*Exhibit No.:*
*Issue:* *Depreciation*
*Witness:* *John A. Robinett*
*Sponsoring Party:* *MoPSC Staff*
*Type of Exhibit:* *Surrebuttal Testimony*
*Case No.:* *ER-2016-0023*
*Date Testimony Prepared:* *May 16, 2016*

# MISSOURI PUBLIC SERVICE COMMISSION

## COMMISSION STAFF DIVISION

## ENGINEERING ANALYSIS UNIT

# SURREBUTTAL TESTIMONY

# OF

# JOHN A. ROBINETT

## THE EMPIRE DISTRICT ELECTRIC COMPANY

## CASE NO. ER-2016-0023

*Jefferson City, Missouri*
*May 2016*

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SURREBUTTAL TESTIMONY

OF

JOHN A. ROBINETT

THE EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2016-0023

Q. Please state your name and business address.

A. John A. Robinett, P.O. Box 360, Jefferson City, Missouri 65102.

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

A. I am a Utility Engineering Specialist in the Engineering Analysis Unit, Commission Staff Division with the Missouri Public Service Commission ("Commission" or "PSC").

Q. Please describe your work and educational background.

A. A copy of my work and educational experience was provided in Appendix 1 of Staff's *Cost-of-Service Revenue Requirement Report.*

Q. Are you the same John A. Robinett that contributed to the Staff *Cost-of-Service Revenue Requirement Report* and Rebuttal Testimony filed in this proceeding?

A. Yes, I am.

Q. How is your testimony organized?

A. I will first discuss the inconsistencies of The Empire District Electric Company's ("Empire" or "Company") witness Thomas J. Sullivan's recommended depreciation rates with the inclusion of future estimated additions and retirements.

The second issue I will discuss is Empire's mischaracterization of Staff's depreciation rate recommendation. Next, I will discuss Empire's failure to collect net salvage that was built into rates on authority from an order it sought in Case No. ER-2004-0570. Subsequently, I will discuss Empire's request for the Riverton Reserve deficiency amortization that Empire created by requesting a change in depreciation accrual method.

Finally, I will discuss Staff's recommendations related to depreciation in this case.

**Depreciation Rate Adjustment to Collect for Future Additions and Retirements**

Q. Do Empire's recommended depreciation rate lives reflect the expected life of the plants to their retirement date?

A. Yes, but the actual lives are adjusted by Mr. Sullivan to reflect future interim additions and retirements.

Q. What affect do the future interim additions and retirements have on the depreciation rate recommendation?

A. The inclusion of future interim additions and retirements raises the depreciation rates at the beginning of the life of a facility when costs are minimal. Essentially, it appears that Mr. Sullivan's goal is to collect more from ratepayers at the beginning of a plant's life in order to stabilize the depreciation rate over time as expenses continue to increase.

Q. Do all of Mr. Sullivan's depreciation rates reflect future interim additions and retirements?

A. No. Mr. Sullivan's discussion of Empire's recommended more "stable" depreciation accrual rates implies that the depreciation rates would not need to be adjusted up or down, because future additions and retirements are already factored into the rate. However, Mr. Sullivan contradicts this position when he discusses 0 percent depreciation rates on page 13 of his rebuttal testimony, beginning at line 9:

> If, at some future point in time, additional investment is added to that account, then at the time of the next rate case the depreciation rate would be reset to a level that recovers that investment over the remaining life of that asset.

Furthermore, upon closer review of Schedule TJS-2, specifically, Staff determined that not all accounts reflect future interim additions and retirements. The appendices to Schedule TJS-2 show the projected future interim additions and retirements by facility and account. Some of these accounts have additions with the only retirement being at end of projected useful life, others have yearly additions and retirements, and some even have zero additions or retirements until the end of useful life retirement.

Q. What is Staff's interpretation on the three issues raised at the bottom of pages 3 and 4 of Mr. Sullivan's rebuttal testimony?

