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Depreciation

Witness:

Donald S. Roff

Sponsoring Party:

Empire District

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**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

SURREBUTTAL TESTIMONY

OF

DONALD S. ROFF

THE EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2004-0570

**SURREBUTTAL TESTIMONY
OF
DONALD S. ROFF**

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1 **INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME, TITLE, AFFILIATION AND**
3 **BUSINESS ADDRESS.**

4 A. My name is Donald S. Roff and I am a Director with the public accounting
5 firm of Deloitte & Touche LLP. My business address is 2200 Ross
6 Avenue, Suite 1600, Dallas, Texas 75201.

7 **Q. ARE YOU THE SAME DONALD S. ROFF THAT FILED DIRECT**
8 **AND REBUTTAL TESTIMONY IN THIS PROCEEDING BEFORE**
9 **THE MISSOURI PUBLIC SERVICE COMMISSION**
10 **(“COMMISSION) ON BEHALF OF THE EMPIRE DISTRICT**
11 **ELECTRIC COMPANY (“EMPIRE” OR “COMPANY”)?**

12 A. Yes, I am.

13 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL**
14 **TESTIMONY?**

15 A. The purpose of my surrebuttal testimony is to respond to the rebuttal
16 testimony and positions put forth by Commission Staff (“Staff”) witnesses
17 Gregory E. Macias and Guy C. Gilbert and Missouri Office of the Public
18 Counsel (“OPC”) witness Michael J. Majoros, Jr. on the subjects of
19 depreciation and depreciation accounting. There are at least three primary
20 topics addressed by my testimony including: the treatment of net salvage;
21 the use of a life span methodology (or alternatively the estimate of an
22 appropriate life span) and the use of the remaining life depreciation

1 technique. There are also issues related to Generally Accepted Accounting
2 Principles (“GAAP”), regulatory accounting principles and rules and other
3 miscellaneous misstatements that I address.

4 **Q. WHAT IS THE ISSUE WITH RESPECT TO NET SALVAGE?**

5 A. Fundamentally, Staff and OPC propose to treat net salvage on a cash basis.
6 Staff proposes to treat actual net salvage as an operating expense. OPC
7 proposes to handle actual net salvage through depreciation expense and
8 accumulated depreciation.

9 **Q. HOW DO YOU RESPOND?**

10 A. I believe that the cash basis approach is a violation of regulatory
11 accounting rules. Aquila, Inc. witness H. Davis Rooney addresses this and
12 provides a very good discussion in his rebuttal testimony as to the effect of
13 **NOT** providing for net salvage as a component of depreciation expense
14 and accumulated depreciation. The Staff approach is most improper.
15 However, there is an even more fundamental issue with respect to net
16 salvage.

17 **Q. WHAT IS THE MORE FUNDAMENTAL ISSUE WITH RESPECT**
18 **TO NET SALVAGE?**

19 A. The more fundamental issue with respect to net salvage is really a
20 combination of related concepts. These concepts include the measurement
21 of an appropriate net salvage allowance consistent with regulatory rules
22 and accounting principles, as well as the appropriate and correct inclusion
23 of net salvage in equally appropriate depreciation rates.

1 **Q. WHY DO YOU SAY THAT MEASUREMENT OF AN**
2 **APPROPRIATE NET SALVAGE ALLOWANCE CONSISTENT**
3 **WITH REGULATORY RULES AND ACCOUNTING PRINCIPLES**
4 **IS ONE OF THE FUNDAMENTAL ISSUES IN THIS**
5 **PROCEEDING?**

6 A. I say that the measurement of net salvage is a fundamental issue in this
7 proceeding because the other parties have not properly measured the
8 appropriate net salvage allowance consistent with regulatory rules and
9 accounting principles. The correct method for measuring net salvage is
10 described at page 28 of my rebuttal testimony.¹ This is clear, straight-
11 forward and unambiguous. I have determined my recommended net
12 salvage allowances in precisely this manner. The regulatory rules require
13 net salvage to be recorded into the accumulated provision for depreciation
14 account.

