

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty Utilities :
: :
: :
Proposed General Increase in : Docket No. 16-_____
Natural Gas Rates : :

DIRECT TESTIMONY OF

DANE A. WATSON

SUBMITTED ON BEHALF OF

LIBERTY UTILITIES (MIDSTATES NATURAL GAS) CORP. D/B/A LIBERTY UTILITIES

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1 **I. Introduction**

2 **Q. Please introduce yourself?**

3 A. My name is Dane A. Watson. My business address is 1410 Avenue K, Suite
4 1105B, Plano, Texas 75074. I am a Partner of Alliance Consulting Group.
5 Alliance Consulting Group provides consulting and expert services to the utility
6 industry. I am testifying on behalf of Liberty Utilities (Midstates Natural Gas)
7 Corp., which I refer to in my testimony as "*Liberty Midstates*," or the "*Company*").

8 **Q. Please describe your educational background?**

9 A. I hold a Bachelor of Science degree in Electrical Engineering from the University
10 of Arkansas at Fayetteville and a Master's Degree in Business Administration
11 from Amberton University.

12 **Q. Please describe your professional background?**

13 A. Since graduation from college in 1985, I have worked in the area of depreciation
14 and valuation. I founded Alliance Consulting Group in 2004 and am responsible
15 for conducting depreciation, valuation, and certain accounting-related studies for
16 clients in various industries. My duties related to depreciation studies include the
17 assembly and analysis of historical and simulated data, conducting field reviews,
18 determining service life and net salvage estimates, calculating annual
19 depreciation, presenting recommended depreciation rates to utility management
20 for its consideration, and supporting such rates before regulatory bodies.

21 My prior employment from 1985 to 2004 was with Texas Utilities Electric
22 Company, called TXU, and successor companies. During my tenure with TXU, I
23 was responsible for, among other things, conducting valuation and depreciation

24 studies for the domestic TXU companies. During that time, I served as Manager
25 of Property Accounting Services and Records Management in addition to my
26 depreciation responsibilities.

27 I have twice been Chair of the Edison Electric Institute's Property
28 Accounting and Valuation Committee and have been Chairman of EEI's
29 Depreciation and Economic Issues Subcommittee. I am a Registered
30 Professional Engineer in the State of Texas and a Certified Depreciation
31 Professional. I am a Senior Member of the Institute of Electrical and Electronics
32 Engineers and served for several years as an officer of the Executive Board of
33 the Dallas Section of IEEE as well as national and global IEEE offices. I served
34 as President of the Society of Depreciation Professionals twice, most recently in
35 2015.

36 **Q. Do you hold any special certification as a depreciation expert?**

37 A. The Society of Depreciation Professionals has established national standards for
38 depreciation professionals. The SDP administers an examination and has certain
39 required qualifications to become certified in this field. I met all requirements and
40 hold a Certified Depreciation Professional certification.

41 **Q. Have you previously testified at any regulatory commission?**

42 A. I have conducted depreciation studies and testified on depreciation and valuation
43 issues before more than thirty utility commissions across the United States,
44 including FERC. A list of proceedings in which I have provided testimony is
45 included in my prefiled direct testimony as **Exhibit 6.0.1**.

46 **II. SUMMARY OF TESTIMONY AND RECOMMENDATIONS**

47 **Q. What is the purpose of your direct testimony?**

48 A. The purpose of my direct testimony is to

- 49 • discuss the recent Liberty Midstates – Illinois Book Depreciation Accrual Rate
50 Study at September 30, 2015;
- 51 • discuss the recent Liberty Midstates – Shared Services Book Depreciation
52 Accrual Rate Study at September 30, 2015; and
- 53 • support and justify the recommended depreciation rate changes for Liberty
54 Midstates, based on the results of these depreciation studies.

55 **Q. Please explain the difference between the two depreciation studies?**

56 Because Liberty Midstates operates in multiple jurisdictions, its assets may be
57 categorized into Illinois assets, which are located in Illinois and used to serve
58 only Illinois customers, and shared services assets which are used to serve (in
59 this case) Illinois customers as well as customers that are not in Illinois. Illinois
60 assets include gas transmission, distribution, and general plant that serve Illinois
61 customers only. Shared Services assets include general plant items such as
62 buildings, software, and computer hardware that serve the customer base in
63 Illinois, Iowa, and Missouri. Therefore, I prepared an Illinois depreciation study
64 and a shared services depreciation study.

65 **Q. Please summarize your conclusions regarding depreciation rate changes
66 for Liberty Midstates' assets based on the results of the depreciation
67 studies?**

68 A. The depreciation studies and analyses performed under my supervision fully
69 support the Company's proposed depreciation rates applied to September 30,

70 2015 depreciable plant balances for Transmission plant, Distribution plant, and
71 General function plant. The studies follow regulated industry's long-standing
72 precedent for Average Life Group or "ALG" straight-line depreciation. In this way,
73 all customers are charged for their appropriate share of the capital expended for
74 their benefit. In order to ensure intergenerational equities, the Commission
75 should adopt the life characteristics and net salvage parameters proposed in this
76 study.

