

Exhibit No:	
Issue:	Depreciation
Witness:	Thomas J. Sullivan
Type of Exhibit:	Direct Testimony
Sponsoring Party:	Missouri Gas Energy
Case No.:	GR-2009-
Date Prepared:	April 1, 2009

MISSOURI PUBLIC SERVICE COMMISSION

MISSOURI GAS ENERGY

CASE NO. GR-2009-

DIRECT TESTIMONY OF

THOMAS J. SULLIVAN

Jefferson City, Missouri

April 1, 2009

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APRIL 1, 2009

Q. Please state your name and business address.

A. Thomas J. Sullivan, 11401 Lamar, Overland Park, Kansas 66211.

Q. What is your occupation?

A. I am currently a Managing Director in the Rate and Regulatory Advisory Solution Set of the Enterprise Management Solutions Division of Black & Veatch Corporation.

Q. How long have you been associated with Black & Veatch?

A. I have been employed by the Company since 1980.

Q. What is your educational background?

A. I earned a Bachelor of Science Degree in Civil Engineering from the University of Missouri - Rolla in 1980, summa cum laude, and a Master of Business Administration degree from the University of Missouri - Kansas City in 1985.

Q. Are you a registered professional engineer?

A. Yes, I am a registered Professional Engineer in the State of Missouri.

Q. To what professional organizations do you belong?

A. I am a member of the American Society of Civil Engineers.

Q. What is your professional experience?

A. I have been responsible for the preparation and presentation of numerous studies for gas, electric, water, and wastewater utilities. Clients served include investor-owned utilities,

publicly owned utilities, and their customers. Studies involve valuation and depreciation, cost of service, cost allocation, rate design, cost of capital, supply analysis, load forecasting, economic and financial feasibility, cost recovery mechanisms, and other engineering and economic matters.

Prior to joining the Enterprise Management Solutions Division in 1982, I worked as a staff engineer in Black and Veatch's Energy and Water Divisions.

Q. Have you previously appeared as an expert witness?

A. Yes, I have. In Schedule TJS-1, I list cases where I have filed expert witness testimony.

Q. For whom are you testifying in this proceeding?

A. I am testifying on behalf of Missouri Gas Energy ("MGE" or "Company").

Q. What is the purpose of your testimony in this matter?

A. To review the Company's existing depreciation rates and, where appropriate, recommend changes to those rates such that the rates will, as accurately as possible, match the useful life of the property and the Company's recent experience with net salvage. Based on this review, I am recommending the following:

1. The Company use the average service life ("ASL") for Account 380 – Services of 32 years contained in the 2005 Report on Depreciation Accrual Rates ("2005 Report") I prepared for the Company in June 2005 to meet its requirements of 4 CSR 240.040(6).
2. The Company use the ASL for Account 376 – Mains of 44 years contained in the 2005 Report I prepared for the Company in June

2005 to meet its requirements of 4 CSR 240.040(6). This ASL is equal to the ASL underlying the Company's existing depreciation rate for Mains.

3. The Company use a net salvage allowance for Mains and Services of 0.12 percent and 0.25 percent, respectively, based on the Company's actual experience for the period 2004-2008.

4. The average service life and net salvage components be combined with the resulting total depreciation rates for Mains equaling 2.39 percent and for Services equaling 3.38 percent.

5. The Company establish separate sub-accounts for transportation equipment (Account 392) for automobiles and small trucks (Account 392.1) and heavy trucks (Account 392.2) and establish separate depreciation rates for these sub-accounts, 13.33 percent for Account 392.1 and 7.62 percent for Account 392.2.

Q. Do you sponsor any Schedules in connection with your direct testimony?

A. Yes, in addition to Schedule TJS-1 previously discussed, I sponsor the following exhibits:

Schedule TJS-2 – Report on Depreciation Accrual Rates

Schedule TJS-3 – Net Salvage Calculation

Schedule TJS-4 – Transportation Equipment Proposed Depreciation Rate

These schedules were prepared under my direction and supervision.

SERVICES

Q. What is the current depreciation rate for Account 380 – Services?

A. Based on the Stipulation and Agreement in the Company's last rate case in Case No. GR-2006-0422, the current depreciation rate is 3.13 percent. This is a total depreciation rate (including both ASL and net salvage) based on an ASL of 40 years and a negative net salvage allowance of 25 percent. The current rate consists of two components, 2.50 percent based on a 40 year ASL (1/40) and 0.63 percent based on a 25 percent negative net salvage allowance (0.25/40).

