

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of Missouri Public Service)
tariff sheets designed to increase rates)
for gas service provided to customers in)
the Missouri service area of the company.)

Case No. GR-93-172

AFFIDAVIT OF TED ROBERTSON

STATE OF MISSOURI)
) SS
COUNTY OF COLE)

Ted Robertson, of lawful age, being first duly sworn, deposes and states:

1. My name is Ted Robertson. I am a Public Utility Accountant II for the Office of the Public Counsel.
2. Attached hereto and made part hereof for all purposes is my direct testimony consisting of pages 1 through 57 and Schedules 1 - 3.
3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.



Ted Robertson

Subscribed and sworn to before me this 28th day of May, 1993.



Bobbie J. Richards
Notary Public

My commission expires November 3, 1996.

BOBBIE J RICHARDS
NOTARY PUBLIC STATE OF MISSOURI
COLE COUNTY
MY COMMISSION EXP. NOV 3, 1996

1 DIRECT TESTIMONY
2 OF
3 TED ROBERTSON
4 MISSOURI PUBLIC SERVICE DIVISION
5 UTILICORP UNITED INC.
6 CASE NO. GR-93-172
7

8 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

9 A. Ted Robertson, P.O. Box 7800, Jefferson City, Missouri 65102.
10

11 Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

12 A. I am employed by the Office of the Public Counsel of the State of
13 Missouri (OPC or Public Counsel) as a Public Utility Accountant II.
14

15 Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND OTHER
16 QUALIFICATIONS.

17 A. I graduated from Southwest Missouri State University in Springfield,
18 Missouri, with a Bachelor of Science Degree in Accounting. In
19 November, 1988, I passed the Uniform Certified Public Accountant
20 examination, and obtained C.P.A. certification from the state of
21 Missouri in 1989.
22

23 Q. WHAT IS THE NATURE OF YOUR CURRENT DUTIES WHILE IN THE
24 EMPLOY OF OPC?

25 A. Under the direction of the Chief Public Utility Accountant, I am
26 responsible for performing audits and examinations of the books and
27 records of public utilities operating within the state of Missouri.

Direct Testimony of
Ted Robertson

1 Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE MISSOURI PUBLIC
2 SERVICE COMMISSION (MPSC OR COMMISSION)?

3 A. Yes. I have filed testimony on behalf of the Missouri Office of the
4 Public Counsel in the cases listed on Schedule 1 attached to this
5 testimony.

6
7 Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

8 A. I will present the Public Counsel's position on FASB Statement No.
9 106, Manufactured Gas Site Remediation Costs, Interest On Customer
10 Deposits and Accounting Authority Orders.

11
12 FASB STATEMENT NO. 106
13

14
15
16 Q. WHAT IS FINANCIAL ACCOUNTING STANDARDS BOARD
17 STATEMENT NO. 106?

18 A. Employers Accounting For Postretirement Benefits Other Than
19 Pensions (SFAS 106) is an official pronouncement of the Financial
20 Accounting Standards Board (FASB) that establishes new Generally
21 Accepted Accounting Procedures (GAAP) for employers providing
22 postretirement benefits other than pensions (OPEB), of which,
23 retiree health care and life insurance premiums are generally the
24 largest costs. SFAS 106 requires employers to change accounting
25 methods for OPEB costs from a cash basis used by most employers to
26 an accrual basis. Most companies, including MoPub, are required to
27 implement SFAS 106 for Financial Reporting purposes by 1993.

Direct Testimony of
Ted Robertson

1 Q. PLEASE EXPLAIN THE DIFFERENCE BETWEEN THE ACCRUAL AND
2 THE CASH METHOD.

3 A. The accrual method will require employers to estimate the future cost
4 of postretirement benefits and recognize the expense of providing
5 these benefits during the employee's service. SFAS 106 also provides
6 for an amortization to the current year's expense all or a portion of
7 the OPEB liability for employee services prior to the implementation
8 of SFAS 106. Under the cash or pay-as-you-go (PAYGO) method,
9 postretirement benefit expenses are recognized on a Company's books
10 when the costs are actually paid.

11
12 Q. DOES SFAS 106 REPRESENT A CHANGE FROM THE WAY MOPUB HAS
13 BEEN ACCOUNTING FOR THE BENEFIT COSTS?

14 A. Yes. The Company has in the past recorded OPEB costs, for both
15 financial reporting and regulatory purposes, on a PAYGO basis.
16 That is, the Company recognized the costs of providing the benefits
17 as the claims or insurance premiums were actually paid.

18
19 Q. WHAT IS PUBLIC COUNSEL'S POSITION ON OPEB COSTS AND THE
20 NEW FASB PRONOUNCEMENT?

21 A. Public Counsel recommends that a best estimate of OPEB expense for
22 one year be included in the cost of service. With that in mind, Public
23 Counsel believes that the current level of actual PAYGO expenditures
24 provides the best estimate of annualized expense.

Direct Testimony of
Ted Robertson

1 Q. WHY DOES PUBLIC COUNSEL BELIEVE PAYGO IS THE BEST
2 ESTIMATOR OF THE CURRENT YEAR'S COST?

3 A. Current expenditures for OPEB expense are a known and measurable
4 quantity. In contrast, any estimate of accrued OPEB costs is highly
5 speculative and easily manipulated. PAYGO has been consistently
6 used by all parties to rate cases prior to the issuance of SFAS 106.
7 It has a proven track record that recognizes the OPEB cost for one
8 year, whereas SFAS 106 includes not only an estimate of current year
9 expense, but also an amortization of prior years estimated expense.
10

11 Q. PLEASE EXPLAIN WHY THE ADOPTION OF SFAS 106 WILL USUALLY
12 RESULT IN A LARGE INCREASE IN THE COST OF PROVIDING
13 POSTRETIREMENT BENEFITS.

14 A. Employers must identify the amount of postretirement benefits related
15 to their employees and retirees prior years service under accrual
16 accounting and either recognize the benefit amount in the year of
17 adoption or amortize it over a transition period, usually twenty years.
18 In addition, employers must also recognize benefits being earned in
19 the current year. In many instances, the current service costs do
20 not vary much from the current cash payments. The increase in the
21 SFAS 106 costs is largely due to the accrual of estimated future
22 expenses relating to employee service provided in prior periods, that
23 is, the determination of the transition obligation and its resulting
24 amortization.

Direct Testimony of
Ted Robertson

1 Q. WHY IS THE FASB REQUIRING A CHANGE FROM CASH BASIS TO
2 ACCRUAL BASIS?

3 A. Cash basis accounting for postretirement benefits was accepted in the
4 past, as these obligations were considered small and benefits are
5 viewed as revocable. That view has changed due primarily to the
6 rising trend in medical costs which have caused increased concern
7 regarding potential future liabilities. Because FASB views both other
8 postretirement benefits and pension benefits as forms of deferred
9 compensation, it concluded similar accounting treatment was
10 necessary.
11

12 Q. IS THERE A REASON WHY THE FINANCIAL ACCOUNTING
13 STANDARDS BOARD DID NOT ADDRESS PENSION EXPENSE AND
14 POSTRETIREMENT HEALTH CARE EXPENSE IN THE SAME
15 STATEMENT?

