**BEFORE THE**

**FLORIDA PUBLIC SERVICE COMMISSION**

**DOCKET NO. 20230023-GU**

**IN RE: PETITION FOR RATE INCREASE BY**

**PEOPLES GAS SYSTEM, INC.**

**PREPARED DIRECT TESTIMONY AND EXHIBIT**

**OF**

**DANE A. WATSON**

**ON BEHALF OF PEOPLES GAS SYSTEM, INC.**

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**BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

**PREPARED DIRECT TESTIMONY**

**OF**

**DANE A. WATSON**

**ON BEHALF OF PEOPLES GAS SYSTEM, INC.**

**I. POSITION, QUALIFICATION, AND PURPOSE**

**Q.** Please state your name, address, occupation and employer.

**A.** My name is Dane A. Watson. My business address is 101 E. Park Blvd, Suite 220, Plano, Texas 75074. I am employed by Alliance Consulting Group.

**Q.** Please describe your duties and responsibilities in that position.

**A.** I am the Managing Partner in Alliance Consulting Group (“Alliance”). As the Managing Partner of Alliance, I am responsible for performing and defending depreciation studies across the United States in a variety of regulatory proceedings. My duties include the assembly and analysis of historical and simulated data, conducting field reviews, estimating service life and net salvage estimates, calculating annual depreciation, presenting recommended depreciation rates to utility management, and supporting such rates before regulatory bodies. I have performed more than 300 depreciation studies in my career, appeared in more than 200 cases, and testified before 35 regulatory bodies as an expert witness on the subject of depreciation.

**Q**. Please provide a brief outline of your business experience.

**A.** Since graduating from college in 1985, I have worked in the areas of depreciation and valuation. I founded Alliance in 2004, and I am responsible for conducting depreciation, valuation, and certain other accounting-related studies for utilities in various regulated industries. My prior employment from 1985 to 2004 was the Texas Utilities and successor companies (“TXU”). During my tenure with TXU, I was responsible for, among other things, conducting valuation and depreciation studies for the domestic TXU Companies. During that time, in addition to my depreciation responsibilities, I also served as Manager of Property Accounting Services and Records Management.

**Q**. What is your educational background?

**A.** I hold a Bachelor of Science degree in Engineering from the University of Arkansas at Fayetteville and a Master’s Degree in Business Administration from Amberton University. I am a registered Professional Engineer in the State of Texas.

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

**A.** Yes. The Society of Depreciation Professionals (the “Society”) has established national standards for depreciation professionals. The Society administers an examination and has certain required qualifications to become certified in this field. I met all the requirements and have become a Certified Depreciation Professional (“CDP”).

**Q**. Please describe your other professional activities.

**A.** I have twice served as Chair of the Edison Electric Institute (“EEI”) Property Accounting and Valuation Committee and have been Chairman of EEI’s Depreciation and Economic Issues Subcommittee. I am a Senior Member of the Institute of Electrical and Electronics Engineers (“IEEE”) and have held numerous offices on the Executive Board of the Dallas Section of IEEE as well as National and Worldwide offices. I have also served twice as the President of the Society of Depreciation Professionals.

**Q.** Have you previously testified before state and/or regulatory commissions?

**A.** Yes. I have testified before numerous state and federal agencies in my 38-year career in performing depreciation studies. I have conducted depreciation studies, filed written testimony, and/or testified before the Commissions identified in my Exhibit No. DAW-1, Document No. 1.

**Q.** What is your responsibility and participation in the preparation of the Updated Depreciation Study for Peoples Gas System, Inc. (“Peoples” or the “company”)?

**A.** I was personally responsible for, participated in, and directed all aspects of the work performed by Alliance resulting in the recommendations contained in my Exhibit No. DAW-1, Document No. 2, the Updated Depreciation Study.

