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APPLICATION OF EL PASO ELECTRIC COMPANY TO CHANGE RATES	§	BEFORE THE STATE OFFICE
	§	OF
	§	ADMINISTRATIVE HEARINGS

REBUTTAL TESTIMONY

OF

JOHN J. SPANOS

FOR

EL PASO ELECTRIC COMPANY

NOVEMBER 19, 2021

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EXHIBITS

I. Introduction and Qualifications

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is John J. Spanos. My business address is 207 Senate Avenue, Camp Hill, Pennsylvania.

Q. HOW ARE YOU EMPLOYED?

A. I am employed by Gannett Fleming Valuation and Rate Consultants, LLC ("Gannett Fleming") as President.

Q. ARE YOU THE SAME JOHN J. SPANOS WHO SUBMITTED DIRECT TESTIMONY ON BEHALF OF EL PASO ELECTRIC COMPANY?

A. Yes, I am. I am also providing this rebuttal testimony on behalf of El Paso Electric Company ("EPE" or the "Company").

II. Purpose and Summary of Rebuttal Testimony

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to respond to the depreciation related issues of Public Utility Commission of Texas Staff ("Staff") witness Heidi Graham and City of El Paso ("CEP") witness David J. Garrett.

Q. WHAT RECOMMENDATIONS HAVE BEEN MADE BY EACH WITNESS?

A. Ms. Graham recommends the exclusion of interim retirements in the development of depreciation rates for production plant. Mr. Garrett also recommends the exclusion of interim retirements, which is a different practice from what he proposes in other jurisdictions. In addition, Mr. Garrett recommends four different service life estimates and seven different net salvage percentages for mass property accounts from those proposed by the Company in the Depreciation Study that I conducted and described in my direct testimony.

Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.

A. In my testimony, I will address the various proposals made by each witness. I will explain how the recommendations in my direct testimony represent the best estimates of future service lives and net salvage percentages for the Company's assets. Specifically, I will address:

- Interim Retirements: Both Ms. Graham and Mr. Garrett recommend the exclusion of interim retirements from depreciation expense. Interim retirements are the retirements of assets for life span property, such as a power plant, that occur prior to the final retirement of the entire facility. While past precedent of the Commission has been to exclude interim retirements from depreciation, this precedent is inconsistent with the practices of all other jurisdictions in the country, with authoritative depreciation texts, and with the Federal Energy Regulatory Commission ("FERC") Uniform System of Accounts. Further, the Commission's precedent is, at this point, over 30 years old. Experience in the industry over the past 30 years has demonstrated that interim retirements have and will occur for facilities such as power plants. The costs of assets to be retired as interim retirements must, therefore, be recovered over their service lives by including interim retirements in depreciation expense. Exclusion of interim retirements from depreciation expense in this case will produce intergenerational inequity by deferring these costs to be paid by future customers who receive no benefit from these assets.

- Mass Property Service Lives and Net Salvage: Mr. Garrett has recommended different service life and net salvage estimates for some mass property accounts. The process of estimating service lives for mass property (for example, transmission and distribution plant accounts) incorporates statistical life analysis but must also make sense by including informed judgment. The same is true for the estimation of net salvage. The changes proposed by Mr. Garrett to many of the mass property accounts are based primarily on statistical analysis of historical data and do not apply adequate practical judgment of the assets studied.

III. Interim Retirements

Q. YOU HAVE EXPLAINED IN YOUR DIRECT TESTIMONY THAT INTERIM RETIREMENTS MUST BE INCLUDED IN ORDER TO BE CONSISTENT WITH AUTHORITATIVE DEPRECIATION TEXTS AS WELL AS THE UNIFORM SYSTEM OF ACCOUNTS. WHAT JUSTIFICATION HAS BEEN PRESENTED TO SUPPORT MS. GRAHAM'S AND MR. GARRETT'S POSITIONS THAT INTERIM RETIREMENTS SHOULD NOT BE INCLUDED?

A. The only justification Ms. Graham and Mr. Garrett offer for their recommended exclusion of interim retirements is prior Commission precedent regarding interim retirements.

Neither Ms. Graham nor Mr. Garrett have provided any other reason to support continuation of this precedent, and they fail to address the fact that exclusion of interim retirements from depreciation expense contradicts depreciation authorities, the FERC Uniform System of Accounts, and the practice of every other jurisdiction in the country.