Q. Please explain the term negative net salvage.

A. Negative net salvage means the same thing as a net cost of removal. For MGE, the net salvage allowance includes salvage, reimbursements, and cost of removal. Net salvage equals salvage plus reimbursements minus cost of removal. Salvage and reimbursements are amounts received by the Company when plant is retired or replaced and therefore reduce the amount of plant depreciated, and cost of removal is an expense incurred when plant is retired or replaced and therefore increases the amount depreciated. Therefore, a positive net salvage allowance reduces the depreciation rate and a negative net salvage allowance increases the depreciation rate.

Q. Does the existing depreciation rate for Services provide a reasonable match with the useful life of the property?

A. No, it does not. The 40 year ASL is too long. Based on the analyses contained in my 2005 Report (Schedule TJS-2) and supplemental data and analyses I

provided in connection with Case No. GR-2006-0422, the most reasonable ASL for Services is 32 years.

Q. What is the ASL you recommended for Services in your 2005 Report?

A. In the 2005 Report, I recommended an ASL of 32 years. This ASL was based on analysis of regional gas utilities and simulated plant balance analysis.

Q. Please summarize the supplemental data and analyses you provided in Case No. GR-2006-0422.

A. The supplemental data and analyses I provided in Case No. GR-2006-0422 indicated that the magnitude of MGE's safety line replacement program ("SLRP") significantly impacts (reduces) the ASL for Services on MGE's system. Also, based on data available through 2006, limited analysis of MGE's mortality experience with Services indicated an ASL of 28 years.

Q. Does the net salvage allowance underlying the current depreciation rate for Services reflect the Company's recent experience?

A. No, it does not. The current allowance of negative 25 percent results in a depreciation rate allowance of 0.63 percent (0.25 divided by 40 years). Based on the Company's year-end 2008 plant balance for Services of \$323,088,664, this depreciation rate correlates with an annual net salvage amount of negative \$2,035,000. The Company's net salvage for Services has averaged negative \$806,000 over the last five years, as shown in Schedule TJS-3. This is comparable to a 0.25 percent depreciation rate net salvage allowance.

Q. What depreciation rate are you recommending that the Company use for Account 380 – Services?

1 A. I am recommending that the Company use a depreciation rate of 3.38 percent.
2 This is based on an ASL of 32 years (1/32 equals 3.13 percent) plus a negative
3 net salvage allowance of 0.25 percent (\$800,000 divided by \$323,088,664).

4 **Q. Does this conclude your prepared direct testimony related to Services?**

5 A. Yes, it does.
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MAINS

Q. What is the current depreciation rate for Account 376 – Mains?

A. Based on the Stipulation and Agreement in the Company's last rate case in Case No. GR-2006-0422, the current depreciation rate is 2.16 percent. This is a total depreciation rate (including both ASL and net salvage) based on an ASL of 44 years and a positive net salvage allowance of 5 percent. The current rate consists of two components, 2.27 percent based on a 44 year ASL (1/44) minus 0.11 percent based on a positive 5 percent net salvage allowance (0.05/44).

Q. Does this depreciation rate provide a reasonable match with the useful life of the property?

A. Yes, it does. The 44 year ASL is equal to the ASL recommended in my 2005 Report.

Q. Does the net salvage allowance underlying the current depreciation rate for Mains reflect the Company's recent experience?

A. No, it does not. The current allowance of positive 5 percent results in a depreciation rate allowance of negative 0.11 percent (0.05 divided by 44 years). Based on the Company's year-end 2008 plant balance for Mains of \$375,529,186, this depreciation rate correlates with an annual net salvage amount of positive \$413,000. The Company's net salvage for Mains has averaged negative \$450,000 over the last five years, as shown in Schedule TJS-3. This is comparable to a 0.12 percent depreciation rate net salvage allowance.

Q. What depreciation rate are you recommending that the Company use for Account 376 - Mains?

1 A. I am recommending that the Company use a depreciation rate of 2.39 percent.
2 This is based on an ASL of 44 years ($1/44$ equals 2.27 percent) plus a negative
3 net salvage allowance of 0.12 percent (\$450,000 divided by \$375,529,186).