**Q.** What are the purposes of your prepared direct testimony in this proceeding?

**A.** The purposes of my direct testimony are to (1) discuss the Updated Depreciation Study conducted from Peoples’ gas depreciable assets based on actual historical data as of December 31, 2021 and the forecasted plant and reserve balances as of December 31, 2024, and (2) support and justify the recommended depreciation rates for the company’s assets.

**Q.** Did you prepare an Exhibit in support of your prepared direct testimony?

**A.** Yes. Exhibit No. DAW-1 consisting of three Documents prepared under my direction and supervision.

 Document No. 1 Testimony Experience of Dane A. Watson

 Document No. 2 Updated Depreciation Study

 Document No. 3 Functional Summary Comparison of Depreciation Expense - Schedules 1-3

 To the best of my knowledge, the information contained in my exhibit is true and correct.

**Q.** Is the Updated Depreciation Study included as Document No. 2 to this testimony the same document that you prepared in the company’s filing on December 28, 2022?

**A.** No. After the books were closed for 2022 year-end activity, the company updated its forecast data to include 2022 actuals and revised forecasts for 2023 and 2024. Those updates produced changes in forecast plant balances and accumulated depreciation. Using these updated inputs, I prepared the Updated Study using the same approach and depreciation system used to prepare the Depreciation Study filed on December 28, 2022. This testimony refers to the Updated Depreciation Study included in Document No. 2 of my exhibit as the “Updated Study”. The updates did not make any changes to the average service life and net salvage parameters presented in the Depreciation Study, filed on December 28, 2022.

**Q.** Does the Updated Study represent a material change in the company’s proposed 2024 test year depreciation expense from the study filed in December 2022?

**A.** No. The best point of comparison is the annual status report for 2024, included as Appendix F in both versions of the Depreciation Study, which shows the implementation of new depreciation rates. The resulting 2024 test year depreciation expense amounts shown below are in the 2024 reserve walkforward schedules, Appendix F-2.

**PEOPLES GAS DEPRECIATION STUDY COMPARISON**



The increase of $62 thousand is .07 percent of the total from the December 2022 Study.

**II. TESTIMONY STRUCTURE, DEPRECIATION DEFINTION, AND STUDY PURPOSE**

**Q.** How is your direct testimony structured?

**A.** My direct testimony has five sections. The first two are introductory in nature.

 In Section III, I explain the property included in the Updated Study; the four-phase approach I used to conduct the Updated Study; and the depreciation system I used for the Updated Study.

 In Section IV, I explain how depreciation rates are determined, including identifying the formula for depreciation rates. This portion of my direct testimony also explains and fully discusses each portion of the depreciation rate formula that is supported by the Updated Study. Section IV is broken into the following subparts, which align with the components of the depreciation rate formula that the Updated Study supports: (A) Depreciation Rate Formula; B) Life Estimation; (C) Theoretical Reserve; (D) Net Salvage Amounts and Percentages; (E) Remaining Life Analysis; and (F) Depreciation Accrual and Rates.

 In Section V, I discuss the change in depreciation expense as a result of the proposed depreciation rates. Specifically, I explain why Peoples’ depreciation expense is increasing.

1. What definition of depreciation have you used for the purposes of conducting a depreciation study and preparing your direct testimony?

**A.** The term “depreciation,” as used herein, is considered in the accounting sense–that is, a system of accounting that distributes the cost of assets, less net salvage (if any), over the estimated useful life of the assets in a systematic and rational manner. Depreciation is a process of allocation, not valuation. In other words, depreciation expense allocates the cost of the asset, including any estimated net salvage (the negative of this is also known as net removal) necessary to remove the asset, as an ongoing cost of operations over the economic life of the asset. However, the amount allocated to any one accounting period does not necessarily represent an actual loss or decrease in value that will occur during that particular period. The company accrues depreciation on the basis of the original cost of all depreciable property included in each functional property group. On retirement, the full cost of depreciable property, less the net salvage value, is charged to the depreciation reserve.