A. Issue 1, Failure to recognize that many component assets have average service life that is less than the entire lifespan of the generating unit. All depreciation rates are calculated based on a given time looking forward. Periodic review and updating of depreciation rates will occur over the life of the generating unit.

Issue 2, Failure to recognize that capital improvements that are made after the initial in-service date of the asset will have service lives that are less than the entire lifespan of the generating units. Depreciation rates are assigned on the account level, not the individual asset level. There has always been a lag that the Company must book depreciation on an asset that is placed into service between rate cases. Periodic review of depreciation rates lessens the effect of this issue.

Issue 3, Failure to recognize that in order for the generating units to achieve the relatively long lifespans historically experienced, significant capital improvements are made to extend the asset life and/or to bring the units up to current technology and regulations such that the plants can continue to economically provide service. These relatively large capital additions usually have service lives much less than the lifespan of the generating unit. Mr. Sullivan is correct that lately with environmental policies, large expenditures have taken place at Empire's Asbury facility. Staff would like to point out that Empire filed a case seeking the inclusion of that plant which hit during true-up. Similarly, in this case Empire filed a case seeking to capture the plant additions for the conversion of Riverton Unit 12 to a combined cycle. Staff's rate recommendation for Asbury collects the in-service dollars of today over the remaining life of the asset, plus a portion for interim net salvage. Staff's current recommendation for Riverton Unit 12 does not reflect the additional plant in the direct case; the additional plant will be included as part of true-up. Staff intends to adjust the rate recommendation for Riverton Unit 12 during the true-up portion of this case.

Q. Do Mr. Sullivan's recommended depreciation rates guarantee full recovery at the end of the life of a generating facility?

A. No. The dependence on the accuracy of a projected future retirement date and the ever-changing regulatory environment make it nearly impossible to hit full recovery of the asset at the time of retirement. Additionally, Empire's recommended depreciation rates do not collect terminal net salvage consistent with Report and order from Case No. ER-2004-0570; therefore, full recovery will not be reached even by Mr. Sullivan's recommendation.

Q. What is the basis for Staff's rate recommendations on accounts Mr. Sullivan recommends zero recovery going forward until further plant is added?

A. Staff transferred reserves from the accounts where the 0 percent depreciation rate recommendation existed to cover the reserve deficiency at Riverton Units 7 and 8. These transfers dropped the reserves below full recovery of original cost plus net salvage. So, Staff then calculated a depreciation rate to recover the remaining portion of original cost and net salvage over remaining life of the asset based on Empire's projected retirement dates.

Q. Does Mr. Sullivan's recommendation seem to be consistent with treatment in Case No. ER-90-138?

A. No. Mr. Sullivan is recommending shutting off depreciation rate for plant that Empire expects to operate 10 more years. Some of his recommended zero rate accounts have longer projected lives than the 10 years of Energy Center Units 1 and 2. In Case No. ER-90-138, depreciation experts assigned non-zero depreciation rates to the two hydraulic accounts that were over-accrued but built no expense into customer rates for those two accounts. Mr. Sullivan's recommendation does not build in expense for the 0 percent depreciation rates, consistent with the Order in ER-90-138, but will require Empire to come back to the Commission to assign a depreciation rate when new plant is added in the future.

Q. Does Mr. Sullivan's 0 percent depreciation rate recommendation have the potential to create intergenerational inequities, seemingly the very issue he takes with Staff's recommendation of reserve transfer?

A. Yes. By shutting off depreciation for some accounts, Mr. Sullivan is essentially admitting former rate payers paid for an asset to quickly. Future ratepayers who will receive benefit and use out of the plant under Mr. Sullivan's recommendation will not have to pay until some future addition is placed in service. This seems counter to Mr. Sullivan's testimony in a sense that he claims to account for future plant additions and retirements in his study, yet he recommends shutting off depreciation on accounts with expected lives of 10, 25 and 35 more years.

**Mischaracterization of Recommended Depreciation Rates**

Q. Do Schedules TJS-3 and TJS-4 attached to Mr. Sullivan's Rebuttal Testimony accurately depict Staff's recommended depreciation rate scenario for production accounts in this case?

