

Exhibit No.
Witness: James T. Selecky
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: Missouri Industrial Energy Consumers
Case No. EC-2002-1
Subject: Depreciation Rates

**Before the
Missouri Public Service Commission**

Staff of the Missouri Public Service Commission)	
)	
Complainant)	Case No. EC-2002-1
v.)	
Union Electric Company, d/b/a)	
AmerenUE)	
Respondent.)	

Rebuttal Testimony of

James T. Selecky

On Behalf of

Missouri Industrial Energy Consumers

May 17, 2002
Project 7651



BRUBAKER & ASSOCIATES, INC.
ST. LOUIS, MO 63141-2000

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

Staff of the Missouri Public Service Commission)	
)	
Complainant)	
v.)	Case No. EC-2002-1
Union Electric Company, d/b/a AmerenUE)	
Respondent.)	

STATE OF MISSOURI)
)
COUNTY OF ST. LOUIS) SS

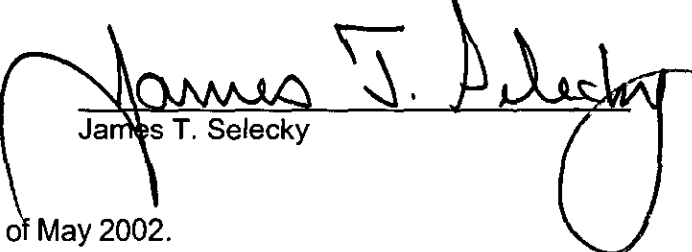
Affidavit of James T. Selecky

James T. Selecky, being first duly sworn, on his oath states:

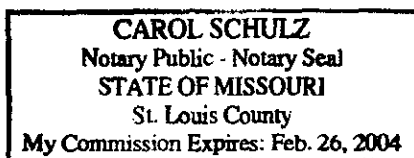
1. My name is James T. Selecky. I am a consultant with Brubaker & Associates, Inc., having its principal place of business at 1215 Fern Ridge Parkway, Suite 208, St. Louis, Missouri 63141-2000. We have been retained by the Missouri Industrial Energy Consumers in this proceeding on their behalf.

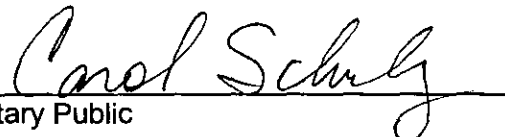
2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony which was prepared in written form for introduction into evidence in Missouri Public Service Commission Case No. EC-2002-1.

3. I hereby swear and affirm that the rebuttal testimony is true and correct and shows the matters and things it purports to show.


James T. Selecky

Subscribed and sworn to before this 16th day of May 2002.




Notary Public

My Commission Expires February 26, 2004.

**Before the
Missouri Public Service Commission**

Staff of the Missouri Public Service Commission)	
)	
Complainant)	
v.)	Case No. EC-2002-1
Union Electric Company, d/b/a AmerenUE)	
)	
Respondent.)	

Rebuttal Testimony of James T. Selecky

1 **Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 **A James T. Selecky; 1215 Fern Ridge Parkway, Suite 208; St. Louis, MO 63141-2000.**

3 **Q WHAT IS YOUR OCCUPATION AND BY WHOM ARE YOU EMPLOYED?**

4 **A I am a consultant in the field of public utility regulation and a principal in the firm of**
5 **Brubaker & Associates, Inc., energy, economic and regulatory consultants.**

6 **Q PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

7 **A These are set forth in Appendix A to this testimony.**

8 **Q ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?**

9 **A I am appearing on behalf of the Missouri Industrial Energy Consumers (MIEC). MIEC**
10 **includes many of AmerenUE's (UE or Company) largest purchasers of electricity**
11 **service.**

1 **Q ON WHAT SUBJECTS WILL YOU TESTIFY?**

2 A My testimony addresses Missouri Public Service Commission Staff's (Staff) position
3 on the treatment of net salvage for book depreciation purposes and the ratemaking
4 treatment of any accumulated depreciation reserve imbalances. The fact that I am
5 not addressing an issue should not be construed as an endorsement of the Staff's
6 position.