16 A. Yes. The FASB issued a separate statement on other postretirement
17 benefits because of the difficulty in measuring the future OPEB
18 liability. Although I am not suggesting that estimating the cost of
19 future pension benefits is an easy task, estimating the cost of OPEBs,
20 especially health care, requires more assumptions, making the
21 process more difficult. In addition to the assumptions required for
22 pension expenses (life expectancy, retirement date, employee
23 turnover, and discount rate), the estimation of future health care
24 costs require the following assumptions:

Direct Testimony of
Ted Robertson

- 1 • Rate of increase of medical costs.
- 2 • Marital and dependency status of retirees.
- 3 • Costs reimbursed by Medicare.
- 4 • Costs absorbed by retirees through premium
- 5 contributions, caps on benefits, deductibles, and co-
- 6 payments.

7

8 These assumptions are utilized to develop several key liabilities and

9 costs, namely,

- 10
- 11 • Expected Post Retirement Benefit Obligation (EPBO) - The
 - 12 difference between the actuarial present value of future
 - 13 benefits less future participant contributions;
 - 14 • Accumulated Post Retirement Benefit Obligation (APBO) - The
 - 15 portion of the EPBO attributable to service prior to the
 - 16 valuation date;
 - 17 • Service Cost - Recognition of the post-retirement benefits
 - 18 earned during the valuation year as a result of service during
 - 19 the year; and
 - 20 • Net Periodic Post Retirement Benefit Cost (NPPBC) - The
 - 21 amount to be recognized in the financial statement as the annual
 - 22 expense (cost) for the post-retirement benefits plans.

23

24 Q. DOES THE MPSC ALLOW UTILITIES TO INCLUDE CURRENT OPEB

25 EXPENSES AS A COST OF SERVICE IN REVENUE REQUIREMENT

26 CALCULATIONS?

Direct Testimony of
Ted Robertson

1 A. To the best of my knowledge, this Commission has never excluded
2 reasonable current OPEB expenses from the cost of service.

3
4 Q. DOES SFAS 106 PROVIDE FOR AN APPROPRIATE MATCHING OF THE
5 COSTS TO THE PERIOD OF EMPLOYEE' SERVICE?

6 A. No. Based on my analysis of the components of the SFAS 106 accrual,
7 it does not provide a better matching of revenues and expenses nor
8 is it an appropriate measure of the current cost of providing utility
9 service. The Company proposed SFAS 106 expense (NPPBC) consists
10 primarily of the following components:

- 11
12 • Service Cost - The obligation to pay future benefits attributable
13 to employee service for the period.
- 14 • Interest Cost - The accrual of interest (time value of money) on
15 the Accumulated Postretirement Benefit Obligation (APBO) and
16 on estimated benefit payments during period.
- 17 • Transition Obligation - A cost to recognize post-retirement
18 benefits earned and accrued prior to the valuation date. It is
19 the APBO less the fair value of plan assets less any previously
20 recognized postretirement benefit cost plus any prepaid
21 postretirement costs. This cost can be recognized in one of two
22 ways:

- 23
24 1. The entire transition obligation can be recognized at the
25 date of adoption. This method if recognizing the

Direct Testimony of
Ted Robertson

1 transition obligation is referred to as **immediate**
2 **recognition**; or

- 3
4 2. Amortize the transition obligation over the larger of 20
5 years or the average future working lifetime of active plan
6 participants. This method of recognizing the transition
7 obligation is referred to as **delayed recognition**. MoPub
8 has elected this method in determining its proposed OPEB
9 expense.

10
11 By definition, the service cost is the portion of the expected
12 postretirement benefit obligation attributed to service rendered by
13 employees during a given period for financial reporting. In other
14 words, this is the OPEB cost that is attributable to the cost of service
15 presently being provided by current employees to ratepayers.

16
17 The SFAS 106 expense is significantly greater than the PAYGO cost
18 because of the interest on the APBO and the amortization of the
19 transition obligation. These components of the SFAS 106 accrual
20 relate to prior employee service costs that should have been assigned
21 to prior periods, but are instead being proposed for recognition in
22 the current period and future periods. If the Company had
23 recognized the OPEB liability on an accrual basis historically, the
24 amortization of the transition obligation would be eliminated.
25 Similarly, if the Company had originally funded the liability, the

Direct Testimony of
Ted Robertson

1 interest on the APBO would be offset by the return on assets set
2 aside to pay the future benefits.

3
4 The magnitude of the SFAS 106 accrual is not so much the result of
5 attributing OPEB costs to current employee service as it is the result
6 of having to make up for OPEB costs that were not accrued or funded
7 in the past. Including the entire SFAS 106 accrual in the cost of
8 service would require ratepayers to pay for OPEB costs that are
9 associated with current employee service, it would also require that
10 present ratepayers pay estimated costs related to past years employee
11 service.

12
13 If the Commission wants to implement the accrual method on a
14 prospective basis, the annual accrual should include only the service
15 cost component of the SFAS 106. This is, by definition, the
16 component of the SFAS 106 accrual that is attributable to current
17 employee service. The other components of the SFAS 106 accrual
18 which the Company is proposing to recognize, the interest cost and
19 the amortization of the transition obligation, do not pertain to current
20 service, but rather, relate to prior employee service. To include the
21 SFAS 106 accrual in the cost of service for ratemaking purposes would
22 put costs properly attributable to prior generations of ratepayers on
23 the current generation of ratepayers; this does not constitute an
24 appropriate application of the matching principle.

Direct Testimony of
Ted Robertson

1 Q. SHOULD THE ACCRUAL PURSUANT TO SFAS 106 BE INCLUDED IN
2 MOPUB'S COST OF SERVICE FOR RATEMAKING PURPOSES?

3 A. No. The Commission should not adopt accrual accounting for
4 ratemaking purposes simply because it is required for financial
5 reporting purposes. The Financial Accounting Standards Board has
6 not been granted authority to determine utilities' cost of service for
7 ratemaking purposes. The Commission should not cede its authority
8 to the FASB and adopt SFAS 106. Financial reporting practices are
9 not a surrogate for proper ratemaking practices.

10
11 Including the accrual pursuant to SFAS 106 in the cost of service for
12 ratemaking purposes would put an undue burden on the present
13 generation of ratepayers. The present ratepayers would pay more
14 than past ratepayers, when OPEBs were recognized on a PAYGO
15 basis. Current ratepayers would also pay more than future
16 ratepayers, because the expense would diminish in the future when
17 amortization of the transition obligation is completed and when
18 earnings on OPEB funds (if funded) would offset the other
19 components of the SFAS 106 accrual.

20
21 Q. WILL UTILITIES EARNINGS BE IMPACTED IF THEIR SFAS 106
22 EXPENSES ARE REJECTED FOR RATEMAKING PURPOSES?

23 A. No. Paragraph 364 of SFAS 106 states, "For some rate-regulated
24 enterprises, FASB Statement No. 71, Accounting for the Effects for
25 Certain Types of Regulation, may require that the difference between
26 net periodic postretirement benefits cost as defined in this Statement

Direct Testimony of
Ted Robertson

1 and amounts of postretirement benefit cost considered for ratemaking
2 purposes be recognized as an asset or liability created by the actions
3 of the regulator. Those actions of the regulator change the timing of
4 recognition of net periodic postretirement benefit cost as an expense;
5 they do not otherwise affect the requirements of this Statement."

6
7 Thus, SFAS 106 itself explicitly provides for differences between the
8 treatment of OPEB for financial reporting purposes and for
9 ratemaking purposes. The accounting treatment for financial
10 reporting purposes does not control the accounting treatment for
11 ratemaking purposes.