15 **Q. WHY DO YOU SAY THAT NET SALVAGE MUST BE INCLUDED**
16 **IN DEPRECIATION RATES?**

17 A. I say that net salvage must be included in depreciation rates because the
18 regulatory rules require this treatment. As discussed in my rebuttal
19 testimony at page 11, line 22:

20 C. Rates. Utilities must use percentage rates of
21 depreciation that are based on a method of depreciation that
22 allocates in a systematic and rational manner the service
23 value (defined as the difference between original cost and
24 net salvage value of utility plant) of depreciable property to
25 the service life of the property.

¹ Roff rebuttal testimony, page 28 line 20. "Net salvage is expressed as a percentage of plant retired by dividing the dollars of net salvage by the dollars of original cost of plant retired."

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This Instruction is equally clear, straight-forward and unambiguous.

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Neither Staff nor OPC has developed depreciation rates reflecting this

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requirement. The Staff recommendation to treat net salvage as a current

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operating expense is a clear violation of the regulatory rules required to be

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followed by Missouri utilities. Moreover, the Staff position defies tenets of

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intergenerational equity. This is evident from the statement by Staff

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witness Macias at page 5, lines 3 through 6 of his rebuttal testimony:

9

The Staff's position is that the Company should continue to collect
in rates the costs associated with the removal of plant *after its*
useful life, (emphasis added) and that the amount should be based
on the costs that the Company is currently experiencing.

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Thus, at the very best, the last generation of customers that benefited from

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the use of asset pays the full cost of its ultimate removal. This is unfair and

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unreasonable.

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MACIAS REBUTTAL TESTIMONY

18

Q. MR. MACIAS CONTENDS THAT THE COST OF REMOVAL

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THAT YOU HAVE ESTIMATED IS SPECULATIVE, AS IT IS TO

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OCCUR FAR INTO THE FUTURE AND THAT THE

21

OCCURRENCE OF SUCH REMOVAL COST IS UNPROVEN AND

22

NOT SUBSTANTIATED BY EMPIRICAL EVIDENCE. DO YOU

23

AGREE?

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A. No. I do agree that cost of removal is an estimate. Depreciation is also an

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estimate and both are subject to periodic review and evaluation. The cost

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of removal allowances that I have recommended are based upon a

1 substantial amount of empirical evidence. I have summarized the
2 retirements, salvage and cost of removal recorded in the 15-year period
3 from 1989 through 2003 and included the summary as Surrebuttal
4 Schedule DSR-1. This summary has been prepared in three sections, each
5 containing a five-year period. The top section contains amounts from 1989
6 through 1993; the middle section contains amounts from 1994 through
7 1998; and the bottom section contains amounts from 1999 through 2003.
8 There is also a grand total line. From this summary, one can see that there
9 is considerable retirement, salvage and cost of removal activity. Mr.
10 Macias' assertions at page 5 of his rebuttal testimony regarding "unproven
11 and not substantiated" removal cost are unfounded. Quite the contrary, as
12 over \$28,760,000 of cost of removal have been incurred relative to over
13 \$55,000,000 of retirements in the past 15 years. This is a significant
14 population upon which to base estimates regarding future salvage and cost
15 of removal allowances.

16 **Q. MR. MACIAS ALSO APPEARS TO BE OPPOSED TO THE**
17 **FORMULA THAT YOU HAVE USED TO CALCULATE FUTURE**
18 **COST OF REMOVAL CLAIMING THAT THE FORMULA IS NOT**
19 **SUBSTANTIATED BY ANY EMPIRICAL EVIDENCE AND THE**
20 **COMPANY HAS PROVIDED NO EVIDENCE OF THE**
21 **FORMULA'S ACCURACY OR RELIABILITY. DO YOU AGREE?**

22 A. Absolutely not. I have already addressed the substantial amount of
23 empirical evidence supporting my historical salvage and cost of removal

1 analysis. With respect to the formula's accuracy and reliability, these
2 arguments are "red herrings". The ratio of salvage or cost of removal to
3 retirements represents one of the basic cause and effect relationships
4 evident in depreciation analysis. Such a relationship provides the purest
5 basis for matching revenues through the rate-making process with expenses
6 via depreciation. The cause is the retirement, and the effect is the salvage
7 or cost of removal associated with that retirement event. The formula is
8 inherently accurate. The reliability question is addressed during the
9 evaluation phase of the depreciation study where consideration is given to
10 the type of asset retired, the age of the asset retired, the source of any
11 salvage amount and the amount of the cost of removal, as well as any
12 trends in net salvage experience during the period analyzed. Mr. Macias
13 misses the mark. The fundamental question is whether reasonable
14 estimates of future net salvage can be made. The answer is a resounding
15 "yes". The formula used to measure history is not the issue.