Because there is no basis other than Commission precedent to support Ms. Graham's and Mr. Garrett's positions, a review of prior Commission decisions is important to explain why the Commission should reconsider the issue of interim retirements. There is no reason to continue a precedent that is no longer supported by facts and based on decisions that were made more than three decades ago. Further, industry experience over the past 30 years shows that not only do interim retirements occur, but also that they can be significant, as illustrated in the example provided in my direct testimony (pages 14-20). Excluding interim retirements from depreciation expense fails to achieve the objective of allocating costs over an asset's service life and instead defers costs to future customers resulting in intergenerational inequity.

Q. MS. GRAHAM AND MR. GARRETT CITE TO VARIOUS CASES IN THEIR DIRECT TESTIMONIES THAT SUPPORT THE COMMISSION'S PRIOR TREATMENT OF INTERIM RETIREMENTS. WHAT REASONS WERE PROVIDED IN THOSE CASES FOR EXCLUDING INTERIM RETIREMENTS?

A. As I discussed in my direct testimony, Docket Nos. 8425 and 8431 were decided based on a false assumption that interim retirements were not "known and measurable."[1] Experience has proven this assumption incorrect. The orders in Docket No. 40443 and the Southwestern Public Service Company case referenced in Mr. Garrett's testimony have simply relied on the prior rulings in Docket Nos. 8425 and 8431 to guide their decision-making. Continuing to rely on precedent that has been proven incorrect is not responsible, particularly when it results in future customers paying for assets that do not provide them service.

[1] *Application of Houston Lighting & Power Co. for Authority to Change Rates,* Docket No. 8425, Order (June 20, 1990) at Finding of Fact No. 212; *Application of Houston Lighting & Power Co. for a Final Reconciliation of Fuel Costs through September 30, 1988*, Docket No. 8431, Order (June 20, 1990) at Finding of Fact No. 212.

Q. MR. GARRETT HAS CHALLENGED THE USE OF INTERIM RETIREMENTS IN THIS CASE. DOES HE DISAGREE IN PRINCIPLE WITH THE INCLUSION OF INTERIM RETIREMENTS IN DEPRECIATION?

A. No. Apparently he does not disagree with the inclusion of interim retirements in depreciation expense, because he has recommended estimates for interim retirements in many proceedings in other jurisdictions including for EPE in its New Mexico jurisdiction which sets forth the same asset base.[2] While he typically proposes different estimates than those proposed by the utility in those cases, he usually includes interim retirements in depreciation. Mr. Garrett's approach in this case is, therefore, inconsistent with his approach in most if not all other jurisdictions. Given his proposed interim retirements in other jurisdictions, Mr. Garrett does not appear to disagree with the use of interim retirements as a concept. It seems he has, instead, simply followed the Commission precedent and proposed not to use them in this case.

Q. DO YOU AGREE WITH MR. GARRETT'S ASSESSMENT THAT INCLUSION OF INTERIM RETIREMENTS WOULD RESULT IN A SUBSTANTIAL AND HARMFUL IMPACT TO CUSTOMERS[3]?

A. No. Mr. Garrett provides no support or any explanation for this statement. I believe it is far more concerning that the exclusion of interim retirements will result in intergenerational inequity as discussed in my direct testimony.

Q. DOES THE EXCLUSION OF INTERIM RETIREMENTS CREATE STRANDED COST OR INTERGENERATION INEQUITY?

A. Yes. The recovery of the recently retired plants were not fully recovered during the time the assets were in service because the authorized depreciation rates did not include the interim retirement component.

Q. WHAT IS YOUR RECOMMENDATION REGARDING INTERIM RETIREMENTS?

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[2] In the Matter of El Paso Electric Company for Revision of its Retail Electric Rates Pursuant to Advice Notice No. 267, Case No. 20-00104-UT, Direct Testimony of David Garrett at page 120, line 12-14, attached as Exhibit JJS-1R.

[3] Direct Testimony of David J. Garrett, page 19, lines 3-7.

A. Experience has shown that interim retirements can and will occur. Proper application of depreciation principles, therefore, requires that estimates of interim retirements be incorporated into depreciation rates. While Commission precedent has been to exclude interim retirements, this precedent is outdated, inconsistent with the FERC Uniform System of Accounts, out of step with all other jurisdictions, and produces intergeneration inequity. Therefore, it should now be reconsidered. In order to produce appropriate depreciation rates for production plant (and general plant structures), my recommendation is to include interim retirements in depreciation rates.

