change in the future, which would change the ELG blocking assumed in prior accounting periods.

Q. AREN'T YOU IMPOSING AN UNREALISTIC CONSTRAINT BY PROPOSING THAT THE ACCUMULATED PROVISION FOR DEPRECIATION BE MAINTAINED IN SUCH DETAIL?

A. I am putting no greater unrealistic constraint on the accumulated provision for depreciation that is warranted under the concept of maintaining some form of consistency in the depreciation process. In other words, if the Company chooses the ELG life calculation, it should also be required to be consistent both in the salvage area and in the accumulated provision for depreciation.

Q. ARE YOU THE ONLY ONE RECOGNIZING THAT A PROBLEM EXISTS WITH ELG DUE TO THE ACCUMULATED PROVISION FOR DEPRECIATION?

A. No. The Federal Communications Commission ("FCC") expressed concern regarding the coordination between the life analysis and the accumulated provision for depreciation if ELG were utilized. The FCC in Docket No. 20188 stated:

> Application of the equal life group procedure requires maintenance of investment and reserve for depreciation data on a vintage level of investment basis. At the present time, AT&T does not have book reserve for depreciation balances at even the plant account or category of investment level, let alone the more desegregated vintage level. Under such conditions, it would appear to be impractical to attempt to change to ELG methods for presently embedded plant. (Emphasis added).

Moreover, the FERC staff recognizes the same problem. The Company's prior depreciation consultant stated the following in a presentation made in 1990:

> The Staff goes beyond what, in my view, can be supported by the above instructions, by imposing a requirement that the reserve for accumulated depreciation provisions be recorded by vintage when ELG rates are used.[3]

Q. DOES THE COMPANY'S INCONSISTENCY BETWEEN THE LIFE ANALYSIS, THE SALVAGE AND ACCUMULATED PROVISION AREAS OF THE DEPRECIATION ANALYSIS RESULT IN INAPPROPRIATE DEPRECIATION RATES?

A. Yes. While a depreciation rate can be developed using any combination of appropriate and/or inappropriate methodologies, procedures and techniques, the role of the regulator is to determine if the result is appropriate given all the various factors which comprise the depreciation rate. I would submit that it is inappropriate to allow the inconsistent application of an ELG process for only the life component of the depreciation analysis, and to then commingle this with an ALG salvage analysis and account for both components on an ALG accumulated provision for depreciation basis. What transpires is the Company first reaps a benefit by receiving depreciation expense on a more accelerated basis under ELG than under ALG for the life analyses. The Company reaps yet a second advantage by performing the salvage analysis on an ALG basis which has a tendency to underestimate the level of recoverable dollars due to salvage in the earlier years of retirement and plant. Finally, to maintain the accumulated provision for depreciation on an average basis ignores the theory behind ELG depreciation, that is to match on a precise basis the retirement of specific investment over the life of the property. By developing a depreciation rate that relies on only one ELG component (life) and employs two ALG components (salvage and reserve), the theory upon which ELG is based, is shattered.

[3] Company's response to Cities' 1st, Question 51, Attachment 2, page 5 of 16 in Docket No. 12820 before the Public Utility Commission of Texas.

SUMMARY

Q. PLEASE SUMMARIZE YOUR TESTIMONY REGARDING THE USE OF ELG DERIVED DEPRECIATION RATES?

A. ELG derived depreciation rates in theory represent possibly the most accurate measurement of depreciation over time, but only under the assumption of perfect forecasting for up to 100 years into the future. However, many things do not translate from the theoretical world to the real world in a manner that allows their actual usage. ELG is one such theoretical approach that cannot meet the reasonableness test for application in utility ratemaking proceedings. The ELG procedure magnifies the inevitable errors that exist when one forecasts occurrences into the future. This magnification of the error defeats the theoretical basis for employing ELG, that is the attempt to match the consumption of the value of the item in question to the customer receiving the benefit from such investment and in effect provides a continuous erratic pattern of recovery of investment through depreciation.

The ELG procedure not only requires perfect future forecasting, but does so in a manner which ignores the imprecise selection process of the ASL and dispersion curve it relies upon. The establishment of an ASL and dispersion curve is predicated on the commingling of hundreds, if not thousands, of transactions over many decades. The analysis of historic data further assumes the ASL and dispersion curve is representative of all historical plant on average. The proponents of ELG conveniently forget that an energy utility's investments are comprised of numerous different types of material which do have different life characteristics. The Company's investment in different types of plant with their corresponding different life characteristics is but another of the myriad of averaging assumptions and approximations that are required in depreciation analysis. When a depreciation analyst estimates the future, the analyst should not forget the past upon which projections have been predicated.

The ELG process suffers from yet another major flaw as presented by the Company. That flaw is that it does not correlate the life and salvage analysis under the same premises. In

other words, the Company is more than willing to establish life analysis on ELG calculation procedures in order to increase the level of depreciation expense from that normally obtained from an ALG calculation procedure. However, the Company is also more than happy to rely on an equivalent ALG concept in developing the net salvage component of the depreciation rate. Thus, the final rate becomes a conceptual mixture of both ELG and ALG, both to the benefit of the Company versus that of the customers.

As with the deficiency of ELG in relationship to the salvage analysis, the ELG procedure also suffers from the inappropriate reliance on average levels of accumulated provision for depreciation rather than precise equal life group blockings. Once again, this inconsistent application of depreciation parameters, which are indirectly interrelated in the development of a final depreciation rate, only serves to distort the final process.

The ELG procedure also does not properly comport with the matching principle. Customers pay a disproportionate level of depreciation and return on investment necessary to serve them over the life of the investment. Even though ELG depreciation may result in ratepayers paying less total nominal dollars over time, this relationship does not necessarily hold true on a present value basis. Thus, ELG also fails from a fairness and reasonable basis to ratepayers over time.

Finally, the Commission should recognize that the Company's outside depreciation witness, Mr. Spanos, believes that ALG based depreciation rates also produces appropriate and acceptable results. Mr. Spanos is testifying to ALG depreciation during before this same Commission in the EPE case. I strongly recommend that the Commission recognizes that all parties in this proceeding believe ALG is a reasonable approach to depreciation, while only the Company believes that ELG is a fair and just basis to charge depreciation to customers. I believe that ELG fails from so many different aspects as requested in this proceeding that this Commission should continue its position, which is the same position taken by the vast majority of other states and energy utility companies which do not utilize ELG for depreciation purposes, and again deny the request for ELG calculated depreciation rates.