16 **Q. MR. MACIAS ASSERTS THAT "APPLYING THIS FORMULA TO**
17 **THE COMPANY'S HISTORICAL RECORDS CAN'T (sic)**
18 **POSSIBLY ACCURATELY PREDICT FUTURE COST OF**
19 **REMOVAL." IS HE CORRECT?**

20 A. No. While it is not well defined (in fact, not defined at all) what Mr.
21 Macias means by an accurate prediction of future cost of removal, it is
22 clear that recent historical net salvage relationships can be utilized to
23 estimate future levels of depreciation expense. These calculations are

1 certainly accurate as they depend upon precise relationships and
2 application of precise formulas. In addition, such calculations are
3 predictive, much in the same way that average service life estimates are
4 predictive. Mr. Macias has no problem taking historical data into a life
5 analysis module and using the results of that analysis to estimate future
6 depreciation expense. The process is no different for net salvage.

7 **Q. MR. MACIAS ALSO ASSERTS THAT COMPANY PROPOSAL**
8 **WILL COLLECT “FAR MORE MONEY IN RATES FOR COST OF**
9 **REMOVAL THAN IS CURRENTLY BEING SPENT”.² IS THIS AN**
10 **ACCURATE STATEMENT?**

11 A. Not really. It is impossible to say what portion of depreciation expense is
12 being collected in rates for cost of removal. What is true is that under my
13 recommended depreciation rates, the accrual for negative net salvage as
14 part of depreciation expense exceeds the actual cost of removal that has
15 been incurred. This is not unusual and occurs because the accrual negative
16 net salvage as part of depreciation expense includes a component for every
17 future retirement of the existing depreciable asset base in all future periods,
18 not just the net salvage that occurs in the current period. His statement is
19 quite misleading as it implies that accrued costs of removal will all be
20 expended in the next year or several years, when in fact those costs will be
21 expended over many years in the future.

22 **Q. MR. MACIAS ALSO SEEMS TO IMPLY THAT THE**
23 **DEPRECIATION RATE COMPARISON THAT YOU PROVIDED**

² Macias rebuttal testimony, page 7, lines 5 and 6.

**IN YOUR DIRECT TESTIMONY (SCHEDULE DSR-4) IS
INVALID. DO YOU HAVE A COMMENT?**

A. I would agree that numerous factors influence a company's depreciation rates. But this comparison was not developed to highlight those factors or differences. Rather, the comparison was developed to indicate the range of depreciation rates in use, and more importantly, to demonstrate how far out of the mainstream that Empire's current (and Staff and OPC's proposed) depreciation rates are. It is comforting to note that the Kansas Corporation Commission includes net salvage in the development of approved depreciation rates and obviously endorses that practice. In a parallel case filed by Empire before the Arkansas Public Service Commission in which Arkansas Staff testimony was filed last week, the remaining life technique including a net salvage allowance was used by Staff witness Gayle Freier. While Mr. Macias' comments that the only conclusion that can be drawn from the summary is that some companies are currently generating more cash flow from depreciation than others is quite true, it is also true that virtually every utility on that list is generating more cash flow through depreciation than Empire is. The exercise was not to provide a precise comparison of depreciation parameters and methodologies, but rather to provide a "sanity check" as to the reasonableness of Empire's existing depreciation rates (and Staff's and OPC's proposals). To that end, the summary and comparison is quite valid.