7 **Q WHAT METHOD, PROCEDURE AND TECHNIQUE IS THE STAFF PROPOSING**
8 **TO UTILIZE TO DETERMINE UE'S BOOK DEPRECIATION RATES?**

9 A Staff witness Jolie Mathis recommends using the straightline method, the broad
10 group procedure, and the whole life technique to calculate depreciation rates. Staff is
11 also recommending that net salvage be excluded from the development of the book
12 depreciation rates. The net salvage experience has been used to develop a net
13 salvage ratio that has, in the past, been used to calculate UE's book depreciation
14 rates.

15 **Q PLEASE DEFINE WHAT IS MEANT BY NET SALVAGE.**

16 A Net salvage is simply the value received from the sale or reuse of retired property
17 (salvage value), less the cost of retiring such property (cost of removal). Net salvage
18 can either be positive or negative. If the salvage value exceeds the cost of removal,
19 the net salvage is positive. If the cost of removal is greater, then the salvage value
20 received as a result of retirement, then the resulting net salvage is negative.

1 **Q IS STAFF PROPOSING TO EXCLUDE ALL NET SALVAGE FROM UE'S**
2 **RATEMAKING FORMULA?**

3 **A** No. Staff is proposing to remove the net salvage factor from the whole life formula
4 that is used to calculate the book depreciation rates. Net salvage cost would be
5 included as an expense in UE's revenue requirement. The level of net salvage
6 expense would be based on a current actual expense determination made by the
7 Staff.

8 **Q DO YOU SUPPORT STAFF'S PROPOSED TREATMENT OF NET SALVAGE?**

9 **A** Yes. I support excluding net salvage from the development of UE's depreciation
10 rates. The net salvage expense should be included in UE's revenue requirement as
11 an operating expense and not a component of the book depreciation rates. However,
12 I disagree with the amount of net salvage that the Staff has included in UE's revenue
13 requirement.

14 **Q WHY DO YOU SUPPORT EXCLUDING THE NET SALVAGE RATIOS FROM THE**
15 **DEVELOPMENT OF THE BOOK DEPRECIATION RATES?**

16 **A** The net salvage ratios contained in UE's current depreciation rates produce
17 excessive depreciation expense and do not reflect the current level of net salvage
18 expense that UE experiences. Arguably, including the net salvage ratio in the
19 development of the depreciation rates results in collecting future net salvage costs
20 from current ratepayers.

Q WHY DO YOU BELIEVE UE'S CURRENT NET SALVAGE RATIOS PRODUCE DEPRECIATION RATES AND EXPENSES THAT ARE EXCESSIVE?

A This is based on a comparison of the net salvage expense included in the depreciation expense with the level of net salvage expense UE actually experiences. UE's current depreciation expense contains an annual net salvage component of approximately \$27 million. However, UE's actual net salvage expense is approximately \$8 million. That is, the current depreciation rates provide for a net salvage expense that is over three times larger than UE's actual incurred net salvage expense.

Q PLEASE EXPLAIN HOW YOU DEVELOPED THE DEPRECIATION EXPENSE THAT IS ASSOCIATED WITH NET SALVAGE.

As Table 1 below shows UE's current approved net salvage ratios produce an annual depreciation expense component associated with net salvage of approximately \$27 million.

TABLE 1	
Depreciation Expense Associated with Net Salvage	
<u>Function</u>	<u>Net Salvage Expense (000)</u>
Production	\$(486)
Transmission	(5)
Distribution	28,675
General	<u>(1,114)</u>
Total	\$27,071

1 To calculate the \$27 million of depreciation expense associated with net
2 salvage, I developed depreciation rates for UE employing the currently approved
3 parameters with and without net salvage. The difference between the two
4 depreciation rates was applied to the 2000 plant in service. This calculation
5 generated the expense that UE currently has in its depreciation rates that is
6 associated with net salvage.

7 **Q HOW DOES THE AMOUNT OF NET SALVAGE THAT IS INCLUDED IN UE'S**
8 **DEPRECIATION RATES COMPARE WITH UE'S ACTUAL NET SALVAGE**
9 **EXPERIENCE?**

10 **A** Table 2 below shows UE's actual net salvage experience. As Table 2 shows, over
11 the last five years UE's net salvage experience has averaged approximately \$8.14
12 million per year, and over the last ten years its net salvage experience has averaged
13 approximately \$9.04 million per year. When compared with the results in Table 1,
14 Table 2 clearly shows that UE has incurred net salvage expense that is significantly
15 less than the amount of net salvage that is currently built into its depreciation rates.