IV. Mass Property Service Life Estimates

Q. PLEASE SUMMARIZE THE DIFFERENCES BETWEEN THE COMPANY'S AND CEP'S PROPOSALS FOR PLANT SERVICE LIVES.

A. For service lives, particularly those for mass property, the Company and the CEP have estimated survivor curves that differ for four accounts. Iowa survivor curves were used by each party to estimate average service life, and each party conducted similar statistical analyses using the retirement rate method. Staff witness Ms. Graham did not disagree with the service life estimates proposed in the Depreciation Study, but the estimates proposed by CEP witness Mr. Garrett differ for two transmission and two distribution plant accounts. The estimates proposed by Mr. Garrett are not as reasonable for the types of assets studied as those I have recommended in the Depreciation Study.

Q. CAN YOU PRESENT THE DIFFERENCES IN MASS PROPERTY SERVICE LIVES FOR EACH PARTY?

A. Mr. Garrett on behalf of CEP has proposed adjustments to four mass property service life estimates as summarized in Table 1 below. The curves in this table set forth the currently approved survivor curve, the Company's proposed survivor curve and CEP's survivor curve. Staff does not propose any changes to the mass property survivor curves made in the filed Depreciation Study.

Table 1. Comparison of Mass Property Service Life estimates

Account	Current Estimate	EPE	CEP
Account 353, Station Equipment	48-R4	50-R4	58-R3
Account 356, Overhead Conductors and Devices	60-R5	60-R5	65-R4
Account 362, Station Equipment	60-R2	65-R2	71-R1.5
Account 366, Underground Conduit	57-R4	65-R4	71-R4

Q. WOULD YOU ADDRESS THE RECOMMENDATIONS OF MR. GARRETT?

A. Mr. Garrett uses similar methodology to that used in the Depreciation Study for estimating service lives of plant, but he relies heavily upon the mechanical results of statistical analysis, sometimes at the expense of critical judgment. Therefore, his estimates are outside the range of reasonable expectations for the property that was studied.

Q. YOU HAVE INDICATED THAT MR. GARRETT EMPHASIZES HIS STATISTICAL ANALYSIS TO SUPPORT HIS ESTIMATES. IS THERE REASON WHY CONSIDERATIONS BEYOND THE STATISTICAL ANALYSIS WOULD BE MORE IMPORTANT?

A. Yes. The historical data available for the statistical analysis of this property only spans a 27-year period from 1993-2019. Most of the assets studied have lives of 40 to 50 years or more, so 27 years is a relatively short period of time in comparison to the overall life cycles of most of the assets. Emphasizing the statistical results as Mr. Garrett has done, one would ideally use a significantly longer period of data (at least the length of the average life) that would clearly demonstrate the life cycle of the assets. However, since only 27 years of data are available, one must consider factors other than the statistical analysis in order to make a reasonable service life estimate.

Q. CAN YOU ILLUSTRATE AN EXAMPLE OF THE DIFFERENCES BETWEEN YOUR SERVICE LIFE ESTIMATES AND THOSE OF MR. GARRETT?

A. Yes. I will use Account 362, Station Equipment, as an example. This account includes distribution station equipment assets such as transformers, circuit breakers, capacitor banks, regulators, reclosures, electronic relays and control equipment, and bus work and

foundation. The currently approved estimate for this account is the 60-R2 survivor curve. This type curve reflects an average life of 60 years and a maximum life of 110 years. All of the types of assets in the account, except bus work and foundation, have an expected average life between 15 and 50 years. The bus work and foundation have an expected average life longer than 50 years; however, with newer types of equipment being placed in service, most bus work and foundation cannot be reused. Additionally, there have been considerable retirements during ages 20 through 40, which reflects changes in control equipment and breakers. However, the R2-type curve represents a good dispersion of all of the types of assets within the account. I have recommended a 65-R2 type curve, which is a good representation of the historical activity, is five years longer than the current average service life estimate, and reflects the anticipated life characteristics of distribution station equipment. The industry range for average service life of distribution station equipment is 45-60 years. An average service life estimate slightly beyond the upper limit is reasonable because the Company has had stable load for the assets, there has not been load upgrades of assets, and the Company's plan for how the assets will be utilized has remained consistent. In contrast, Mr. Garrett recommends an unrealistic 71 year average life, which reflects a maximum life of 138 years. Not only is this a drastic increase from the currently approved 60 year average, it is significantly above the industry range for this type of equipment and does not represent realistic life characteristics for distribution station equipment. This illustrates the flaw in Mr. Garrett's approach to life estimation.