1 **Q. MR. MACIAS CONTENDS THAT THE RETIREMENT DATES**
2 **THAT WERE PROVIDED TO YOU ARE UNSUBSTANTIATED**
3 **AND UNREASONABLE. IN PARTICULAR, HIS ARGUMENT IS**
4 **THAT NEITHER YOU NOR THE COMPANY HAS**
5 **DEMONSTRATED A PLAN FOR THE REPLACEMENT OF THIS**
6 **CAPACITY. DO YOU HAVE ANY COMMENTS?**

7 A. Yes, I do. Mr. Macias makes these claims of non-substantiation and
8 unreasonableness, but then provides no basis for the statements. With
9 respect to the notion of replacement capacity, such an effort was not within
10 the scope of my depreciation study. Moreover, it is highly unlikely that the
11 Staff would allow depreciation on an un-constructed power plant. These
12 arguments are specious at best.

13 **Q. DO YOU HAVE ANY OTHER COMMENTS REGARDING THE**
14 **REBUTTAL TESTIMONY OF MR. MACIAS?**

15 A. Yes. I wish to address the gratuitous statement made by Mr. Macias at
16 page 7, line 16 of his rebuttal testimony. I fail to see how the Staff method
17 relieves Company management of any burden, much less the level of cost
18 of removal to be collected in rates. The cash basis endorsed by the Staff is
19 improper, inequitable and inappropriate. It is improper because it does
20 comport with traditional cause and effect relationships evident in
21 depreciation analysis. It is inequitable because the wrong generation is
22 being charged for removal costs. It is improper because it violates this
23 Commission's statutes and rules. The Staff's approach must be rejected.

1 **GILBERT REBUTTAL TESTIMONY**

2 **Q. CAN YOU SUMMARIZE THE ISSUES ADDRESSED IN MR.**
3 **GILBERT'S REBUTTAL TESTIMONY?**

4 A. Yes. Mr. Gilbert's rebuttal testimony addresses the topics of Production
5 Plant life spans, remaining life depreciation technique and specific
6 depreciation parameters.

7 **Q. WHAT IS MR. GILBERT'S ISSUE REGARDING PRODUCTION**
8 **PLANT LIFE SPANS?**

9 A. Mr. Gilbert seems to dislike the remaining life technique associated with a
10 life span methodology (to be further addressed below) as well as indicating
11 that such an approach results "in a return of estimated capital investment in
12 a period that is typically less than the used and useful life of the asset".³
13 He goes on to say that this approach "unfairly shifts costs from a later
14 generation of ratepayers to the current generation of ratepayers".⁴

15 **Q. ARE THESE ASSERTIONS CORRECT?**

16 A. Not only are these assertions incorrect, but Mr. Gilbert provides no
17 documentation or support for his claims.

18 **Q. PLEASE EXPLAIN.**

19 A. One need only look at the question and answer shown on page 3, lines 10
20 through 12 of his rebuttal to see this lack of support. The question asks
21 how does the Company's production plant amortization proposal defeat
22 intergenerational equity, and the response is "The fixed assets should be

³ Gilbert rebuttal testimony, page 3, lines 2 and 3.

⁴ Ibid. page 3, lines 4 and 5.

1 depreciated over that asset's expected useful life." The answer is not even
2 responsive to the question. Having said that, as I have described in my
3 depreciation study, my direct testimony and my rebuttal testimony, one
4 purpose of the life span approach is to provide for the allocation of costs
5 over the useful life of the assets. My life span approach produces the result
6 described in this answer.

7 **Q. MR. GILBERT ASSERTS THAT IT IS DIFFICULT TO PERFORM**
8 **A RELIABLE LIFE ANALYSIS FOR PRODUCTION PLANT. IS**
9 **HE CORRECT?**

10 A. I believe that he is correct. Whether such an analysis is at a disaggregated
11 level (plant/unit), or an aggregated level (primary account), "there is
12 insufficient data for actuarial analysis".⁵ This is why my life span
13 approach is superior.

14 **Q. DOES MR. GILBERT AGREE WITH THE RATIONALE**
15 **UNDERLYING THE COMPANY'S PRODUCTION PLANT**
16 **AMORTIZATION REQUEST?**

17 A. It would seem that the answer to that question is "no", although the
18 response and justification provided are jumbled and unclear. Mr. Gilbert
19 implies that the Company has somehow inappropriately subdivided the
20 production plant accounts so as to restrict the results based solely upon
21 estimates that I have developed. While it is certainly true that the
22 production plant accounts have been sub-divided, and it is equally true that
23 the depreciation study recommendations that I have made are based

⁵ Gilbert rebuttal testimony, page 3, lines 18 and 19.

