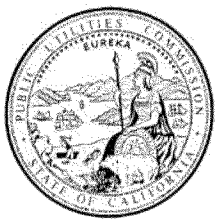
Docket:	:	A.13-12-012
Exhibit Number	:	ORA-15
Commissioner	:	C. Peterman
ALJ	:	J. Wong
Witness	:	M. Karle



OFFICE OF RATEPAYER ADVOCATES
CALIFORNIA PUBLIC UTILITIES COMMISSION

Report on the Results of Operations for Pacific Gas and Electric Company Test Year 2015 Gas Transmission and Storage Rate Case

Plant, Depreciation Expense and Reserve, and Rate Base

San Francisco, California
August 11, 2014

TABLE OF CONTENTS

DEPRECIATION

I. INTRODUCTION

This exhibit presents the analyses and recommendations of the Office of Ratepayer Advocates (ORA) regarding Pacific Gas and Electric Company's (PG&E) forecasts of depreciation expense and reserve, and asset depreciation rate changes for Test Year (TY) 2015.

Depreciation expense is related to the magnitude of the company's plant-in-service. As new plant is placed in service, the level of depreciation concomitantly increases. This expense enables the company to recover the original cost of capital investments, less any estimated net salvage over the useful life of the asset. The depreciation reserve balances for the TY are calculated in the Results of Operations (RO) model, which incorporates the estimated depreciation expenses based on net plant addition forecasts and automatically calculates the reserve requirement for the TY.

II. SUMMARY OF RECOMMENDATIONS

The following table summarizes ORA's recommendations regarding Net Salvage Rates:

Net Salvage Recommendations (%)			
FERC Account	Gas Accord V	PG&E Proposed	ORA Proposed
353	-10	-50	-20
367	-15	-50	-25
369	0 or -1	-20	-10

ORA does not make recommendations with regard to the company's average service lives (ASL) or mortality curves, except to note generally that PG&E's current ASL for GT&S assets are much shorter than what would be reasonably expected relative to the industry for many FERC accounts, and that the Company's proposals to lengthen service lives in this proceeding still result in ASL which are in some

cases shorter than industry averages. ORA's lack of life curve recommendations should not be taken to constitute support of the Company's position.

III. GENERAL OVERVIEW

Depreciation is the recovery of the original cost of fixed capital assets less the estimated net salvage over the useful life of the property by means of an equitable plan of charges through operating expenses. Depreciation expense is a legitimate cost of service.[1] In ratemaking, recovery of depreciation expense is through a single depreciation rate with components that provide for capital recovery, the cost of removal and salvage. Determination of the level of expense is based on the function of the level of plant balance and of the parameters (net salvage value and service life) that are applied to the gross salvage amount received, less the cost of removing the asset.

The Federal Energy Regulatory Commission (FERC) defines depreciation as:

> "Depreciation, as applied to depreciable electric plant, means the loss in service value not restored by current maintenance, incurred in connection with the consumption or prospective retirement of electric plant in the course of service from causes which are known to be in current operation and against which the utility is not protected by insurance. Among the causes to be given consideration are wear and tear, decay, and action of the element, inadequacy, obsolescence, changes in the art, changes in demand and requirements of the public authorities."[2]

[1] D.12-11-051, p. 658.

[2] 18 Code of Federal Regulation, Part 101.

The current depreciation accrual rates for PG&E's gas transmission and storage assets were authorized by the CPUC via the approval of the Gas Accord V settlement. Consistent with the guidelines described in the January 3, 1961 Commission Standard Practice (SP) U-4, *Determination of Straight-Line Remaining Life Depreciation Accruals,* PG&E utilized the straight-line remaining–life methodology to develop its proposed 2015 depreciation accrual rates. This method uses the following formula to calculate the annual depreciation accruals:

$$\text{Depreciation Expense} = \frac{\text{Plant Balance - Reserve - Gross Salvage + Cost of Removal}}{\text{Remaining Service Life of Asset(s)}}$$

IV. NET SALVAGE

Net salvage consists of the gross salvage value of an asset less the cost of removing the asset. The net salvage rate is meant to recover these future removal costs over the full lifetime of that asset as a part of the depreciation rate.

A summary of ORA's recommended net salvage by FERC Account is included in Table 15-1.

Table 15-1
ORA Net Salvage Recommendations

Net Salvage Recommendations			
FERC	Current NSR	PG&E Proposed	ORA Proposed
353	-10	-50	-20
367	-15	-50	-25
369	0 or -1	-20	-10

While ORA makes recommendations herein regarding select net salvage rates, the absence of an ORA recommendation regarding any given parameter does not constitute an endorsement of PG&E's position.

A. Net Salvage and the Proposed Decision in PG&E's Distribution General Rate Case (A.12-11-009)

In PG&E's 2014 GRC, the Company recommended a number of substantial increases to net salvage rates. The Proposed Decision (PD) of ALJ Pulsifer decided

as a matter of policy to limit the increases to net salvage for the rate cycle. The PD stated:

> In the interests of balancing potential cost impacts on both current and future customers, we conclude that a cap on removal cost increases is reasonable, and would not unduly shift deferred cost burden risk to customers in future GRC cycles.
> …we generally adopt no more than 25% of the estimated net increase from current rates that [would] otherwise result from applying PG&E's net negative salvage rates.[3]

ORA generally makes net salvage rate recommendations in the current proceeding in accordance with the guidance provided by the PD in PG&E's 2014 GRC and its stated preference for a policy of gradualism in making changes to depreciation parameters.

