

STATE CORPORATION COMMISSION

BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

JUN 30 2008

 Docket Room

In the Matter of a General Investigation into
Depreciation Issues.

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08-GIMX-1142 GIV

STAFF'S MOTION TO OPEN A GENERIC INVESTIGATION
INTO DEPRECIATION ISSUES

COMES NOW, the Staff of the State Corporation Commission of the State of Kansas and moves the Commission for an order opening a generic docket to examine depreciation issues arising in utility rate cases. In support of this Motion, Staff states:

1. On November 16, 2006, the Commission ordered Staff to continue its investigation into the need for a generic to examine cost of removal depreciation policies, and file a motion specifying what issues should be addressed in a generic docket.¹ In that docket, the Commission approved an agreement that provided for the booking of a "regulatory liability" of the amount associated with cost of removal in the depreciation accrual.²

2. On May 12, 2008, the Commission ordered Staff to "follow-up with the Commission by June 30, 2008 concerning the opening of a generic docket involving depreciation issues."³

¹ Order Granting Joint Motion and Approving Stipulated Settlement Agreement, Docket No. 06-KGSG-1209-RTS, p. 5. November 16, 2006.

² Direct Testimony in Support of Settlement, Docket No. 06-KGSG-1209-RTS, p. 3. November 1, 2006.

³ Order Approving Contested Settlement Agreement, Docket No. 08-ATMG-280-RTS, p. 21, May 21, 2008.

3. In response to these directives, Staff files this motion and the attached Report and Recommendation (Attachment A). In its Report and Recommendation Staff outlines the significant issues regarding depreciation that have arisen in rate cases before the Commission: 1) treatment of net salvage costs for all accounts in light of Federal Energy Regulatory Commission (FERC) Order 631; 2) terminal net salvage with regard to decommissioning generating facilities; and 3) use of Equal Life Group (ELG).

4. Disputes have arisen regarding the application of FERC Order 631 to salvage and retirement costs of assets not within the purview of the Order, or the appropriate treatment for such costs for depreciation purposes. Staff indicates that so far negotiation of depreciation rates has been part of a wider settlement. For example, the most recent Atmos case resulted in a non-unanimous stipulated agreement that used present value for salvage for AROs and future value for salvage of non-legal retirement obligations.

5. The contentiousness of the salvage value issue is due to the increasing incidence of net salvage being a negative value. Net Salvage is Gross Salvage minus the Cost of Removal (or Cost to Retire). When Gross Salvage is greater than Cost of Removal, the resulting “positive” Net Salvage means the utility will receive money at the time of retirement. But when Net Salvage is “negative” and the company will pay out money at the time of retirement there is an issue regarding how to properly and accurately reflect that future negative value in rates possibly decades before the asset will be retired. Ratepayers possibly pay rates that include removal costs long before the utility pays to retire the asset. Staff’s Report and Recommendation supports Staff’s opinion that the Commission should consider establishing a general policy with regard to this issue.

6. Terminal Net Salvage refers to the decommissioning of an entire plant facility and includes both salvage and removal cost, for electric generating facilities. The issue of whether to include terminal net salvage in depreciation rates arose in the last Westar case.⁴ The Commission included terminal net salvage in rates. The Court reversed citing lack of substantial competent evidence. The Court of Appeals found that in order to include terminal net salvage in depreciation rates, there would need to be evidence and a detailed plan that the utility would actually dismantle a generating facility upon retirement.⁵ On remand the Commission adjusted depreciation to reflect Staff's proposal which eliminated terminal net salvage costs from depreciation expense. Although that issue would appear to be settled by judicial decision, at least with regard to Westar, Staff suggests that it would be appropriate for the Commission to explicitly consider adopting the same policy for all electric utilities.⁶

7. An integral part of depreciation rate calculation is determining life expectancy of the asset. Atmos, in the last rate case, proposed using Equal Life Group procedure as opposed to Average Lines or Vintage Group. Staff surmises it may be desirable for the Commission to determine whether, and under what circumstances, ELG is appropriate depreciation procedure.

