

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

Application Of Kentucky Power Company For:)	
(1) A General Adjustment Of Its Rates For Electric)	
Service; (2) An Order Approving Its 2014)	
Environmental Compliance Plan; (3) An Order)	Case No. 2014-00396
Approving Its Tariffs And Riders; And (4) An)	
Order Granting All Other Required Approvals)	
And Relief)	

REBUTTAL TESTIMONY OF
DAVID A. DAVIS
ON BEHALF OF KENTUCKY POWER COMPANY

VERIFICATION

The undersigned, David A. Davis, being duly sworn, deposes and says he is the Manager, Property Accounting Policy and Research that he has personal knowledge of the matters set forth in the forgoing testimony for which he is identified as the witness contained therein is true and correct to the best of his information, knowledge and belief.

David A. Davis

David A. Davis

STATE OF OHIO

)

) Case No. 2014-00396

County of FRANKLIN

)

Subscribed and sworn to before me, a Notary Public in and before said County and State, by David A. Davis, this the 27th day of April 2015.

Kathy L. Messer

Notary Public

My Commission Expires: August 18, 2017

**REBUTTAL TESTIMONY OF
DAVID A. DAVIS ON BEHALF OF
KENTUCKY POWER COMPANY
BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY**

CASE NO. 2014-00396

TABLE OF CONTENTS

I.	Introduction	1
II.	Purpose of Rebuttal Testimony	1
III.	Mitchell Plant Terminal Net Salvage.....	2
IV.	Summary and Conclusion	7

**REBUTTAL TESTIMONY OF
DAVID A. DAVIS ON BEHALF OF
KENTUCKY POWER COMPANY
BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY**

I. INTRODUCTION

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

2 A. My name is David A. Davis. My business address is 1 Riverside Plaza, Columbus,
3 Ohio 43215. My position is Manager – Property Accounting Policy and Research for
4 American Electric Power Service Corporation (“AEPSC”) a wholly owned subsidiary of
5 American Electric Power Company, Inc. (“AEP”).

6 **Q. ARE YOU THE SAME DAVID A. DAVIS WHO PREVIOUSLY FILED**
7 **DIRECT TESTIMONY IN THIS PROCEEDING ON BEHALF OF KENTUCKY**
8 **POWER COMPANY?**

9 A. Yes, I am.

II. PURPOSE OF REBUTTAL TESTIMONY

10 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY IN THIS**
11 **PROCEEDING?**

12 A. My rebuttal testimony responds to depreciation related recommendations made by Lane
13 Kollen on behalf of the Kentucky Industrial Utility Customers, Inc.

14 **Q. PLEASE SUMMARIZE THE ACTIONS YOU PROPOSE THE COMMISSION**
15 **TAKE IN CONNECTION WITH THE RECOMMENDATIONS,**
16 **SUGGESTIONS AND PROPOSALS MADE BY INTERVENOR WITNESS**
17 **KOLLEN?**

1 A. For the reasons I discuss in more detail in this rebuttal testimony, the Commission
2 should:

3 1. Reject Mr. Kollen's recommendation to eliminate the Company's escalation of
4 Mitchell Plant's terminal net salvage amount to the plant's retirement date when
5 calculating Mitchell Plant depreciation rates. The Commission should accept
6 the Mitchell Plant depreciation rates as filed by the Company for reasons
7 explained in Section III, below.
8

9 2. Accept the depreciation rates proposed by the Company for Big Sandy Plant,
10 Transmission Plant, Distribution Plant and General Plant. Neither Mr. Kollen
11 nor other intervenors recommended any adjustments to these Company
12 proposed depreciation rates or to the methods and procedures used by the
13 Company to calculate those rates.
14

15 **Q. WHAT IS THE TOTAL EFFECT ON DEPRECIATION EXPENSE OF MR.**
16 **KOLLEN'S ADJUSTMENT TO MITCHELL PLANT'S TERMINAL NET**
17 **SALVAGE RATES?**

18 A. Mr. Kollen's adjustment to Mitchell Plant's terminal net salvage rates reduces
19 depreciation expense by \$0.761 million. Mr. Kollen references this depreciation
20 expense change on page 38, line 2 of his testimony and provides a detailed calculation
21 of the adjustment in his Exhibit ___(LK-16).

III. MITCHELL PLANT TERMINAL NET SALVAGE ESCALATION

22 **Q. WHAT IS NET SALVAGE AND HOW DOES IT AFFECT DEPRECIATION**
23 **RATES AND DEPRECIATION EXPENSE?**

24 A. Salvage includes amounts received for depreciable property retired due to sale,
25 reimbursement or reuse of the property. Removal cost is the expenditure incurred in
26 connection with retiring, removing or dispensing of property. Net salvage is the
27 difference between salvage and removal cost.

1 Positive net salvage occurs when salvage exceeds removal cost. Positive net
2 salvage decreases depreciation rates and expense. Negative net salvage occurs when
3 removal cost exceeds salvage. Negative net salvage increases depreciation rates and
4 expense.