1. FERC 353 – Lines

PG&E's current approved net salvage rate for FERC Account 353 is -10%, and PG&E is proposing to increase the rate fivefold, to -50%. The gross plant balance in the account as of December 31, 2012 was $195,965,630, which according to the Company's depreciation report consists of the cost of installed gas pipelines used wholly or predominantly for conveying gas from point of connection with transmission or field lines to structures and improvements used wholly or predominantly in connection with underground storage of natural gas.[4]

In making its recommendation PG&E relies entirely on historical data, stating that the net salvage rate for the account "should be increased to reflect the recorded data."[5] Reliance on historical cost data is not appropriate for this account, as recorded retirements have represented a miniscule portion of plant balance. While the plant balance is nearly $200 million, mean retirements for the period 1994-2014 were $42,232 yearly, or approximately .0002% of the total 2012 plant balance. The exclusive use of historical retirements which consist of a small portion of the total

[3] Proposed Decision of ALJ Pulsifer, p. 589-590.

[4] PG&E Workpapers, Chapter 15A, p. WP 15A-50.

[5] Id.

plant investment does not constitute a valid sample for the purpose of determining what future costs may be.

PG&E's recommended net salvage rate is far higher than industry norms. In response to ORA discovery, PG&E provided a summary of depreciation parameter recommendations made in other rate cases by Gannett Fleming (GF), the consultant who performed PG&E's depreciation study. The mean net salvage rate recommended by GF for FERC 353 was -24%, and the median was -18%.[6] The recommendations include one arguable outlier, a company for whom GF recommended a net salvage rate of -100%. This is more than double the next highest rate, at -40%. Excluding the -100% value from the analysis leaves a mean and median recommended net salvage rate of -15%. The net salvage rate recommended in PG&E's testimony is more than triple that.

ORA recommends that the Commission adopt a net salvage rate of -20%. This conservative increase represents a high net salvage rate relative to the industry, but is much closer to the mean than the value recommended by PG&E. The Company's recommended increase to -50% is far too large an increase for a single rate cycle. It is appropriate to apply the concept of gradualism in increasing net salvage, and in formulating ORA's recommended -20% value ORA has done so consistent with the PD in PG&E's 2014 GRC. Capping the increase at 25% of PG&E's recommendation is appropriate, and doing so leaves ORA's recommended value of -20%.

2. FERC 367 – Mains

The current approved net salvage rate for PG&E's FERC Account 367 is -15%, and PG&E is proposing to increase the rate to -50%. The gross plant balance in the account as of December 31, 2012 was $2,622,731,723, which contains three asset classes: GTP36700 ($1,952,417,021); GTE36700 ($639,540,812); and GTS36700 ($30,773,890). According to the Company's depreciation report, the account balance consists of the cost of installed transmission systems mains.[7]

[6] PG&E response to ORA data request ORA-049, Q 01.

[7] PG&E Workpapers, Chapter 15A, p. WP 15A-143.

PG&E's recommended net salvage rate is far higher than industry norms. Both the mean and median net salvage rates in the industry recommendations provided by Gannett Fleming were -20%, comparable to the -15% currently authorized for PG&E.[8] PG&E's recommended -50% net salvage rate would be among the highest in the industry; the highest recommended rate reported in Gannett Fleming's data was -40%.

ORA recommends a net salvage rate of -25%. This conservative increase still represents a high net salvage rate relative to the industry, but is much closer to the mean than the value recommended by PG&E. The Company's recommended increase to -50% is far too large an increase for a single rate cycle. It is appropriate to apply the concept of gradualism in increasing net salvage, and in formulating ORA's recommended -25%[9] value ORA has done so consistent with the PD in PG&E's 2014 GRC. Capping the increase at 25% of PG&E's recommendation is appropriate, and doing so leaves ORA's recommended value of -25%.

3. FERC 369 – Station Equipment

The current approved net salvage rate for PG&E's FERC Account 369 is 0 or -1% depending on asset class. PG&E is proposing to increase the net salvage rate to -20%. The gross plant balance in the account as of December 31, 2012 was $236,316,712, which contains three asset classes: GTP36900 ($225,230,079); GTE36900 ($5,936,008); and GTS36900 ($5,150,625). According to the Company's depreciation report, the account consists of the cost of installed meters, gauges, and other equipment used in monitoring or regulating gas in connection with transmission system operations.[10]

PG&E's recommended net salvage rate is roughly double the industry norm. The mean recommended net salvage rate in the industry data provided by Gannett Fleming was -9%, while the median was -10%.[11] In recommending -20%, PG&E

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[8] PG&E response to ORA data request ORA-049, Q 01.

[9] 23.75% rounded to 25% for simplicity.

[10] PG&E Workpapers, Chapter 15A, p. WP 15A-169.

[11] PG&E response to ORA data request ORA-049, Q 01.

relies entirely on historical cost data,[12] but does not explain why the Company's recorded costs are substantially higher than those seen elsewhere in the industry.

ORA Recommends a net salvage rate of -5% for FERC 369, consistent with the employment of gradualism in the PD in PG&E's 2014 GRC. Capping the increase at 25% of PG&E's recommendation is appropriate, and doing so leaves ORA's recommended value of -5%.

[12] PG&E Workpapers, Chapter 15A, p. WP 15A-169.