1 partially upon my estimates, that does not negate the process nor render the
2 results incomplete or useless. In fact, associating the specific parameters
3 related to production plant in a more meaningful way (plant/unit) provides
4 a better determination of depreciation expense. Mr. Gilbert's argument is
5 without merit.

6 **Q. MR. GILBERT REJECTS THE USE OF THE REMAINING LIFE**
7 **TECHNIQUE, CLAIMING SUCH USAGE IS BASED UPON A**
8 **DESIRE BY THE COMPANY TO MAXIMIZE DEPRECIATION**
9 **EXPENSE. IS THIS TRUE?**

10 A. While I cannot speak for the Company, I can say that within my
11 depreciation study there was no desire or objective to maximize
12 depreciation expense. My charge was to develop depreciation rates that
13 provide for the systematic and rational allocation of costs over the useful
14 life the assets. The selections and recommendations that I have made were
15 developed with these goals in mind. My recommendations are also within
16 industry norms.

17 **Q. MR. GILBERT ALSO CLAIMS THAT YOU HAVE DEVELOPED**
18 **INFLATED RESERVE REQUIREMENTS CAUSED BY**
19 **INACCURATE ESTIMATES OF SALVAGE COSTS OF REMOVAL**
20 **(sic) AND SHORTER LIVES. ARE THESE CLAIMS VALID?**

21 A. Not at all. The theoretical reserve has not been artificially inflated. It is
22 merely a product of the parameters that I have selected in my study. The
23 net salvage estimates that I have made are highly accurate and are based

1 upon a substantial amount of historical experience. Mr. Gilbert may not
2 agree with my methodology, but the estimates are anything but inaccurate.
3 Lastly, LONGER lives were used for the Transmission, Distribution and
4 General Plant functions which encompass 56% of the depreciable base and
5 depreciation expense. Mr. Gilbert's claims are just wrong. He finally
6 asserts that this Commission has historically determined that the Average
7 Life Group – Whole Life method of depreciation is appropriate for energy
8 utilities. However, he fails to mention that this Commission has authorized
9 the use of the remaining life technique for other utilities.⁶ And the reasons
10 for using the remaining life technique for those other utilities are equally
11 appropriate for energy utilities such as Empire.

12 **Q. MR. GILBERT IMPLIES THAT YOU HAVE UTILIZED**
13 **INCONSISTENT AND CONFLICTING INFORMATION**
14 **RELATIVE TO THE RETIREMENT OF PRODUCTION ASSETS,**
15 **AND THAT SUCH INCONSISTENCIES HAVE OCCURRED**
16 **BEFORE. DO YOU HAVE ANY COMMENTS?**

17 A. Yes, I do. To the best of my knowledge I have been consistent in the
18 application of the retirement date information that was provided to me.
19 Mr. Gilbert references Case No. ER-97-394. My recollection of the issues
20 in that proceeding on this topic dealt with a difference of opinion as to the
21 appropriate retirement date, not inconsistent or conflicting information. He
22 goes on to assert at page 6 that I have more than tripled the annual accrual
23 for the production plant account. A review of Rebuttal Schedule DSR-1R

⁶ Roff Rebuttal Testimony, page 32 and 33.

1 reveals no such result. In fact, the increase for production plant as shown
2 in Column [7] is only about 125%. Mr. Gilbert's remarks are misleading
3 in that regard.

4 **Q. WHAT IS MR. GILBERT'S POSITION WITH RESPECT TO THE**
5 **ISSUE OF NET SALVAGE?**

6 A. Mr. Gilbert (as does Mr. Macias) maintains that my net salvage
7 recommendations are highly speculative and fail to comply with the
8 Commission's standard regarding "known and measurable". I could find
9 nothing in the Missouri statutes that contained the words "known and
10 measurable". In my thirty-one years of serving the utility industry, it has
11 been my experience that the term "known and measurable" deals with
12 when to recognize an asset in service, and it has not been tied to estimates
13 of net salvage allowances. Mr. Gilbert's assertion is just not applicable.