A. No. Staff's recommendation is not solely dependent on remaining years of estimated life as Mr. Sullivan claims. Staff has included an interim net salvage component for all production facilities, which is not included in Schedules TJS-3 and TJS-4.

Q. Why does Staff not include future interim additions and retirements as part of its depreciation rates?

A. Staff accounts for known and measurable expenses, only including additions that are used and useful at the time of Staff's analysis. Current rate payers should not be asked to cover costs for future unknown and unmeasurable additions or retirements that may come from legislation or technology changes.

Q. What do Schedules TJS-3 and TJS-4 indicate to Staff?

A. A review of Schedule TJS-4, which includes large future additions to plant, when compared to Schedule TJS-3, indicates Mr. Sullivan's recommended depreciation rates are increased at the beginning of life of facility to reflect large future unknown additions. Mr. Sullivan's schedules of large investments also do not reflect scaled additions at plants that have recently been placed into service. Asbury's AQSC project nearly doubled the original cost of the Asbury plant, and Riverton Unit 12 Conversion cost is approximately 4 times the plant balances at June 30, 2015. Mr. Sullivan is seeking to recover more from early rate payers, evidenced by the change in rates between his two example schedules, which are directly tied to future additions.

Q. Do Schedules TJS-3 and TJS-4 accurately portray Mr. Sullivan's recommended depreciation rates for production facilities?

A. No. Mr. Sullivan's recommended depreciation rates do not contain a net salvage component. Schedules TJS-3 and TJS-4 appear to contain a net salvage component and fail to properly reflect Staff or Mr. Sullivan's recommended depreciation rates.

Q. Does Staff agree with Mr. Sullivan that a depreciation review and adjustment of depreciation rates will only occur every five (5) years as Schedules TJS-3 and TJS-4 indicate?

A. No. Staff would note that Empire is required to file a depreciation study every five (5) years.[1] Recent rate case frequency would indicate Staff would have the opportunity to review rates more often than every five (5) years. Here is a list of years for recent rate cases Empire filed: 2004, 2006, 2008, 2010, 2011, 2012, 2014, and 2016.

**<u>Riverton Reserve Deficiency Amortization</u>**

Q. Does Staff agree with Mr. Sullivan's claim on page 2 of his rebuttal testimony that Staff reduced Empire's estimated cost of removal associated with Riverton Units 7 and 8?

A. No. Staff did not reduce Empire's adjustment. Staff's recommendation of the reserve adjustments and continued depreciation cannot guarantee full recovery of future unknown dismantlement costs. At the time when the plants have been fully dismantled, Staff will commit to review the reserves and recommend adjustments to cover any deficiency that may remain.

Q. Are the transfer of reserves recommended by Staff from, as Mr. Sullivan calls them, "fully-accrued" accounts?

[1] 4 CSR 240-3.175.

A. Five of the eight accounts from which reserves are transferred are the same accounts Mr. Sullivan has recommended 0 percent depreciation rates on, so Empire would not collect any depreciation expense for those accounts under Empire's recommendation. These five accounts have reserves that exceed the original cost, so in that sense they are "fully accrued," as Mr. Sullivan states. However, Mr. Sullivan is correct that some of the accounts have 10, 25, and 35 years until the projected retirement date. Staff's recommended adjustments would reduce reserves for these accounts to below the original cost and would allow continued recovery of depreciation expense over the remaining life of the plant.

Q. On page 7 of Mr. Sullivan's direct testimony, he stated that Empire's 5-year amortization would mitigate a potential for inter-generational subsidy. How is the issue of a potential inter-generational subsidy mitigated using Staff's recommendation of adjusting the reserves to offset the reserve deficiency?

