

BEFORE THE STATE OF NEW JERSEY
OFFICE OF ADMINISTRATIVE LAW

I/M/O THE PETITION OF NUI UTILITIES, INC)
D/B/A ELIZABETHTOWN GAS COMPANY) BPU DOCKET NO. GR02040245
FOR APPROVAL OF INCREASED BASE) OAL DOCKET NO. PUC 3719-02
TARIFF RATES AND CHARGES FOR GAS)
SERVICE AND OTHER TARIFF REVISIONS)

DIRECT TESTIMONY OF MICHAEL J. MAJOROS, Jr.
ON BEHALF OF THE
NEW JERSEY DIVISION OF THE RATEPAYER ADVOCATE

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Introduction

17. Please state your name.

1. My name is Michael J. Majoros, Jr.

17. By whom and in what capacity are you employed?

1. I am Vice President of Snavelly King Majoros O'Connor & Lee, Inc. (ASnavelly King@), an economic consulting firm with offices at 1220 L Street, N.W., Suite 410, Washington, D.C. 20005.

17. Have you attached a summary of qualifications and experience?

1. Yes. Appendix A is a brief description of my qualifications and experience. It also contains a listing of my appearances before state and Federal regulatory bodies.

17. At whose request are you appearing?

1. I am appearing at the request of the New Jersey Division of the Ratepayer Advocate (ARatepayer Advocate@).

Subject of Testimony

17. What is the subject of your testimony?

1. The subject of my testimony is depreciation.

17. Do you have any specific experience in the field of public utility depreciation?

1. Yes. Among other areas, my firm specializes in the field of public utility depreciation. Our clients have ranged from consumer organizations such as the Ratepayer Advocate to carriers such as AT&T. We have appeared as expert witnesses on depreciation before the regulatory commissions of more than half the states in the country. I have testified in over

80 proceedings on the subject of public utility depreciation, including several appearances before the Board of Public Utilities.

Purpose of Testimony

17. What is the purpose of your testimony?

1. The Ratepayer Advocate asked me to review Elizabethtown Gas Company's (ACompany@) depreciation-related testimony and exhibits¹. I was asked to express an opinion regarding the reasonableness of the Company's depreciation proposal and make an alternative recommendation if warranted.

17. Do you have an opinion regarding the reasonableness of the Company's depreciation proposal?

1. Yes. In my opinion, the Company's depreciation proposal is unreasonable. It will produce excessive depreciation in this rate case and unnecessarily increase the revenue requirement. It will also contribute to any depreciation-related attrition which occurs between rate cases. It reflects accounting changes since the last depreciation study which appear to be designed to artificially increase depreciation rates. Most important, however, is the fact that the Company's proposal is irrational and inconsistent with the principles and fundamentals of current thinking regarding capital recovery.

17. Please summarize your disagreements with the Company's proposals.

¹ The Company's depreciation testimony and exhibits were prepared and sponsored by Company witness John Spanos.

1. I have several disagreements with the Company's proposals. I disagree with service life parameters and I disagree with Mr. Spanos's application of the life span method. These are important issues which I would ordinarily challenge, but there is a much larger issue in this proceeding. My overwhelming disagreement, and the most important depreciation issue in this proceeding, is with Mr. Spanos's net salvage proposals. Mr. Spanos and the Company have made net salvage the major depreciation issue in this proceeding. Hence, although I disagree with Mr. Spanos's life parameters and/or procedures, I have focused on his net salvage proposal.

Q. Please compare the Company's depreciation proposal to your proposal.

2. The following table makes the comparison based on November 30, 2002 plant balances.

Depreciation Based on November 30, 2002 Balances	
Company	\$23,735,860 ¹
Majoros	<u>14,781,319²</u>
Difference	<u><u>\$(8,954,541)</u></u>

Preparation of Testimony

17. What did you do in order to prepare this testimony?
1. I reviewed the Company's filing and exhibits. I prepared interrogatories and reviewed the responses. I also reviewed the responses to Staff discovery relating to depreciation. I visited the Company and discussed its study and operations, and I went through Mr. Spanos's tour photographs with Mr. Douglas Staebler, a Company witness. I also visited a typical main and service replacement project in Metuchen, New Jersey. A copy of my field trip report is attached as Exhibit____(MJM-1). Management and operating personnel provided detailed presentations and fielded numerous questions during the course of the tour.