12
13 Q. HAS THE NATIONAL ASSOCIATION OF REGULATORY UTILITY
14 COMMISSIONERS (NARUC) ADOPTED A RESOLUTION ADDRESSING
15 SFAS 106?

16 A. Yes. At the 104th Annual Convention of NARUC, a resolution was
17 adopted which urged the various bodies which control financial
18 reporting to recognize that individual commissions should have the
19 latitude to address OPEB including the use of regulatory assets. A
20 copy of the resolution, as found in the NARUC NEWS, is attached to
21 this testimony as Schedule 2.

22
23 Q. HAS THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER
24 ADVOCATES (NASUCA) ADOPTED A RESOLUTION ADDRESSING
25 SFAS 106?

Direct Testimony of
Ted Robertson

1 A. Yes. At the 1992 NASUCA annual convention, resolution 1992-17 was
2 adopted. The resolution urges federal and state regulatory
3 commissions to adopt the PAYGO as the basis for determining the cost
4 of OPEBs to include in the cost of service. This resolution has been
5 attached to my testimony as Schedule 3.

6
7 Q. ARE THERE ANY OTHER REASONS WHY SFAS 106 SHOULD NOT BE
8 ADOPTED FOR COST OF SERVICE PURPOSES?

9 A. Yes. The underlying premise of SFAS 106 is that companies have a
10 firm quantifiable liability for the obligation to make future OPEB
11 payments at an assumed level. The existence of that liability is,
12 however, questionable and its quantification entails many farreaching
13 assumptions. Given the material number and effect of assumptions
14 required to calculate the future obligation, it is reasonable that the
15 obligation is not "known and measurable". Of significance is the fact
16 that most if not all of the plan benefits are offered at the discretion
17 of management and may be amended or even terminated at will.

18
19 The checks and balances which make SFAS 106 workable in a general
20 business context are completely lacking in the utility arena.
21 Nonutility companies must also implement SFAS 106 for financial
22 reporting purposes in fiscal years beginning after December 15, 1992,
23 but those companies cannot automatically adjust their prices to reflect
24 the change in accounting methods. To the extent that the SFAS 106
25 accrual exceeds the current PAYGO for nonutility companies, the
26 reported income of those companies will be reduced accordingly. The

Direct Testimony of
Ted Robertson

1 effect of this accounting change cannot be easily passed on the
2 customers through increased prices and neither should it since unless
3 actual funding occurs there will be no change in cash flow associated
4 with SFAS 106. Nonutility companies must make difficult choices in
5 balancing the interests of the employee against the interests of
6 investors.

7
8 By contrast, the authorization of rates which permit utilities to pass
9 through an accrued level of future payments encourages the use of
10 generous estimates, rather than prudent cost control. The
11 Commission should not remove this incentive to the Company to strike
12 a proper balance in the determination of future payments.

13
14 Q. SHOULD THE LARGE NUMBER AND COMPLEXITY OF THE
15 ASSUMPTIONS REQUIRED TO CALCULATE FUTURE OBLIGATIONS
16 BE OF CONCERN TO THE COMMISSION?

17 A. Yes. The accrual calculations under SFAS 106 involve the selection
18 of numerous actuarial assumptions including the health care cost
19 trend rate (HCCTR). In particular, the actuary must project the
20 HCCTR decades into the future as well as a host of other ingredients
21 in the SFAS 106 calculations. The extended period of time over which
22 the actuary must project the assumptions make the SFAS 106
23 calculations far too speculative and uncertain. SFAS 106 calculations
24 are subject to considerable revision and change over time. Also, the
25 actuary has considerable discretion over the assumptions which factor
26 into the actuarial calculations.

Direct Testimony of
Ted Robertson

1 Additionally, the discretion exercised by a Company in changing or
2 eliminating benefits offered to its retirees impacts the SFAS 106
3 assumptions from year to year. Ratepayers could be required to
4 provide funds to utilities under the guise of providing postretirement
5 benefits to Company retirees, only to see the plans radically modified
6 or eliminated in future years. Because of the statutory laws against
7 retroactive ratemaking, regulators would likely be prohibited from
8 assessing and returning to the ratepayer any overcollections received
9 by the Company due to benefit plan modifications. The only viable
10 solution would place the regulator in the often difficult position of
11 seeking prospective rate reductions.

12
13 Q. DOES MOPUB'S ADJUSTMENT MEET THE "KNOWN AND
14 MEASURABLE" STANDARD?

15 A. No, it does not. St. Louis County Water Co., Case No. WR-91-361,
16 Order Establishing Test Year, pp. 2-3, (September 6, 1991), states:

17 An additional period may be tacked onto the test year to include
18 an update of significant items from the test year. Recognition
19 of "known and measurable" changes in significant items
20 comprise the update of the test year. An update period
21 concludes after the test year, but prior to the date the Staff
22 files its revenue requirement determination. By the time the
23 Staff files its revenue requirement determination, there will be
24 actual data for the update period for the Staff to use in its
25 case.

26 The Order goes on to state,

27 "Isolated adjustments," or changes to isolated items, such as
28 items imposed by government, e.g., increases in the cost of
29 postage, are presented to the Commission for a determination as
30 to whether they are "known and measurable". If the isolated
31 items are known and measurable, it may be contended that the
32 test year numbers should be adjusted for the changes.

Direct Testimony of
Ted Robertson

1 Previously, I expressed concerns as to the numerous assumptions
2 required to calculate the SFAS 106 liability and expense given that
3 even small changes to the retiree plan may have significant impacts on
4 SFAS 106 accruals. It is, therefore, my opinion, that the "known and
5 measurable" standard has not been satisfied.

6
7 Q. SHOULD UTILITIES BE REQUIRED TO DEMONSTRATE EFFORTS AT
8 COST CONTROL?

9 A. Yes. Regulated utilities should make every effort to examine the
10 reasonableness of the cost to the ratepayer of providing these
11 benefits or perhaps, whether or not these benefits should even be
12 provided. Since postretirement benefits represent a considerable
13 expense to ratepayers, they should be included in any evaluation of
14 overall compensation levels.

15
16 Q. TO YOUR KNOWLEDGE HAS MOPUB MADE ANY EFFORT TO CONTAIN
17 THE COSTS OF PROVIDING THESE BENEFITS?

18 A. Yes, on page 12 of the direct testimony of Company witness, Beth A.
19 Armstrong, she states, "The availability of OPEBs has been reduced
20 in an effort by MPS to control cost. During the renegotiation of union
21 benefits in 1990, OPEB coverage was eliminated for employees under
22 52 years of age. Postretirement medical and life insurance benefits
23 were also eliminated for all nonunion employees hired after September
24 1988. Replacement benefits designed to assure that MPS could
25 continue to attract and maintain a quality work force included an
26 employee stock option plan and 401k benefits.