A. The potential for an inter-generational subsidy issue arises only because of the deficiency created when Empire requested to use the Life Span method of depreciation. Empire's recommendation for amortization is unnecessary, as there are sufficient depreciation reserves within the Generation accounts to cover the reserve deficiency in the Riverton steam accounts. Staff's recommendation transfers reserves from other accounts that would have been included in the Steam Generation accounts and Other Generation accounts. Had the Mass Asset method of depreciation still been in effect, total reserves between Riverton Units 7 and 8, Asbury Units 1 and 2, and Iatan 1 would have been sufficient to retire the original cost of Riverton Units 7 and 8 without sending those total Steam Generation group reserves negative. Previous ratepayers have over-paid, according to Mr. Sullivan's recommendation for 0 percent rates of several accounts. He does not recommend returning the over collection, just to stop collecting going forward until some future event forces the rate to need to be turned back on.

Q. Does Staff's recommendation create an explicit inter-generational subsidy as claimed by Mr. Sullivan at line 9 of page 10 of rebuttal testimony?

A. No. Staff's recommendation creates no inter-generational subsidy, although Empire's recommendation of a 5-year amortization does create the same subsidy about which Mr. Sullivan expresses concern. Had not the change in depreciation reserve reporting occurred, there would be no question of where reserves would have come from to cover retirement. The Steam production reserves would have been where the retirement of reserves would have occurred. The separation of reserves by unit has caused the appearance of deficiencies. Staff transferred reserves from the eight most accrued production accounts to cover the deficiency at Riverton Units 7 and 8. Based on Staff's recommendation, future generations that receive no benefit from Riverton Units 7 and 8 will not be subsidizing that deficiency, because money that has already been collected will be used to cover that deficiency. Instead of giving future customers a windfall by stopping depreciation on five accounts from which those same customers will be receiving benefit, those customers will continue to pay depreciation expense on those accounts for the remaining life of those plants.

Q. Please summarize Staff's recommendations related to the deficiency of Riverton Units 7 and 8.

A. Staff recommends that the Commission deny Empire's request to amortize unrecovered reserve related to Riverton Units 7 and 8. Staff recommends that the Commission order Empire to book the transfer of reserves recommended by Staff to cover the shortfall of reserves.

**Stopped Depreciation**

Q. On page 12 of Mr. Sullivan's rebuttal testimony, he says, "setting the depreciation rate of an asset that is fully depreciated at 0 percent is not the same thing as stopping depreciation on an asset that has a depreciation rate of something other than zero, when it is fully depreciated." How do you respond?

A. Mr. Sullivan is correct that his recommendation for no recovery going forward is different from what Empire has done by arbitrarily stopping deprecation at times over the course of the last 25 years.

Q. Did Mr. Sullivan's 0 percent depreciation rate recommendation on plant accounts cause Staff to investigate into why rates were being set to zero and had Empire stopped depreciation on accounts previously?

A. Yes Staff asked multiple data requests related to the 0 percent rate recommendation and stopped depreciation.

Q. At page 13 lines 12-14 of his rebuttal testimony, Mr. Sullivan asserts that depreciation accrual would "automatically" stop when an asset is fully retired, and there is no plant in service against which to apply a depreciation rate. Has Empire stopped depreciation on plant that was not fully retired?

A. Yes. Mr. Sullivan's seems to be referring to an adjustment for Riverton Units 7 and 8, specifically account 314, that are now fully retired; however, the period of stopped depreciation occurred in 2007 and had a 16 month duration. In Data Request No. 0173 Empire provided the accounts where stopped depreciation occurred for various periods of time since 2005 when these facilities were not fully retire. Empire stopped depreciation on these accounts that were not fully retired:

Riverton Units 7 and 8 account 314,
Energy Center Units 1 and 2 accounts 342, 344, and 346,
State Line CT accounts 341 and 346,
State Line CC account 342,
Iatan 1 account 316I,
Iatan Common accounts 314IC, 315IC, and 316IC,
Transmission account 352I related to Iatan, and
Transmission account 354 Towers and Fixtures.

Q. In Mr. Sullivan's rebuttal testimony beginning at page 13 lines 8 through 12, he discusses a 0 percent depreciation rate, which would allow a future change to the depreciation rate in the event additional investment would be added to that account. Are these statements consistent with his position that depreciation rates should include future interim additions and retirements?