77 Both the Illinois study and the shared services study incorporate updated
78 service lives in the proposed depreciation rates. The Illinois study also accounts
79 for increased removal costs for Transmission and Distribution plant in the
80 proposed depreciation rates. The shared services study also incorporates
81 reallocated depreciation reserves for shared services General function plant in
82 the proposed depreciation rates.

83 The Company's depreciation rates should be set at the levels supported in
84 the studies in order to recover Liberty Midstates' total investment in property over
85 the estimated remaining life of the assets.

86 **Q. How are the depreciation studies used to determine the Company's**
87 **depreciation expense for the test year in this case?**

88 A. The information presented in the depreciation studies is based on September 30,
89 2015 depreciable plant balances and all of the conclusions are based on those
90 balances. The Company will use the depreciation rates determined in the studies
91 to calculate the appropriate depreciation expense going forward, including for the
92 test year in this case.

93 **Q. Prior to this depreciation study, how did the Company determine its**
94 **depreciation rates?**

95 A. Liberty Midstates began operations in Illinois in 2012 pursuant to the Commission
96 approvals obtained in Docket No. 11-0559. In that docket, the Commission
97 approved the acquisition by Liberty Midstates of the utility assets of Atmos
98 Energy Corporation located in Illinois, Missouri and Iowa. Upon initiation of
99 service, the Company used the depreciation rates that had been used by Atmos
100 prior to the acquisition. Liberty Midstates is not aware of the underlying life or net
101 salvage parameters used to derive these depreciation rates.

102 **Q. What effect did the lack of background regarding existing depreciation**
103 **rates have on your approach to the depreciation studies in this case?**

104 A. Essentially the lack of information regarding the existing rates simply left me to
105 use current best practices to determine the appropriate factors—starting from a
106 blank slate so to speak. Best practices include interviewing Company subject
107 matter experts and assigning lives and net salvage parameters to each account
108 based on professional judgment and experience.

109 **Q. Given the lack of background, how did you proceed?**

110 A. First, I reset depreciation rates to incorporate the most current life expectations.
111 Second, I applied most current estimates of net salvage in order to accurately
112 estimate removal costs for Transmission and Distribution plant.

113 In addition, the Company sought to implement Vintage Group Amortization for its
114 General Plant Assets in FERC Accounts 391, 393-395, and 3970 to-3995.

115 **Q. What is Vintage Group Amortization?**

116 A. FERC adopted Accounting Release 15 in 1997 to enable Companies to retire
117 small low-volume assets without detailed record keeping. Many companies
118 across the United States have adopted Vintage Group Accounting to track small
119 general plant accounts. FERC established the following criteria for the use of
120 vintage year accounting:

- 121 1. the individual classes of assets for which vintage year
122 accounting is followed are high volume, low value items;
123
- 124 2. there is no change in existing retirement unit designations,
125 for purposes of determining when expenditures are capital or
126 expense;
127
- 128 3. the cost of the vintage groups is amortized to depreciation
129 expense over their useful lives and there is no change in
130 depreciation rates resulting from the adoption of the vintage
131 year accounting;
132
- 133 4. interim retirements are not recognized;
134
- 135 5. salvage and removal cost relative to items in the vintage
136 categories are included in the accumulated depreciation
137 account and assigned to the oldest vintage first; and
138
- 139 6. properties are retired from the affected accounts that, at
140 the date of the adoption of vintage year accounting, meet or
141 exceed the average service life of properties in that account.
142

143 A vintage year method of accounting for the general plant
144 accounts that meets all of the foregoing requirements may
145 be implemented without obtaining specific authorization from
146 the Commission to do so.¹
147

148 Given these criteria, it is reasonable for the Company to use vintage group
149 amortization as they have proposed in this case.

150 III. DEPRECIATION ANALYSIS PHILOSOPHY

¹ Federal Energy Regulatory Commission, *Vintage Year Accounting for General Plant Accounts*, AR- 15 (1997) available at <http://www.ferc.gov/enforcement/acct-matts/docs/ar-15.asp>.

151 **Q. Please describe the depreciation analysis philosophy reflected in the**
152 **current depreciation studies?**

153 A. The objective of any sound depreciation philosophy should be the matching of
154 expense with revenue over the life of the asset. In general, the life of the asset is
155 determined by several factors including the rate of physical deterioration,
156 obsolescence, weather, maintenance, or (in some cases) the economic
157 usefulness of an entire operating unit. The function of depreciation is to
158 recognize the cost of an asset spread over its useful life. Book depreciation
159 techniques should not accelerate or defer the recovery of an asset in comparison
160 to its appropriate useful life.

