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July 2, 2001

Dorothy Wideman
Executive Secretary
Michigan Public Service Commission
6545 Mercantile Way
Lansing, Michigan 48911

HAND DELIVERY
e-file

Re: Upper Peninsula Power Company
Depreciation
MPSC Case No. U-13001

Dear Ms. Wideman:

Enclosed for filing are an original and four (4) copies of Application and Direct Testimony and Exhibits of Paul J. Gerrard. An electronic version of this is also being filed.

Very truly yours,

LOOMIS, EWERT, PARSLEY,
DAVIS & GOTTING, P.C.

Sherri A. Wellman

Sherri A. Wellman

SAW/kkf
Enclosure
cc w/enc.: Robert P. Tarvis

S T A T E O F M I C H I G A N

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * *

In the matter of the application of	)	
UPPER PENINSULA POWER COMPANY	)	Case No. U-13001
for approval of depreciation rates and practices.	)	
______________________________________	)	

APPLICATION

Now comes Upper Peninsula Power Company ("UPPCO"), and hereby applies for approval of its proposed depreciation rates and practices and respectfully represents to the Commission as follows:

1. UPPCO a Michigan corporation, is a wholly owned subsidiary of WPS Resources, with its principal offices located at Houghton, Michigan and is engaged as a public utility in the generation, purchase, transmission, distribution, and sale of electric energy in the Upper Peninsula of Michigan.

2. As indicated by the records and files of this Commission, UPPCO serves certain cities, villages and townships located in the counties of Alger, Baraga, Delta, Houghton, Iron, Keweenaw, Marquete, Menominee, Ontonagon, and Schoolcraft. UPPCO's primary service area is known as its Integrated System serving, directly or indirectly, various communities and localities in each of the above-named counties, except Iron County. In Iron County, UPPCO serves in and about the City of Iron River, such service area known as UPPCO's Iron River System.

3. Since January 1, 1994, UPPCO has been accruing depreciation at the rates and according to methods last authorized and approved by this Commission by its Orders dated November 10, 1993, and October 24, 1996, issued in Case No. U-10371. The

October 24, 1996 Order contemplates and provides that UPPCO would continue to accumulate data for further depreciation studies and would submit to this Commission between July 1, 1999, and July 1, 2001, proposed revised depreciation accrual rates to be effective after December 31, 2001.

4. Pursuant thereto UPPCO has initiated further studies of its depreciation practices to determine whether or not there should be revisions in the practices approved in such Orders. Such studies have been completed, and the results thereof are set forth in the prepared testimony and exhibit being concurrently filed herewith.

5. Based in the foregoing, UPPCO proposes to accrue depreciation annually upon a remaining life basis, by application of the percentage rates set forth in the exhibit filed herewith to one-twelfth of the annual percentage rates applied to the average of the beginning and ending balances for each calender month of each applicable class of its depreciable properties. UPPCO is also proposing to switch from depreciation accounting to amortization accounting for general plant excluding general structures and vehicles.

6. UPPCO represents to this Commission that its proposed annual depreciation accrual rates are just and reasonable and that they should be approved and authorized by this Commission. UPPCO proposes to make periodic depreciation studies and to review annual depreciation accrual rates should further studies reveal changes in the basic service lives or other factors which would require an earlier revision of depreciation practices.

7. To date, UPPCO has been accruing depreciation by use of the depreciation accrual rates approved in Case No. U-10371. UPPCO proposes that it be authorized to continue the use of such rates until the later of, final Order of the Commission in this case is received authorizing the effective date of the new rates or December 31, 2001.

WHEREFORE, UPPCO requests this Commission to make and enter its order approving the proposed depreciation rates and practices as herein proposed.

Respectfully submitted,

UPPER PENINSULA POWER COMPANY

Dated: July 2, 2001

By: Sherri A. Wellman

Harvey J. Messing (P23309)
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S T A T E   O F   M I C H I G A N

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * *

In the matter of the application of **UPPER PENINSULA POWER COMPANY** for approval of depreciation rates and practices.	))))	Case No. U-13001

DIRECT TESTIMONY
AND EXHIBITS OF PAUL J. GERARD
ON BEHALF OF UPPER PENINSULA POWER COMPANY

Q. Please state your full name and business address.

A. Paul J. Gerard. Depreciation Analyst, Wisconsin Public Service Corporation, 700 North Adams Street, P.O. Box 19002, Green Bay, Wisconsin 54307

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

A. I am employed by Wisconsin Public Service Corporation ("WPS Corp"). My title is Depreciation Analyst. I am responsible for all book depreciation functions associated with the regulated entities within WPS Resources Corporation.

Q. Would you please describe your educational background and work experience?

A. I have an Associates Degree in Accounting earned from Northeast Technical Institute in 1965. During the period 1975-1981 I completed three separate programs sponsored by Depreciation Programs, Inc. The Programs are offered by DPI in association with the Center for Depreciation Studies of the College of Applied Sciences and the Division of Continuing Education, Western Michigan University.

