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Witness: Gregory E. Macias
Sponsoring Party: MoPSC Staff
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Case No.: ER-2004-0570
Date Testimony Prepared: November 4, 2004

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

FILED³

DEC 2 8 2004

REBUTTAL TESTIMONY Missouri Public
Service Commission

OF

GREGORY E. MACIAS

EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2004-0570

Jefferson City, Missouri
November 2004

Exhibit No. 55
Case No(s) ER-2004-0570
Date 12-08-04 Rptr EF

BEFORE THE PUBLIC SERVICE COMMISSION

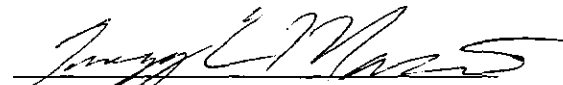
OF THE STATE OF MISSOURI

In The Matter of the Tariff Filing of The Empire)
District Electric Company to Implement a)
General Rate Increase for Retail Electric)
Service Provided to Customers in its Missouri)
Service Area.)
Case No. ER-2004-0570

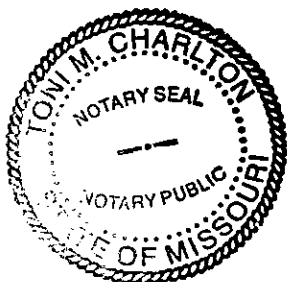
AFFIDAVIT OF GREGORY E. MACIAS

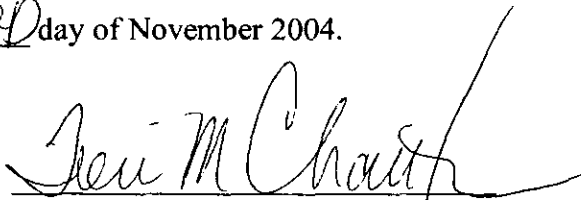
STATE OF MISSOURI)
)
COUNTY OF COLE) ss.

Gregory E. Macias, being of lawful age, on his oath states: that he has participated in the preparation of the following rebuttal testimony in question and answer form, consisting of 7 pages to be presented in the above case; that the answers in the following rebuttal testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.


Gregory E. Macias

Subscribed and sworn to before me this 30th day of November 2004.




Notary

TONI M. CHARLTON
NOTARY PUBLIC STATE OF MISSOURI
COUNTY OF COLE
My Commission Expires December 28, 2004

REBUTTAL TESTIMONY

OF

GREGORY E. MACIAS

EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2004-0570

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1 “relative low existing depreciation rates”; 2) the production plant final retirement dates; and
2 3) the effects of negative net salvage (i.e., cost of removal).

3 **EXISTING DEPRECIATION RATES AND REMAINING LIFE METHOD OF**
4 **ADJUSTMENT**

5 Q. Please comment on the existing depreciation rates.

6 A. Mr. Roff believes that Empire’s depreciation rates, ordered in Case No.
7 ER-2002-424, are inappropriate due to the relative magnitude of other utilities’ depreciation
8 rates. This comparison has no validity due to the numerous factors influencing a company’s
9 depreciation rate. The only conclusion that can be drawn from these comparisons is that some
10 companies are currently generating relatively more cash flow from depreciation than others.
11 Furthermore, Mr. Roff does not indicate whether the comparison utilities’ depreciation rates
12 have a component for cost of removal or salvage. In fact, the depreciation rates of Kansas
13 City Power and Light include a component for cost of removal and salvage. A comparison of
14 Empire’s depreciation rates to Kansas City Light and Power’s depreciation rates is one of
15 apples to oranges.

16 Q. Please explain how the existing depreciation rates are affecting Mr. Roff’s
17 recommended annual depreciation expense.

18 A. Mr. Roff uses the remaining life method of adjustment to develop his
19 depreciation rates and resulting depreciation expense. In addition to the recovery of the
20 original cost of investment, the remaining life method of adjustment recognizes any
21 depreciation reserve imbalance and adjusts the depreciation rate to eliminate that imbalance
22 over the estimated remaining life of the account. A depreciation reserve imbalance is the
23 difference between the booked depreciation reserve and the calculated theoretical reserve.

1 Mr. Roff has testified that the Company is experiencing a deficient level of
2 accumulated reserve for depreciation due to his assertion that the existing depreciation rates
3 are too low and have been generating an insufficient amount of annual depreciation expense.
4 The reason Mr. Roff calculated a theoretical reserve that is much greater than the accumulated
5 reserve for depreciation for the mass property accounts is because he has included an
6 excessive amount of estimated cost of removal. Mr. Roff is recommending the use of
7 remaining life depreciation rates to increase annual depreciation expense to make up this
8 purported deficiency over the remaining lives of the accounts. It is important to understand
9 that the depreciation reserve deficiency for mass property accounts only exists because of the
10 inclusion of cost of removal into the depreciation calculation.

11 Based on a theoretical reserve calculated using Staff's average service lives, the
12 accumulated reserve for depreciation for mass property accounts has over-accrued
13 \$61 million.

14 For production plant accounts, in addition to excessive cost of removal, the period
15 over which depreciation expense is to be collected has been significantly shortened due to a
16 shortening of service life. This life span treatment further escalates the theoretical reserve for
17 production plant accounts and is an additional component of the reserve deficiency.

18 **LIFE SPAN RETIREMENT DATES**

19 Q. Your second point of rebuttal is the proposed final retirement dates for the
20 production plants. What is your primary disagreement?