161 **Q. What objective do you seek to achieve in recommending depreciation**
162 **rates?**

163 A. The objective of computing depreciation is to ensure that all customers using the
164 assets pay their pro rata share for the investment in those assets, including the
165 cost of retirement. This is consistent with the Commission's description of Staff's
166 position that the "purpose of depreciation accounting is . . . to distribute the cost
167 or other basic value of tangible capital assets, less salvage (if any), over the
168 estimated useful life of the unit (which may be a group of assets) in a systematic
169 and rational manner."²

170 This objective is achieved by allocating the cost or depreciable base of a
171 group of assets over the service life of those assets, on a straight-line basis, by
172 charging a portion of the consumption of the assets to each accounting period. In

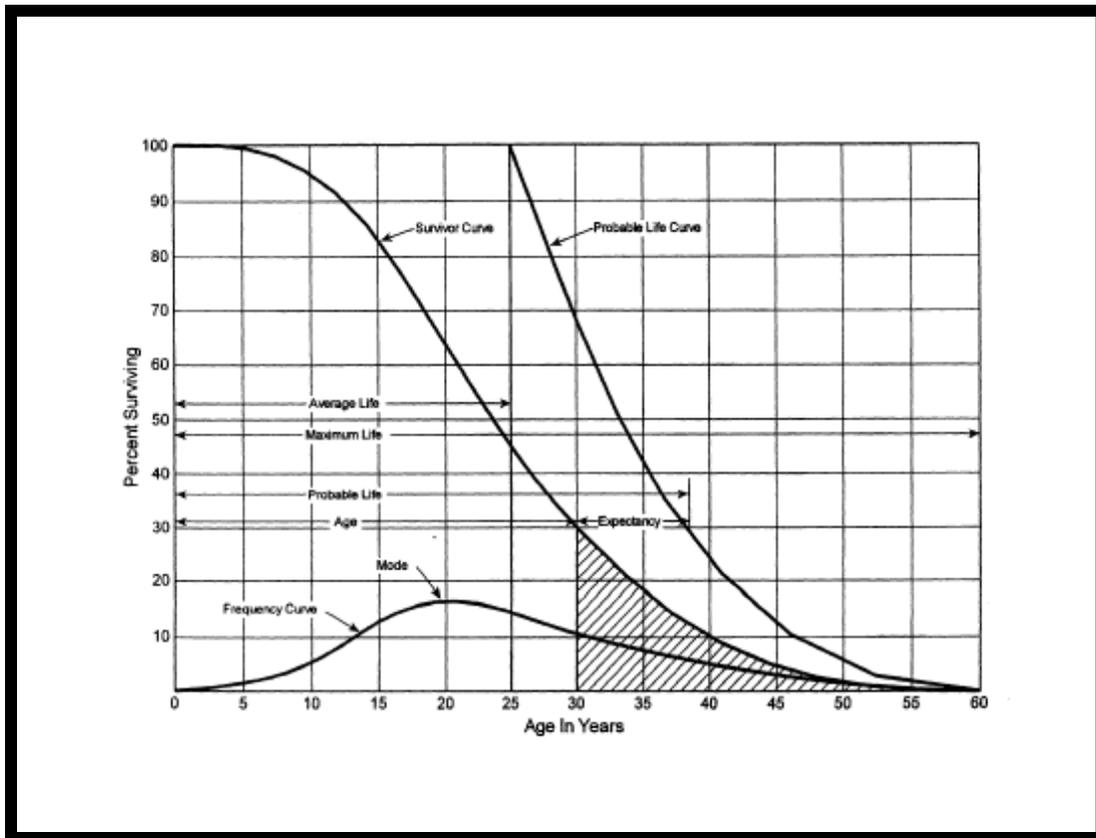
² Cent. Ill Co. Docket 06-0070 (Cons.) at 22-23 (Order, Dec. 27, 2006) (citing Hahne & Aliff. Accounting for Public Utilities. Release No. 14. Section 6.03[1]).

173 Docket 11-0767, Staff noted that the Straight Line method is an acceptable
174 method and used across the utility industry.³

175 **Q. What are Iowa survivor curves?**

176 A. The Iowa Curves are the result of an extensive investigation of life
177 characteristics of physical property made at the Iowa State College Engineering
178 Experiment Station in the first half of the twentieth century. Through common
179 usage, revalidation, and regulatory acceptance, these curves have become a
180 descriptive standard for the life characteristics of industrial property. An example
181 of an Iowa Curve is shown in table 6.0.1 of my prefiled direct testimony.

182 **Table 6.0.2**



183

³ Illinois-American Water Co. Docket 11-0767 at 61 (Order, Sept 19, 2012).

184

185 There are four families in the Iowa Curves which are distinguished by the
186 relation of the age at the retirement mode (largest annual retirement frequency)
187 and the average life. The four families are designated as “R”— Right, “S” —
188 Symmetric, “L” — Left, and “O” — Origin Modal. First, for distributions with the
189 mode age greater than the average life, an "R" designation (i.e., Right modal) is
190 used. The Iowa Curves are discussed in more detail in the general discussion
191 portions of the depreciation studies that I will discuss in my direct testimony.