**Q.** Please generally describe the purpose of the updated Study.

**A.** The key functions of the Updated Study are to: (1) determine the average service lives for Distribution and General Plant; (2) determine the net salvage percentages for Distribution and General Plant; (3) calculate the theoretical reserve of each property group based on the remaining life of the group, the total life of the group and the estimated net salvage; (4) develop depreciation rates, including an annual depreciation accrual; and (5) develop depreciation rates for plant that Peoples will add to its rate base that currently are not currently capitalized on its books.

**Q.** Based on the Updated Study, what conclusions do you reach?

**A.** I conclude that the depreciation rates developed for Peoples’ utility accounts as set forth in the Updated Study, which is sponsored by me and included as Document No. 2 of my exhibit, encompass the best and most recent information for calculating Peoples’ depreciation expense associated with these assets and are reasonable and appropriate for use in recovering the cost of Peoples’ assets and net salvage.

 Based on life and net salvage parameters developed and applied to forecast plant assets and depreciation reserve balances as of December 31, 2024, the depreciation rates in the Updated Study will result in an increase in the annual depreciation expense of approximately $9.0 million per year. This amount was determined by comparing the depreciation expense difference between the current depreciation rates and the proposed depreciation rates as of December 31, 2024. A functional summary comparison of depreciation expense is shown in Document No. 3, Schedule 1, of my exhibit, and a more detailed comparison is shown in Document No. 2, Appendix B of my exhibit.

**III. PEOPLES’ DEPRECIATION RATE STUDY**

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

**A.** In this section of my direct testimony, I describe the property included in the Updated Study; the four-phase approach I used to conduct the December Study and the Updated Study; and the depreciation system (straight-line method, Average Life Group procedure, remaining-life technique) used for the Updated Study.

**Q.** Did the company give you any specific information for conducting the Updated Study?

**A.** Yes. The company gave me the following information for the Updated Study:

 a. Historical data to analyze for life and net salvage to assist in making recommendations for Distribution and General Plant assets based on actual historical data as of December 31, 2021.

 b. Plant and reserve balances to calculate the theoretical reserves and the recommended whole life and remaining life depreciation rates, including the annual depreciation expense accrual, on forecast plant and reserve balances as of December 31, 2024.

 c. Information related to the operations, conditions, plans and programs was communicated to me from company subject matter experts and recorded in my interview notes.

 d. Information regarding the new assets recently added or projected to be added during the forecast period in the gathering plant, and Liquified Natural Gas (“LNG”) plant function, as well as the company’s planned use of those assets.

**Q.** Can you describe the new asset groups (i.e., LNG and Renewable Natural Gas (“RNG”)) included in this study?

**A.** Yes. Two of the new categories of plant have previously been addressed in the prior depreciation study. Accounts 33600 and 36400 utilize the same depreciation parameters approved in the existing rates. The third category of plant is similar to Account 33600 but involves a contractual agreement with Brightmark for an RNG facility and is given the designation Account 33601.

**Q.** Please discuss Account 33601, RNG Plant Leased – 15 Years.

**A.** The Brightmark project is described in greater detail in the Direct Testimony of Peoples’ witness Lew Rutkin, Jr. In short, the company entered into an agreement with Brightmark for Peoples to own and operate the RNG facility. After 15 years, the Company will retire the facility off its books, transfer ownership to Brightmark, and Brightmark will then cover all ongoing operations and maintenance cost, and well as any removal obligations for the facility. To match the structure of the contract, the company will depreciate the facility over the 15-year contract but will not need to reflect any removal cost in the depreciation rate. The depreciation rate in this study for this account follows that concept.

**Q.** What property is included in the Updated Study?

**A.** There are two general classes, or functional groups, of depreciable property that are analyzed in the Updated Study: (1) Distribution Plant and (2) General Plant property. The Distribution Plant functional group primarily consists of pipe, numerous general and city gate stations, meters and associated facilities used to distribute gas to customers of Peoples. General Plant property is plant (such as office buildings) used to support Peoples’ overall operations.