TABLE 2**UE's Net Salvage Analysis**

<u>Year</u>	<u>Cost of Removal (000)</u>	<u>Gross Salvage (000)</u>	<u>Net Salvage (000)</u>
2000	\$ (15,713)	\$ 3,211	\$ (12,502)
1999	(11,587)	3,886	(7,701)
1998	(10,444)	9,868	(576)
1997	(12,388)	2,702	(9,686)
1996	(15,660)	5,439	(10,221)
1995	(17,608)	5,670	(11,938)
1994	(14,653)	2,975	(11,679)
1993	(12,399)	3,318	(9,081)
1992	(11,271)	3,563	(7,708)
1991	(11,602)	2,260	(9,342)
5-Year Average	\$ (13,158)	\$ 5,021	\$ (8,137)
10-Year Average	\$ (13,333)	\$ 4,289	\$ (9,043)

1 **Q IN GENERAL, WHAT CAUSES THE DISPARITY BETWEEN NET SALVAGE**
2 **EXPENSE INCLUDED IN DEPRECIATION RATES AND ACTUAL NET SALVAGE**
3 **EXPERIENCE?**

4 **A Proposed net salvage percentages that are included in the development of**
5 **depreciation rates essentially reflect the impact of future inflation and may not reflect**
6 **economies of scale that would occur if large retirement activity incurred during a**
7 **single year. In addition, net salvage ratios included in depreciation rates may be**
8 **developed from limited retirement experience that may not be typical.**

1 **Q WHAT DO YOU PROPOSE IN THIS PROCEEDING?**

2 A I propose the Missouri Public Service Commission (Commission) eliminate the net
3 salvage ratio from the development of the depreciation rates. The net salvage
4 expense that is included in UE's ratemaking revenue requirement should be based on
5 current levels of net salvage expense.

6 **Q IS THERE ANY PRECEDENT FOR TREATING NET SALVAGE AS AN EXPENSE**
7 **AS OPPOSED TO A COMPONENT OF THE CALCULATED DEPRECIATION**
8 **RATES?**

9 A Yes. The Commission issued an order in The Empire District Electric Company's
10 (Empire) rate proceeding (Case No. ER-2001-299) in September 20, 2001, which
11 stated the following regarding the development of Empire's depreciation rates:

12 "The Staff's approach of treating net salvage cost as an expense
13 based on Empire's recent historical data reduces this uncertainty.
14 Additionally, separately stating net salvage costs, rather than
15 incorporating it into depreciation rates, appropriately identifies the
16 significance of net salvage cost on rates. The Commission finds that
17 net salvage costs considered in setting rates should be based on
18 historical net salvage cost that Empire has actually incurred in the
19 recent past and that it should be treated as an expense." (Report and
20 Order, Case No. ER-2001-299, p. 12)

21 Also, the National Association of Regulatory Utility Commissioners (NARUC)
22 in its Public Utility Depreciation Practices (August 1996) indicates that commissions
23 have abandoned the procedure of including net salvage in the depreciation rates and
24 have moved to current period accounting for gross salvage and/or cost of removal.
25 The publication indicates that in some jurisdictions, gross salvage and cost of
26 removal are accounted for as income and expense, respectively, when they are
27 realized. It is clear that NARUC supports the procedure of including net salvage as a
28 separate expense.