14 **Q. IS MR. GILBERT CORRECT THAT THE REMOVAL OF A**
15 **POWER PLANT IS AS SPECULATIVE AS THE COST ESTIMATE**
16 **TO REMOVE THAT POWER PLANT?**

17 A. I do not agree. I believe that plants will retire and will be removed. I also
18 believe that a reasoned estimate of such activities and costs is possible. In
19 either case, I think neither the event nor the process is speculative.

20 **Q. WHAT ABOUT MR. GILBERT'S ARGUMENTS THAT THESE**
21 **SITES HAVE VALUE AND MAY BE REUSED?**

22 A. It is important not to mix the treatment of depreciable assets, e.g., a power
23 plant, with the treatment and value of non-depreciable assets, e.g., the land

1 upon which the power plant resides. The fact that a site may be reused
2 reinforces the idea that an existing facility will be demolished or in some
3 way taken down to accommodate new generation.

4 **Q. MR. GILBERT CONCLUDES HIS REBUTTAL TESTIMONY**
5 **WITH A SERIES OF QUESTIONS AND ANSWERS ON PAGE 9**
6 **DEALING WITH THE SUBJECT OF INTERIM RETIREMENTS.**
7 **DO YOU HAVE ANY COMMENTS?**

8 A. Yes, I do. I found this section of Mr. Gilbert's rebuttal testimony quite
9 confusing as it appeared to me that the answers were not particularly
10 responsive to the questions. For example, the question at page 9, line 4
11 directly asks: "What other parameters used in the calculation of the
12 Company's recommended depreciation rates would you care to describe
13 and discuss?" The answer is: "The Company has conducted a salvage
14 study that, in light of the current theoretical reserve over accrual, would
15 greatly inflate the estimated cost of retirement for future additions and
16 retirements." My first response to this is that the salvage and cost of
17 removal analysis that I conducted was based entirely on historical figures.
18 I disagree with Mr. Gilbert, as my calculations demonstrate a significant
19 under- accrual.

20 **Q. IN THE NEXT QUESTION, MR. GILBERT INSINUATES THAT**
21 **THE COMPANY'S SALVAGE STUDY INFLATES THE**
22 **PROPOSED DEPRECIATION RATES. HIS RESPONSE IS THAT**
23 **THE COMPANY HAS REVERSED THE COMMISSION'S**

1 **DECISION TO EXPENSE SALVAGE COSTS ON A CURRENT**
2 **BASIS BY INCLUDING A NET SALVAGE COMPONENT OF**
3 **DEPRECIATION EXPENSE IN THE REVENUE REQUIREMENT.**
4 **MOREOVER, THIS REVENUE REQUIREMENT ESTIMATE IS**
5 **BASED UPON A GROSSLY INFLATED COST OF REMOVAL**
6 **RELATIVE TO A RELATIVELY SMALL NUMBER OF**
7 **RETIREMENTS. DO YOU AGREE?**

8 A. No. I do not believe that there is a specific requirement in Missouri to
9 handle net salvage in the manner suggested by the Staff. The cost of
10 removal included in my analysis has not been inflated and represents actual
11 costs incurred associated with asset retirement. I looked at Schedule 2
12 prepared by Mr. Gilbert and am having difficulty with both the purpose of
13 this schedule and its significance. It appears to me that there is more than
14 adequate retirement activity upon which to base a salvage and cost of
15 removal analysis and formulate appropriate net salvage allowance
16 recommendations.

17 **Q. MR. GILBERT SUGGESTS THAT THERE IS A BIAS**
18 **INTRODUCED BY THE USE OF A FIFO CONVENTION. IS HE**
19 **CORRECT?**

20 A. Mr. Gilbert is correct that the Company uses a FIFO ageing convention.
21 Mr. Gilbert is also correct that older unit cost retirements are being
22 recorded. He concludes that net salvage figures must be inflated. He fails
23 to also recognize that a FIFO ageing convention produces the longest

1 average service life. This occurs because every retirement is from the
2 oldest surviving vintage balance. Each retirement occurs at the maximum,
3 producing the longest life. Thus any alleged distortion due to low unit
4 retirement costs are offset by the resulting longer average service life. His
5 argument is one-sided and, therefore without merit. He continues by
6 referring to my recommendations as “unproven parameters”. No where
7 does he discuss what this means, how they are unproven, and indirectly,
8 does not even define the parameters in question. I assume the reference is
9 to net salvage figures, which are proven based upon historical experience.
10 The more appropriate issue is whether these parameters have need
11 developed in as systematic and supportable manner and whether their
12 application results in the development of a reasonable level of net salvage
13 included in annual depreciation. In my expert opinion, they do.