Since 1981 I have been a member of the American Gas Association/Edison Electric Institutes Depreciation Committee, which has since evolved in to the EEI Property Accounting and Valuation Committee. Since 1990 I have been a member of the Society of Depreciation Professionals. Membership in both of these committees has included attending annual conference and training sessions. I have 33 years experience working with utility plant continuing property records and book depreciation, and have participated in or led four depreciation studies for WPS Corp.

Q. Please describe the purpose of your testimony?

A. I have been asked by Upper Peninsula Power Company ("UPPCO") to support its request for new depreciation rates and practices. During 1998, Upper Peninsula Energy Corporation, the holding company for UPPCO, merged with WPS Resources Corporation ("WPS Resources"), the holding company for Wisconsin Public Service Corporation ("WPS Corp"). As a result of the merger, UPPCO is now a wholly owned subsidiary of WPS Resources. As part of the synergy savings of this merger, a single accounting system and depreciation system serve both UPPCO and WPS Corp, and is managed at the WPS Corp headquarters in Green Bay, Wisconsin.

Q. Are you sponsoring any exhibits?

A. Yes, I am sponsoring as Exhibit A-__(PJG-1) UPPCO's 2001 depreciation study.

Q. Was this exhibit prepared by you or under your direction and supervision?

A. Yes. The depreciation study, Exhibit A-__(PJG-1), was performed at the WPS Corp headquarters in Green Bay, Wisconsin. WPS Corp has historically performed its own studies in-house.

Q. What is the purpose of a depreciation study?

A. A depreciation study is performed to insure that the depreciation element included in the cost of service for the particular accounting period represents as accurate a measurement as is possible. The cost allocated to each accounting period includes an allocation of the cost of the asset itself plus an allocation of the estimated costs of retiring the assets and is reduced on the disposal of the assets.

Q. In preparing the study what guidelines did you follow?

A. The Federal Regulatory Energy Commission and State Public Service Commissions have issued definitions of depreciation that include the need to define an asset's life in order to measure the decrease of the asset's ability or capacity to perform present and future service. Application of a depreciation rate tp an asset's cost provides for the consumption or loss in service capacity due to use, wear and tear, physical deterioration, the elements, obsolescence, inadequacy, or the demands of public authority.

Q. Would you describe the basic procedures employed in performing this study?

A. The depreciation study was performed separately for the Integrated System and the Iron River System. Historical plant additions, requirements, transfers, adjustments, removal, salvage and reserve balances were obtained from UPPCO. Depreciation rates were determined based on estimated remaining life. Simulated plant record ("SPR") procedures were used to determine average service lives, which were then used to determine estimated remaining lives for each account. The SPR method was not used for production plants. Instead, engineering, operating, and system planning personnel were consulted in conjunction with <u>field visits to the plants</u> in order to determine a probable remaining life for each plant.

Q. Would you please describe how the remaining life estimates were determined?

A. Yes. The methodology utilized in determining depreciation rates differed by classes of property. For production plants, an estimated remaining life was used to determine required annual depreciation amounts and resultant depreciation rates. The remaining life for the categories of production plant was based on the following: For the Warden steam production plant, system planning personnel were consulted. In the prior study, a ten (10) year remaining life as of the end of 1992 was agreed upon. A new remaining life estimate provided by WPS Corp system planning is ten (10) years based on the plant has been converted to burn natural gas and/or coal. Based on recent plant testing, it is planned to run the plant for two months in the summer of 2001 to meet summer peak demands and provide generation during a time when other plants are scheduled for outages. The plan is to keep the plan available for this purpose and as a standby unit in case of need when base load units are available. For the hydro plants, remaining lives approved in the prior depreciation study were based on retirement dates by the license expiration dates. Since that study, new forty (40) year licenses have been received in 2000 for Prickett, AuTrain, and Cataract. The Bond Falls Project, which includes the Victoria and Bond Falls hydro facilities, is in the process of being re-licensed and is in the settlement stage. A license is expected in 2001 for this project. The McClure, Hoist , and Silver Lake sites are in the process of being licensed for the first time. These sites were declared FERC jurisdictional in 1991. A forty (40) year license period is being applied for. UPPCO therefore, suggests a thirty (30) year remaining life for McClure, Hoist, and Silver Lake as the license period starts with the year in which the sites were declared FERC jurisdictional. UPPCO proposes to further reduce the remaining life for all plants by five (5) years to provide for the recovery of future interim additions. The December 31, 1999 plant balances all the hydro plants except Cataract have been increased to reflect the 2000-2003 capital projects required by FERC. "Exhibit A-1" of the depreciation study, is a copy of the five (5) year budget for the hydro plants. "Exhibit A-2" of the depreciation study is an explanation of these projects. Summary Schedule S-1 itemizes the amounts for reconciliation to the December 31, 1999 FERC Form 1 plant balance. For the combustion turbine plants, operating personnel were consulted. These units are in good operating condition and a remaining life of ten (10) years is expected. This would place these units in the 35-40 year life span range, which is consistent with lives used for similar units industry wide. For distribution plant and general structures, the remaining life was based on the simulated plant study results. Schedule 2 for each account shows this calculation.