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

**A.** With the assistance of my staff, I conducted the Updated Study in four phases as described in Document No. 2 of my exhibit. The four phases are: Data Collection, Analysis, Evaluation, and Calculation. During the initial phase of the Study, I collected historical data through December 31, 2021, to be used in the analysis. After the data was assembled, I performed analyses to determine the life and net salvage percentage for the different property groups being studied. As part of this process, I conferred with field personnel, engineers, and managers responsible for the installation, operation, and removal of the assets to gain their input into the operation, maintenance, and salvage of the assets. This information combined with the Study results, was then evaluated to determine how the results of the historical asset activity analysis, in conjunction with the company’s expected future plans, should be applied. The final phase is the calculation of depreciation rates and the theoretical reserve.

 The authoritative treatise on depreciation studies, titled “Depreciation Systems,” documents the following stages of a depreciation study: “statistical analysis, evaluation of statistical analysis, discussions with management, forecast assumptions, and document recommendations.”[[1]](#footnote-2) My approach mirrors this process, and following this approach ensures that Alliance comprehensively and thoroughly projects the future expectations for the company’s assets. Document No. 2 of my exhibit shows Figure 2, which demonstrates the four phases of the Updated Study conducted for Peoples.

**Q.** What depreciation system did you use for the Updated Study?

**A.** The straight-line (method), the Average Life Group (“ALG”) (procedure), remaining-life (technique) depreciation system was used for this Study. This is the same methodology used by Peoples and approved by this Commission for the existing depreciation rates established in Docket No. 20200166-GU, which was consolidated with the 20200051-GU Rate Case.

**Q.** What is a survivor curve?

**A.** A survivor curve represents the percentage of property remaining in service at various age intervals. The Iowa Curves, the predominantly used survivor curve method in the utility industry, are the result of an extensive investigation of life characteristics of physical property made at Iowa State College Engineering Experiment Station in the first half of the prior century. Through common usage, revalidation and regulatory acceptance, the Iowa Curves have become a descriptive standard for the life characteristics of industrial property. For more detail on survivor curves see Document 2 of my exhibit.

**Q.** How are survivor curves used in this study?

**A**. Most property groups can be closely fitted to one Iowa Curve with a unique average service life. The blending of judgment concerning current conditions and future trends along with the matching of historical data permits a depreciation analyst to make an informed selection of an account’s average service life and survivor curve. When selecting an average service life, a survivor curve is also selected. When recommending depreciation rates, a depreciation analyst selects the average service life and survivor curve that are used to compute remaining life and theoretical reserve.

**IV. DETERMINATION OF THE DEPRECIATION RATES**

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

**A.** In this section, I explain how depreciation rates are determined, including identifying the formula for depreciation rates. This portion of my direct testimony also explains and fully discusses each portion of the depreciation rate formula that is supported by my Updated Study. Section IV is broken into the following subparts, which aligns with the components of the depreciation rate formula that the Updated Study supports: (A) The Depreciation Rate Formula; (B) Life Estimation; (C) Theoretical Reserve; (D) Net Salvage Amounts or Percentages; (E) Remaining Life; and (F) Depreciation Accrual and Rates.

**(A) THE DEPRECIATION RATE FORMULA**

**Q.** How are the depreciation rates determined?

**A.** The formula used to derive depreciation rates calculates annual depreciation accrual amounts for each group by dividing the original cost of the asset (gross plant), less book depreciation reserve, less estimated net salvage, by the group’s respective remaining life. The resulting annual accrual amounts for all depreciable property within an account are accumulated, and the total is divided by the original cost (gross plant) of all depreciable property within the account to determine the depreciation rate.