192 **IV. LIBERTY MIDSTATES BOOK DEPRECIATION STUDIES**

193 **A. Summary of the Illinois Study**

194 **Q. Please describe the Illinois depreciation study you performed for the**
195 **Company?**

196 A. For the Illinois depreciation study, I undertook a comprehensive analysis of
197 annual depreciation for the Company that is based on its depreciable plant in
198 service as of September 30, 2015. Because the Company had accounting
199 records for transactional data from 2000-2015, I combined the gas utility plant of
200 Illinois, Iowa, and Missouri. I then analyzed the property characteristics of the
201 combined Transmission plant, Distribution plant, and General plant. After
202 developing common life and net salvage parameters based on these property
203 characteristics, I computed depreciation rates at the state level for each entity.
204 This depreciation study for Illinois assets is attached to my prefiled direct
205 testimony as **Exhibit 6.0.2**.

206 **Q. What depreciation rates for Illinois assets are you recommending in this**
 207 **proceeding?**

208 A. My recommended depreciation rates for the Company's Illinois assets are
 209 provided in Appendix B of the Illinois depreciation study. Based on updated
 210 service life and net salvage rates for the Company's Illinois depreciable plant in-
 211 service as of September 30, 2015, I derived the appropriate depreciation rates
 212 for Transmission plant, Distribution plant, and General plant. I summarize the
 213 results in Table 6.0.2 of my prefiled direct testimony:

Table 6.0.2

LIBERTY MIDSTATES ILLINOIS ASSETS

**Comparison of Existing vs. Proposed Depreciation Rates
 as of September 30, 2015**

Function	Depreciable Plant at 9/30/15	Current Annual Expense	Proposed Annual Expense	Expense Change
Intangible	141,145	12,209	0	(12,209)
Transmission	1,932,455	56,277	16,937	(39,340)
Distribution	48,753,574	1,692,687	1,564,812	(127,875)
General	4,618,173	381,453	359,299	(22,153)
Total Illinois	55,445,347	2,142,627	1,941,049	(201,578)

214

215 **Q. What Illinois asset accounts show the largest change in depreciation**
 216 **expense between the current and proposed accrual rates?**

217 A. Two accounts show large decreases in depreciation expense: Account 3762
 218 Plastic Mains and Account 3761 Steel Mains. The current accrual rate is for

219 these accounts is a composite 2.77 percent used for all 376 subaccounts. Our
220 life recommendations for these two accounts are 63 R1.5 and 65 R3 for
221 Accounts 3761 and 3762 respectively. The net salvage parameters we
222 recommend are negative twenty percent and negative five percent respectively.
223 These parameters produce a decrease of \$81,000 and \$137,000, respectively.

224 **A. Summary of the Shared Services Study**

225 **Q. Please describe the shared services depreciation study you performed for**
226 **the Company?**

227 A. In performing the shared services depreciation study I developed common life
228 and net salvage parameters for each of the shared services assets, and I
229 computed depreciation rates for each account containing those assets. Although
230 I typically would run an historic life analysis, as I did in the depreciation study for
231 Illinois. I was unable to do so for shared services assets because these assets
232 were added by Liberty Midstates after 2013. Essentially, the assets are too new
233 to allow me to perform an historic life analysis. The shared services depreciation
234 study is attached to my prefiled direct testimony as **Exhibit 6.0.3**.

235 **Q. What depreciation rates for shared services assets are you recommending**
236 **in this proceeding?**

237 A. My recommended depreciation rates for the Company's shared services assets
238 are provided in Appendix B of the shared services depreciation study. Based on
239 updated service life and net salvage rates for the Company's Illinois depreciable
240 plant in-service as of September 30, 2015, I derived the appropriate depreciation

241 rates for General plant. I summarize the results in Table 6.0.3 of my prefiled
 242 direct testimony:
 243

Table 6.0.3

LIBERTY MIDSTATES SHARED SERVICES ASSETS

**Comparison of Existing vs. Proposed Depreciation Rates
 as of September 30, 2015**

Acct	Description	Plant at 9/30/15	Current Annual Expense	Proposed Annual Expense	Expense Change
3740	Land and Land Rights	157,767			
3900	General Structures & Improvement	6,571,914	328,596	164,634	(163,962)
3910	Office Furniture & Improvement	821,765	39,034	41,088	2,054
3921	Transportation Equip<12,000 LB	193,571	20,112	19,565	(547)
3940	Tools, Shop, and Garage Equipment	15,990	720	800	80
3980	Misc. Equipment	157,495	5,670	7,875	2,205
3990	OTH-Other Tangible Property	249,555	35,661	35,651	(11)
3991	Other Tangible Property - Servers H/W	30,326	5,756	6,065	309
3993	Other Tangible Property - Network H/W	348,710	66,185	49,816	(16,369)
3994	Other Tangible Property - PC Hardware	2,884,964	547,566	576,993	29,427
3995	Software 3 Yr Life	414,156	59,183	138,052	78,869
3995	Software 5 Yr Life	2,927,436	418,331	585,487	167,157
3995	Software 7 Yr Life	9,851,364	1,407,760	1,407,338	(422)
	Plus Amortization for Reserve Difference			0	0
	Total	24,625,013	2,934,573	3,033,362	98,789