Q. Please describe the negative net salvage factor?

A. During the last 10-15 year period utilities and regulators have become increasingly aware of the need to provide greater internally generated funds for costs that will be incurred to ultimately dismantle and remove production plant facilities. The means to generate these funds has been to increase the negative net salvage factor included in the depreciation calculation.

Site specific studies were performed at WPS Corp for steam, hydro, and other production facilities by in-house engineering personnel in 1989. The studies have been updated twice since then to reflect more current prices and cost of labor and materials. The initial studies were extensive and done for each of the nine (9) steam plants, fifteen (15) hydro plants, and six (6) combustion turbine units. Rather than incur additional costs to perform studies for the UPPCO production facilities the data base gathered in the WPS Corp study has been used as a source for estimating ultimate net salvage costs for the UPPCO units. WPS Corp engineers have related the UPPCO units to the most similar unit within the WPS Corp system. An adjustment factor was then applied to the WPS Corp cost estimate to consider megawatt and square footage differences. Since the dollars are as of January 1996, the Handy Whitman Index was used to restate the cost estimates to 2000 prices. Section C of the depreciation study details the calculation. The dollars are in present value, and have not been escalated to forecasted retirement dates. Because in some cases the resultant negative net salvage factor derived from the calculation is significantly higher than the present factor, only partial movement to the current percent is proposed as a step towards those factors. Section B of the depreciation study is a description of the net salvage analysis taken from the last depreciation study performed for WPS Corp.

Q. Do you have any further comments in connection with Transmission Plant?

A. Yes. The transmission plant is presented in two categories. Plant investment related to fifty (50) and higher KV rating is shown separate from plant investment related to under 50Kv rating. An independent system operator, the American Transmission Company ("ATC"), has been formed to own and operate fifty (50) and higher kV equipment. WPS Corp turned over these assets to the ATC by year end 2000. WPS Resources has not yet formally turned the similar UPPCO assets to the ATC, but intends to make the transfer during the second quarter of 2001. The under 50kV assets that remain will be reclassified to the distribution accounts. For that reason, it is proposed to leave the presently certified depreciation rates in place for the assets to be transferred to the ATC. For the assets that will be reclassified to distribution, the same depreciation rate that is being applied for in this study for the distribution plant is requested.

Q. Is UPPCO proposing to switch from depreciation accounting to amortization accounting?

A. Yes. This application includes a request to switch from depreciation to amortization accounting for general plant, excluding general structures and vehicles. WPS Corp presently uses amortization accounting for general plant. The use of amortization accounting has been increasing among utilities nationally as a means of reducing resources required to maintain records for high volume low cost assets. Since the WPS Corp accounting systems are also used for UPPCO, a switch to the same method of asset accounting and recovery will enable better utilization of these systems. Also, the same replacements and maintenance policies in place for WPS Corp are now being used for UPPCO operations. The methodology proposed to implement this accounting is as follows: Assets within an account and placed in service in the same calendar year will be grouped in to a single vintage account. During the year in which the assets are placed in service, a half month's amortization will be recorded in the month the assets are closed to plant, and a full month amortization will be recorded in all subsequent months. No retirements or transfers will be recorded for the vintage record during the amortization period. At the end of the amortization period all investment for the vintage record will be retired. Interim net salvage, which is expected to be minimal, will be charged to the reserve of the oldest vintage still being amortized. The accounting for the accruals and reserves will remain the same, i.e., charge amortization to account 403 with the offsetting credit to account 108. For existing plant and accumulated reserve balances at December 31, 2001, an allocation will be made to assign the reserve to vintage records based on a dollar-year weighted average allocation. All vintage records older than the amortization period selected for the account will be grouped into a single vintage record and amortized until full recovery is realized.

Q. Please describe the treatment for vehicles.

A. In the past a depreciation rate had not been certified for account 392 - vehicles, because depreciation for this account is not part of depreciation expense. Depending on the usage of the vehicle, the depreciation on this equipment is charged to construction projects and capitalized as part of the projects, or charged to operations and maintenance when utilized for that purpose. The fleet management and accounting practices in place at WPS Corp have been put in place or the UPPCO fleet also. Account 396-Power Operated Equipment is now being accounted for in the same manner as account 392, therefore, account 396 is no longer part of the depreciation study.

Q. Please describe the accrual methodology used.

A. The monthly accrual is based on one twelfth of the annual depreciation rate applied against the product of the actual average beginning and end of month plant balance. This has the effect of booking a half-month of depreciation for assets in the month of addition or retirement. Accruals are thus matched to the same time period that assets are actually in service.

Q. In your opinion, Mr. Gerard, what depreciation rates should UPPCO use to determine the annual depreciation charge?

A. Exhibit A-__(PJG-1) represents my view of the rates which should be adopted by UPPCO to provide the capital recovery necessary to absorb the property retirements, as they occur, together with the retirement costs without causing any abnormal charge to the ratepayers or causing the shareholders to sustain a non-recoverable cost. These rates would, if adopted, remain in effect until a subsequent depreciation study was performed which would adjust the rates upward or downward to provide for changes in the retirement patterns or costs incurred during the intervening years.

Q. Does this conclude your testimony?

A. Yes.