1 **Q WHAT LEVEL OF NET SALVAGE EXPENSE HAS THE STAFF INCLUDED IN**
2 **UE'S REVENUE REQUIREMENT?**

3 **A The Staff is proposing to include \$9,043,000 of net salvage expense in UE's revenue**
4 **requirement.**

5 **Q DO YOU AGREE WITH THE STAFF'S RECOMMENDATION?**

6 **A No. I propose the Commission utilize the five-year average of UE's actual net**
7 **salvage expense to develop the level of net salvage expense to be included in UE's**
8 **rates. As Table 2 shows, the five-year average expense for net salvage is**
9 **\$8,137,000. This represents UE's recent net salvage expense history, which is**
10 **consistent with the Empire order.**

11 **Q AS A RESULT OF REMOVING THE NET SALVAGE EFFECTS FROM THE**
12 **DEPRECIATION RATES, ARE THERE ANY OTHER ADJUSTMENTS THAT**
13 **SHOULD BE MADE TO UE'S ANNUAL DEPRECIATION EXPENSE?**

14 **A Yes. Including net salvage ratios in UE depreciation rates in the past has resulted in**
15 **overstating UE's depreciation expense for a number of years. As a result, UE's**
16 **accumulated depreciation reserve is significantly overstated. Since UE's depreciation**
17 **rates are based on the whole life procedure, the over accrual of depreciation expense**
18 **does not flow back to the ratepayers. Therefore, the Commission should feed back to**
19 **the ratepayers any over collection of depreciation expense that is currently contained**
20 **in the accumulated depreciation reserves.**

1 **Q HAVE YOU PERFORMED A CALCULATION TO DETERMINE IF UE'S**
2 **DEPRECIATION RESERVES ARE OVER-ACCRUED?**

3 **A** No. However, the Staff has estimated that UE's accumulated depreciation reserve is
4 over-accrued by \$981.7 million. Because this over-accrual is significant, the
5 Commission should feed back to ratepayers the over-accrual over time.

6 **Q IS ALL OF THIS OVER-ACCRUAL RELATED TO EXCLUDING THE NET**
7 **SALVAGE FROM THE WHOLE LIFE DEPRECIATION RATE?**

8 **A** No. A portion of this over-accrual is related to excluding the net salvage from the
9 whole life depreciation rate, and a portion of the over-accrual is related to the
10 lengthening of service lives.

11 **Q HOW MUCH OF THE OVER-ACCRUAL DOES THE STAFF RECOMMEND IS**
12 **RELATED TO THE EXCLUSION OF NET SALVAGE FROM THE WHOLE LIFE**
13 **DEPRECIATION RATES?**

14 **A** The Staff witness Jolie Mathis states that approximately \$345 million of the \$982
15 million over-accrual is tied to the removal of net salvage from the depreciation rates. I
16 believe the Staff has understated the size of the over-accrual that is related to net
17 salvage.

18 **Q HAVE YOU DETERMINED HOW MUCH OF THIS OVER-ACCRUAL IS RELATED**
19 **TO THE EXCLUSION OF NET SALVAGE FROM THE DETERMINATION OF THE**
20 **WHOLE LIFE DEPRECIATION RATES?**

21 **A** Yes. I have determined that \$445.425 million of the over-accrual is related to net
22 salvage. To determine this amount, I calculated how much of the change in

depreciation rates the Staff is requesting in this proceeding is related to the removal of net salvage from the current depreciation rates and how much of the change in depreciation expense is related to the lengthening of lives. As shown on Table 3 below, 45.37% is related to removing net salvage from the development of the book depreciation rates.

TABLE 3		
<u>Allocation of Depreciation Reserve Over-Accrual</u>		
<u>Depreciation Reserve Analysis</u>		
	(000)	
Actual 2000 Depreciation Reserve (26 Accounts)	\$ 2,480,149	
Staff's Theoretical Reserve (26 Accounts)	<u>1,498,481</u>	
Over-Accrual	\$ 981,668	
<u>Change in Depreciation Rate</u>		<u>Percent</u>
Life	\$ (32,590)	54.63%
Net Salvage	<u>(27,071)</u>	<u>45.37%</u>
Total	\$ (59,661)	100.00%
<u>Allocation of Over-Accrual</u>		
Life (Over-Accrual x Percent)	\$ 536,243	
Net Salvage (Over-Accrual x Percent)	<u>445,425</u>	
Total	\$ 981,668	

Q WHAT IS YOUR RECOMMENDATION IN THIS PROCEEDING REGARDING THE TREATMENT OF THE OVER-ACCRUAL?