I also accumulated data from the Company's depreciation data base and prepared several analyses and calculations to test Mr. Spanos's proposals. Finally, I calculated remaining life accruals and rates using Mr. Spanos's proposed life parameters and September 30, 2001 balances and my recommendations concerning net salvage. These calculations are contained in Exhibit____(MJM-2).

Excessive Depreciation

17. What is an excessive depreciation rate?

1. An excessive depreciation rate is one that produces depreciation expense which is more than is necessary to return a company's capital investment over the life of the asset. In other words, since service lives and depreciation rates are inversely related, a life which is too short will result in a rate which is too high, thus producing excessive depreciation.

17. Have any courts addressed the concept of excessive depreciation?

1. Yes, the concept of excessive depreciation was explained by the U.S. Supreme Court in a landmark 1934 decision, Lindheimer v. Illinois Bell Telephone Company, as follows:

If the predictions of service life were entirely accurate and retirements were made when and as these predictions were precisely fulfilled, the depreciation reserve would represent the consumption of capital, on a cost basis, according to the method which spreads that loss over the respective service periods. But if the amounts charged to operating expenses and credited to the account for depreciation reserve are excessive, to that extent subscribers for the telephone service are required to provide, in effect, capital contributions, not to make good losses incurred by the utility in the service rendered and thus to keep its investment unimpaired, but to secure additional plant and equipment upon which the utility expects a return.

Confiscation being the issue, the company has the burden of making a convincing showing that the amounts it has charged to operating expenses for depreciation have not been excessive. That burden is not sustained by proof that its general accounting system has been correct. The calculations are mathematical, but the predictions underlying them are essentially matters of opinion. They proceed from studies of the behavior of large groups of items. These studies are beset with a

host of perplexing problems. Their determination involves the examination of many variable elements and opportunities for excessive allowances, even under a correct system of accounting, [are] always present. The necessity of checking the results is not questioned. The predictions must meet the controlling test of experience.²

17. How does the Company's proposal produce excessive depreciation?

1. The Company's proposal produces excessive depreciation because it includes an unsupportable and unreasonable request for negative net salvage in its depreciation rate calculations.

17. How did the Company calculate its depreciation rates?

1. The Company generally used the remaining life technique to calculate its recommended depreciation rates. Remaining life depreciation is calculated as shown below:

Remaining Life Depreciation

$$\text{Accrual} = \frac{\text{Plant in Service} - \text{Depreciation Reserve} - \text{Estimated Future Net Salvage}}{\text{Remaining Life}}$$

In a depreciation study it is axiomatic that the shorter the remaining life, the higher the resulting depreciation. If the life is too short, the resulting depreciation is excessive. Also, if the cost of removal built into the future net salvage is too great, it increases the numerator in the equation above and depreciation accruals are excessive. Accruals are converted to percentage rates and then applied to plant balances. When the accruals are too high, the resulting rates are also too high.

17. How do excessive depreciation rates produce excessive revenue requirements?

² Lindheimer v. Illinois Bell Telephone Company, 292 U.S. 151, 168-170, 54 S.Ct. 658, 665-666 (1934). (Emphasis added; footnote deleted.)

1. Excessive depreciation rates produce excessive depreciation expense. Since depreciation expense flows dollar-for-dollar into the revenue requirement, excessive depreciation expense results in an excessive revenue requirement.
17. Who pays for excessive depreciation rates?
 1. Ratepayers pay for excessive depreciation rates.
17. If depreciation can be excessive, can it also be deficient?
 1. Yes, depreciation can be deficient and in those circumstances the Company would be in an underrecovery situation.
17. Is the Company protected from underrecovery?
 1. Yes, the remaining life technique provides an automatic true-up because it is based on net plant, i.e., original cost minus the depreciation reserve. The remaining life technique also protects the Company from any early retirements resulting from mistakes it may have made. Again, that is because these retirements are charged to the depreciation reserve. The remaining life technique provides substantial protection to the Company. The remaining life technique does not, however, protect ratepayers from excessive depreciation resulting from lives which are too short or from unsupportable and unreasonable negative net salvage proposals.

Net Salvage

17. What is net salvage?

1. Net salvage is the difference between gross salvage and cost of removal.³ Net salvage is positive when gross salvage exceeds cost of removal. Conversely, net salvage is negative when cost of removal exceeds gross salvage. A positive net salvage ratio reduces the depreciation rate and revenue requirement, whereas a negative net salvage ratio increases the depreciation rate and revenue requirement for estimated future cost of removal.
17. Why do you say that net salvage is the most important depreciation issue in this case?
1. Net salvage is the most important issue in this case because the Company and Mr. Spanos chose to make net salvage the most important depreciation issue. In his response to S-EDEP-32, Mr. Spanos provided a summary of the causes of his proposed depreciation expense increase. That response is attached as Exhibit___(MJM-3). The following table summarizes Mr. Spanos's response.