244 **Q. What shared services asset accounts show the largest change in**
 245 **depreciation expense between the current and proposed accrual rates?**

246 A. Account 3995 overall shows an increase in depreciation expense. The existing
247 depreciation rates used a seven year life for all assets in this account. However,
248 stratifying the software into a three-, five- and seven-year lives better aligns the
249 capital recovery with the use of the assets. This change results in an increase of
250 \$167,000 in annual depreciation expense related to the 5-year life assets and
251 \$79,000 related to the 3-year life assets. Average service life and Iowa curve
252 recommendations for all depreciable are listed in more detail in Appendix C of
253 the shared services depreciation study.

254 **B. Overview of Depreciation Study Method**

255 **Q. What definition of depreciation did you use in preparing your depreciation**
256 **studies?**

257 A. The term “depreciation,” as I use it, is a system of accounting that distributes the
258 cost of assets, less net salvage (if any), over the estimated useful life of the
259 assets in a systematic and rational manner. It is a process of allocation, not
260 valuation. Depreciation expense is systematically allocated to accounting periods
261 over the life of the assets. The amount allocated to any one accounting period
262 does not necessarily represent the loss or decrease in value that will occur
263 during that particular period. Thus, depreciation is considered an expense or
264 cost, rather than a loss or decrease in value. The Company accrues depreciation
265 based on the original cost of all property included in each depreciable plant
266 account. On retirement, the full cost of depreciable plant, less any net salvage
267 amount, is charged to the depreciation reserve.

268 **Q. Please describe your depreciation study approach?**

269 A. As described in each of the depreciation studies, I conducted the studies in four
270 phases: (1) Data Collection, (2) Analysis, (3) Evaluation, and (4) Calculation.

271 With respect to the Illinois asset study, I began by collecting the historical
272 data to be used in the analysis. After the data had been assembled, I performed
273 analyses to determine the life and net salvage percentage for the different
274 property groups being studied. I could not perform this collection and analysis for
275 the shared services assets because the shared services assets all came into
276 existence after 2013 and there is no retirement history to analyze.

277 As part of the process for the study, I conferred with field personnel,
278 engineers, and managers responsible for the installation, operation, and removal
279 of the assets to gain their input into the operation, maintenance, and salvage of
280 the assets. I then evaluated the information obtained from these discussions,
281 combined with the results of the historical asset activity analysis (if any), in
282 conjunction with the Company's expected future plans. Using all of these
283 resources, I then calculated the depreciation rate for each function.

284 **Q. What property classes are included in the depreciation studies?**

285 A. With respect to the Illinois asset depreciation study, there are three distinct
286 classes of property: Transmission, Distribution, and General plant. The shared
287 services depreciation study only includes the General plant class.

288 **Q. Please describe these property classes?**

289 A. The Transmission plant functional group consists of mains, regulators, structures,
290 and communication equipment to transmit natural gas to the distribution system.
291 The Distribution plant functional group consists of structures, distribution mains,

292 regulating equipment, services, meters, regulators, and other equipment to
293 distribute natural gas across on the distribution system. The General plant
294 functional group contains facilities associated with the overall operation of the
295 business such as buildings, office equipment, and computers, and transportation
296 and power operated equipment rather than with a specific transmission or
297 distribution classification.

298 **Q. What depreciation methodology did you use?**

299 A. The ALG, straight-line, remaining-life depreciation system was employed to
300 calculate annual and accrued depreciation in the studies for all plant except
301 assets found in FERC Accounts 391, 393-395, 397-3995. The ALG methodology
302 is widely used across the utility industry across the United States.

303 **C. Transmission, Distribution and General Plant**

304 *1. Life of Transmission, Distribution and General Plant*

305 **Q. What is the significance of an asset's useful life?**

306 A. In the context of a depreciation study, an asset's useful life is used to determine
307 the remaining life over which the remaining cost (original cost plus or minus net
308 salvage, minus accumulated depreciation) can be allocated to normalize the
309 asset's cost and spread it ratably over future periods.

310 **Q. How did you determine the average service lives for each account in the
311 depreciation studies?**

312 A. I used actuarial analysis to establish appropriate average service lives for each
313 Illinois asset account within each functional group. The Illinois depreciation study
314 includes graphs and tables supporting the actuarial analysis and the chosen Iowa

315 Curves (which represent the percentage of property remaining in service at
316 various age intervals) used to determine the average service lives for analyzed
317 accounts.

318 Because of the lack of historical data for the Company's shared services
319 assets, I used my used my professional judgment and conferred with Company
320 subject matter experts to establish a proposed average service life for each
321 shared services asset account.