A. No. Mr. Sullivan indicated that his depreciation study includes in the depreciation rate recognition of future unknown and unmeasurable interim additions and retirements. A 0 percent depreciation rate, then, would mean that not only is the account fully accrued, but there are also no anticipated future interim additions or retirements. It is absurd to suggest that there would be no interim additions or retirements, and thus recommend a depreciation rate of 0 percent, for plant assets that will have an additional 10 to 35 years of life based on ultimate retirement date projections from Empire.

Q. What adjustments did Staff recommend related to stopped depreciation?

A. Staff recommended adjustments for various accounts dating back to 2005, which are all electronic records. Empire, in its responses to data requests, acknowledges that it had stopped booking depreciation reserves at various times since the ER-90-138 order; however, those records are in paper format and much harder to track and correct.

Q. What is the authoritative source that Empire uses to justify the stopping of depreciation accrual?

A. In response to Data Request No. 0147, Empire cited a *Report and Order* from Case No. ER-90-138. This Report and Order approved a *Stipulation and Agreement* with depreciation rates attached. A note on the schedule of depreciation rates states, "* Note: Account fully accrued and no depreciation expense to be taken until Plant Balance exceeds the Reserve for Depreciation." Only two accounts are denoted with an asterisk; they are Hydraulic Production account numbers 333 Turbines & Generators and 334 Accessory Electric Equipment.

The accounting schedules filed with Staff's direct case in ER-90-138 reflected no depreciation expense for those two accounts, meaning Staff did not recommend depreciation expense to be collected or booked for those two accounts in that case. However, that situation differs from the case at hand, in which, from 2005 to present, Staff recommended and the Commission approved, depreciation expense related to the stopped accounts, in which the company was collecting from ratepayers but not booking.

Q. Does the Order in ER-90-138 give Empire the authority to stop depreciation?

A. No. In fact, the depreciation rates given to Empire for that case were non-zero rates; however, review of accounting schedules indicate that no depreciation expense was built into the rates for those two hydraulic accounts.

No stipulations and agreements or orders in Empire rate cases since ER-90-138 have included similar language that addresses stopping depreciation expense. Even if the Commission were to determine that the footnote language from that case authorized depreciation expense to 0 for the two accounts specified in the stipulation and agreement, that case from 1990 did not apply generally to all accounts. The Report and Order approving the stipulation and agreement in Case No. ER-90-138 has no precedential value in subsequent cases due to the order not specifically accepting and ordering a footnote on a depreciation schedule as the policy of the Commission going forward. If the Commission wanted to authorize similar treatment to other accounts subsequent to ER-90-138, it would have needed to specify so in later orders.

As I mentioned previously, in ER-90-138, Staff understands the Commission's order to have authorized Empire to stop booking depreciation, but the Company also was not allowed to collect depreciation for those specified accounts. In this case, the Company continued to collect depreciation expense, despite not booking it in the appropriate accounts.

Q. Is Empire stopping accruals on either of the Hydraulic Production accounts as was authorized by the *Report and Order* in Case No. ER-90-138?

A. No. Empire stopped accrual on the following accounts for a period of time since 2005:

Riverton Units 7 and 8 accounts 314 and 316,
Energy Center Units 1 and 2 accounts 342, 344, and 346,
State Line CT accounts 341 and 346,
State Line CC account 342,
Iatan 1 account 316I,
Iatan Common accounts 314IC, 315IC, and 316IC,
Transmission account 352I related to Iatan, and
Transmission account 354 Towers and Fixtures.

Q. Are any of the adjustments Staff made related to Hydraulic production accounts?

A. No. In fact, Empire did not identify any hydraulic accounts as having stopped booking depreciation to reserves for the period 2005 through present.

Q. Was depreciation expense built into rates during the period of time that Empire stopped booking depreciation reserve on these accounts?

A. Yes. Empire was collecting depreciation from customers and decided that it would not book the accruals for certain periods of time.