Direct Testimony of
Ted Robertson

1 Q. DOES OPC HAVE ANY OTHER CONCERNS WITH MOPUB'S SFAS 106
2 EXPENSE ADJUSTMENT?

3 A. Yes. Public Counsel is concern about statements made by Ms.
4 Armstrong in her direct testimony. On page 15 of her testimony she
5 said, "Missouri Public Service uses ERISA funding requirements and
6 the advice of the actuary in the management of the pension plans and
7 the SFAS No. 106 as an actuarial means of managing the cost of the
8 other postretirement benefits offered." and continuing on to page 19,
9 "[t]here are no restrictions associated with withdrawal of plan assets
10 from a trust because there is no legal requirement to fund OPEB
11 benefits." These statements are extremely vague on whether the
12 Company intends now or in the future to fund its SFAS 106 liabilities.
13 The Public Counsel is seriously concerned about the nonfunding of
14 the liabilities, the lack of adequate safeguards for insuring that
15 excess funds are not arbitrarily used by MoPub as dividend payments
16 or subsidies to nonregulated affiliates, and the lack of federal tax
17 deductibility or federal laws for funding and fund income protection,
18 such as ERISA pension requirements. There is a very real risk that
19 revenues attributed to a SFAS 106 adjustment will be dissipated
20 rather than expended for future benefits.

21
22 Q. WHAT LEVEL OF OPEB EXPENSE WOULD PUBLIC COUNSEL
23 RECOMMEND THAT THE MPSC INCLUDE IN THE INSTANT CASE?

24 A. The Public Counsel recommends that the Commission include the test
25 year PAYGO amount as the best estimate of the instant case
26 postretirement benefit expense. The Company has not established

Direct Testimony of
Ted Robertson

1 that its SFAS 106 accrual is anymore accurate or appropriate for
2 regulatory ratemaking purposes than current actual expenditures.
3 It has, however, convinced the Public Counsel that Commission
4 recognition of SFAS 106 accrual in rates would provide the Company
5 with a substantially increased cash flow that is not cost based or
6 adequately safeguarded. Acceptance of the Public Counsel's
7 recommendation reduces the Company proposed cost of service by
8 \$102,752 and increases its rate base by an equal amount.

9
10 MANUFACTURED GAS SITE REMEDIATION COSTS

11
12 Q. WHAT ARE MANUFACTURED GAS SITE REMEDIATION COSTS?

13 A. The issue relates to the Company's request for ratemaking treatment
14 of remediation costs for former manufactured gas plant (MGP).
15 Remediation costs can be defined as all investigations, testing, land
16 acquisition if appropriate, remediation and/or litigation
17 costs/expenses or other liabilities excluding personal injury claims
18 and specifically relating to gas manufacturing facility sites, disposal
19 sites, or sites to which material may have migrated, as a result of the
20 operation or decommissioning of gas manufacturing facilities.

21
22 Q. WHAT IS THE PUBLIC COUNSEL'S POSITION ON THE
23 MANUFACTURED GAS SITE REMEDIATION COSTS PROPOSED BY
24 MOPUB?

25 A. Public Counsel takes the position that the Company has requested
26 improper regulatory treatment for the expenses. The Company

Direct Testimony of
Ted Robertson

1 proposes that remediation costs of \$350,000 should be amortized to
2 Missouri operations cost of service, both electric and gas, over three
3 years, i.e., \$116,667 per year, with the unamortized balance included
4 as an addition to rate base (\$350,000). Its proposal passes 84.39% of
5 the costs to the electric division operations and the remainder,
6 15.61%, to the gas division operations. The increase in the gas
7 division rate base is \$54,635, while the increase to the gas cost of
8 service is \$18,212. The Public Counsel opposes allowing any of the
9 costs to flow through to the electric division because no electric
10 customer, current or historic, benefited from the manufactured gas
11 service. Therefore, they should not be held responsible for any of
12 the costs. The Public Counsel also recommends that the Commission
13 disallow recovery of the MGP site remediation costs, in the instant
14 case, for the reasons discussed in the following testimony.

15
16 Q. WERE THE REMEDIATION COSTS AN ISSUE IN THE RECENT MOPUB
17 ELECTRIC RATE FILING (CASE NO. ER-93-37)?

18 A. Yes, In that filing, the Public Counsel opposed the inclusion of any
19 manufactured gas plant remediation costs in the electric division's
20 cost of service or rate base. The position taken was based on the
21 Public Counsel's determination that the costs at issue are appropriate
22 only to gas operations, if appropriate at all. OPC witness, Russell
23 Trippensee, on page 41 lines 22-25 of his direct testimony states,
24 "[i]f the costs are found to be prudent and that current ratepayers
25 should pay for cleanup related to the provision of gas service to

Direct Testimony of
Ted Robertson

1 customers over 40 years ago, the gas ratepayers should bear the
2 costs."

3
4 Q. CAN PUBLIC COUNSEL PROVIDE THE MPSC WITH AN EXAMPLE OF
5 CLEANUP COSTS OF OTHER MULTISERVICE UTILITY COMPANIES
6 AND HOW THE COSTS WERE RECOVERED?

7 A. Yes. Nuclear decommissioning costs are probably the largest cleanup
8 costs currently being borne by Missouri ratepayers. In the case of
9 Union Electric Company, these costs are borne strictly by the electric
10 ratepayers. Neither Union Electric gas ratepayers nor their previous
11 water ratepayers were allocated any of these costs. Nuclear
12 decommissioning costs relate to the service that current customers are
13 receiving. Numerous other examples exist where multi-service
14 utilities incur costs which are specific to one type of utility service.
15 I would point out that the Commission has traditionally set rates on a
16 stand alone basis for utilities with multiple services. To allow
17 allocation of MGP site remediation costs to the electric ratepayers
18 would violate this fundamental principle of regulation.

19
20 Q. IS MOPUB POTENTIALLY LIABLE FOR EXPENSES RELATED TO THE
21 INVESTIGATION AND CLEANUP OF THE FORMER MGP SITES?

22 A. Yes, it would appear that the Company is at least partially and
23 possibly fully liable for the costs. The direct testimony of Company
24 witness, Robert C. Beck, page 10, states in part that two federal
25 statutes have the greatest environmental regulatory impact with
26 respect to former MGPs. They are, the 1976 Resource Conservation

Direct Testimony of
Ted Robertson

1 and Recovery Act (RCRA) enacted to address the treatment, storage,
2 management and disposal of solid wastes and the 1980 Comprehensive
3 Environmental Response, Compensation and Liability Act (CERCLA or
4 Superfund).

5
6 Under the provisions of CERCLA, the Company is falls under one or
7 more of the identified potentially responsible parties (PRP) categories
8 and therefore may be held strictly, jointly, and severally liable for all
9 cleanup costs. CERCLA specifically includes in its PRP classifications
10 the present owner and operator of a site, past owners of a site and
11 transporter of hazardous substances disposed of at a site when the
12 transporter selected the site.

13
14 Q. MOPUB IS A POTENTIALLY RESPONSIBLE PARTY FOR HOW MANY
15 MGP SITES?

16 A. The Company has investigated and developed a list of MGP sites, that
17 it currently or formerly has had ownership interests, that could
18 involve it as a PRP under the Superfund statute. It has been
19 determined to date that the Company is potentially responsible for
20 nine sites. Of the nine sites: Chillicothe, Clinton, Lexington
21 (Farrar ST. & S.W. Blvd.), Sedalia and Trenton are fully owned, but
22 the Company is only a partial owner in the Nevada site and has no
23 ownership interest in the Lexington (10th St. & Highland Ave.) or
24 the two Marshall sites.

Direct Testimony of
Ted Robertson

1 Q. WHAT STEPS HAVE BEEN TAKEN TO DETERMINE POSSIBLE
2 HAZARDOUS WASTE PROBLEMS?

3 A. The Company's response to OPC Data Request No. 44 describes that
4 preliminary assessments of the Lexington site located at Farrar Street
5 and Southwest Boulevard and the Marshall site located at Boyd Street
6 and Lafayette Avenue were conducted by Ecology and Environment
7 under contract by EPA Region VII.