4 **Q. Does this conclude your prepared direct testimony related to Mains?**

5 A. Yes, it does.
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TRANSPORTATION EQUIPMENT

Q. What is the current depreciation rate for Account 392 – Transportation Equipment?

A. Based on the Stipulation and Agreement in the Company's last rate case in Case No. GR-2006-0422, the current depreciation rate is 7.83 percent. This is a total depreciation rate (including both ASL and net salvage) based on an ASL of 11.5 years and a positive net salvage allowance of 10 percent. The current rate consists of two components, 8.70 percent based on a 11.5 year ASL (1/11.5) minus 0.87 percent based on a positive 10 percent net salvage allowance (0.10/11.5).

Q. Does this depreciation rate provide a reasonable match with the useful life of the property?

A. No, it does not. At the time of the last rate case and at the time of my 2005 Report, the Company primarily leased automobiles and small trucks. As discussed more fully in the direct testimony of Michael R. Noack, the Company is now purchasing automobiles and small trucks. At the time of the last rate case and my 2005 Report, Account 392 consisted almost exclusively of heavy trucks. The life characteristics of small and large vehicles are significantly different.

Q. What is the ASL you are recommending for Transportation Equipment?

A. I am recommending that the Company establish separate sub-accounts for small and large vehicles. Account 392.1 would consist of passenger cars, light trucks, and sport utility vehicles (SUVs) and Account 392.2 would consist of heavy trucks. By establishing the separate sub-accounts, the Company will be able to

1 more precisely recognize the difference in life characteristics between these two
2 classes of vehicles.

3 As shown in Schedule TJS-4, the Company's standard for the vehicles
4 comprising Account 392.1 is 6 years. Also shown in Schedule TJS-4 is the result
5 of our retirement analysis of the heavy trucks, which make up the historical
6 Account 392 and will make up the proposed Account 392.2, showing an ASL of
7 10.5 years.

8 **Q. Does the net salvage allowance underlying the current depreciation rate for**
9 **Transportation Equipment reflect the Company's recent experience?**

10 A. No, it does not. The current allowance is equal to a positive 10 percent. The
11 Company's recent experience is equal to 20 percent.

12 **Q. What depreciation rate are you recommending that the Company use for**
13 **Transportation Equipment?**

14 A. I am recommending that the Company use a depreciation rate of 13.33 percent
15 for Account 392.1. This is based on an ASL of 6 years ($1/6$ equals 16.66
16 percent) minus a positive net salvage allowance of 3.33 percent ($0.20/6$). I am
17 recommending that the Company use a depreciation rate of 7.62 percent for
18 Account 392.2. This is based on an ASL of 10.5 years ($1/10.5$ equals 9.52
19 percent) minus a positive net salvage allowance of 1.90 percent ($0.20/10.5$).

20 **Q. Does this conclude your prepared direct testimony related to Transportation**
21 **Equipment?**

22 A. Yes, it does.
23

1 **Q. Are you making any other depreciation rate recommendations?**

2 A. Not at this time.

Expert Witness Testimony of Thomas J. Sullivan

- Peoples Natural Gas Company of South Carolina, South Carolina Public Service Commission Docket No. 88-52-G (1988). Natural gas utility revenue requirements and rate design.
- Peoples Natural Gas (UtiliCorp United, Inc.), Iowa Utilities Board Docket No. RPU-92-6 (1992). Natural gas utility class cost of service study and peak day demand requirements.
- Peoples Natural Gas (UtiliCorp United, Inc.), Kansas Corporation Commission Docket No. 193,787-U (1996). Natural gas utility class cost of service study, rate design, and peak day demand requirements.
- Southern Union Gas Company, Railroad Commission of Texas Gas Utilities Docket No. 8878 (1998). Natural gas utility depreciation rates.
- Southern Union Gas Company, City of El Paso (1999). Natural Gas utility depreciation rates.
- UtiliCorp United, Inc., Kansas Corporation Commission Docket No. 00-UTCG-336-RTS (1999). Natural gas utility weather normalization, class cost of service, and rate design.
- Philadelphia Gas Works, Pennsylvania Public Utility Commission Docket No. R-00006042 (2001). Natural gas utility revenue requirements.
- Missouri Gas Energy, Missouri Public Service Commission Docket No. GR-2001-292 (2001). Natural gas utility depreciation rates.
- Aquila Networks, Iowa Utilities Board Docket No. RPU-02-5 (2002). Natural gas utility class cost of service study, rate design, and weather normalization adjustment.
- Aquila Networks, Michigan Gas Utilities, Michigan Public Service Commission Case No. U-13470 (2002). Natural gas utility class cost of service study, rate design, and weather normalization adjustment.
- Aquila Networks, Nebraska Public Service Commission Docket No. NG-0001, NG0002, NG0003 (2003). Natural gas utility weather normalization adjustment.
- Aquila Networks, Missouri Public Service Commission Docket No. GR-2003 (2003). Natural gas utility class cost of service study, rate design, annualization adjustment, and weather normalization adjustment.
- North Carolina Natural Gas, North Carolina Utilities Commission Docket No. G-21-Sub 442 (2003). Filed intervenor testimony on behalf of the municipal customers regarding natural gas cost of service and rates related to intrastate transmission service.