322 The objective of life selection is to estimate the future life characteristics of
323 assets, not simply measure the historical life characteristics. Therefore, as
324 detailed in both studies, I relied on my judgment to incorporate any differences in
325 the expected future life characteristics of the assets into the selection of lives.
326 More information can be found in the life analysis section of each study.

327 **Q. What average service lives for Transmission, Distribution, and**
328 **General Function Illinois plant do you recommend?**

329 A. Appendix C of the Illinois depreciation study sets forth my
330 recommendation as to service lives for these Illinois assets. Those results are
331 replicated in Table 6.0.4 of my prefiled direct testimony:

Table 6.0.4

LIBERTY MIDSTATES ILLINOIS ASSETS

**Proposed Depreciation Parameters by Account
at September 30, 2015**

Acct	Description	Average Service Life	Iowa Curve
3660	T&D-Structures & Improvements	50	S3

3661	T&D-Other Structures	50	S3
3670	T&D-Mains-STL-PLST-CI-Mixed	25	SQ
3671	T&D-Mains-STL	70	R2.5
3672	T&D-Mains-PLST	N/A	N/A
3690	T&D-M&R Station Equipment	40	R2.5
3700	Communication Equipment	25	S2.5
3742	T&D-Land Rights	70	R2.5
3750	Structures and Improvements	45	R2
3760	Mains	25	SQ
3761	T&D-Mains-STL	63	R1.5
3762	T&D-Mains-PLST	65	R3
3780	Measuring & regulating stn eqt-General	40	R4
3790	Measuring & regulating stn eqt-City gate check stn	45	S2
3800	Services	33	L0
3810	Meters	31	L1
3820	Meters Installations	27	L0.5
3830	House regulators	27	L0.5
3840	House Regulatory installations	27	L0.5
3850	Industrial measuring & regulating stn eqt	45	R3
3870	Other Equipment	10	R2
3900	General Structures & Improvement	33	L05
3901	GEN-Structure Frame	33	L05
3902	GEN-Improvements	33	L05
3903	GEN-Improvements Leased Premise	33	L05
3910	Office Furniture & Improvement	15	L3
3920	Transportation Equipment	8	L3

3921	Transportation Equip<12,000 LB	8	L3
3930	Stores Equipment	18	L3
3940	Tools, Shop, and Garage Equipment	13	L0
3950	Laboratory Equipment	15	L3
3960	Power Operated Equipment	12	L0
3961	GEN- Ditchers	12	L0
3962	GEN-Backhoes	12	L0
3963	GEN- Welders	12	L0
3970	Communications Equipment	11	L2
3971	GEN-Comm Eq. Mob Radios	11	L2
3972	GEN-Comm Eq. Fixed Radios	11	L2
3973	GEN-Comm Eq. Telemetry	11	L2
3980	Misc. Equipment	16	R1.5
3993	OTH-Oth Tang Prop - Network - H/W	7	SQ
3994	OTH-Oth Tang Prop - PC Hardware	7	SQ
3995	OTH-Oth Tang Prop - PC Software	5	SQ

332 **Q. What average service lives for General function shared services plant, do**
 333 **you recommend?**

334 A. Appendix C of the shared services depreciation study sets forth my
 335 recommendation as to service lives for these Illinois assets. Those results are
 336 replicated in Table 6.0.5 of my prefiled direct testimony:

Table 6.0.5
LIBERTY MIDSTATES SHARED SERVICES ASSETS
Proposed Depreciation Parameters by Account
at September 30, 2015

Acct	Description	Average Service Life	Iowa Curve
3900	Structures and Improvements	40	R2
3910	Office Furniture & Improvement	20	L2
3921	Transportation Equip<12,000 LB	10	SQ
3940	Tools, Shop, and Garage Equipment	20	SQ
3980	Misc. Equipment	20	SQ
3990	OTH-Other Tangible Property	7	SQ
3991	Other Tangible Property - Servers H/W	5	SQ
3993	Other Tangible Property - Network H/W	7	SQ
3994	Other Tangible Property - PC Hardware	5	SQ
3995	Other Tangible Property - Software 3 Yr Life	3	SQ
3995	Other Tangible Property - Software 5 Yr Life	5	SQ
3995	Other Tangible Property - Software 7 Yr Life	7	SQ

337 2. *Net Salvage Rates for Illinois Transmission, Distribution, and General*
 338 *Plant*

339 **Q. How did you determine the net salvage rates that you used in your study**
 340 **for Illinois Transmission, Distribution, and General plant?**

341 A. In order to determine the net salvage rates used in the Illinois depreciation study,
 342 I examined Liberty Midstates' experience by observing the average net salvage
 343 rates for various bands (or combinations) of years. I use averages (such as the
 344 five-year average band) in order to smooth timing differences resulting from
 345 when retirements, removal cost, and salvage are booked and natural variations
 346 between years. By looking at successive average bands, or "rolling bands," an
 347 analyst can see trends in the data that would signal the future net salvage in the

348 account. This examination, in combination with the feedback of Company
349 personnel related to any changes in operations or maintenance that would affect
350 future net salvage allowed for the selection of the best estimate of future net
351 salvage for each account.