Q. IS THERE ANOTHER ASSET CLASS TO DISCUSS RELATED TO LIFE ANALYSIS THAT SHOWS HOW MR. GARRETT'S ESTIMATES ARE FLAWED?

A. Yes. I will discuss transmission Account 353, Station Equipment. The currently approved estimate for this account is the 48-R4 survivor curve. Although the types of assets in this account are very similar to the distribution equipment in Account 362 discussed above, there are some different life expectations for some of the transmission assets. First, transmission assets have shorter replacement cycles than the comparable distribution assets due to the loads to which they are subjected. Second, the initial breakers for transmission primarily used oil. When they were installed, they were very good assets. However, there is currently a focus in the industry on replacing these assets due to the difficulty in getting

replacement parts and high maintenance costs as these assets approach 50 years of age. The replacements use gas breakers, which are not expected to last as long but will have lower maintenance costs. Third, there is a greater need for more diversity in the functionality of relay/control equipment, requiring electro-mechanical assets to be replaced by microprocessor assets. Consequently, a future life for transmission station equipment should have an overall life comparable to the 48-year life currently approved. I have estimated an average life of 50 years. In contrast, Mr. Garrett recommends an increase of 10 years to 58 years for these assets. There is nothing related to transmission substation assets that would justify his proposed increase, particularly given the type of new assets that are currently being placed in service in transmission substations. The survivor curve reflects the best estimate of future life expectancy, not an attempt to determine what resulted in the past. Mr. Garrett has only looked at historical data in developing his estimates, which is an incomplete analysis for estimating service lives.

Q. PLEASE DISCUSS MR. GARRETT'S ERROR WITH RESPECT TO HIS SERVICE LIFE ESTIMATION FOR ACCOUNT 356, OVERHEAD CONDUCTORS AND DEVICES.

A. The assets in transmission Account 356 are overhead conductors and devices, which are transmission lines supported by transmission poles in Account 355. The currently approved survivor curve for Account 356 is the 60-R5. I have recommended the continued use of the 60-R5 type curve based on the life characteristics through age 50 and the expectation that overhead conductors older than 50 years will be replaced more rapidly in the future than they have in the past due to the replacement of the generating assets from which the transmission lines originate. Additionally, the overall life cycle of overhead conductors should be similar to the poles that support them. The transmission poles have a recommended life of 55-S3, which has an overall life cycle similar to the 60-R5 curve. Mr. Garrett proposes a 65-R4 type curve, which increases the average and maximum life for this account without any consideration of the related poles. This is an error and his recommendation for this account should be rejected.

Q. CAN YOU EXPLAIN WHY MR. GARRETT'S LIFE ESTIMATE FOR ACCOUNT 366, UNDERGROUND CONDUIT, IS UNREALISTIC?

A. Yes. The assets in distribution Account 366 relate to underground conduit that protects underground conductors. The currently approved estimate is a 57-R4 type curve. In recent years, there has not been a high level of retirements, which would statistically support a longer life. The dispersion of retirements has consistently supported the R4-type curve. However, given the life expectancy of the underground conductors and devices, which will have shorter lives than the conduit itself, and the expected replacement projects for conduit, an average increase of eight years is reasonable. Therefore, I recommended a 65-R4 survivor curve. However, Mr. Garrett recommends a change from the 57-R4 type curve approved in the last rate case to a 71-R4 type curve. In other words, he recommends a 14-year average increase based on a life characteristic approved five years ago. This is not realistic, is not supported by the nature of the assets, and should be rejected by the Commission.

Q. DO AUTHORITATIVE DEPRECIATION SOURCES SUPPORT YOUR ASSERTION THAT A COMPREHENSIVE DEPRECIATION STUDY SHOULD INCORPORATE FACTORS OTHER THAN STATISTICAL ANALYSIS?