**Q.** What portion of the formula used to derive depreciation rates is supported by the Updated Study?

**A.** The Updated Study determines several pieces of the overall formula used to derive depreciation rates. The portions of the formula derived by the Updated Study are:

a.Plant and Depreciation Reserve Balance: The depreciation reserve was provided by the company with the projected gross plant balance amounts and the projected depreciation reserve as of December 31, 2024. The Updated Study depreciation reserve balance is subtracted from gross plant.

b.Life Estimation: The Updated Study describes the analytical tools used to estimate the appropriate average service lives and retirement survivor curve for each depreciable account.

c.Theoretical Reserve: The theoretical reserve represents the portion of a property group’s cost that would have been accrued as depreciation reserve if current expectations were used throughout the life of the property group for future depreciation accruals. The theoretical reserve for the asset group serves as a point of comparison to the book reserve to determine if the unrecovered investment of the asset and its removal cost are over or under-accrued.

 d. Net Salvage Amounts or Percentages: The Updated Study supports the overall net salvage percentages. The Updated Study calculates and recommends the net salvage percentages for Distribution and General Plant accounts. For these plant accounts, salvage and removal cost percentages are calculated by dividing the current cost of salvage or removal, as supported by the Updated Study, by the original installed cost of the retired asset.

e.Remaining Life: The Updated Study supports the remaining life calculation by determining the appropriate average service lives and retirement survivor curve for each account.

f.Resulting Annual Depreciation Accrual and Depreciation Rates: As discussed above, the Updated Study calculates the depreciation rates and the annual accrual amounts are then derived from these rates. The computation of the annual depreciation rates and annual accrual amounts is shown in Appendix A of Exhibit DAW-1, Document No. 2.

**(B.) LIFE ESTIMATION**

**Q.** What method does the study use to analyze historical data for Distribution and General plant to estimate life characteristics?

**A.** I analyzedall Distribution and General Plant accounts using the actuarial analysis (retirement rate method) to estimate the life of the property in each account. Depreciation analysts use models of property mortality characteristics that have been validated in research and empirical applications in much the same manner as human mortality is analyzed by actuaries.

**Q.** How did you determine the average service lives for Distribution and General plant?

**A.** As noted above, I used actuarial analysis and judgment to determine the appropriate average service lives for each account in the Distribution and General functions. Graphs and tables supporting the analysis and the chosen Iowa Curves used to determine the average service lives for analyzed accounts are found in the Determination of the Lives and Net Salvage section of Document No. 2 of my exhibit, Appendix D. A summary comparison of the approved and proposed depreciable lives is shown in Document No. 3, Schedule 3 and Document No. 2, Appendix C of my exhibit.

**Q.** Please describe some of the changes in the average service lives for the various Distribution and General accounts.

**A.** For Distribution and General Accounts, there are 7 accounts with increasing lives; one account with decreasing lives; and 28 accounts where there is no change. Examples of some of the changes in average service lives for Distribution and General Plant are as follows:

a. The two accounts with the largest life increases, which each increased by 3 years, were: (1) Distribution Account 38700 Other Equipment; and (2) Distribution Account 39204 Trailers and Other.

b. All the accounts (6 out of 36) with increasing lives have increases of 3 years or less. Further discussion of the increases is detailed for each account in the Updated Study report.

c. General Account 39201 Vehicles up to ½ ton decreased in life by 1 year.

 Further discussion of the decreases is detailed for each account in the Updated Study report.

**Q.** What method did you use in the Updated Study to predict the life characteristics of assets that will be added during the forecast period which currently are not part of the company’s plant-in service assets or were recently added to the company’s plant-in service assets?

**A.** Since no historical data was available for those assets, I reviewed information provided by company personnel and reviewed the life parameters used by other natural gas utilities across the nation.The proposed lives for these accounts are shown in Appendix C of the Updated Study and are discussed in Document No. 2 of my exhibit.

**(C.) THEORETICAL RESERVE**

**Q.** What purpose does the theoretical reserve serve in a depreciation study?

**A.** The theoretical reserve represents the portion of a property group’s cost that would have been accrued as depreciation reserve if current life and net salvage expectations were used and achieved throughout the life of the property group for depreciation accruals. The theoretical reserve for the asset group serves as a point of comparison to the book reserve to determine if the unrecovered investment of the asset and its removal cost are over or under-accrued.

