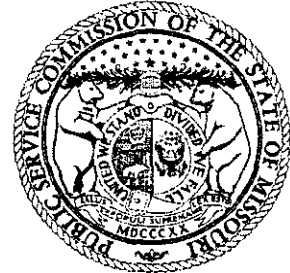


## Notice of *Ex Parte* Contact

TO: All Commissioners  
All Parties in Case No. TM-2002-232

FROM: Connie Murray *CM*

DATE: May 20, 2002



On April 29, 2002, in case number ER-2002-217, the Staff of the Missouri Public Service Commission filed direct testimony of Paul W. Adam, including the attached pages (39-41). In preparation for a hearing in case number ER-2002-217, I recently read Mr. Adam's testimony.

The Commission is currently considering the issue of the transfer of assets from GTE Midwest Incorporated, d/b/a Verizon Midwest in case number TM-2002-232, a contested case.

The Commission is bound by the same *ex parte* rule as a court of law. *Ex parte* communications must be made known to all parties to a contested case so that those parties have the opportunity to respond. According to the Commission's rules (4 CSR 240-4), when a communication (either oral or written) occurs outside the hearing process, any member of the Commission or Regulatory Law Judge who received the communication shall prepare a written report concerning the communication and submit it to each member of the Commission and the parties to the case. The report shall identify the person(s) who participated in the *ex parte* communication, the circumstances which resulted in the communication, the substance of the communication, and the relationship of the communication to a particular matter at issue before the Commission.

Therefore, I submit this report pursuant to the rules cited above. This will ensure that any party to this case will have notice of the attached information and a full and fair opportunity to respond to the comments contained therein.

cc: Executive Director  
Secretary/Chief Regulatory Law Judge  
General Counsel

1 Double Collection of Net Salvage Cost

2 Q. What could happen if a company continues to collect net salvage cost  
3 determined by the "traditional" whole life technique, spends the excess cash for other  
4 activities and reaches a date, after the "inflection point," when bills for removal cost exceed  
5 the collection of net removal cost dollars from customers?

6 A. Staff have considered this and we are concerned about this occurring. One  
7 alternative is that the customers will pay the company twice for net removal cost. The  
8 company would effectively be saying, "Sorry, the previous management spent the money our  
9 customers gave this company 10, 20 and 30 years ago that was designated for net removal  
10 cost and now that money is gone. If you don't give us the money again, we will go broke."  
11 This is not exactly what may be said but it is the pitfall of the "traditional" whole life  
12 technique's calculation of net salvage depreciation rates.

13 Q. Is there any other potential double collection situation that can occur when the  
14 "traditional" whole life technique is used that concerns Staff?

15 A. Yes. One that confronts Missouri ratepayers today. Recently, all Missouri  
16 plant of GTE (This company changed their name to Verizon after a merger with another  
17 telephone company) has been sold to another telephone company. GTE's depreciation rates  
18 were determined utilizing a "traditional" technique. During the past decade or two of GTE's  
19 operation in Missouri, it has annually collected more for plant removal than it spent. GTE's  
20 excess collection into the depreciation reserve can be speculated to have been in the tens of  
21 millions of dollars annually. The theoretical determination of accrual would be small when  
22 compared to the actual accrual. In other words, GTE has collected a large excess depreciation  
23 accrual that is designated for future removal cost.

1           There are two concerns to be addressed as a result of the sale of GTE's plant. First,  
2 the amount of depreciation accrual that should be collected from customers is the original cost  
3 of the plant. Original cost is, by definition, the "cost of property to the person first devoting it  
4 to public service." (Ref: FERC definition of "Original Cost," p. 22 of this direct testimony.)  
5 The GTE accruals for each account should be subtracted from the "original cost" of the plant  
6 sold. The difference is the amount the new owner is due to collect from customers via  
7 depreciation. Staff are concerned about this being ordered or not ordered as part of the sale of  
8 the plant. Staff do not believe Missouri consumers using the GTE plant, under any other  
9 name, should pay more than the "cost of property to the person (Company) first devoting it to  
10 public service." (Ref: FERC definition of "Original Cost," p. 22 of this direct testimony.)

11           Secondly, Staff believes that the new owner of the GTE plant determined the purchase  
12 price based on an analysis of future earnings. Logically, GTE should give the new owner the  
13 net salvage monies in the accrual. This would include the excess collection from customers  
14 due to using "traditional" depreciation. This excess is the difference between a theoretical  
15 calculation (i.e., what the accrual balance should be) and the actual accrual balance. The  
16 Missouri consumers have paid this excess to GTE over many years. Staff's concern is that  
17 GTE will simply keep all this money. If this is the case, GTE will reap a windfall profit on the  
18 sale of the Missouri plant due to the money GTE collected using "**traditional**" depreciation  
19 techniques to set depreciation rates. These "traditional" depreciation rates provided funds for  
20 the retirement of plant decades in the future.<sup>10</sup> In the last two paragraphs the author points

21

---

<sup>10</sup> Ref: Schedule 6 to this direct testimony, an article on Nuclear operators weigh decommissioning, relicensing options.

1 out that power companies currently purchasing nuclear power plants may reap a "tidy profit"  
2 [windfall profit] in a transition of ownership.) GTE will not be responsible for paying for any  
3 portion of the future removal cost when the plant is ultimately retired. Staff's concern is that  
4 the new owner will expect the same customers to pay them, the new owner, the full cost to  
5 remove retired plant. If this occurs, Missouri customers of GTE plant will be paying double  
6 for a portion of the removal cost of GTE plant that is sold.

7 Q. What technique can avoid this situation and how does it avoid the "double  
8 collection" situation?

9 A. The "**full recovery**" **whole life technique** will avoid the "double collection"  
10 situation. By always collecting a level of net removal cost from customers that is equal or  
11 nearly equal to the company's actual net removal cost, the company is protected from a false  
12 concept that a specific ROE (return on equity) will give them more cash flow from customers  
13 than is truly a reasonable amount of cash flow for the stated ROE. Also, the "**full recovery**"  
14 **whole life technique** will avoid customers being asked to pay cost of removal charges a  
15 second time. Customers will always be paying a cost of removal adequate for the company to  
16 pay the current cost-of-removal bills. This is reasonable and it augments management's  
17 responsibility to utilize funds for the purpose the customers were "told" they were designated  
18 for.

19 **Inherent Risk of Booking Future Events and the Future Events' Net Salvage Costs**

20 Q. To whom do non-accounting professionals turn, to verify the accuracy of  
21 **revenue requirement** determinations?

22 A. It is a conundrum, with no clear answer. During a rate case, a company will  
23 propose a need to increase **revenue requirement** while Staff may propose a different