A. Yes. All depreciation texts are clear that service life estimates are forecasts of future conditions. It is widely understood by depreciation professionals that exclusive reliance on the statistical analysis of historical data is inappropriate for life estimation. The National Association of Regulatory Utility Commissioners' (NARUC's) *Public Utility Depreciation Practices* specifically discusses the impropriety of relying solely on mathematical analysis of historical data in making service life estimates.

Q. DOES NARUC EXPLAIN THE IMPORTANCE OF A SUBJECTIVE COMPONENT TO ESTIMATING SERVICE LIVES?

A. Yes. NARUC makes it clear that there must be a subjective component to estimating service lives. Chapter XIII of *Public Utility Depreciation Practices*, entitled "Actuarial Life Analysis", discusses and emphasizes the subjective nature of the process of estimating

service lives. The chapter begins by explaining that analysis of historical data is only one part of the process of estimating service lives:

> Actuarial analysis objectively measures how the company has retired its investment. The analyst must then judge whether this historical view depicts the future life of the property in service. The analyst takes into consideration various factors, such as changes in technology, services provided, or capital budgets.[4]

NARUC explains that the process of estimating service lives must go beyond a simple objective measurement of the past. In describing the determination of a survivor curve estimate (referred to as the "projection life" in this passage), NARUC states:

> The projection life is a projection, or forecast, of the future of the property. Historical indications may be useful in estimating a projection life curve. Certainly the observations based on the property's history are a starting point. Trends in life or retirement dispersion can often be expected to continue. Likewise, unless there is some reason to expect otherwise, stability in life or retirement dispersion can be expected to continue, at least in the near term.
> Depreciation analysts should avoid becoming ensnared in the mechanics of the historical life study and relying solely on mathematical solutions. The reason for making an historical life analysis is to develop a sufficient understanding of history in order to evaluate whether it is a reasonable predictor of the future. The importance of being aware of circumstances having direct bearing on the reason for making an historical life analysis cannot be understated. These circumstances, when factored into the analysis, determine the application and limitations of an historical life analysis.[5]

Thus, NARUC strongly advises against the approach used by Mr. Garrett, stating clearly that "relying solely on mathematical solutions" should be avoided.

Q. HAVE YOU INCORPORATED THE VARIOUS FACTORS DISCUSSED BY NARUC INTO YOUR SERVICE LIFE ESTIMATES?

A. Yes. In support of the Depreciation Study, I conducted site visits and had discussions with various EPE personnel to familiarize myself with the Company's assets. I have also performed depreciation studies for the Company in the past and have incorporated information obtained from those studies in the current study. In addition, throughout my

[4] National Association of Regulatory Utility Commissioners, *Public Utility Depreciation Practices*, 1996, p. 111.
[5] National Association of Regulatory Utility Commissioners, *Public Utility Depreciation Practices*, 1996, p. 126. Emphasis added.

career of over 35 years in depreciation analysis, I have performed hundreds of depreciation studies, in a similar manner, for many utility companies. I incorporated the knowledge obtained from this experience into my recommendations.

Q. ARE THERE OTHER COMPONENTS OF THE SURVIVOR CURVES RECOMMENDED BY MR. GARRETT THAT NEED TO BE CONSIDERED?

A. Yes. The average life component of the survivor curve is not the only aspect of Mr. Garrett's curve that needs to be considered. The most appropriate survivor curve for an asset class includes not only the average service life, but the type curve and the maximum life. An example is Account 362, Station Equipment, where Mr. Garrett recommends a 71-R1.5 type curve. This account reflects transformers, circuit breakers, electronic relay equipment, regulators, and capacitor banks. None of these assets have an expected average life of 71 years, and the 71-R1.5 type curve also anticipates a maximum life of 138 years. This is unreasonable for the type of assets in the distribution substation account.

Q. WHAT IS YOUR RECOMMENDATION REGARDING THE SERVICE LIFE ESTIMATES IN THIS CASE?

A. Because of their limited basis, I recommend that the service life changes proposed by Mr. Garrett be rejected, and that the estimates proposed in the Depreciation Study be accepted for use by the Company. The estimates provided in the Depreciation Study are based on thorough analysis of the available data as well as consideration of the real-life characteristics of the assets studied and future expectations for those assets.