**Q.** How did you determine the theoretical reserve reflected in the Updated Study?

**A.** I computed the theoretical reserves in the Updated Study based on projected plant balances as of December 31, 2024. The theoretical reserve was calculated using a reserve model that relies on a prospective concept relating future retirement and accrual patterns for property, given current life and salvage estimates. More specifically, the theoretical reserve of a property group was determined from the estimated remaining life of the group, the total life of the group, and estimated net salvage. This computation for the straight-line, remaining-life theoretical reserve ratio, which I describe in more detail in Document No. 2 of my exhibit, involved multiplying the vintage balances within the property group by the theoretical reserve ratio for each vintage.

**Q.** Is it desirable for the depreciation reserve to conform to the theoretical reserve?

**A.** Yes. It is desirable for the depreciation reserve to conform as closely as possible to the theoretical reserve. When remaining life rates are used, the theoretical reserve provides the basis for any over-accrual or under-accrual in setting the depreciation rates at the appropriate level based on current parameters and expectations.

**Q.** How do the book and theoretical reserve compare in this study?

**A.** As shown in Document No. 2 of my exhibit, Appendix E, the theoretical reserve is lower than the book reserve, creating a surplus that is netted over the remaining life of the account and has the effect of decreasing the depreciation rate. Rates by account for Distribution and General are shown in Document No. 2 of my exhibit, Appendix B.

 Overall, the Updated Study found a surplus of $119.6 million at December 31, 2024 based on the recommended life and net salvage parameters. The depreciation rates are designed to eliminate that surplus over the remaining life of the distribution depreciable assets and the average remaining life for the accounts where the company is proposing general plant amortization.

**Q.** How was the difference between the book and theoretical reserve handled in the Peoples’ last depreciation study?

**A.** The Florida Public Service Commission (“Commission”) approved the use of remaining life to amortize that amount in Docket No. 20200166-GU. This Updated Study proposes the same methodology.

**(D.) NET SALVAGE AMOUNTS OR PERCENTAGES**

**Q.** What is net salvage as determined for all the company’s plant assets?

**A.** While discussed more fully in the Updated Study itself, net salvage is the difference between the gross salvage (what the asset was sold for) and the cost of removal (cost to remove and dispose of the asset) (“COR”). If the COR exceeds gross salvage, net salvage is negative. Some plant assets can experience significant negative removal cost percentages due to the amount of removal cost and the timing of any capital additions versus the retirement.

 Salvage and removal cost percentages are calculated by dividing the current cost of salvage or removal by the original installed cost of the assets retired.

**Q.** How did you determine the net salvage percentages for each asset group in Distribution and General plant?

**A.** I started by using an industry-standard method that divides the current cost of removal and salvage by the original installed cost of the assets retired. However, I also applied judgment to select a net salvage percentage that represents the future expectations for each account. The recommended lives and net salvage parameters remain the same in the Study filed December 28, 2022 and the Updated Study. In applying this judgment, I compiled and considered historical salvage and removal data by account to determine values and trends in gross salvage and removal cost. The account data for retirements, gross salvage, and COR covered the period from 1983 - 2021 and is detailed in the Updated Study. I calculated moving averages with this data, with the intent to remove timing differences between retirement and salvage and removal cost; I analyzed those moving averages over varying periods up to 10 years. These calculations are shown in Document No. 2, Appendix D of my exhibit.

**Q.** Is it sufficient to only analyze historical data to form your life and net salvage estimates?

**A.** No. Historic life and salvage data are the primary factors to consider in making life and net salvage recommendations, but it is crucial to incorporate future trends, changes in equipment and company-specific operational information before finally making life and net salvage recommendations. Once all the calculations and data are prepared, I applied professional judgment, considered company expectations and trends, and evaluated the magnitude of the potential change to determine the appropriate net salvage percentages. A comparison of the approved and proposed net salvage percentages is shown in Document No. 3, Schedule 2 and in Document No. 2, Appendix C of my exhibit.