21 A. Mr. Roff proposes final retirement dates for Empire's production facilities that
22 are unsubstantiated and unreasonable. His recommended depreciation rates are designed for
23 the final retirements of all of Empire's coal fired generation by 2014. Neither Mr. Roff nor

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1 the Company have demonstrated that the Company has planned for the replacement of the
2 approximately 382 MW of capacity that will be lost by the final retirement of every coal fired
3 generation facility that the Company owns. Additionally, I believe that it is noteworthy to
4 mention that while Mr. Roff testifies that Company personnel told him the estimated dates of
5 retirement for the production plants, there isn't a single Company employee who has provided
6 sworn testimony regarding the final retirement of any production plant.

7 Staff witness Guy C. Gilbert, PE, RG, has addressed the issue of production plant final
8 retirement dates in greater detail in his rebuttal testimony that he is filing in this docket.

9 **COST OF REMOVAL**

10 Q. Mr. Roff discusses the effect of negative net salvage as an element of the
11 increase in annual depreciation expense. Could you please define negative net salvage?

12 A. Negative net salvage occurs when the cost of removal exceeds gross salvage;
13 net salvage being gross salvage less cost of removal. Gross salvage is the recovered
14 marketable value of retired plant. Cost of removal is the cost associated with the retirement
15 from service and disposition of plant. Negative net salvage is sometimes also referred to as
16 net salvage expense; however, for clarity I will refer to negative net salvage as cost of
17 removal net of salvage.

18 Q. Mr. Roff states that the existing depreciation rates are understated because the
19 cost of removal net of salvage has been improperly recognized in the past. Do you agree?

20 A. No. The currently ordered depreciation rates are appropriate because they are
21 designed to recover the company's investment in plant over the average used and useful life
22 of the various plant accounts. The same is true about the depreciation rates that I
23 recommended in my direct testimony.

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1 Q. How is the cost of removal net of salvage currently recognized?

2 A. Currently, the Company is collecting in rates an amount for cost of removal
3 that reflects the amount the Company was experiencing at the time of the last rate case. The
4 Staff's position is that the Company should continue to collect in rates the costs associated
5 with the removal of plant after its useful life, and that the amount should be based on the costs
6 that the Company is currently experiencing. The amount of cost of removal net of salvage
7 that the Staff believes is appropriate was presented in the direct testimony of Staff Auditor
8 Leasha Teel.

9 Q. How does Mr. Roff propose to collect cost of removal for the Company?

10 A. Mr. Roff has proposed to collect in rates an amount for cost of removal that is
11 speculated to occur far into the future. The means by which he estimates this speculative
12 occurrence of removal cost is unproven and not substantiated by empirical evidence.

13 Q. How are the speculative cost of removal and gross salvage calculated in
14 Mr. Roff's depreciation study?

15 A. Historical data is used to calculate a ratio of the current cost of removal
16 amount divided by the original cost of plant associated with regular retirements in a year (cost
17 of removal percent) and a ratio of the current gross salvage amount divided by the original
18 cost of plant associated with regular retirements in the same year (gross salvage percent). The
19 gross salvage percent less the cost of removal percent is the net salvage percent experienced
20 in that year. The company is proposing to use the cost of removal and gross salvage
21 percentages for the past 5, 10 or 15 years, depending on the account, as a basis for predicting
22 the cost of removal and gross salvage that will be experienced by current plant in service for
23 decades into the future.

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1 Q. Why are you opposed to using Mr. Roff's formula for calculating future cost of
2 removal net of salvage?

3 A. This formula is not substantiated by any empirical evidence and the Company
4 provides no evidence of the formula's accuracy or reliability. I am not aware of any report or
5 study establishing that the cost of removal net of salvage many decades into the future can be
6 accurately determined by this method. Some argue that because past estimates of present cost
7 of removal using this formula were too low, the formula must result in a conservative estimate
8 of actual future events. However, explaining that previous estimates for future cost of
9 removal were too low only demonstrates that the method and procedure for predicting the
10 amount is flawed. This argument would have you believe that even though you arrive at the
11 "wrong answer," the formula is "proven" because the sign is right.

12 Q. Are you saying that applying this formula to the Company's historical records
13 can't possibly accurately predict future cost of removal net of salvage?

14 A. Yes. Distant future events such as the compound rate of inflation,
15 environmental regulations and technological advances cannot be predicted, nor can it be
16 assumed that historical patterns will be consistently repeated.

17 Furthermore, future practices may not necessitate the removal of plant in the same
18 manner as today, if at all. Retired plant could be sold or abandoned in place. There is no
19 assurance that plant will in fact be removed or that the Company will actually experience any
20 cost of removal expense. It is not appropriate to increase depreciation rates to allow Empire
21 to build large reserves for costs it may or may not experience, at some unspecified date, far
22 into the future.

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1 Q. Are there other benefits to the currently ordered method of expensing current
2 cost of removal and gross salvage?

3 A. Yes. The Staff method currently in place reduces the risk that customers will
4 overpay for the future, unknown, cost of removal that may or may not be experienced.

5 Mr. Roff's proposal is that the Company collect far more money in rates for cost of
6 removal today than is currently being spent. Therefore, at some point in the future, the
7 Company will be collecting less money in rates for cost of removal than is required to be
8 spent at that time, assuming the intention is to only collect the amount of money necessary to
9 retire and remove plant.

10 In other words, if Empire is building its depreciation reserve today to fund future
11 retirements, by collecting more money than it is spending, the Company will have to draw
12 down the depreciation reserve at some point in the future when retirements are made. At that
13 time, Empire will be collecting less money for cost of removal from its customers than is
14 needed. There is no indication that Empire is retaining the current customer-supplied cash
15 until the time it will be needed.

16 The Staff's method currently in place relieves future Company management of the
17 burden of collecting less money in rates than the cost of removal net of salvage at some time
18 in the future.

19 Q. Does this conclude your rebuttal testimony?

20 A. Yes.