8
9 Q. WERE ANY OTHER SITE INVESTIGATIONS CONDUCTED?

10 A. Yes. Company personnel investigated and identified one site as an
11 immediate problem. That site, Clinton, had residuals on the surface
12 so the entire area was fenced. The Company also hired an
13 environmental firm, Burns & McDonnell, to conduct preliminary
14 assessments at each of the nine former MGP sites. The purpose of the
15 preliminary assessments were threefold:

- 16 1. Determine if there is a potential for contamination.
- 17 2. Assess the degree of potential contamination.
- 18 3. Assess the impact of potential contamination on human health
19 and the environment.

20
21 Q. HAS ANY ACTUAL CLEANUP ACTION OCCURRED TO DATE?

22 A. No. Expenditures, however, have been incurred relating to the MGP
23 site identifications, consultant investigations, attorney fees and
24 personnel training. The Company response to OPC Data Request No.
25 54 states, "Approximately \$114,478 has been actually incurred to
26 date. MoPub is currently in the early stages of a \$250,000 contract

Direct Testimony of
Ted Robertson

1 with Burns & McDonnell Waste Consultants, Inc. (WCI) to conduct
2 expanded investigations at one or two sites. Total cleanup costs for
3 the sites has not been projected at this time. All costs incurred to
4 date have been charged to FERC account 186.10"

5
6 Q. SHOULD RATEPAYERS BE HELD RESPONSIBLE FOR COSTS
7 ASSOCIATED WITH ASSETS THAT ARE NO LONGER IN SERVICE?

8 A. No. Current ratepayers should not be held responsible for costs that
9 do not increase service capabilities or provide cost benefits. The
10 MGP site remediation costs being incurred are associated with plant
11 that is no longer in service and therefore no longer used and useful.
12 The Company is asking the Commission to have the customer pay for
13 plant that does not operate to provide current utility service. I don't
14 believe this is a normal practice of this Commission, and it is
15 unreasonable to force a consumer to pay for something they are not
16 using. MoPub is entitled the opportunity to earn a fair rate of return
17 only upon the money prudently invested in property used and useful
18 in rendering utility service.

19
20 Q. PLEASE EXPLAIN THE CONCEPT "USED AND USEFUL".

21 A. One of the Public Counsel's main objections to the Company proposed
22 treatment of this issue is that it violates the regulatory "used and
23 useful" standard. The general rule is that, "the rate base on which
24 a return may be earned is the amount of property used and useful, at
25 the time of the rate inquiry, in rendering a designated utility
26 service." (A.J.G. Priest, Principles of Public Utility Regulation

Direct Testimony of
Ted Robertson

1 (1969), p. 139, vol. 1). This principle is certainly grounded in
2 common sense. In dividing the responsibility for a utility's operations
3 between ratepayers and stockholders, regulators have traditionally
4 required that stockholders rather than ratepayers be required to
5 bear the costs of any utility investment which is not used and useful
6 to provide service to the ratepayers.

7
8 In a recent discussion of the policy in Missouri, State ex rel. Union
9 Electric v. Public Service of the State of Missouri, 765 S.W. 2d 618
10 (Mo. App. 1988), the Court of Appeals for the Western District
11 endorsed the used and useful policy. That case involved Union
12 Electric's appeal of the Commission's denial of the costs of cancellation
13 of its Callaway II nuclear unit. The Commission ruled that the risk
14 of cancellation should be borne by the shareholder, since if it was
15 not, the shareholder's investment would be practically risk free. The
16 Court, in upholding the Commission's decision, stated,

17
18 The utility property upon which a rate of return can be earned
19 must be utilized to provide service to its customers. That is,
20 it must be used and useful. This used and useful concept
21 provides a well-defined standard for determining what
22 properties of a utility can be included in its rate base.

23
24 Q. ARE THE MGP SITE REMEDIATION COSTS RECOVERABLE FROM
25 INSURERS OR OTHER POTENTIALLY RESPONSIBLE PARTIES?

26 A. Public Counsel Data Request No. 62 requested, "For each site,
27 identify all PRPs. Include documentation supporting Company's
28 efforts (particularly legal) in identifying all PRPs and estimates or

Direct Testimony of
Ted Robertson

1 projections of the PRPs potential liabilities. Also, has MPS made any
2 attempt to recover preliminary investigation expenditures from other
3 PRPs." To which the Company's response said, "Pursuant to the
4 Comprehensive Environmental Response, Compensation, and Liability
5 Act of 1980 (CERCLA) potentially responsible parties (PRP) include
6 current property owners and generators of the contamination. MPS
7 is currently reviewing the ownership history of the sites to determine
8 if PRPs, other than the current property owners for the sites the
9 company no longer owns, exist. MPS has not at this time made any
10 estimates or projections of the PRPs potential liabilities. MPS has not
11 made any attempt to date to recover preliminary investigation
12 expenditures from other PRPs."

13
14 While the Company has not completed its review of potential PRPs, the
15 Bell, Boyd & Lloyd invoices attached to the Company response to OPC
16 Data Request No. 54 show that a substantial portion of the
17 approximately \$58,000 in charges paid to the legal firm were for
18 review of insurance issues for submitting claims, review of projects
19 on insurance, preparation of correspondence to AEGIS, review
20 insurance listings, review insurance contracts and cases regarding
21 notices of claim, review insurance documents to determine insurers
22 to whom to give notice, review insurance listings to give notice to
23 non-AEGIS carrier, etc. The lack of information for potential cost
24 recovery from other PRPs and insurance claims increases
25 substantially the impossibility of accurately determining the level of

Direct Testimony of
Ted Robertson

1 MGP site remediation costs MoPub is or will eventually be responsible
2 for.

3
4 Q. WHAT IS THE NATURE OF THE REMEDIATION COSTS?

5 A. The remediation and any future cleanup costs are in actuality a legal
6 requirement that must be met in order to satisfy federal statutes on
7 the proper handling of hazardous wastes in order to alleviate adverse
8 environmental effects. The expenditures have been incurred to
9 identify and assess MGP sites that may require further action to
10 protect the health and safety of Missouri citizens. They are not
11 expenditures related to the providing of utility service to current or
12 future MoPub ratepayers.

13
14 The purpose of the regulatory ratemaking process is to identify a
15 reasonable monetary return that the monopoly enterprise has the
16 opportunity to earn. Regulation does not guarantee that level of
17 earnings, nor does it force a company to return any overearnings
18 retroactively, in the event overearnings occur. Even if the former
19 MGPs are assumed to have been used and useful utility property at
20 the time the pollution of the land occurred, and the cleanup costs had
21 not been anticipated while the plant was in use, current ratepayers
22 should not be held captive to their recovery. In simplistic terms,
23 the ratepayers part of the regulatory bargain is to provide the
24 company with a level of revenues that allow it to earn the Commission
25 approved rate of return on current used and useful investment along
26 with the costs of operating and maintaining that investment, and no

Direct Testimony of
Ted Robertson

1 more. Ratepayers do not assume, willing or implied, any risk
2 assumed by the stockholders.

