

Exhibit No.
Issue: Depreciation
Witness: Donald S. Roff
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Sponsoring Party: Empire District Electric
Case No. ER-2008-0093
Date Testimony Prepared: April 2008

**Before the Public Service Commission
of the State of Missouri**

Surrebuttal Testimony

of

Donald S. Roff

April 2008

SURREBUTTAL TESTIMONY
OF
DONALD S. ROFF
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2008-0093

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

3 A. My name is Donald S. Roff and I am President of Depreciation Specialty
4 Resources. My business address is 2832 Gainesborough Drive, Dallas, Texas
5 75287.

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

11 A. Yes.

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

13 A. The purpose of my surrebuttal testimony is to address the subject of depreciation
14 rates and depreciation accounting and the position stated by the Missouri Public
15 Service Commission Staff (“Staff”) witness Ms. Rosella L. Schad.

16 **Q. HAVE YOU PREPARED ANY SCHEDULES IN CONNECTION WITH**
17 **YOUR TESTIMONY?**

1 A. Yes. Surrebuttal Schedule DSR-1 has been provided to identify third party
2 reimbursements for the period 2000 - 2006. Surrebuttal Schedule DSR-2 has
3 been provided to identify insurance proceeds. Surrebuttal Schedule DSR-3
4 contains the salvage and cost of removal analyses for certain accounts. Each will
5 be discussed later in my surrebuttal testimony.

6 **Q. WERE THESE SCHEDULES PREPARED BY YOU, OR UNDER YOUR**
7 **DIRECT SUPERVISION?**

8 A. Yes, they were.

9 **Q. WHAT ARE THE ISSUES ADDRESSED BY STAFF WITNESS MS.**
10 **SCHAD IN HER REBUTTAL?**

11 A. Ms. Schad itemizes five issues or concerns in her rebuttal testimony. The first is
12 her interpretation of the Commission's Order Approving Stipulation and
13 Agreement in Case No. EO-2005-0263. The second deals with my proposal to
14 change certain negative net salvage allowances in the form of a "cap" to the level
15 of cost of removal. The third area is Empire's request to use a vintage
16 amortization accounting process for certain General Plant accounts. The fourth
17 area relates to the treatment of third party reimbursements in the net salvage
18 allowance for certain accounts. The fifth area expresses Staff's concern with
19 what Ms. Schad describes as "Empire's deficiencies in maintaining historical
20 mortality records and salvage/cost of removal data". Lastly, Ms. Schad addresses
21 the OPC proposal to utilize remaining life depreciation rates, a subject that I also
22 address in my rebuttal testimony.

23 **Q. WHAT IS YOUR UNDERSTANDING OF THE COMMISSION'S ORDER**

1 **APPROVING STIPULATION AND AGREEMENT IN CASE NO. EO-**
2 **2005-0263?**

3 A. The Order states the following: “The Commission should review Empire’s
4 depreciation and amortization rates accordingly in Empire’s future rate cases.”
5 Thus, I believe the interpretation expressed by Ms. Schad, that the Commission’s
6 order prohibits changes in depreciation rates and costs while the regulatory plan is
7 in effect is incorrect. As far as I can tell, there is no automatic amortization under
8 the regulatory plan to compensate for an increase (or decrease) in depreciation
9 rates. The Order does state that the Commission should review Empire’s
10 depreciation rates in future cases. That is the exact intent of Empire’s request for
11 revised depreciation rates in this proceeding. Empire witness Keith will further
12 discuss in his surrebuttal testimony the inappropriateness of Ms. Schad’s
13 recommendation to use regulatory amortization in place of ordinary rate revenue
14 for recovery of deprecation expense

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

16 A. The existing depreciation rates for four accounts for Empire have a negative net
17 salvage limit of 100% and were changed to negative 125% in my depreciation
18 study. These accounts are:

19 Account 355 - Transmission, Poles and Fixtures
20 Account 364 - Distribution, Poles, Towers and Fixtures
21 Account 365 - Distribution, Overhead Conductors and Devices
22 Account 369 - Distribution, Services

23 In addition, the current depreciation shows that Account 356, Transmission,

1 Overhead Conductors and Devices should have a net salvage cap of negative
2 125%.

3 Ms. Schad testifies that I have not provided evidence in this case that the 100%
4 negative net salvage cap approved by the Commission is appropriate and I have
5 not provided support to change the magnitude of the cap to negative 125%.
6 Surrebuttal Schedule DSR-3 contains the salvage and cost of removal analysis for
7 each of these five accounts. At page 7, line 8 of her rebuttal testimony, she
8 provides some figures for Account 364 in support of her position.