Q. Does Staff share the same opinion as Mr. Sullivan that Staff "is seeking to re-examine a position it essentially agreed to by its silence"?

A. No. Staff has not examined this issue prior to this case. In fact, Mr. Sullivan's recommendation of 0 percent rates caught Staff's attention and drove Staff to investigate to determine if Company had stopped depreciation accrual previously as it was recommending in the current case.

Q. When did Staff become aware of Empire stopping depreciation?

A. In its review of Empire's depreciation study, Staff discovered depreciation rate recommendations of 0 percent for five accounts on a going-forward basis. These accounts are: State Line Combined Cycle plant account 342 Fuel Holders, State Line Combustion Turbine account 341 Structures and Improvements, Energy Center Units 1 and 2 accounts 342 Fuel Holders, account 344 Generators, and account 346 Miscellaneous Power Equipment. Staff submitted nine data requests related to the recommendation of 0 percent depreciation rates. Empire's responses indicate that it is setting depreciation rates to 0 percent for accounts where reserves are equal to or higher than original cost. Following responses to data requests in this case, Staff understands that Empire, based on its response to Data Requests, has been stopping depreciation since a stipulation and agreement was ordered in Case No. ER-90-138.

Q. Did Empire create an intergenerational inequity by stopping booking of depreciation reserves it had collected from rate payers?

A. Yes. If the Commission does not order Staff's recommended adjustments, the Company will have collected just over $3 million from rate payers that are not reflected in the reserves, forcing future rate payers to pay for reserves that were not properly recorded.

Q. What is Staff's recommendation related to stopped depreciation accruals for Empire?

A. In the case at hand, Case No. ER-2016-0023, Staff calculated and recommends $3,082,367 of positive adjustments to depreciation reserves to reflect depreciation accruals that should have been booked during the period when depreciation rates were set to 0 percent. However, because of issues transitioning from paper to electronic records, and because of the brief period of time where cost of removal was expensed, a total value of stopped depreciation is not easily determinable.

**Staff Recommendations**

Q. What are Staff's Recommendations for depreciation-related issues in this case?

A. Staff recommends the Commission:

1. Order Empire to use the depreciation rates attached in Appendix 3 to Staff's Cost-of-Service - Revenue Requirement Report in Schedule JAR(DEP) – d1.

2. Order Empire to book the adjustments to depreciation reserves related to stopped depreciation. Staff's recommended reserve adjustments are found in the table on page 94 of Staff's *Cost-of-Service - Revenue Requirement Report* and the table on page 15-16 of this rebuttal testimony.

3. Order Empire to perform the reserve transfers proposed by Staff to cover the reserve shortfall at Riverton Units 7 and 8. Staff's recommended transfers are found in the table on page 95 of Staff's *Cost-of-Service -*

*Revenue Requirement Report* and the table on page 5-6 of this rebuttal testimony.

4. Not authorize the amortization recommended by Empire to recover the under-recovery of reserves at Riverton Units 7 and 8.

Q. Does this conclude your surrebuttal testimony?

A. Yes.

**BEFORE THE PUBLIC SERVICE COMMISSION**

**OF THE STATE OF MISSOURI**

| | | |
|---|---|---|
| In the Matter of The Empire District Electric Company's Request for Authority to Implement a General Rate Increase for Electric Service | ) ) ) | Case No. ER-2016-0023 |

**AFFIDAVIT OF JOHN A. ROBINETT**

STATE OF MISSOURI )
) ss.
COUNTY OF COLE )

**COMES NOW JOHN A. ROBINETT** and on his oath declares that he is of sound mind and lawful age; that he contributed to the foregoing SURREBUTTAL TESTIMONY; and that the same is true and correct according to his best knowledge and belief.

Further the Affiant sayeth not.

John A. Robinett
**JOHN A. ROBINETT**

**JURAT**

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 13th day of May, 2016.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 12, 2016
Commission Number: 12412070

D Suzie Mankin
Notary Public