V. Mass Property Net Salvage Estimates

Q. CAN YOU SUMMARIZE EACH PARTY'S POSITION ON NET SALVAGE ESTIMATES FOR MASS PROPERTY?

A. Mr. Garrett has proposed adjustments to several net salvage percentage estimates as summarized in Table 2 below. The numbers in this table set forth the percentage of original cost that will be required to be expended to retire and salvage the associated plant in service. Staff does not propose any changes to the net salvage estimates made in the filed Depreciation Study.

Table 2: Comparison of Net Salvage Estimates

Account	Current Estimate	EPE (Spanos)	CEP (Garrett)
Account 355, Wood and Steel Poles	(25)	(20)	(15)
Account 356, Overhead Conductors and Devices	(10)	(15)	(10)
Account 362, Station Equipment	(2)	(5)	0
Account 364, Poles, Towers and Fixtures	(20)	(30)	(25)
Account 366, Underground Conduit	(10)	(5)	0
Account 368, Line Transformers	(5)	(15)	(10)
Account 369, Services	(15)	(15)	0

For each account, Mr. Garrett proposes a lower negative net salvage estimate than what has been proposed in the Depreciation Study, "based on a balancing of the overall historical net salvage experienced observed in each account with the more recent net salvage experience."[6]

Q. WHAT IS THE BASIS FOR THE NET SALVAGE ESTIMATES PROPOSED IN THE DEPRECIATION STUDY?

A. The net salvage percentages proposed in the Depreciation Study were estimated based on a review of the Company's historical net salvage data for the period 1993 through 2019, as well as consideration of the Company's expectations for the future and my own industry experience with the estimated net salvage used by other electric utility companies. Like the development of service life estimates, net salvage estimates are intended to model future expectations for the Company and should not be based solely on historical data. This is particularly important for net salvage estimates as there is clearly a trend toward higher removal costs required for most mass property accounts with a continued increase into the future.

Q. CAN YOU EXPLAIN WHY THE DEPRECIATION STUDY RECOMMENDATIONS FOR THE NET SALVAGE ESTIMATES ARE APPROPRIATE AND THOSE USED BY MR. GARRETT ARE NOT?

[6] Direct Testimony of David J. Garrett, page 30, lines 11-12.

A. Yes. I will use Account 364, Poles and Fixtures, as an example. The industry net salvage range for distribution poles is negative 20 to negative 100 percent. Since the previous depreciation study I performed for EPE, net salvage has averaged between negative 61 percent and negative 79 percent. This is due to the added cost of removal required to retire poles. These costs include an increased number of personnel necessary to retire these assets in compliance with significant new safety requirements. Additionally, due to environmental concerns, the market for retired poles has decreased considerably in the last several years and is expected to continue to decrease into the future. Given the combination of the statistical analysis over the last five years, the industry range, and future expectations based on safety and environmental issues, the negative 30 percent net salvage estimate used in the Depreciation Study is reasonable. In contrast, Mr. Garrett recommends only a modest change from what has been experienced in recent years, even though recent statistics support a significant increase in negative net salvage. Therefore, Mr. Garrett must either be anticipating gross salvage to increase or the recent cost of removal indications to drastically decrease. There is no support for either of these expectations, and an even greater negative estimate than the negative 30 percent used in the Depreciation Study would not be unreasonable given the nature of these assets.

Q. CAN YOU PROVIDE ANOTHER EXAMPLE TO ILLUSTRATE WHY THE NET SALVAGE ESTIMATES USED IN THE DEPRECIATION STUDY ARE MORE REASONABLE AND APPROPRIATE THAN MR. GARRETT'S?

A. Yes. Account 368, Line Transformers, is another example that emphasizes the need to employ a more appropriate process for determining a net salvage percentage than that used by Mr. Garrett. The industry net salvage percentage range for these assets is negative 5 to negative 20 percent. Since the previous depreciation study I performed for EPE, the statistical net salvage has ranged from negative 21 percent to negative 32 percent. The overall average net salvage for the 1993-2019 period was negative 13 percent and, during the most recent five years, was negative 26 percent. Therefore, the negative 15 estimate percent estimate used in the Depreciation Study is appropriate. Mr. Garrett does recognize a more negative trend, but his negative 10 percent recommendation does not have any basis

and is unreasonable given the Company's most recent retirement experience for these assets.

Q. PLEASE DISCUSS THE DIFFERENCES IN THE REMAINING FIVE ACCOUNTS RELATED TO THE NET SALVAGE PERCENTAGES RECOMMENDED BY THE DEPRECIATION STUDY AND MR. GARRETT.