9 **Q. HOW DO YOU CHARACTERIZE HER DISCUSSION OF THE DATA**
10 **ASSOCIATED WITH ACCOUNT 364?**

11 A. It is incorrect.

12 **Q. PLEASE EXPLAIN.**

13 A. While Ms. Schad shows the correct total figures, she has mischaracterized the
14 amount that she describes as salvage. There are several components of Account
15 108, Accumulated Provision for Depreciation. These include, salvage, cost of
16 removal, retirements, depreciation accruals and other credits. The other credits
17 include third party payments, as well as insurance proceeds, which are NOT
18 salvage. In my depreciation study, special treatment was given to these
19 transactions. Moreover, Ms. Schad provides no basis for not changing the net
20 salvage cap from 100% to 125%. The basis for my selections is contained on
21 Surrebuttal Schedule DRS-3.

22 **Q. WHAT ARE THIRD PARTY PAYMENTS?**

23 A. In this depreciation study, third party payments are amounts received from

1 someone other than a customer, generally a government agency, and represent
2 payments for replacement assets. These amounts have been separately identified,
3 contrary to the testimony of Ms. Schad, and have been provided as Surrebuttal
4 Schedule DSR-1.

5 **Q. HOW WERE THESE THIRD PARTY PAYMENTS TREATED IN YOUR**
6 **DEPRECIATION STUDY?**

7 A. In order to properly reflect the impact of these third party payments on the net
8 salvage allowance, the third party payments were related to additions. This
9 treatment provides the correct credit, similar to how Contributions in Aid of
10 Construction (“CIAC”) are accounted for in the study.

11 **Q. HOW DOES EMPIRE ACCOUNT FOR CIAC?**

12 A. Customer contributions are credited to construction (Plant in Service).

13 **Q. PLEASE EXPLAIN HOW YOUR TREATMENT OF THIRD PARTY**
14 **PAYMENTS IS SIMILAR TO HOW THE EFFECT OF EMPIRE’S**
15 **ACCOUNTING FOR CIAC IS REFLECTED ON EMPIRE’S BOOKS,**
16 **ESPECIALLY FROM A DEPRECIATION ANALYSIS PERSPECTIVE.**

17 A. Consider the following two examples. A customer pays \$400 for a line extension
18 that costs Empire \$1,400 to construct. The \$400 payment is credited to the
19 construction work order making the actual addition to plant in service \$1,000. In
20 the second example, the Department of Transportation (“DOT”) requires Empire
21 to relocate a line due to highway construction. Empire bills the DOT \$4,000 as
22 payment for its construction cost of \$14,000. In this case, Empire records an
23 addition of \$14,000 and a credit to accumulated depreciation of \$4,000. In order

1 to reflect this payment correctly from a depreciation analysis standpoint, the third
2 party reimbursement of \$4,000 must be related to the \$14,000 addition, producing
3 an equivalent salvage percentage of 28.57%. Thus, the depreciation factor is
4 71.43% of the \$14,000 investment balance, producing the correct total
5 depreciation of \$10,000. The data provided in the depreciation study is complete,
6 and Ms. Schad's assertion that the Staff can't evaluate the appropriateness of
7 including reimbursements in the depreciation rate calculation is unfounded.

8 **Q. HOW WERE INSURANCE PROCEEDS TREATED IN YOUR**
9 **DEPRECIATION STUDY?**

10 A. Insurance proceeds were eliminated from the depreciation study salvage and cost
11 of removal analysis.

12 **Q. WHY WERE THE INSURANCE PROCEEDS ELIMINATED FROM THE**
13 **SALVAGE AND COST OF REMOVAL ANALYSIS?**

14 A. The insurance proceeds were eliminated from the salvage and cost of removal
15 analysis because they are not a component of depreciation. The regulatory
16 definition of depreciation is:

17 Depreciation, as applied to depreciable utility plant, means the loss in
18 service value not restored by current maintenance, incurred in connection
19 with the consumption or prospective retirement of utility plant in the
20 course of service from causes which are known to be in current operation
21 and against which the utility is not protected by insurance. Among the
22 causes to be given consideration are wear and tear, decay, action of the
23 elements, inadequacy, obsolescence, changes in the art, changes in
24 demand and requirements of public authorities.

25 Thus insurance is not a part of depreciation and insurance proceeds were
26 appropriately eliminated from the salvage and cost of removal analysis. The
27 amounts eliminated are shown on Surrebuttal Schedule DSR-2.

1 **Q. YOU MENTIONED ABOVE THAT MS. SCHAD CLAIMS THAT EMPIRE**
2 **DOES NOT PROVIDE A BASIS FOR CHANGING THE NET SALVAGE**
3 **CAP FROM NEGATIVE 100% TO NEGATIVE 125%. WHAT IS THE**
4 **BASIS FOR YOUR RECOMMENDATION?**

5 A. The basis for my recommendation is contained in Surrebuttal Schedule DSR-3. A
6 review of the cost of removal percentages for these five accounts for the period
7 2002 – 2006, the most recent five-year band, shows a minimum of 152%. My
8 negative 125% cap is conservative.