**Cause of Mr. Spanos's
Depreciation Expense Increase (000)**

<u>Description</u>	<u>Amount</u>
1) Depreciation Expense at Existing Rates	\$14,337
2) Changes in Plant and Reserve Balances	<u>(2,244)</u>
3) Net	12,093
4) Spanos Difference to Service Life Changes	359
5) Spanos Difference to Net Salvage	<u>8,800</u>
6) Spanos Total	\$21,251

The \$2.2 million reduction on line 2 means that all things being equal, a recalculation of depreciation rates without changing any lives or net salvage parameters would reduce depreciation

³ AGross salvage is the amount recorded for the property retired due to the sale, reimbursement, or reuse of the property.@ ACost of removal is the cost incurred in connection with the retirement from service and the disposition of depreciable plant.@ Public Utility Depreciation Practices, 1996, National Association of Regulatory Utility Commissioner's (ANARUC Manual@), pages 320 and 317.

expense by \$2.2 million. Consequently, Mr. Spanos's proposal to change parameters would increase depreciation expense by \$359,000 for lives and \$8.8 million for net salvage⁴.

17. How did Mr. Spanos arrive at such a high number for future cost of removal?

1. Mr. Spanos arrived at that number as a result of a combination of Company changes to accounting practices and his approach to the analysis using data which incorporates the changed accounting practices.

17. Was Mr. Spanos aware of these changes to accounting practices?

1. According to Mr. Spanos's response to S-EDEP-9, Athere were no accounting changes since the Company's last depreciation study which had, or potentially had, an effect on the analysis of this depreciation study.⁵ This statement is inconsistent, however, with Mr. Spanos's study where he states that the Acost of removal has been high since the 1990's. The primary cause of the high levels of cost of removal was the standardization of labor costs assigned to remove the old service and install the new service.⁶ While Mr. Spanos might not consider this to be an accounting change, it certainly affects accounting records and the results of his study.

17. Please explain the Astandardization of labor cost@ change.

1. This relates to the retirement of portions of services associated with the replacement of mains.

APrior to July 1992, none of these costs had been recorded as cost of removal.⁷ However, based on

⁴Contrast this proposed annual amount with the Company's total net salvage experience for 1997 through 2001 of \$7.3 million, as shown in Exhibit____(MJM-4).

⁵ Response to S-EDEP-9.

⁶ Spanos's study, p. II-14.

⁷ Response to DEP-46 (emphasis added).

a July 1, 1992 memo from Glyn Hazelden to Robert Clancy, Athese costs are [now] being allocated as follows: 35% is allocated to cost of removal, 30% is allocated to the installation of the new main and 35% is allocated to service transfer expense.@⁸

17. Is the Company able to support these allocation ratios with any studies?

1. No.⁹ In my opinion they appear to be arbitrary.

17. What was the practice prior to 1992?

1. According to the Company, APrior to 1992, these costs were all charged to service transfer expense.@¹⁰

17. What was done in the field?

1. According to the July 1, 1992 memo, Athe people in the field were to continue to charge [these costs to] service transfer expense and the allocations to other accounts was to be performed in the Accounting Department.@¹¹

17. Why did the Company make this change?

1. According to the Company, Ait was decided that, rather than track the time for each activity or each job, we should develop the standard percentages set out in the memorandum attached to RAR-DEP-46.@¹²

17. How much cost of removal has been recorded as a result of the change?

⁸Response to RAR-DEP-46 and RAR-DEP-8.

⁹Response to RAR-DEP-63.

¹⁰Response to RAR-DEP-84.

¹¹Response to RAR-DEP-46.

¹² Response to RAR-DEP-84.

1. The Company is unable to identify or provide that amount.¹³
17. How does the change impact Mr. Spanos's study?
1. The change resulted in greater charges to cost of removal, which are incorporated into Mr. Spanos's study.
17. Have there been any other accounting changes since the last depreciation study which have an effect on Mr. Spanos's study?
1. Yes. During the 1997 to 1999 time period, the Company installed and upgraded a PeopleSoft Asset Management system. The Company explained that this installation resulted in incorrect retirement and cost of removal levels for 1997-2000. In fact, in his supplemental filing Mr. Spanos actually recalculated his life study and net salvage studies for Services when he discovered the errors resulting from this change. The recalculation resulted in an increase to Mr. Spanos's original proposal.
17. Were there any other changes?
1. Yes. Exhibit__(MJM-5) shows the Meters and Installations net salvage history from Mr. Spanos's study. Obviously something changed in 1995, since prior to 1995 there was no cost of removal and, subsequently, a substantial amount of cost of removal was recorded.
17. What caused this change?