8. Staff moves the Commission for an order opening a generic docket to address the depreciation issues identified above and discussed more fully in Staff's Report and Recommendation. Staff suggests the matter may be best handled in a generic proceeding so that electric and natural gas utilities, as well as all other interested parties, have an opportunity to fully participate. Staff proposes interested parties, including Staff, be provided an opportunity to file initial comments to the issues preliminarily identified in Commission's order opening the

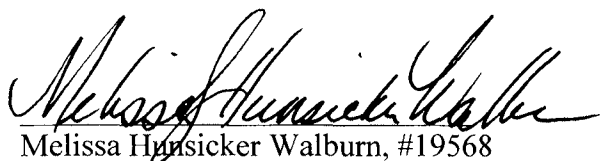
⁴ 05-WSEE-981-RTS.

⁵ *Order (1) Addressing Depreciation Adjustment Following Remand; (2) Determining Transmission Revenue Requirement for Purposes of Calculating Refunds and Prospective Rates; (3) Resolving ITC Related Issues; (4) Determining Interest on Refunds; and (5) Form of Refunds*, Docket No. WSEE-981-RTS, July 31, 2007.

⁶ *Order Adopting Further Procedure Following Remand*, Docket No. 05-SWEE-981-RTS, February 8, 2008.

generic docket, and also on what precise issues should be addressed in the general investigation. Staff suggests the parties be given an opportunity to file responsive comments. Upon reviewing both the comments and responsive comments, Staff recommends the Commission determine the issues and develop a procedure schedule appropriate for the issues and scope of the proceeding at that time.

WHEREFORE, Staff respectfully requests the Commission issue an order opening a generic investigation, and for any further relief the Commission deems just and appropriate.



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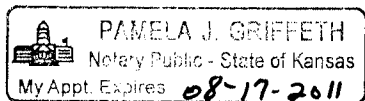
For Commission Staff

VERIFICATION

STATE OF KANSAS)
)
COUNTY OF SHAWNEE) SS:

Melissa J. Hunsicker Walburn, of lawful age, being first duly sworn upon oath states:

That she is the attorney for the Corporation Commission Staff in this matter; that she has read and is familiar with the foregoing Motion and the attached Report and Recommendation and that the statements made therein are true and correct to the best of her information, knowledge and belief.



Melissa J. Hunsicker Walburn
Melissa J. Hunsicker Walburn

Subscribed and sworn to before me this 30th day of June 2008.

Pamela J. Griffeth
Notary Public

My appointment expires: *August 17, 2011*

**BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS**

In the Matter of a General Investigation into Depreciation Issues.)	Docket No. 08-_____ - _____-GIV
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STAFF REPORT AND RECOMMENDATION

COMES NOW the Staff of the State Corporation Commission of the State of Kansas (Staff and Commission, respectively) and submits this report and recommendation addressing issues related to depreciation in rate cases.

I. Introduction

1. Depreciation rates generally are intended to allow a utility to recover the original cost of its investment, including salvage value minus cost of retirement, over the life of an asset or group of assets. While depreciation rates themselves are not expected to be uniform among types of facilities or across companies, the Commission Staff has generally attempted to be consistent with regard to the methodologies or principles allowed to be used in establishing depreciation rates. During the last several years, several significant issues with regard to depreciation rates have arisen in rate cases before the Commission; treatment of net salvage costs for all accounts in light of Federal Energy Regulatory Commission (FERC) Order 631; terminal net salvage with regard to decommissioning of generating facilities; and use of Equal Life Group (ELG). When the Commission approved the Joint Stipulated Agreement between some of the parties in the most recent Atmos rate case it also ordered Staff to follow-up with the Commission by June 30, 2008 concerning the commencement of a docket to examine depreciation issues

arising in utility rate cases.¹ This Report and Recommendation concurs, the Commission should commence a general investigation with the goal of establishing a uniform policy with regard to each of these depreciation issues, as discussed more specifically below.