A. For all five remaining accounts in which Mr. Garrett recommends a different estimate, he proposes a smaller net salvage component than those in the Depreciation Study, but he does not provide any support for his recommendation. The recommendation in the Depreciation Study are reasonable and supported by recent data, and they should be approved.

Transmission Account 355, Poles and Fixtures, currently has a net salvage percentage of negative 25 percent. The industry range is typically negative 20 percent to negative 75 percent for transmission poles. The data for the last few years reflects a reduction in net salvage percentage. However, this is due to some late recorded cost of removal in the last two years, not the elimination of cost of removal charges. Therefore, the recommendation in the Depreciation Study, which considers industry information, statistical data, and expectations of the future, is reasonable in changing from negative 25 to negative 20 percent. Mr. Garrett has unreasonably proposed a larger drop, from negative 25 to negative 15 percent, without considering the relevant factors behind the recent activity for this account.

Second, transmission Account 356, Overhead Conductors and Devices, currently has a net salvage percentage of negative 10 percent. The industry range is typically negative 15 percent to negative 60 percent for transmission overhead conductors. Similar to Account 355, there has been a delay in some of the costs of removal being recorded in the last few years; however, even with the reduced cost of removal in the last few years, the average has been negative 14 percent from 2015-2019. Therefore, a change to the bottom of the industry range of negative 15 percent, as proposed in the Depreciation Study, is reasonable. Mr. Garrett has unreasonably proposed to maintain the negative 10 percent net salvage level without any support or explanation.

Third, distribution Account 362, Station Equipment, currently has a net salvage percentage of negative 2 percent. The industry range is typically 0 percent to negative 20 percent net salvage. This account in recent years has experienced considerable gross salvage that is not expected to continue into the future. The net salvage for similar assets in transmission Account 353, Station Equipment, is negative 5 percent, and the cost of removal in recent years has increased considerably. Therefore, the Depreciation Study's recommendation of negative 5 percent, which anticipates that cost of removal will exceed gross salvage, is more appropriate than Mr. Garrett's proposal to change to zero percent for these assets.

Fourth, distribution Account 366, Underground Conduit, currently has a net salvage percentage of negative 10 percent. The industry net salvage range is quite wide. Underground conduit is expected to have greater cost of removal than gross salvage. The Depreciation Study recommends a change from negative 10 percent to negative 5 percent, reflecting the expectation that cost of removal will exceed gross salvage. Mr. Garrett proposes a zero percent net salvage, which is not realistic or supported by any explanation.

Finally, distribution Account 369, Services, currently has a net salvage percentage of negative 15 percent. The industry range for this account is also very wide, but in all cases a negative net salvage is utilized. The Depreciation Study recommends maintaining the negative 15 percent, as it is at the lower end of the industry range. Mr. Garrett has proposed the use of zero percent, which is not realistic and again is not supported.

Q. WHAT IS YOUR RECOMMENDATION REGARDING THE NET SALVAGE ESTIMATES IN THIS CASE?

A. I recommend that Mr. Garrett's proposed net salvage adjustments be rejected as they are based on a limited analysis of historical net salvage data and exclude other relevant analysis and expectations. The estimates provided in the Depreciation Study were based not just on the historical net salvage data but on practical expectations of the Company's future as well as industry experience.

VI. Mr. Garrett's Misconception of the Depreciation Study Overestimating Depreciation

Q. PLEASE ADDRESS THE CONCERNS OF MR. GARRETT RELATED TO OVERESTIMATING DEPRECIATION[7].

A. Mr. Garrett expresses concern over the possibility that, if depreciation rates are too high, they would allow a utility to recover more depreciation expense than is necessary to return its capital investment over the service lives of the utility property related to that investment and, thereby, produce an excessive depreciation reserve. Mr. Garrett claims that such excess depreciation encourages or incentivizes unnecessary replacements.