¹³ Id.

1. Prior to fiscal year 1995, all costs relating to the replacement of meter sets were recorded as installation costs. In fiscal 1995, a procedural change in the field operations was made under which personnel began to charge the amount of labor to remove the meter sets as cost of removal.¹⁴
17. Are there any internal documents relating to this change?
1. Apparently not. The Company states Acurrently, no internal documents can be located relating to this change.¹⁵
17. Do you have any doubts that a change was made?
1. No, it is clear that a change was made and the change had an impact on Mr. Spanos's depreciation study. In my opinion, the validity of the change is in question.
17. Why is the validity of the change in question?
1. According to Mr. Spanos's workpapers, the cost of removal is actually being assigned to Meter Installations. However, it is not clear to me that Meter Installations are ever removed, or at least their removal is infrequent.
17. Who made this change?
1. The Company's Operations and Account management made the change.¹⁶
17. How did all of these accounting changes contribute to Mr. Spanos's high cost of removal estimates?
1. Mr. Spanos's analysis of cost of removal was based on a historical summary of retirements, cost of removal and gross salvage. Any accounting changes which increased annual cost of removal in these summaries resulted in more cost of removal than otherwise would have been included.

¹⁴ Response to RAR-DEP-53.

¹⁵ Id.

¹⁶ Response to RAR-DEP-72.

Obviously, each of these accounting changes, since the last study, had an impact on Mr. Spanos's study and contributed to the excessive cost of removal amounts he is proposing in this proceeding.

17. Earlier you stated that the form of Mr. Spanos's analyses resulted in higher cost of removal ratios. Please explain.
1. Mr. Spanos's net salvage analysis relates removal costs in current dollars to retirements in very old dollars. The result is that the cost of removal estimates reflect a substantial amount of inflation which is then projected into the future by the application of the inflated rates to total plant balances.
17. Does Mr. Spanos agree that his net salvage ratios are inflated?
1. Yes. In response to S-EDEP-12, Mr. Spanos stated "As much as the estimated future net salvage percentages approximate the historical percentages they reflect the same level of inflation."¹⁷ In other words, Mr. Spanos's proposed ratios are not stated at their net present value; they reflect a future value estimate assuming continued inflation. Thus, they would charge ratepayers today for inflation which has not yet occurred.
17. Do the Company's retirement procedures contain any features that tend to exacerbate the inclusion of future inflation in cost of removal estimates?
1. Yes, the Company uses the first-in, first-out (FIFO) procedure to age the retirements if it is unaware of the actual age of the assets.¹⁸ The FIFO procedure assumes that the assets retired are the oldest assets, hence they are stated in the oldest dollars. This exacerbates the inflation reflected in Mr. Spanos's cost of removal analysis because he is comparing the very oldest FIFO retirement dollars to current removal costs.

¹⁷ Response to S-EDEP-12.

¹⁸ Response to RAR-DEP-7.

17. Please explain why you believe that Mr. Spanos violated the principles underlying the Board's previous decision regarding the Company's current depreciation rates?

1. The current depreciation rates were established in December 1987 in the Company's last base rate case, BPU Dkt. GR86121374. The BPU adopted the ALJ's Initial Decision and certain Stipulations in that proceeding. The depreciation rates that were approved were covered in pages 67 to 77 of the Initial Decision.¹⁹ Those pages are attached as Exhibit____(MJM-6).

Net salvage was a major issue in that proceeding. Both Board Staff and Rate Counsel (the Ratepayer Advocate predecessor) opposed the Ahigh negative values incorporated in [the Company witness's] conclusions.²⁰ Indeed, Board Staff presented a witness to testify to that position. Both parties concluded that Athe traditional ratio procedure [Mr. Spanos's procedure] does not yield a reasonable relationship between the value of the retirement and the value of the net salvage for petitioner.²¹

¹⁹ Response to RAR-DEP-75.

²⁰ Initial Decision, OAL Dkt. No, PUC355-87, PUC 2654-87 and PUC4065-87, Agency Dkt. Nos. GR861213874, GR870261 and GT8608930, (A1987 Decision @) page 73.