352 **Q. Is this a reasonable method for determining net salvage rates?**

353 A. The methodology I used in preparing the Illinois depreciation study is commonly
354 employed throughout the industry and is the method recommended in
355 authoritative texts. It is a reasonable approach to determining net salvage rates.

356 **Q. What are your net salvage recommendations for the Company's Illinois
357 assets?**

358 A. My net salvage recommendations for the Company's Illinois assets are found in
359 Appendix C of the Illinois depreciation study. A detailed history for each account
360 is shown in Appendix D of the Illinois depreciation study. Table 6.0.6 of my
361 prefiled direct testimony shows a summary of those recommendations by
362 account:

Table 6.0.6

LIBERTY MIDSTATES ILLINOIS ASSETS

**Proposed Net Salvage Percentage by Account
at September 30, 2015**

Acct	Description	Net Salvage Percentage
3660	T&D-Structures & Improvements	-5
3661	T&D-Other Structures	-5
3670	T&D-Mains-STL-PLST-CI-Mixed	0
3671	T&D-Mains-STL	-20

3672	T&D-Mains-PLST	N/A
3690	T&D-M&R Station Equipment	-10
3700	Communication Equipment	0
3742	T&D-Land Rights	0
3750	Structures and Improvements	0
3760	Mains	0
3761	T&D-Mains-STL	-20
3762	T&D-Mains-PLST	-5
3780	Measuring & regulating stn eqt-General	-10
3790	Measuring & regulating stn eqt-City gate check stn	-10
3800	Services	-50
3810	Meters	-35
3820	Meters Installations	-35
3830	House regulators	0
3840	House Regulatory installations	0
3850	Industrial measuring & regulating stn eqt	-10
3870	Other Equipment	0
3900	General Structures & Improvement	0
3901	GEN-Structure Frame	0
3902	GEN-Improvements	0
3903	GEN-Improvements Leased Premise	0
3910	Office Furniture & Improvement	0
3920	Transportation Equipment	6
3921	Transportation Equip<12,000 LB	6
3930	Stores Equipment	0

3940	Tools, Shop, and Garage Equipment	0
3950	Laboratory Equipment	0
3960	Power Operated Equipment	10
3961	GEN- Ditchers	10
3962	GEN-Backhoes	10
3963	GEN- Welders	10
3970	Communications Equipment	0
3971	GEN-Comm Eq. Mob Radios	0
3972	GEN-Comm Eq. Fixed Radios	0
3973	GEN-Comm Eq. Telemetry	0
3980	Misc. Equipment	0
3993	OTH-Oth Tang Prop - Network - H/W	0
3994	OTH-Oth Tang Prop - PC Hardware	0
3995	OTH-Oth Tang Prop - PC Software	0

363 2. *Net Salvage Rates for Shared Services General Plant*

364 **Q. How did you determine the net salvage rates that you used in your study**
365 **for shared services General plant?**

366 A. Because there have been few if any retirements of shared services general plant,
367 I used my professional judgment to establish the proposed net salvage
368 parameters. Given the lack of historical data, this is a reasonable approach to
369 determining net salvage parameters under the circumstances. It is an industry
370 practice to use professional judgment and input from subject matter experts if no
371 historic data exists. I have presented testimony in such cases in Alaska,

372 Michigan, and Texas and those recommendations were adopted by each
373 regulatory body.

374 **Q. What are your net salvage recommendations for the Company's shared**
375 **services General plant?**

376 A. My net salvage recommendations for the Company's shared services General
377 plant are found in Appendix C of the shared services depreciation study. As a
378 summary, I recommend a zero net salvage percentage for each of the shared
379 services General plant accounts.

380 **D. Reserve Reallocation**

381 **Q. What is reserve reallocation?**

382 A. Reserve reallocation when the book reserve is re-spread within a functional
383 group based on the theoretical reserve within each function.

384 **Q. Did you align the Company's depreciation reserve with the life and net**
385 **salvage characteristics of the transmission, distribution and general plant**
386 **functions?**

387 A. In the process of analyzing the Company's depreciation reserve, I observed that
388 the depreciation reserve positions of the accounts were generally not in line with
389 the life characteristics found in the analysis of the Company's assets. To allow
390 the relative reserve positions of each account within a function to mirror the life
391 characteristics of the underlying assets, I reallocated the depreciation reserves
392 for all accounts within each function. Since the basis of the current depreciation
393 rates is unknown, I believe reserve reallocation is the best solution to resolve the
394 differences in reserve position.

395 **Q. Does the reallocation of the depreciation reserve change the total reserve?**

396 A. The reallocation of the depreciation reserve does not change the total reserve.

397 The depreciation reserve represents the amounts that have been collected as a
398 systemic allocation of the cost of an asset over its useful life, including any net
399 salvage that may be required to remove that asset from service upon retirement.