5 **Q. WHAT TYPES OF NET SALVAGE ARE TYPICALLY CONSIDERED FOR**
6 **PRODUCTION PLANT TYPE PROPERTY IN A DEPRECIATION STUDY?**

7 A. A depreciation study for production plant type property typically considers both terminal
8 and interim net salvage.

9 **Q. HOW DOES TERMINAL NET SALVAGE DIFFER FROM INTERIM NET**
10 **SALVAGE?**

11 A. Terminal net salvage includes the final cost to retire the plant at the end of its useful life
12 less any salvage received from the property retired (net salvage). Interim net salvage
13 represents amounts received (salvage) net of removal cost incurred from retirements
14 from the time a plant is placed in service until its final retirement. Net salvage is
15 included in a depreciation study to recognize that there will be a cost and/or potential
16 salvage associated with those retirements which needs to be included in the depreciation
17 calculation.

18 **Q. DOES MR. KOLLEN TAKE EXCEPTION TO THE INCLUSION OF EITHER**
19 **TERMINAL OR INTERIM NET SALVAGE IN THE CALCULATION OF**
20 **MITCHELL PLANT'S DEPRECIATION RATES AND EXPENSES?**

21 A. No. Mr. Kollen does not take exception to the inclusion of either terminal or interim net
22 salvage in the calculation of Mitchell Plant's depreciation rates and expenses. However,

1 he does take exception to escalating the terminal net salvage amounts of Mitchell Plant
2 when calculating its depreciation rates.

3 **Q. WHAT REASONS DOES MR. KOLLEN GIVE FOR EXCLUDING THE**
4 **ESCALATION FACTOR THAT THE COMPANY APPLIED TO THE**
5 **MITCHELL PLANT TERMINAL NET SALVAGE AMOUNTS?**

6 A. Mr. Kollen discusses his reasons for excluding an escalation factor in the calculation of
7 Mitchell Plant's terminal net salvage amounts on pages 36-37 of his testimony. His
8 reasons include the following:

- 9 1. There is no certainty that the Company will dismantle the Mitchell plant when it
10 retires. It may be more economical to retire the plant in place, in which case the
11 plant will not be demolished.
- 12 2. There is uncertainty on the cost that will be incurred when the plant is retired
13 and the Company's proposed escalation compounds the uncertainty of the cost
14 estimate.
- 15 3. Use of 2040 dollars for 2015 ratemaking purposes is an inherent mismatch and
16 forces today's customers to subsidize future customers. If the cost estimate
17 escalates in future years, then if the increased cost is reasonable and prudent,
18 those increases can be reflected in future depreciation rates.
19
20
21

22
23 **Q. HOW DO YOU RESPOND TO MR. KOLLEN'S CRITICISM OF THE**
24 **COMPANY'S INCLUSION OF AN ESCALATION RATE IN THE**
25 **CALCULATION OF DEPRECIATION RATES FOR MITCHELL PLANT?**

26 A. Since the terminal net salvage amount represents the net salvage the Company expects
27 to incur when the plant retires and the demolition study which was used to determine
28 the terminal net salvage was performed in 2013, it is necessary to inflate the 2013

1 demolition cost estimates to the 2040 Mitchell Plant estimated retirement date to obtain
2 a reasonably accurate estimate of total demolition cost.

3 Standard depreciation practices incorporate net salvage at retirement date in the
4 calculation of depreciation rates as indicated in NARUC's "Public Utility Depreciation
5 Practices" (August 1996), at page 18, lines 9-13:

6 Net salvage is expressed as a percentage of plant retired by dividing the dollars
7 of net salvage by the dollars of original cost of plant retired. The goal of
8 accounting for net salvage is to allocate the net cost of an asset to accounting
9 periods, making due allowance for the net salvage positive or negative, **that will**
10 **be obtained when the asset is retired.** (emphasis added)
11

12 In states where AEP utilities operate, utility commissions have adopted
13 depreciation calculations based on production plant demolition studies comparable to
14 the ones sponsored by KPCo in this proceeding and have accepted the practice of
15 escalating generating unit retirement costs to the date of retirement. For example, the
16 Indiana Utility Regulatory Commission ruled in a case involving non-AEP affiliate
17 Public Service Company of Indiana, Cause No. 42359 (Order dated May 18, 2004, page
18 71), that escalation (inflation) should be factored into dismantlement costs. The Indiana
19 commission addressed a depreciation study sponsored by Mr. John Spanos for the utility
20 stating:

21 We find Mr. Spanos' approach to be realistic and consistent with past
22 experience. Inflation has been a fact of life in the American economy
23 for many years. Not factoring inflation into dismantlement costs to be
24 incurred in the future would understate those costs, with the result being
25 that future customers would have to pay costs arising from facilities that
26 are not serving them. This result flies in the face of matching rates with
27 costs incurred for service, as sound ratemaking principle followed by
28 this Commission. Moreover, current customers receive a benefit by
29 factoring in inflation, as it may appropriately allow for a reduction in rate