²¹ Id.

In her initial Decision, the ALJ described the most extreme example which was Account 380, Services, for which [the Company's witness] used a salvage ratio of -100%.²² The ALJ concluded that Notwithstanding the fact that [the Company's witness] was generally a very credible and knowledgeable witness and that his approaches have general acceptance, the ratio procedure does not yield reasonable results for this Company for the purposes of this proceeding.²³

The ALJ cited to the vast mismatch between the cost of removal charges under the Company's approach and its actual experience, much as I described the results from Mr. Spanos's proposal in this proceeding. The ALJ also cited to the fact that the Company's [Mr. Spanos's] approach projects to the future, inflation rates which have been experienced in the past. The ALJ concluded that Under [the Company's] methodology, as long as petitioner's plant grows or plant is replaced at the current cost of new plant, assuming inflation, petitioner will collect more in a removal cost allowance than it will spend on removal costs because of the ratio approach which compares old retirements with current cost of removal.²⁴

17. Did the ALJ focus on any specific accounts in her decision?

1. Yes, the ALJ focused on four accounts. The two largest were 376-Mains and 380-Services. The Company proposed -25% and -100% net salvage ratios respectively, for these two accounts. The ALJ approved -5% and -7.5% respectively.

17. What is Mr. Spanos proposing for those two accounts in this proceeding?

1. Mr. Spanos is proposing -75% for Mains and -100% for Services, the same ratio that the Company proposed and the ALJ rejected in the 1985 case.

²² Id.

²³ Id., p. 74.

²⁴ Id., p. 75.

17. What do you conclude?

1. I conclude that Mr. Spanos's proposals violate the principles underlying the current depreciation rates. Virtually every flaw identified in the ALJ's Initial Decision in the 1987 case continues to be embodied in Mr. Spanos's proposals in this proceeding - even to the recognition that the use of FIFO for retirements also inflates net salvage ratios.

Mr. Spanos has not commented on the 1987 Board Order and the supporting Initial Decision, nor has he discussed the net salvage component of the current depreciation rates, and yet he is intimately familiar with an alternative procedure, which is essentially the same as that reflected in the current rates. In Mr. Spanos's home state of Pennsylvania, the Pennsylvania Public Service Commission long ago recognized the flaws inherent in Mr. Spanos's methodology and rejected it.²⁵ In fact, it is highly likely that the procedure in Pennsylvania provided the model for the net salvage factors incorporated in the Company's current depreciation rates. I believe this is the case because the Pennsylvania approach recognizes that much cost of removal is inherently an expense. I believe that the current net salvage ratios recognize that fact as well.

17. What is the Pennsylvania approach?

1. In Pennsylvania, depreciation rates are calculated without net salvage ratios. A net salvage allowance is added to the accruals. The allowance is based on the average of the last five years of actual net salvage experience. It is, in effect, a normalized expense approach, combined with the true-up features of remaining life depreciation.

Generally Accepted Accounting Principles (GAAP)

17. Why do you believe that Mr. Spanos's proposals violate current GAAP?

²⁵Penn Sheraton Hotel v. Pa. PUC, 198 Pa. Super 618, 184 A.2d 324 (Sept. 1962)

1. Pursuant to SFAS No. 143, which constitutes GAAP at the present time, all companies must determine whether or not they have actual legal obligations to retire their assets for all fiscal years beginning after June 15, 2002. These are called asset retirement obligations (AROs). If companies do not have AROs, any such costs will likely be expensed under the terms of an American Institute of Certified Public Accountants' Proposed Statement of Position (ASOP) on Property, Plant and Equipment.²⁶ If AROs do exist, they must be measured at their net present, not future inflated, values. This Company is subject to SFAS No. 143.
17. Does the SOP on Property, Plant and Equipment also constitute GAAP at the present time?
 1. No. At the present time SFAS No. 143 constitutes GAAP. The SOP does not yet constitute GAAP.
17. Does GAAP control rulemaking?
 1. No, however, the FERC is presently considering changes to the Uniform System of Accounts to recognize SFAS No. 143. Consequently, SFAS No. 143 principles are likely to be reflected in regulatory accounting.
17. Why is SFAS No. 143 relevant in this proceeding?
 1. In my opinion, the foundation of SFAS No. 143 and the expensing provisions of the SOP make sense. If a Company proposes to charge a future cost to current operations, it makes sense that it first establish the requirement to incur such a future cost. If such an obligation is established, it also makes sense for the obligation to be stated at its net present value to ensure that current operations are not charged with future inflation. If such an obligation does not exist, it makes sense to expense any such costs as incurred rather than include them in a depreciation rate calculation.