400 The reallocation process does not change the total reserve for each function; it
401 simply reallocates the reserve between accounts in the function.

402 **Q. Is depreciation reserve reallocation a sound depreciation practice?**

403 A. Depreciation reserve allocation is a sound depreciation practice. The National
404 Association of Regulatory Utility Commissioners endorsed the practice in its 1968
405 publication of *Public Utility Depreciation Practices*, explaining that reallocation of
406 the depreciation reserve is appropriate "...where the change in the view
407 concerning the life of property is so drastic as to indicate a serious difference
408 between the theoretical and the book reserve."⁴ Additionally, the 1996 edition of
409 *Public Utility Depreciation Practices* states that "theoretical reserve studies also
410 have been conducted for the purpose of allocating an existing reserve among
411 operating units or accounts."⁵

412 With respect to the Company, my depreciation study demonstrates that
413 there have been significant changes in the life of the property since the current
414 accrual rates were established. These changes have created a significant
415 difference between the theoretical and the book reserve in each functional group

⁴ *Public Utility Depreciation Practices*, Published by the National Association of Regulatory Utility Commissioners, 1968, page 48.

⁵ *Public Utility Depreciation Practices*, Published by the National Association of Regulatory Utility Commissioners, 1996, page 188.

416 that make the reallocation of the depreciation reserve appropriate in this
417 instance.

418 **Q. Why is it important for the depreciation reserve to conform to the**
419 **theoretical reserve?**

420 A. It is important for the depreciation reserve to conform to the theoretical reserve
421 because this sets the reserve at a level necessary to sustain the regulatory
422 concept of intergenerational equity among the Company's customers, as well as
423 set the depreciation rates at the appropriate level based on current parameters
424 and expectations.

425 **Q. How will the Company implement the reallocation of its depreciation**
426 **reserve if its proposed rates are approved?**

427 A. When the proposed depreciation rates are approved, the Company will reallocate
428 the reserves on its books to match the allocation performed in this study.

429 **E. Vintage Year Depreciation of General Plant Assets, FERC Accounts**
430 **391, 393-395. And 397-3995**

431 **Q. Please describe the Vintage Group methodology?**

432 A. For general plant in accounts 391, 393-395, and 397-3995, Liberty Utilities is
433 requesting to implement to use a vintage year accounting method approved by
434 the FERC in Accounting Release Number 15 ("AR-15"), Vintage Year Accounting
435 For General Plant Accounts, dated January 1, 1997. AR-15 allowed utilities to
436 use a simplified method of accounting for general plant assets, excluding
437 structures and improvements (referred to as "general plant"). The AR-15 release
438 allowed high-volume, low cost assets to be amortized over the associated useful

439 life, eliminated the need to track individual assets, and allows a retirement to be
440 booked at the end of the depreciable life. This method is often referred to as
441 “amortization of general plant.”

442 Adopting the method of accounting allowed in AR-15 changes the level of
443 detail maintained in the asset records and performs the depreciation calculation
444 at a vintage level rather than at a total account level. The plant asset balances
445 will be maintained by vintage installed with the retirement being recorded when
446 book depreciation has been completed. The empirical retirement data for
447 actuarial or semi-actuarial analysis will no longer be reliable; however, the
448 determination of useful life can be made appropriately with the use of market
449 forces, manufacturer expected life, technological obsolescence, business
450 planning, known causes of retirement, and changes in expected future utilization.

451 The depreciation calculation uses a useful life applied to a vintage versus
452 the entire account. The depreciation recovery is complete when the vintage
453 accumulated depreciation is equal to the vintage plant adjusted for estimated
454 salvage and removal costs.

455 **Q. Please describe the methodology or technique employed in analyzing the**
456 **life of Vintage Group Property?**

457 A. I performed actuarial life analysis on each account. The results of the actuarial
458 life analysis, together with my professional judgment, formed the basis of the
459 proposed life for these accounts. The lives being proposed reflect more recent
460 experience and Company information and set an appropriate recovery period for
461 the assets going forward.

462 **Q. Please describe the results of the Vintage Group Depreciation Study?**

463 A. The Company's current depreciation rates were compared to the Depreciation
464 Study recommendations in Appendix B of the depreciation studies. The rates
465 proposed for Vintage Group Illinois property are an increase of \$33,000 based on
466 plant balances as of September 30, 2015 when compared with the Company's
467 current depreciation rates. The rates proposed for Vintage Group shared
468 services property are an increase of \$263,000 based on plant balances as of
469 September 30, 2015 when compared with the annual accrual using the
470 Company's current depreciation rates. The relevant computations are shown in
471 Appendix A-1 to each depreciation study.

472 **V. CONCLUSION**

473 **Q. Did you prepare or directly supervise and control the preparation of each of**
474 **the Exhibits to your prefiled direct testimony?**

475 A. Yes.

476 **Q. Does this conclude your prefiled direct testimony?**

477 A. Yes.