A I concur with the Staff's proposal in this proceeding that the over-accrual should be amortized back to the ratepayers over a 40-year period. Because of the size of the accrual, the use of 40 years is appropriate. However, if the Commission determines

1 that some of the Staff's life recommendations are inappropriate, or that net salvage
2 should be included in rates, then I recommend a shortening of the over-accrual.

3 **Q DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

4 **A Yes, it does.**

Qualifications of James T. Selecky

1 **Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 **A James T. Selecky. My business mailing address is P. O. Box 412000, 1215 Fern**
3 **Ridge Parkway, Suite 208, St. Louis, Missouri 63141-2000.**

4 **Q PLEASE STATE YOUR OCCUPATION.**

5 **A I am a consultant in the field of public utility regulation and am a principal in the firm**
6 **of Brubaker & Associates, Inc., energy, economic and regulatory consultants.**

7 **Q PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL**
8 **EMPLOYMENT EXPERIENCE.**

9 **A I graduated from Oakland University in 1969 with a Bachelor of Science degree with**
10 **a major in Engineering. In 1978 I received the degree of Master of Business Admin-**
11 **istration with a major in Finance from Wayne State University.**

12 I was employed by The Detroit Edison Company (DECo) in April of 1969 in its
13 Professional Development Program. My initial assignments were in the engineering
14 and operations divisions where my responsibilities included evaluation of equipment
15 for use on the distribution and transmission system; equipment performance testing
16 under field and laboratory conditions; and trouble-shooting and equipment testing at
17 various power plants throughout the DECo system. I also worked on system design
18 and planning for system expansion.

19 In May of 1975, I transferred to the Rate and Revenue Requirement area of
20 DECo. From that time, and until my departure from DECo in June 1984, I held

1 various positions which included economic analyst, senior financial analyst,
2 supervisor of Rate Research Division, supervisor of Cost-of-Service Division and
3 director of the Revenue Requirement Department. In these positions, I was
4 responsible for overseeing and performing economic and financial studies and book
5 depreciation studies, developed fixed charge rates and parameters and procedures
6 used in economic studies, providing a financial analysis consulting service to all
7 areas of DECo, developing and designing rate structure for electrical and steam
8 service, analyzing profitability of various classes of service and recommending
9 changes therein, determining fuel and purchased power adjustments and all aspects
10 of determining revenue requirements for ratemaking purposes.

11 In June of 1984, I joined the firm of Drazen-Brubaker & Associates, Inc.
12 (DBA). In April 1995 the firm of Brubaker & Associates, Inc. (BAI) was formed. It
13 includes most of the former DBA principals and staff. At DBA and BAI I have testified
14 in electric, gas and water proceedings involving almost all aspects of regulation. I
15 have also performed economic analyses for clients related to energy cost issues.

16 In addition to our main office in St. Louis, the firm also has branch offices in
17 Kerrville, Texas; Plano, Texas; Denver, Colorado; Asheville, NC; and Chicago,
18 Illinois.

19 **Q HAVE YOU PREVIOUSLY APPEARED BEFORE A REGULATORY COMMIS-**
20 **SION?**

21 **A** Yes. I have testified before the regulatory commissions of the States of Colorado,
22 Connecticut, Georgia, Illinois, Indiana, Kansas, Maryland, Massachusetts, Missouri,
23 New Hampshire, New Jersey, North Carolina, Ohio, Oklahoma, Tennessee, Texas,
24 Utah, Wisconsin, and Wyoming, and the Provinces of Saskatchewan and Alberta. I

1 also have testified before the Federal Energy Regulatory Commission. In addition, I
2 have filed testimony in proceedings before the regulatory commissions in the States
3 of Iowa, Montana, New York, and Pennsylvania. My testimony has addressed
4 revenue requirement issues, cost of service, rate design, financial integrity,
5 accounting-related issues, merger-related issues, and performance standards. The
6 revenue requirement testimony has addressed book depreciation rates, decommis-
7 sioning expense, O&M expense levels, and rate base adjustments for items such as
8 plant held for future use, working capital, and post test year adjustments. In addition,
9 I have testified on deregulation issues such as stranded cost estimates and rate
10 design.

11 **Q ARE YOU A REGISTERED PROFESSIONAL ENGINEER?**

12 **A** Yes, I am a registered professional engineer in the State of Michigan.

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