9 **Q. MS. SCHAD TESTIFIES IN HER REBUTTAL TESTIMONY AT PAGE 5,**
10 **LINE 22, THAT YOU ONLY REFLECTED REIMBURSEMENTS ON A**
11 **SELECTIVE BASIS. IS THIS TRUE?**

12 A. No. Third party reimbursements do not occur in every asset category. I reflected
13 all the reimbursements that were identified for the period 2000 – 2006. Ms.
14 Schad's assertion is incorrect.

15 **Q. MS. SCHAD EXPRESSES A CONCERN REGARDING THE QUALITY**
16 **OR INTEGRITY OF EMPIRE'S MORTALITY DATA. DO YOU HAVE**
17 **ANY COMMENTS?**

18 A. Yes, I do. Ms. Schad seems to be basing this conclusion on the effect of one
19 unique transaction. There were thousands of transactions that made up the data
20 input to the depreciation study. I am absolutely convinced that Empire is in
21 compliance with Missouri rules and that the input data utilized by me in the
22 depreciation study produce reliable and acceptable results. Ms. Schad mentions
23 that I had several e-mail correspondences with Empire seeking clarification and

1 guidance on data entries, adjustments and balances of historical mortality data.
2 This is a normal part of a depreciation study in order to understand Empire's
3 accounting process, as well as to explain the significance of certain historical
4 entries. I am confident that the results and recommendations developed in my
5 depreciation study are based upon accurate and reliable data. The one example
6 that Ms. Schad provides at page 8 of her rebuttal testimony was a unique event,
7 relating to Empire putting one of its units of property into inventory. This one
8 example does not merit concern as to the quality or integrity of Empire's
9 mortality data.

10 **Q. DOES THE STAFF SUPPORT THE VINTAGE AMORTIZATION**
11 **ACCOUNTING THAT YOU HAVE RECOMMENDED?**

12 A. No. Ms. Schad makes reference to a 1997 order in a Missouri Public Service
13 case. In that order, vintage amortization accounting was not approved, but a
14 higher capitalization threshold was authorized.

15 **Q. DO YOU STILL BELIEVE THAT VINTAGE AMORTIZATION**
16 **ACCOUNTING IS A GOOD PROCESS?**

17 A. Yes, I do. Vintage amortization accounting eliminates the need for tracking
18 thousands of small dollar items that are difficult to account for. It also provides
19 an orderly process for retiring and amortizing these asset categories, allowing the
20 Property Accounting department to devote more time to other duties. The
21 alternative proposed by Ms. Schad is to raise the capitalization threshold. This is
22 problematic for several reasons. First, what is the appropriate new threshold?
23 Second, Empire's budgets have already been established at the existing levels.

1 Third, each existing asset that does not meet the proposed threshold would have to
2 be retired, creating a possible under-recovery situation. Fourth, a new threshold
3 does NOT eliminate the problem of unreported retirements. My proposed
4 approach provides a systematic and rational process for retiring and amortizing
5 these assets.

6 **Q. MS. SCHAD TESTIFIES AT PAGE 11, LINE 5, THAT EMPIRE IS NOT**
7 **IN COMPLIANCE WITH 4 CSR 240-3.175 BECAUSE IT DID NOT FILE**
8 **ESTIMATED RETIREMENT DATES WITH THE DEPRECIATION**
9 **STUDY. DO YOU HAVE ANY COMMENTS?**

10 A. It is my understanding that Empire did file estimated retirement dates for Riverton
11 units 7 and 8 in the Integrated Resource Plan (“IRP”). The lives of other facilities
12 extend beyond that 20 year planning horizon. The generating facilities and
13 General Plant structures were not analyzed on a life span basis in the depreciation
14 study, so no retirement date estimates were developed.

15 **Q. PLEASE SUMMARIZE YOUR SURREBUTTAL TESTIMONY.**

16 A. My surrebuttal testimony addresses the depreciation rates, vintage amortization
17 accounting and data integrity issues raised by Staff witness Ms. Schad. I endorse
18 the vintage amortization accounting approach, and encourage this Commission to
19 approve its use for Empire. Such approval will result in a systematic and rational
20 process for those General Plant asset categories and will enable a better use of
21 Property Accounting resources. The Staff has not demonstrated any need for
22 retaining the existing depreciation rates and my recommended depreciation study
23 rates remain appropriate, and I iterate my study recommendations to approve new

1 depreciation rates. Ms. Schad's interpretation of Case No. EO-2005-0263 is
2 incorrect in that the order says nothing about automatically adjusting the
3 regulatory amortization to reflect changes in depreciation rates. The Staff's
4 concerns regarding data integrity are misplaced and limited to a few unique
5 events. Empire's data is accurate and reliable and produces meaningful results.

6 **Q. DOES THIS COMPLETE YOUR SURREBUTTAL TESTIMONY?**

7 A. Yes.