²⁶ Proposed Statement of Position, Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment; Accounting Standards Executive Committee, American Institute of Certified Public Accountants.

17. Does the Company have any legal AROs?
1. The Company initially believed that it had an ARO associated with its replacement of its 4" and 6" elevated pressure cast iron (EPCI) mains.²⁷ However, since these involve replacements, I am not certain they qualify as AROs. Furthermore, even if they did, the remaining 4" to 6" EPCI mains are immaterial to the overall plant account.
17. What is the Company's current thinking regarding the existence of AROs?
1. In my August 20, 2002 field trip to the Company, Mr. Clancy informed me that he believes that the Company does not have any AROs. However, in response to my informal data request during the field trip, the Company renewed its claim that the 4" to 6" EPCI program is an ARO. The Company's response is attached as Exhibit___(MJM-8). If the program is an ARO, the Company will record the net present value as a cost and write up its plant by an equivalent amount.
17. What do you conclude?
1. I conclude that the Company is unable to establish any obligations to incur the future cost of removal that Mr. Spanos is proposing be used to increase the Company's depreciation rates. From a GAAP standpoint, there is apparently only a small obligation amount that may be capitalized when the Company begins accounting under SFAS No. 143 on October 1, 2002.
17. If all of Mr. Spanos's removal cost estimates were determined to represent AROs, are they valued correctly?
1. No, they are vastly overstated because they have been inflated. Even if Mr. Spanos's estimates did represent AROs, which they do not, they would be discounted substantially to their net present

²⁷ Responses to RAR-DEP-56 and 58.

value. Consequently, not only are Mr. Spanos's removal cost estimates overstated in the context of the discussion in the last case, they are overstated in the context of GAAP.

17. What do you recommend?

1. I recommend that the Board recognize the fundamental principles of SFAS No. 143 by requiring that before any future costs of removal are included in current charges to ratepayers, the Company must first establish that it has a legal obligation to incur those costs. Further, if the obligation to incur those costs is established, the costs should be measured at their net present value.

In the meantime, I recommend that the Company use the 5-year rolling average expensing approach. This approach ensures that the Company recovers the net present value of its actual costs, but eliminates the inclusion of future inflation in depreciation rates. In my opinion, this approach is consistent with the principles of SFAS No. 143. This approach is also consistent with reality.

17. Why do you say that this approach is consistent with reality?

1. During my August 20, 2002 field trip, I visited a typical main and service replacement project in Metuchen, New Jersey. I observed almost all aspects of the project except the digging relating to capping of the existing mains and the transfer of service from the old mains to the new mains. Nor did I observe the transfer of service from the existing Service. Nevertheless, I discussed these processes with the Company's Distribution Construction & Engineering Manager as well as the on-site project manager.

Based on these observations and discussions, it became clear that the entire project was a replacement and transfer of service project. From a physical standpoint, the capping of the old main was a very small portion of the overall project. Furthermore, capping the old main was required to transfer service to the new main. In other words, the primary objective of the project was not to retire the old main, it was

to replace and transfer service. The capping of the old main was an expense incurred to transfer service. That is precisely how the Company used to account for the cost, before it made the accounting change in the early 1990's. Consequently, the five-year average normalized expense approach is not only consistent with GAAP, it is consistent with reality. The Company incurs an expense to transfer service.

17. Is there any precedent for this approach?

1. Yes, two Commissions of which I am aware have used such an approach. As explained earlier, the Pennsylvania Commission regularly uses the 5-year average expense approach, and the Kentucky Commission has approved this approach in two recent proceedings.²⁸

17. Have you summarized your recommendation?

1. Yes, Exhibit___(MJM-7) summarizes my recommended depreciation rates using Mr. Spanos's proposed lives and a 5-year normalized net salvage amount and applies those rates to the Company's projected November 30, 2002 plant balances.

17. Does this conclude your testimony?

1. Yes, it does.

²⁸ Company Workpaper ADJ-5A-3.

²⁸ Exhibit___(MJM-7)

²⁸Penn Sheraton Hotel v. Pa. PUC, 198 Pa. Super. 618, 184 A.2d 324 (Sept.1962) ; Kentucky Public Service Commission, Case Nos. 2000-373 and 2001-00244.