3
4 MoPub's proposal states that because federal statutes enacted over
5 ten (10) years ago will cause the Company's expenditures to increase,
6 ratepayers, not stockholders, should be held responsible for those
7 costs. The Company is attempting to pass the natural risks
8 associated with a business that is a continuing enterprise, a "going-
9 concern", entirely from stockholders to ratepayers. Stockholders,
10 not ratepayers, are the actual risk-takers and for assumption of risk
11 they receive a market determined return on their investment. If an
12 unexpected event occurs that affects the Company either in a
13 negative or positive manner, then stockholders, not ratepayers,
14 should weather the effects.

15
16 Q. HOW IS RISK DEFINED?

17 A. Company witness, John C. Dunn, on page 10 of his direct testimony
18 defines investment risk as, "Risk is the probability that the expected
19 return will not be earned because of the impact of some "risky
20 (unplanned) event" on MPS and how frequently such unplanned
21 events take place."

22
23 Q. WHAT IS THE SIGNIFICANCE OF MR. DUNN'S RISK DEFINITION?

24 A. It is a well accepted principle of regulation that common stockholders
25 contribute what is known as "risk capital" to the utility company for
26 which they receive a compensatory rate of return. Among the

Direct Testimony of
Ted Robertson

1 uncertainties that common stockholders accept in return for this
2 added compensation is the danger of earnings shortfall, for whatever
3 reason.

4
5 Company response to OPC Data Request No. 56 identified the
6 acquisition dates for the nine sites extends from 1927 for the
7 Chillicothe, Clinton, Nevada and Trenton sites; to 1945 for the
8 Sedalia site; and 1952 for the Lexington and Marshall sites. Each
9 year, from 1927 through and including 1993, stockholders have been
10 receiving the benefit of a risk premium such as that identified by Mr.
11 Dunn. The stockholders have been rewarded with an additional
12 return, above a risk free investment such as U.S. government
13 securities, on their investment for unplanned, unforeseeable and
14 unexpected events. Now, after receiving the benefit of the additional
15 risk return, in some cases for nearly seventy (70) years, the
16 Company proposes that it is ratepayers, not stockholders, who should
17 be held responsible for the MGP site remediation costs. Ratepayers
18 have satisfied their Commission ordered requirements. They
19 provided the revenues to meet the Company's Commission approved
20 earnings level for each of those years. It is the stockholder that
21 should be responsible for paying the remediation costs because it is
22 the stockholder that has already been remunerated for assuming the
23 risk of an event such as MGP site remediation occurring.

Direct Testimony of
Ted Robertson

1 Q. IS THE PUBLIC COUNSEL PROPOSING THAT THE DEFERRED
2 COSTS, AS PROPOSED BY MOPUB, BE INCLUDED IN THE INSTANT
3 CASE'S COST OF SERVICE?

4 A. No. The Public Counsel's recommendation is that the Commission
5 exclude all MGP remediation costs from the instant case cost of
6 service. This results in the reduction of \$18,212 from proposed
7 expense and \$54,635 from the requested rate base.

8
9 Q. IS THERE AN ALTERNATE PROPOSAL THAT WOULD ALLOW BOTH
10 STOCKHOLDERS AND RATEPAYERS TO SHARE RESPONSIBILITY
11 FOR THE REMEDIATION COSTS?

12 A. Yes. While the Public Counsel does not waiver from the
13 recommendation made earlier, in the alternative, if the Commission
14 decides that current and future ratepayers should be held partially
15 responsible for the remediation costs, the Company could be allowed
16 to amortize an annualized level of prudently incurred remediation
17 costs over the three-year period proposed, but it should not receive
18 rate base recognition for the unamortized expenditures. Use of this
19 sharing method would cause the stockholders to assume some of the
20 monetary responsibility for the remediation efforts.

21
22 Q. HAS THE MPSC ADDRESSED THE UTILIZATION OF COST SHARING
23 MECHANISMS?

24 A. Yes. Regarding the issue of cancellation costs incurred for Rush
25 Island Units 3 and 4, the MPSC Report and Order for Union Electric
26 Company, Case No. ER-77-154, stated on page 24,

Direct Testimony of
Ted Robertson

1 Staff's proposal permits only the recovery of the sunk costs but
2 permits no return on them. Any period of amortization for an
3 extraordinary expense is arbitrary in nature, but the
4 Commission will accept Staff's proposal...

5
6 INTEREST ON CUSTOMER DEPOSITS

7
8 Q. WHAT ISSUES WILL THE PUBLIC COUNSEL ADDRESS REGARDING
9 CUSTOMER DEPOSITS?

10 A. The Public Counsel will address the appropriate rate of interest to
11 pay on customer deposits and the proper level of customer deposits
12 to include in rate base upon which interest expense is calculated.

13
14 Q. WHAT IS THE PUBLIC COUNSEL'S POSITION ON THE APPROPRIATE
15 RATE OF INTEREST TO BE PAID ON CUSTOMER DEPOSITS?

16 A. The Public Counsel believes the interest rate paid on customer
17 deposits should equal the gross rate of return paid by all customers
18 on other amounts included in rate base. Use of the overall rate of
19 return recommended by Public Counsel witness, Mr. John Tuck,
20 results in a interest rate of 12.31%. If the Commission authorizes a
21 rate of return and or capital structure different than that proposed
22 by Mr. Tuck, the interest rate I'm recommending would have to be
23 adjusted to reflect those changes.

24
25 Q. WHY DOES PUBLIC COUNSEL BELIEVE IT APPROPRIATE FOR
26 MOPUB TO PAY THE GROSS RATE OF RETURN AUTHORIZED BY
27 THIS COMMISSION?

Direct Testimony of
Ted Robertson

1 A. The Commission should authorize the payment of the gross rate of
2 return on customer deposits, for two reasons:

3
4 1. It would eliminate the artificial lowering of revenue requirement
5 created by reducing rate base by the customer deposits
6 balance; and

7
8
9 2. It eliminates the subsidies received by the general body of
10 ratepayers from those customers who are required to make a
11 deposit.

12
13 Q. PLEASE SUMMARIZE THE PURPOSE FOR REQUIRING PAYMENT OF
14 A CUSTOMER DEPOSIT?

15 A. Customer deposits are required of some customers based on the belief
16 that they help reduce the necessity of bad debt write-offs. The
17 Public Counsel agrees that this is the primary function of a deposit.
18 The theory underlying the deposit requirements is that certain
19 customers present a higher probability of failing to pay their
20 obligations than the average customer. Those customers are required
21 to pay a deposit to insure that adequate funds are available to pay
22 amounts owed to the Company. If properly calculated the deposit
23 should reduce the risk of bad debts to a level equal to or even less
24 than the bad debt risk associated with the general body of
25 ratepayers.

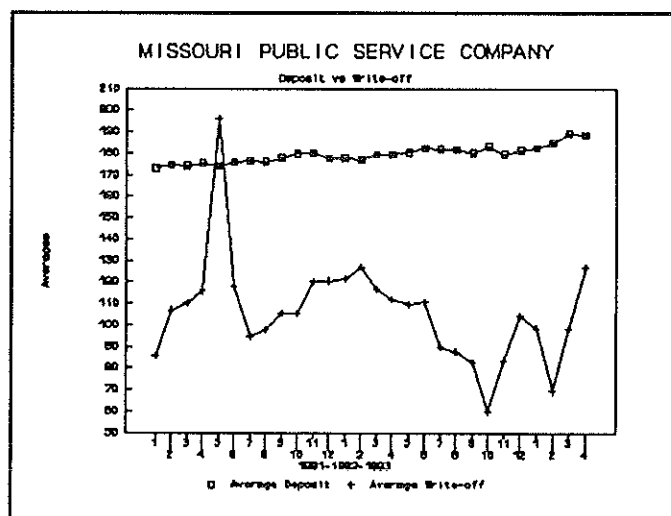
26
27 Q. HAS MOPUB PERFORMED ANY STUDIES OR ANALYSIS THAT
28 SUBSTANTIATES THE VALIDITY OF THE DEPOSIT THEORY ON BAD
29 DEBT WRITE-OFFS?