Mr. Garrett's position is based largely on a short excerpt from the United States Supreme Court decision in *Lindheimer v. Illinois Bell Telephone Co.*, 292 U.S. 151 (1934). In *Lindheimer*, the Court found that the company's depreciation was excessive and, therefore, constituted what the Court characterized as a "contribution" to the utility's "capital." The Court determined that annual depreciation allowances resulting from "studies of the behavior of large groups of items" must "meet the controlling test of experience". However, Mr. Garrett neglected to include in his testimony the two sentences in which the Court explained the "controlling test" it envisioned:

> In this instance, the evidence of expert computations of the amounts required for annual allowances does not stand alone. In striking contrast is the proof of actual condition of the plant as maintained…[8]

The concept referred to by the Court, which is generally known as "physical" or "observed" depreciation, was designed to work in tandem with the measure of "fair value" the Court had previously endorsed in *Smyth v. Ames*, 171 U.S. 361 (1898). Specifically, the Court envisioned ratemaking as a process designed to appraise the current "value" of utility property based on, for example, contemporaneous studies of the cost to reproduce that property at the price levels in effect when rates were being established. Depreciation was viewed as a part of that value-appraisal process. In short, accrued depreciation entered the equation as a component of the overall current "value" of the property forming a utility's rate base.

[7] Direct Testimony of David J. Garrett, page 8, lines 3-15.
[8] *Lindheimer*, 292 U.S. at 170

All of that changed in 1944 when the Court decided *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). In *Hope*, the Court said that, contrary to its prior decision in *Smyth v. Ames*, rate-setting authorities did not have to use the "fair value" approach to avoid "confiscating" utility property and, therefore, utility rates could be established using original cost as the appropriate measure of a utility's rate base. Since the Court's decision in *Hope*, utilities' net investment has become the primary – in fact, in the vast majority of jurisdictions, the exclusive – means of establishing a utility's rate base.

Under the net investment or "original cost" approach, a utility's rate base consists of its investment in used and useful utility property (measured by its original cost) less the amount of that investment previously returned to the utility (measured by the Accumulated Provision for Depreciation maintained on its books of account in accordance with its regulator's prescribed rules for recording depreciation). The Accumulated Provision for Depreciation reflects the past allowances for depreciation, which, when deducted from original cost, establish the net investment on which a utility is permitted to earn a return and which a utility may recover through future depreciation accruals. In short, the original cost measure of value prevents a utility from earning a return on, or a return of, anything more than its actual net investment.

Because of the fundamental change in the way rate base is determined since the *Hope* decision, physical or observed depreciation, which was at the heart of the *Lindheimer* decision, is no longer used in public utility regulation. Net investment, as previously described, has become the primary means of determining rate base. Therefore, the premise underlying Mr. Garrett's concept of "excessive" depreciation or "unnecessary replacements" is over 70 years out of date.

VII. Conclusion

Q. PLEASE SUMMARIZE THE RECOMMENDATIONS OF YOUR REBUTTAL TESTIMONY.

A. For the reasons discussed above, the Commission should adopt the depreciation rates proposed in the Company's filed Depreciation Study. Although the Commission has not previously included the use of interim retirements related to generating facilities, including interim retirements is the most appropriate method for determining depreciation rates. All

authoritative texts support the use of interim retirements for life span assets. Additionally, the service life and net salvage estimate changes proposed by CEP witness Mr. Garrett should be rejected, since they are not consistent with accepted practices of estimation and do not produce reasonable results.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes. It does.

Q. Is CLC-DAC proposing to leave the retirement dates for these facilities unchanged?

A. Yes. Please see the Direct Testimony of Mark E. Garrett for a substantive discussion regarding CLC-DAC's position regarding the retirement dates and accelerated depreciation rates proposed by EPE for these facilities.

Q. In calculating your proposed depreciation rates, what are the retirement dates you used for the generating units at issue?

A. In calculating my proposed depreciation rates, I used the following retirement dates for the generating units at issue: Newman Unit 5 – 2061; Rio Grande Unit 9 – 2058; Montana Power Station Units 1-2 – 2060; and Montana Power Station Units 3-4 – 2061.[134]

Q. Did you incorporate interim retirements in the remaining life calculation for the generating units at issue?

A. Yes. Please see Exhibit DJG-26 for my detailed remaining life calculations.

XVI. CONCLUSION AND RECOMMENDATION — DEPRECIATION

Q. Please summarize the key points of your depreciation testimony.

A. I employed a well-established depreciation system and used actuarial and simulated analysis to statistically analyze the Company's depreciable assets in order to develop reasonable depreciation rates in this case. I made adjustments to the Company's proposed service life and net salvage for several accounts. Regarding

[134] *Id.* at 3-01(d).