missed retirement") was retired on the Company's books, as I have also already explained in my rebuttal testimony.

Lastly, as I previously explained in my rebuttal testimony, Mr. Gilbert was simply mistaken when he claimed that missing retirements ($600,000 of original cost investment at the Sioux Energy Center) would overstate rate base; they do not.

Q. Do you agree with Mr. Gilbert's statement that Ameren Missouri has failed to apply the prescribed level of precision in its retirements?

A. No, I do not, and Mr. Gilbert provides no evidence to back up his assertion. The Company's work order policy requires an approved work order for projects involving just retirements, and also for any project where something is being built or installed. Consequently, we follow the same process to ensure that retirements are booked as we do to ensure that additions are booked.

Q. Mr. Gilbert states in his rebuttal testimony that "Ameren Missouri does not provide to Staff upon request the information needed to perform an appropriate depreciation study." Is this true?

A. No, it is not. As I have explained in my rebuttal testimony, Ameren Missouri offered to make available any data prior to 2005 (when the current PowerPlant system started to be used) that Staff wished to review. Staff has reviewed some of this data since the Company's initial offer was made. As I stated in my rebuttal testimony, Mr. Gilbert wanted to review off-site records on less than 24 hours notice and they were made available. To retrieve all of the Company's plant records from storage could reasonably take longer than that, but we have, as far back as April of this year, offered to sit down with Staff to discuss what plant records Staff believes it needs so that we could develop an orderly way to make them available. Staff has on more than one occasion declined to respond to our offer in this regard.

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Union Electric Company d/b/a Ameren Missouri's Tariffs to Increase Its Annual Revenues for Electric Service.	)))	File No. ER-2012-0166

AFFIDAVIT OF LAURA M. MOORE

STATE OF MISSOURI)
) **ss**
CITY OF ST. LOUIS)

Laura M. Moore, being first duly sworn on her oath, states:

1. My name is Laura M. Moore. I am employed by Union Electric Company d/b/a Ameren Missouri as Managing Supervisor of Regulatory Accounting.

2. Attached hereto and made a part hereof for all purposes is my surrebuttal testimony on behalf of Union Electric Company, d/b/a Ameren Missouri, consisting of 12 pages and Schedule(s) N/A, all of which have been prepared in written form for introduction into evidence in the above-referenced docket.

3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct.

Laura M. Moore
Laura M. Moore

Subscribed and sworn to before me this 7th day of September, 2012.

Julie Donohue
Notary Public

My commission expires: 2/17/2013

Julie Donohue - Notary Public
Notary Seal, State of
Missouri - St. Louis City
Commission #09753418
My Commission Expires 2/17/2013