Direct Testimony of
Ted Robertson

1 A. No. The Company response to OPC Date Request No. 49, questions
2 3 & 4, states, "There are no known analyses that have been
3 performed regarding the costs of maintaining a customer deposit
4 program verses the savings or benefits to ratepayers and
5 stockholders derived from the program ." and "MPS has not
6 performed an analysis of customer deposits relative to its effect on
7 bad debts. Since MPS collects deposits on high risk customers, those
8 that have not established an acceptable credit rating, have been
9 disconnected for nonpayment of a delinquent account, have interfered
10 with or diverted service and have a history of delinquent payments,
11 it is sensible to believe that deposits help reduce bad debts."

12
13 Q. HAS PUBLIC COUNSEL PERFORMED AN ANALYSIS REGARDING THE
14 ADEQUACY OF THE CUSTOMER DEPOSITS AS IT RELATES TO
15 MOPUB'S BAD DEBT WRITE-OFF EXPERIENCE?

16 A. Yes. The graph displayed shows the monthly average customer
17 deposit since
18 January 1991. The
19 average deposit has
20 been steadily
21 growing and as of
22 April 1993 is \$183.00.
23 The monthly average
24 bad debt write-off is
25 also shown on the
26 graph. The average



Direct Testimony of
Ted Robertson

1 write-off over the twelve months ending April 1993 is \$93.00. The
2 average write-off is less than the average deposit in all months except
3 one. This comparison indicates that customers who have made
4 deposits have provided, on average, total assurance that they will not
5 create a bad debt risk for other customers. It could even be said that
6 customers who do not make a deposit pose a greater risk of debt
7 write-off. Yet it is the nondeposit ratepayers who receive the
8 subsidy. The subsidy is caused by requiring people who make a
9 deposit to fund part of the rate base.

10
11 Q. DOES MOPUB'S CUSTOMER DEPOSIT TARIFF SUPPORT THE
12 ASSERTION THAT CUSTOMERS WITH DEPOSITS ELIMINATE THE
13 BAD DEBT RISK TO OTHER RATEPAYERS?

14 A. Yes. Tariff Sheet R-7, Section 1.04(g)(1), sets out the requirements
15 that the Company can in most cases charge a customer deposit equal
16 to utility charges applicable to one billing period plus thirty days.
17 While it is possible for MoPub to charge a deposit that is two times the
18 highest monthly bill in the preceding twelve-month period for
19 customers disconnected under the terms in Tariff Sheet R-7, Section
20 1.04(d). It's no coincidence that the timeframes associated with the
21 customer deposit amounts and the time it takes a utility to cut off a
22 customer for nonpayment is approximately two months. The
23 equalization of the customer deposit amounts and discontinuance of
24 service timeframes provide assurance, that on average, the alleged
25 high risk customers will not place additional risk of bad debt on other
26 customers.

Direct Testimony of
Ted Robertson

Q. PLEASE EXPLAIN HOW USING CUSTOMER DEPOSITS TO REDUCE
RATE BASE ARTIFICIALLY LOWERS REVENUE REQUIREMENT.

A. There are two components of the traditional treatment of customer deposits. The first component is that a level of customer deposits is used to reduce rate base. The effect of this component is to lower the revenue requirement by an amount equal to the effective tax rate times the level of customer deposits. The second component recognizes the requirement that a company pays interest on the deposit. Therefore interest expense is included as an above the line expense. This action raises revenue requirement by an amount equal to the level of customer deposits times the interest rate used. If the interest rate used is less than the effective tax rate, the net effect is to lower the revenue requirement.

Q. CAN YOU PROVIDE AN EXAMPLE OF THIS?

A. Yes. The following example uses Company specific data. I have used the level of customer deposits and the 6% interest rate requested by the Company. The effective tax rate utilizes the capital structure and cost of capital developed by Mr. Tuck.

Customer Deposits	\$824,134
-------------------	-----------

Interest Expense Effect

Interest rate	6.00%
Interest Expense	\$ 49,448

Rate Base Effect

Gross Rate of Return	12.31%
Revenue Requirement Effect	\$ 101,450
Net Revenue Requirement Reduction	\$ 52,002

Direct Testimony of
Ted Robertson

1 This example shows the Company's ratepayers will benefit from a
2 reduced revenue requirement of \$52,002 if the gross rate of return
3 is not paid on customer deposits.

4
5 Q. DOES THIS REVENUE REQUIREMENT REDUCTION CONSTITUTE
6 THE SUBSIDY YOU REFERRED TO IN OUTLINING THE BASIS FOR
7 THE PUBLIC COUNSEL'S RECOMMENDATION?

8 A. Yes. The subsidy exists when the general body of ratepayers are
9 paying lower rates because a subgroup of ratepayers are required to
10 fund an increase in the Company's rate base with customer deposits.
11 If the return (interest) paid to this subgroup of customers is below
12 the gross rate of return then the revenue requirement is lowered for
13 the general body of ratepayers, thus creating the subsidy.

14
15 Q. IS A SUBSIDY WARRANTED WITH REGARD TO MOPUB?

16 A. No. As previously discussed, the average customer deposit exceeds
17 the average write-off. This reduces, if not eliminates, the bad debt
18 risk associated with customers who make a deposit. A subsidy would
19 only be warranted if it could be shown that certain customers place
20 a greater risk to system costs than other customers and should
21 therefore compensate the other customers for assuming that risk.
22 The Company's high risk customers have already provided adequate
23 compensation against increased bad debt write-offs by providing a
24 deposit which is adequate to cover two months' bills.

Direct Testimony of
Ted Robertson

1 Q. WOULD AN INTEREST RATE OF 12.31% ENCOURAGE MORE
2 CUSTOMERS TO PLACE A DEPOSIT WITH MOPUB?

3 A. No. Placement of a deposit is not a voluntary act, nor is it an option
4 based on customer discretion. A customer cannot simply walk into a
5 service center and place a deposit based on their personal desires.
6 Even if they could, it's unlikely that a significant number of
7 customers would place an average of \$183 with the Company for
8 twelve months or more in order to receive \$1.88 in interest per
9 month.

10
11 Collection or noncollection of a deposit is solely determined by
12 Company personnel once the criteria outlined in the tariffs have been
13 met. Placing a deposit with the Company is an involuntary act
14 performed by the ratepayer based on the customer's failure to meet
15 certain predetermined credit criteria. It is highly unlikely that any
16 customer would place a deposit with MoPub were it not required by
17 the tariffs.

18
19 Q. COULD AN EXISTING CUSTOMER CREATE A SITUATION WHICH
20 WOULD MEET TARIFF REQUIREMENTS ALLOWING MOPUB TO
21 REQUEST A DEPOSIT?