14 **MAJOROS REBUTTAL TESTIMONY**

15 **Q. WHAT ARE THE ISSUES ADDRESSED IN MR. MAJOROS’**
16 **REBUTTAL TESTIMONY?**

17 A. Mr. Majoros, in his rebuttal testimony, repeats many of the same
18 discussion contained in his direct testimony. He states that the Company’s
19 depreciation proposal is unreasonable because it produces excess
20 depreciation. He states that the Company’s depreciation proposal reverses
21 several Commission decisions. Mr. Majoros opposes the use of life span
22 approach and also rejects the use of the remaining life depreciation
23 technique. Mr. Majoros characterizes my net salvage proposals as

1 “outlandish”, “astronomical”, “beyond reasonable” and “exorbitant”.

2 Finally, Mr. Majoros indicates that I have not addressed or discussed SFAS

3 No. 143 or FERC Order No. 631.

4 **Q. DOES THE COMPANY’S PROPOSAL PRODUCE EXCESS**
5 **DEPRECIATION?**

6 A. No. I address the subject of excess depreciation in my rebuttal testimony⁷
7 and will not repeat that discussion here. I would merely add that the
8 *Lindheimer* decision also dealt with the determination of depreciation
9 expense based upon fair value, which has no relevance to this proceeding
10 and further make Mr. Majoros’ discussion of excess depreciation
11 inapplicable. Finally, the fact that my proposed depreciation rates are
12 within industry norms (and OPC’s are not) should be strong evidence that
13 my rates are not exorbitant, but that his are clearly inadequate.

14 **Q. ARE YOUR NET SALVAGE PROPOSALS OUTLANDISH,**
15 **ASTRONOMICAL, BEYOND REASONABLE OR EXORBITANT?**

16 A. In my opinion, they are not. What my net salvage allowances are, are
17 based upon an extensive historical analysis utilizing substantial amounts of
18 activity coupled with an evaluation of the significance of the history and its
19 applicability to the surviving asset base into the future. My net salvage
20 allowances are based upon a traditional and near universally accepted
21 analysis procedure. And my net salvage allowances result in a fair and
22 reasonable level of depreciation expense consistent with accounting and
23 regulatory rules.

⁷ Roff Rebuttal Testimony, Page 23.

1 **Q. HAVE YOU REVERSED COMMISSION DECISIONS MADE**
2 **THREE YEARS AGO?**

3 A. I do not believe so. In my opinion, this Commission did not reject the use
4 of the life span approach, but rather found that the retirement dates used by
5 the Company's consultant were unsupportable. The retirement dates that I
6 have utilized were provided by Company personnel and gave consideration
7 to the factors necessary to establish such dates. Next, I can find no
8 regulations that require the expensing of cost of removal in the current
9 period. I could also find no regulations requiring the use of the whole life
10 technique and refer this Commission to Case No. TO-82-3. I again point
11 out that Mr. Majoros has been a frequent advocate of the remaining life
12 technique in numerous prior testimonies.

13 **Q. MR. MAJOROS CLAIMS THAT YOU HAVE NOT ADDRESSED**
14 **OR DISCUSSED SFAS NO. 143 OR FERC ORDER NO. 631. DO**
15 **YOU AGREE?**

16 A. No. It is important to understand that the discussion offered by Mr.
17 Majoros on the topic of SFAS No. 143 and FERC Order No. 631 represent
18 his own special interpretation of these documents. I will concede that my
19 testimonies also represent my interpretation of these two documents. What
20 is important to differentiate are the conclusions reached from those
21 interpretations and the basis for those conclusions. I believe that Mr.
22 Majoros has reached an incorrect conclusion based upon faulty logic and

1 reasoning. He has overextended the principles embedded in SFAS No. 143
2 and attempted to use Order No. 631 as the vehicle for improper application.