- 1 • Texas Gas Service Company, Division of ONEOK, Railroad Commission of Texas Gas
2 Utilities Docket No. 9465 (2004). Natural gas utility depreciation rates.
- 3 • Missouri Gas Energy, Missouri Public Service Commission Docket No. GR-2004-
4 0209 (2004)
5 Natural gas utility depreciation rates.
- 6 • Aquila Networks, Kansas Corporation Commission Docket No. 05-AQLG-367-RTS (2004).
7 Natural gas utility weather normalization, class cost of service, and rate design.
- 8 • Aquila Networks, Iowa Utilities Board Docket No. RPU-05-02 (2005). Natural gas utility
9 class cost of service study, rate design, grain drying adjustment and weather normalization
10 adjustment.
- 11 • PJM Interconnection, LLC, Federal Energy Regulatory Commission Docket No. ER05-1181
12 (2005). Operating cash reserve requirements.
- 13 • Kinder Morgan, Inc., Wyoming Public Service Commission Docket No. 30022-GR-6-73
14 (2006). Natural gas utility weather normalization adjustment, development of load factors,
15 billing cycle adjustment, determination of test year billing units and revenues, and
16 depreciation rates.
- 17 • Missouri Gas Energy, Missouri Public Service Commission Docket No. GR-2006-
18 0422 (2006). Natural gas utility depreciation rates.
- 19 • Kinder Morgan, Inc., Nebraska Public Service Commission Docket No. NG-0036 (2006).
20 Natural gas utility weather normalization adjustment, test year billing determinants and
21 revenues under existing rates, customer and usage trends and rate design.
- 22 • Aquila Networks, Kansas Corporation Commission Docket No. 07-AQLG-431-RTS (2006).
23 Natural gas utility class cost of service study, rate design, irrigation adjustment, and weather
normalization adjustment.
- Aquila Networks, Nebraska Public Service Commission Docket No. NG-0041-RTS (2006).
Natural gas utility jurisdictional and class cost of service study, rate design, and revenue
synchronization adjustment.
- Zia Natural Gas Company, New Mexico Public Regulation Commission Case No. 08-00036-
UT (2008). Natural gas utility billing determinants and revenues, weather normalization
adjustment, customer growth adjustment, peak day analysis, revenue requirement, class cost
of service study, and rate design.
- SourceGas Distribution, LLC, The Public Utilities Commission of the State of Colorado
Docket No. 08S-0108G (2008). Natural gas utility weather normalization adjustment,
irrigation adjustment, group load factor analysis, therm billing, test year billing determinants
and revenues, and trends in customer usage.

- 1 • Black Hills/Iowa Gas Utility Company, LLC (fka Aquila Networks), Iowa Utilities Board
2 Docket No. RPU-08-3 (2008) Natural gas utility weather normalization adjustment, grain
3 drying adjustment, revenue synchronization adjustment, class cost of service study, and rate
4 design.
- 5 • Black Hills/Colorado Gas Utility Company, LLC (fka Aquila Networks), The Public Utilities
6 Commission of the State of Colorado Docket No. 08S-430G (2008) Natural gas utility
7 weather normalization, revenue synchronization adjustment, customer reclassification,
8 thermal billing, test year billing determinants, revenues under existing and proposed rates,
9 class cost of service study, and rate design.
- 10 • Wyoming Gas Company, Wyoming Public Service Commission Docket No 30009-48-GR-8
11 (2008) Natural gas utility weather normalization adjustment, test year billing determinants,
12 revenues under existing and proposed rates, rate of return, revenue requirement, class cost of
13 service study, and rate design.