Negative Net Salvage

2. In 2003, the Federal Energy Regulatory Commission (FERC) issued Order No. 631 establishing uniform accounting and financial reporting for the determination and treatment of liabilities arising from retirement and decommissioning of tangible assets, as well as costs related to those retirement obligations.² FERC 631 altered the Uniform System of Accounts' treatment of an "asset retirement obligation" (ARO) by declaring Present Value of liability be recorded for all assets."

3. While promulgated for the purpose of achieving uniformity and standardization, FERC's Order 631 does not address the treatment of non-legal AROs. Consequently, in subsequent proceedings before this Commission, depreciation issues have been governed by Order 631 when that Order clearly applies. However, disputes have arisen regarding whether Order 631 should also apply to the salvage and retirement costs of assets not within the purview of the Order and, if not, how such costs should be treated for depreciation purposes. In all those cases, Staff and the applicant utility, and sometimes CURB, have thus far been able to negotiate depreciation rates as part of a wider settlement. For example, in the recent Atmos case, the non-unanimous stipulated agreement used present value for salvage for AROs, and future value for salvage of non-legal retirement obligations.³

¹ Order Approving Contested Settlement Agreement, Docket No. 08-ATMG-280-RTS, p. 21, ¶D. May 21, 2008.

² FERC Order No. 631 and FERC Notice of Proposed Rulemaking issued October 30, 2002, Docket No. RM02-7-000 which led to Order No. 631.

³ Dunkel Direct, Docket No. 08-ATMG-280-RTS, pp. 12-21.

4. The treatment of salvage values has been a contentious issue for parties in rate cases, mostly due to the increasing incidence of net salvage being a negative value and lack of clear governing guidelines. Net Salvage is Gross Salvage minus Cost of Removal (or Cost to Retire). When Gross Salvage value is larger than the Cost of Removal, the resulting “positive” Net Salvage means the utility will receive net money at the time of retirement. When there’s a “negative” Net Salvage, the Company will pay out money at the time of retirement. The basic issue lies in how to properly and most accurately reflect that future negative value in rates possibly decades before an asset will be retired. For ratepayers, that means possibly paying rates that include Removal Costs long before the utility pays to retire the asset. Prior to FERC Order 631, companies could use an inflated future Removal Cost which means using a future value that would be the projected value of the asset at the time of its retirement at corresponding inflated-dollar value.

5. In view of the above, Staff believes that it would be desirable for the Commission to consider establishment of a general policy with regard to this issue. In recent cases, CURB has generally suggested that the requirements of Order 631 should apply to all accounts while the utility companies have generally proposed using the traditional approach without distinguishing whether the expected salvage values are positive or negative. Parties to this proceeding may, of course, wish to propose other treatments or argue against a general policy. To date Staff understands that at least two other Commissions in the country have undertaken generic proceedings to consider the application of FERC 631 and future costs of removal.⁴

⁴ Dunkel Direct, Docket No. 08-MDWE-594-RTS, p 5. “*Maryland has adopted the Present Value treatment for the future Costs of Removal in all accounts (both AROs and future Removal Costs that are not legally required.)*” Michigan PUC Case No. U-14292, *In the matter, on the Commission’s own motion, to establish appropriate accounting and ratemaking treatment for State of Financial Accounting No. 143.*

Terminal Net Salvage

6. The issue of Terminal Net Salvage for electric generating facilities arose in the last Westar rate case⁵. Terminal Net Salvage refers to the decommissioning of an entire plant facility, and includes both salvage and removal cost. The Commission included terminal net salvage in rates. The Court reversed citing lack of substantial competent evidence. The Court of Appeals found that in order to include terminal net salvage in depreciation rates, there would need to be evidence and a detailed plan that the utility would actually dismantle a generating facility upon retirement.⁶ On remand the Commission adjusted depreciation to reflect Staff's proposal which eliminated terminal net salvage costs from depreciation expense. Although that issue would appear to be settled by judicial decision, at least with regard to Westar, Staff suggests that it would be appropriate for the Commission to explicitly consider adopting the same policy for all electric utilities.⁷