3 **Q. WHERE DOES MR. MAJOROS OVEREXTEND THE PRINCIPLES**
4 **EMBEDDED IN STATEMENT NO. 143?**

5 A. I believe his first incorrect conclusion is that Statement No. 143 *requires*
6 net salvage to be unbundled from depreciation rates.⁸ SFAS No. 143
7 adequately addresses the identification and measurement of asset
8 retirement obligations (“ARO’s”). And that is where SFAS No. 143 stops.

9 **Q. HOW DOES MR. MAJOROS USE ORDER NO. 631**
10 **INAPPROPRIATELY?**

11 A. I refer the Commission to my rebuttal testimony at page 12, lines 10
12 through 21. Clearly, based upon these two passages, the accounting for
13 non-legal ARO’s was unchanged by Order No. 631 (the first passage) and
14 the FERC recognizes the true boundaries of SFAS No. 143 in the second
15 passage, asserting that the accounting for non-legal removal cost was
16 beyond the scope of that Order. Thus both SFAS No. 143 and Order No.
17 631 does not deal with the accounting for non-legal removal costs and the
18 “separation principle” created by Mr. Majoros is a phantom requirement.
19 What this really means is that most of Mr. Majoros’ rebuttal testimony is
20 unfounded and irrelevant.

21 **Q. ARE THERE ANY OTHER AREAS OF MR. MAJOROS’**
22 **REBUTTAL TESTIMONY THAT YOU WISH TO ADDRESS?**

⁸ Majoros Rebuttal Testimony, page 11, lines 17 and 18.

DONALD S. ROFF
SURREBUTTAL TESTIMONY

1 A. Yes. I am concerned with certain incorrect or misleading statements that
2 are interlaced throughout Mr. Majoros’ rebuttal testimony. To begin, I take
3 offense with Mr. Majoros’ characterization at page 16, line 13. The topics
4 of SFAS No. 143 and FERC Order No. 631 were addressed at length with
5 Empire personnel. I am well aware of the content of both of these
6 documents. These issues, however, were not germane to my depreciation
7 study recommendations.

8 Next, I would like to focus on Mr. Majoros’ rebuttal testimony at page 17,
9 line 13, where he seems to imply that I have inappropriately relied upon the
10 dismantlement estimates of other utilities. It is true that Empire has limited
11 experience with the dismantlement of power plant. Absent its own history,
12 it is logical and common practice to look within the industry to obtain
13 additional or supporting information. This additional information was
14 available in the form of dismantlement cost estimates for other utilities.

15 There were also an adequate number of studies and units (nearly 200 units)
16 for which this information was available. These studies provide a
17 reasonable basis for determining an estimate of the dismantlement costs of
18 Empire’s power plants.

19 Next, Mr. Majoros describes my net salvage estimates as “exorbitant” at
20 page 19, lines 5 through 12. Mr. Majoros confuses price level changes,
21 i.e., removal costs in current dollars, with retirement cost in original cost
22 dollars. He then attempts to bring in the measurement criteria for legal
23 obligations under SFAS No. 143, saying that historical removal costs

1 should be reduced to their fair value. He has improperly extended the
2 measurement process of an ARO to the determination of an appropriate net
3 salvage allowance for non-legal cost of removal. Such a leap in logic is
4 unjustified, as well as not supported by a plain reading of SFAS No. 143.

5 **Q. MR. MAJOROS SUGGESTS THAT OTHER JURISDICTIONS**
6 **HAVE USED THE APPROACH TO NET SALVAGE THAT HE**
7 **ADVOCATES.⁹ WHAT HAS BEEN YOUR EXPERIENCE?**

8 A. It has been my experience that very few companies treat cost of removal as
9 a current expense. Mr. Majoros provides no proof in the form of example
10 companies that follow this practice. The implication that this is a common
11 practice is disingenuous.

12 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

13 A. Yes. However to the extent that I have not addressed issues raised by the
14 other parties do not signify my agreement with them.

⁹ Majoros Rebuttal Testimony, page 21, lines 4 through 33.