**Q.** Please describe the major changes in the net salvage percentages for the various accounts.

**A.** The detailed analysis of each account is described fully in Document No. 2 of my exhibit. Net salvage is trending toward more negative net salvage due to the increased costs of labor, safety, and environmental compliance associated with retiring utility assets and the longer lives being experienced for many assets. For Peoples, net salvage in nine accounts decreased (became more negative) while three increased (became less negative or more positive), there was one account where no comparison could be made and twenty-one accounts were unchanged. Examples of some of the changes in net salvage are:

 a. The most significant changes of 10 percent or more (more negative) in net salvage percentages were in: Distribution Account 37600, Steel Mains, which decreased from negative 50 to negative 60 percent; Account 37800 Measuring and Regulating Stations General which decreased from negative 10 to negative 20 percent; and Account 37900 Measuring and Regulating Stations City Gas which decreased from negative 10 to negative 20 percent.

 b. The most significant increases in net salvage percentage were for General Plant Account 39204 Trailers and Others which increased from a positive 15 percent to positive 20 percent net salvage and Account 39205 Vehicles Over 1 Ton which increased from a positive 4 percent to positive 7 percent net salvage.

 In addition to the account specific detail, general factors impacting removal costs are discussed in the Updated Study. See Document No. 2 of my exhibit.

**Q.** How did you determine the net salvage percentages for accounts where no history exists?

**A.** I used the existing net salvage parameters for Account 33600 RNG and 36400 LNG. The company also has a new category of assets in Account 33601 RNG Plant Leased -15 Years. As mentioned above, the company has entered into a contract for a large portion of the RNG assets. Contract terms specify no net salvage, so no net salvage is proposed for those assets. The net salvage parameter for Account 33601 was requested in a separate Commission docket filed December 15, 2022. The company will review these proposals in future depreciation studies and as the company gains actual experience with these assets.

**Q.** How do the life and net salvage parameters compare between the Depreciation Study filed on December 28, 2022, and the Updated Study?

**A.** There was no change in the proposed life and net salvage parameters for each plant account between the original Depreciation Study and Updated Study. The items that changed were forecast plant balances and accumulated depreciation amounts at December 31, 2024.

**(E.) REMAINING LIFE**

**Q.** Having determined the theoretical reserve, the book reserve, and calculated net salvage, please describe how you used the remaining life for each account to calculate the depreciation rates and annual depreciation accrual expense.

**A.** I used a three-step process to determine the remaining life for each account. First, I used historic data through December 31, 2021 and applied judgment to estimate life and net salvage parameters. Then, I developed the vintage balances and reserves as of December 31, 2024.

 Using those inputs, I estimated the remaining life for each vintage in the group by applying the proposed average life and dispersion curve by vintage and computing the direct weighting remaining life for each plant account.

**(F.) DEPRECIATION ACCRUAL RATES**

**Q.** Please describe the final steps in calculating the depreciation rates and annual depreciation accrual expense.

**A.** I used a two-step process to calculate the depreciation rates. In the first step, as discussed earlier, I used historical data through December 31, 2021, company information, and judgment to estimate life and net salvage parameters. I then used the vintage balances and reserves as of December 31, 2024 to compute the proposed depreciation accrual expense and rates using the estimated life and net salvage parameters.

 In the Updated Study, I calculated the depreciation accrual rates using the same methodology as was used in developing the depreciation rates approved by the Commission in Docket No. 20200166-GU, Order No. PSC-2020-0485-FOF-GU. More discussion on the computation of accrual rates is found in the Updated Study and the calculations are shown in Document No. 2, Appendix A of my exhibit.