Equal Life Group

7. The life expectancy of the asset is an important part of determining the appropriate depreciation rate calculation. In the last Atmos rate case docket, Atmos proposed using the ELG procedure, as opposed to average lines or vintage group, which basically is a procedure that divides vintage groups of assets into subgroups of assets that are expected to have equal lives. As the NARUC depreciation publication states:

“Both the VG (ALG) and ELG procedures are designed to charge to depreciation expense the cost of property installed in a single year (vintage) over the property's service life. Under the VG procedure an average percentage rate is applied annually to the surviving property balance throughout the life of the vintage. The

⁵ Docket No. 05-SWEE-981-RTS.

⁶ *Order (1) Addressing Depreciation Adjustment Following Remand; (2) Determining Transmission Revenue Requirement for Purposes of Calculating Refunds and Prospective Rates; (3) Resolving ITC Related Issues; (4) Determining Interest on Refunds; and (5) Form of Refunds*, Docket No. WSEE-981-RTS, July 31, 2007.

⁷ *Order Adopting Further Procedure Following Remand*, Docket No. 05-SWEE-981-RTS, February 8, 2008.

total cost of the vintage is fully allocated to expense when the last vintage is retired. The ELG procedure is designed to charge to depreciation expense the investment in *each* equal life group by the time *each* group is completely retired.”⁸

Staff opposed use of ELG, primarily due to Atmos’ lack of detailed retirement records for its various plant accounts.⁹ For settlement purposes, depreciation rates resulting from use of Vintage Group procedures were used.

8. Staff surmises it may be desirable for the Commission to determine whether, and under what circumstances, ELG is appropriate depreciation procedure. It may be desirable for the Commission to make general determinations on whether, and under what circumstances, ELG is an appropriate depreciation procedure.

Recommended Procedures

9. Staff suggests the matter may be best handled in a generic proceeding so that electric and natural gas utilities, as well as all other interested parties, have an opportunity to fully participate. Staff proposes interested parties, including Staff, be provided an opportunity to file initial comments to the issues preliminarily identified in Commission’s order opening the generic docket, and also on what precise issues should be addressed in the general investigation. Staff suggests the parties be given an opportunity to file responsive comments. Upon reviewing both the comments and responsive comments, Staff recommends the Commission determine the issues and develop a procedure schedule appropriate for the issues and scope of the proceeding at that time.

⁸ NARUC Public Utility Depreciation Practices, August 1996, p 165.

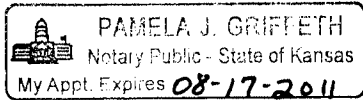
⁹ Dunkel Direct, Docket No. 08-ATMG-280-RTS, p 5-10.

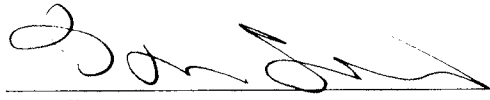
VERIFICATION

STATE OF KANSAS)
)
COUNTY OF SHAWNEE) SS:

Don Low, of lawful age, being first duly sworn upon oath states:

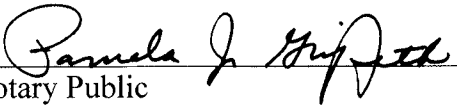
That he has read and is familiar with the foregoing Report and Recommendation and that the statements made therein are true and correct to the best of his information, knowledge and belief.





Don Low

Subscribed and sworn to before me this 30th day of June 2008.



Notary Public

My appointment expires: August 17, 2011

CERTIFICATE OF SERVICE

I, the undersigned, hereby certify that a true and correct copy of the above and foregoing Staffs Motion To Open A Generic Investigation Into Depreciation Issues was placed in the United States mail, postage prepaid, or hand-delivered this 1st day of July, 2008, to the following:

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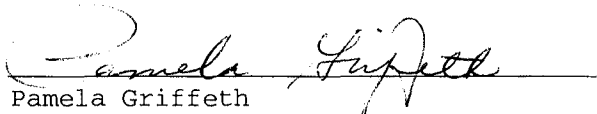
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