1 base because of the increased accumulated reserve for depreciation.
2 **Accordingly, this Commission finds that accounting for inflation in**
3 **determining the dismantlement estimates to be used as part of PSI's**
4 **depreciation rates is reasonable.** (emphasis added)

5

6 **Q. HOW DO YOU RESPOND TO MR. KOLLEN'S ASSERTION THAT THERE**
7 **IS NO CERTAINTY THAT THE COMPANY WILL DISMANTLE THE**
8 **MITCHELL PLANT WHEN IT RETIRES?**

9 A. Based on its historical record, AEP has demonstrated that it demolishes retired
10 generating plants. Since 1955, Appalachian Power Company which is a wholly owned
11 subsidiary of AEP has retired five steam generating plants including Kingsport,
12 Roanoke, Kenova, Logan and Cabin Creek Plants. All five of these plants have been
13 demolished.

14 In addition, AEP affiliate Indiana Michigan Power Company completed the
15 demolition of its Breed generating plant, a 450 MW capacity plant located in Fairbanks,
16 Indiana in 2006. The net cost of demolition (removal less salvage) was \$10,766,584.
17 The net cost divided by the original cost of Breed Plant (\$152,827,396) produced a net
18 salvage ratio of 1.07 which is identical to the 1.07 net salvage ratio used to estimate
19 terminal net salvage for KPCo's share of Mitchell plant.

20 **Q. IS MR. KOLLEN CORRECT WHEN HE MAINTAINS THAT THE**
21 **COMPANY'S PROPOSED ESCALATION COMPOUNDS THE**
22 **UNCERTAINTY OF THE COST ESTIMATE?**

23 A. No. Mr. Kollen has failed to indicate or demonstrate any flaw in the Company's
24 demolition cost estimate performed by Sargent & Lundy, LLC (S&L) that would create

1 uncertainty other than his assertion that the Company may not demolish the plant when
2 it retires. The likelihood of Mitchell Plant's demolition and the necessity of including
3 an escalation factor to properly calculate depreciation rates are both explained above

4 **Q. IS MR. KOLLEN ACCURATE WHEN HE INDICATES THAT USE OF 2040**
5 **DOLLARS FOR 2015 RATEMAKING PURPOSES IS AN INHERENT**
6 **MISMATCH AND FORCES TODAY'S CUSTOMERS TO SUBSIDIZE**
7 **FUTURE CUSTOMERS?**

8 A. No, in fact the opposite is correct. A central tenant of regulatory practice is generational
9 equity where the cost of electric service is borne by the customers who benefit from that
10 service. Using an escalated 2040 terminal demolition cost for Mitchell Plant creates a
11 level amount of depreciation expense to be included in rates for current and future
12 customers. Failure to incorporate escalation in the terminal demolition cost estimate
13 would cause future customers to pay continually increasing amounts. The lack of an
14 escalation would also be contrary to straight line depreciation principles.

IV. SUMMARY AND CONCLUSION

15 **Q. PLEASE SUMMARIZE YOUR CONCLUSIONS REGARDING MR.**
16 **KOLLEN'S RECOMMENDATION TO ELIMINATE THE ESCALATION**
17 **FACTOR USED TO CALCULATE THE TERMINAL NET SALVAGE**
18 **AMOUNT FOR MITCHELL PLANT'S DEPRECIATION RATES.**

19 A. Mr. Kollen is incorrect in his assumption that no escalation should be applied to
20 calculate Mitchell Plant's terminal net salvage cost and the Commission should accept
21 the depreciation rates for Mitchell Plant that were recommended by the Company.

1 He bases his recommendation to exclude Mitchell Plant's terminal demolition
2 cost escalation on his speculation that the Company may or may not dismantle Mitchell
3 Plant at the end of its useful life. He provides no evidence that supports his claim which
4 is contrary to AEP's historical record of demolishing plants after they retire.

5 He states that adding an escalation rate compounds the uncertainty of the
6 demolition cost estimate but provides no arguments that support why he believes there
7 is uncertainty included in the demolition cost estimate. Also, he fails to discuss why
8 escalation produces an inappropriate calculation when considering future cost and
9 calculating depreciation rates that include terminal net salvage amounts.

10 Mr. Kollen finally concludes that the use of 2040 dollars for 2015 ratemaking
11 purposes creates an inherent mismatch and forces today's customers to subsidize future
12 customers. His conclusion is incorrect because it is contrary to straight line
13 depreciation, inconsistent with standard depreciation practices and causes generational
14 inequities by forcing future customers to pay more for demolition cost than current
15 customers.

16 **Q. DO YOU HAVE ANY FURTHER COMMENTS REGARDING THE**
17 **DEPRECIATION RATES RECOMMENDED BY THE COMPANY?**

18 A. Yes. The Commission should accept the depreciation rates recommended by the
19 Company's depreciation study. Neither Mr. Kollen nor other intervenors had any
20 criticism of KPCo's recommended depreciation rates for Big Sandy Plant, Transmission
21 Plant, Distribution Plant or General Plant. The Commission should also accept KPCo's
22 recommended rates for Mitchell Plant for the reasons indicated above.

1 Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

2 A. Yes.