**V. CHANGE IN DEPRECIATION EXPENSE AS A RESULT**

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

**A.** In this section of my direct testimony, I discuss the change in depreciation expense as a result of the proposed depreciation rates. Specifically, I describe the changes in depreciation expense and explain why Peoples’ depreciation expense is increasing.

**Q.** Please summarize the Updated Study results with respect to changes in depreciation expense.

**A.** Based on the depreciation rates indicated in the Updated Study, as applied to forecasted plant balances as of December 31, 2024, the overall change in annual depreciation expense is an increase of approximately $9.0 million for currently existing asset classes. Document No. 3, Schedule 1 of my exhibit, reflects an increase of $8.3 million in Distribution, an increase of $0.7 million in General and no change for intangible property. There is also a decrease of $16,000 for RNG and LNG assets which will be added in the forecast period.

 There are two asset types, Mains (376) and Services (380), in the Distribution function that are driving the increase. Account 37600 Steel Mains, Account 37602 Plastic Mains, Account 38000 Steel Services, and Account 38002 Plastic Services all retained the same average service lives and dispersion, with more negative net salvage. Since these are the company’s largest accounts, the impact is an increase in depreciation expense compared to the existing rates.

**Q.** Have you proposed depreciation rates for certain expected plant additions?

**A.** Yes. In the Updated Study we are updating the depreciation rates including a proposed life, net salvage and resulting depreciation rate for the company’s gathering and LNG plant additions which include: Account 33600 RNG and Account 36400 LNG plant. On December 15, 2022, the company made a separate filing for depreciation accrual rates, lives and net salvage parameters for Account 33601 RNG Plant Leased - 15 years. The same rate included in the separate December filing is proposed in this Updated Study. Accounts 33600 and 36400 use the same life and net salvage parameters approved in the company’s prior docket. The depreciation expense on these assets added through 2024 is proposed to be $3.0 million annually.

**VI. CONCLUSION**

**Q.** Based on the Updated Study, what are the appropriate depreciation parameters (e.g., service life, remaining life, net salvage percentage, and reserve percentage) and resulting depreciation rate for each distribution and general plant account?

**A.** The appropriate depreciation parameters and rate components are set out in the Updated Study submitted as Exhibit DAW-1, Document 2 to my direct testimony.

**Q.** Based on the application of the depreciation parameters in the Updated Study, and a comparison of the theoretical reserves to the book reserves, what are the resulting imbalances, if any?

**A.** Overall, the Updated Study found a surplus of $119.6 million at December 31, 2024 based on the recommended life and net salvage parameters.

**Q.** What, if any, corrective depreciation reserve measures should be taken with respect to any imbalances identified?

**A.** The proposed depreciation rates are designed to eliminate that surplus over the remaining life of the distribution depreciable assets and the average remaining life for the accounts where the company is proposing general plant amortization.

**Q.** What should be the implementation date for revised depreciation rates and amortization schedules?

**A.** The implementation date should be January 1, 2024 as proposed by the company.

**Q.** Mr. Watson, do you have any concluding remarks?

**A.** Yes. The Updated Study and analysis performed under my supervision fully supports setting depreciation rates at the level I have indicated in my direct testimony. The company should continue to periodically review the annual depreciation rates for its property. In this way, the company’s depreciation expense will more accurately reflect its cost of operations and the rates for all customers will include an appropriate share of the capital expended for their benefit.

 The Updated Study analysis for Peoples’ depreciable property for actual plant assets as of December 31, 2021 describes the extensive analysis performed. The forecast plant balances and reserves at December 31, 2024 result in rates that are now appropriate for company property.

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

**A.** Yes, it does.

# EXHIBIT

**OF**

**DANE A. WATSON**

**ON BEHALF OF PEOPLES GAS SYSTEM, INC.**

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1. W.C. Fitch and F.K. Wolf, *Depreciation Systems*, at page 289 (Iowa State Press, 1994). [↑](#footnote-ref-2)