22 A. Yes. Tariff Sheet R-5, Section 1.04 (d), lists several situations in
23 which an existing customer could be forced to place a deposit with
24 the Company. Failure to timely pay your bill five out of the last
25 twelve months would create a situation in which the Company could
26 request a deposit. Most customers, however, would not be likely to

Direct Testimony of
Ted Robertson

pursue this course of action because of two important points, (1) the customer would incur a late payment charge which has a interest rate in excess of the effective tax rate they would receive on any deposit; and (2) the customer would not be able to control the situation because the deposit requirement is based on the Company's discretion, not the customer's.

Q. PLEASE EXPLAIN THE GROSS RATE OF RETURN AND ITS RELATIONSHIP TO THE OVERALL RATE OF RETURN.

A. The gross rate of return is used to determine the gross revenue requirement effect of any change to rate base. The difference between the gross rate of return and the overall rate of return is due to income tax expense. The gross rate of return recognizes the additional income tax expense required in order to obtain the overall rate of return. Therefore, the gross rate of return reflects a rate which incorporates the additional income tax expense.

Q. HOW IS THE GROSS RATE OF RETURN CALCULATED?

A. The following calculation develops the gross rate of return using the weighted cost of capital recommended by Mr. Tuck.

	<u>Weighted Cost of Capital</u>	<u>Tax Effect Multiplier</u>	<u>Gross Rate of Return</u>
Long-term Debt	4.34%	1.0	4.340%
Preferred Stock	.54%	1.5678	.847%
Common Equity	4.54%	1.5678	<u>7.118%</u>
Total			12.31%

Direct Testimony of
Ted Robertson

1 Q. WHY DOES THE LONG-TERM DEBT COMPONENT HAVE A TAX
2 EFFECT MULTIPLIER OF 1.0?

3 A. The change in revenue and interest expense due to a change in rate
4 base is equal. They offset each other when determining net taxable
5 income which is used to calculate income taxes so no change occurs
6 in income tax expense.

7
8 Q. PLEASE EXPLAIN HOW THIS OFFSET OCCURS.

9 A. The overall rate of return is taken times rate base to determine the
10 revenue needed to pay interest expense on debt and provide
11 earnings on stockholder investment. The interest expense used in
12 the income tax calculation is equal to the level of revenue attributable
13 to the interest expense in the overall rate of return. Another way
14 of stating this is that the interest expense used in the calculation of
15 income taxes is synchronized with rate base, i.e., rate base x debt
16 components' weighted cost of capital = interest expense for the
17 calculation of taxable income.

18
19 Q. PLEASE EXPLAIN WHY THE EQUITY COMPONENTS HAVE A TAX
20 EFFECT MULTIPLIER OF 1.5678.

21 A. Changes in revenue associated with equity earnings have no
22 corresponding changes in expense levels used to determine taxable
23 income. As a result, income tax expense will increase or decrease in
24 the same direction as the change in revenue. The equity components
25 of the overall rate of return must be grossed up to reflect this
26 change in income tax expense.

Direct Testimony of
Ted Robertson

1 Q. WHAT WOULD BE THE DIFFERENCE IN THE REVENUE
2 REQUIREMENT USING PUBLIC COUNSEL'S PROPOSAL VERSUS THE
3 SITUATION IF MOPUB HAD NOT COLLECTED ANY CUSTOMER
4 DEPOSITS?

5 A. Zero, unless there is a difference in the bad debt frequency between
6 the two groups of ratepayers. The purpose of requiring certain
7 customers to make deposits is meant to compensate for a perceived
8 frequency differential. In the Company's case, the deposit has
9 virtually eliminated the probability of the deposit group of
10 ratepayers having bad debt expense.

11
12 Q. WHAT LEVEL OF CUSTOMER DEPOSITS DOES THE PUBLIC
13 COUNSEL PROPOSE TO INCLUDE AS AN OFFSET TO RATE BASE?

14 A. \$877,796.
15

16 Q. PLEASE EXPLAIN HOW THIS AMOUNT WAS DEVELOPED.

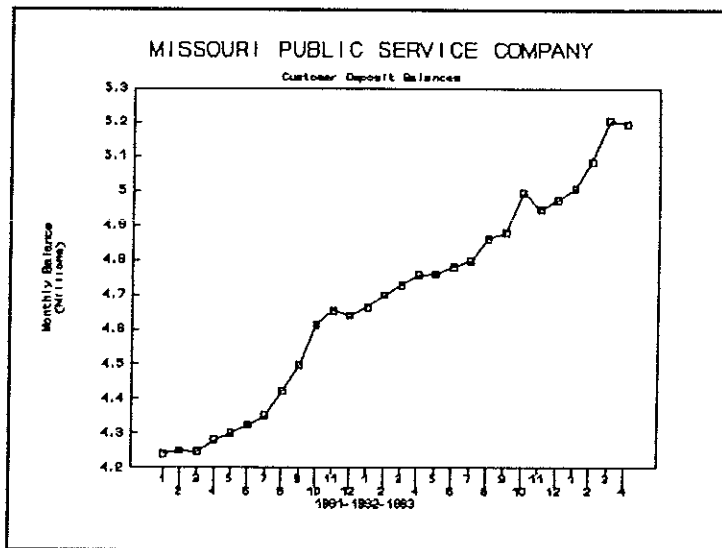
17 A. I used the balance of total customer deposits as of April 1993,
18 \$5,194,061, supplied in the Company supplemental response to OPC
19 Data Request No. 50, multiplied by the Company's gas allocation
20 factor of 16.90%.

21
22 Q. WHY IS IT APPROPRIATE TO USE THE BALANCE AS OF APRIL 1993?

23 A. As can be seen in the graph below, the customer deposits held by the
24 Company have shown a steady rate of growth since January 1991.
25 Since it is apparent that as the Company's customer base grows its
26 deposits balance will also increase, use of the deposit balance at the

Direct Testimony of
Ted Robertson

end of the
Commission
ordered "known
and measurable"
period provides a
better match with
plant in service
levels which are
also growing.



Q. PLEASE SUMMARIZE THE PUBLIC COUNSEL'S POSITION ON THE
APPROPRIATE INTEREST RATE FOR CUSTOMER DEPOSITS.

A. A subgroup of customers should not be required to pay additional
costs that subsidize the rate levels of the general body of ratepayers
absent reasonable cause. The Public Counsel concurs with the
Company that the reason for customer deposits is to reduce bad debt
expense associated with certain high risk customers. The Public
Counsel's analysis has shown that customer deposits held by the
Company have in fact virtually eliminated this risk. It is therefore
reasonable that the Commission should require the Company to pay
an interest rate equal to the gross rate of return, to ratepayers who
make a deposit, to eliminate and avoid further discrimination against
those ratepayers.

ACCOUNTING AUTHORITY ORDERS

1
2
3 Q. PLEASE SUMMARIZE THE MOPUB ACCOUNTING AUTHORITY ORDER
4 ISSUES.

5 A. On December 6, 1989, the Company filed an application (Missouri
6 Public Service, Case No. GO-90-115) for issuance of an accounting
7 order to defer and book to Account 186 the costs incurred to conduct
8 accelerated leak surveys, the additional operation and maintenance
9 costs which have or will be incurred, depreciation expense, property
10 taxes and carrying costs which would normally be expensed at the
11 in-service date on amounts placed in service in connection with a
12 "major gas safety program initiated by MPS". Company stated that
13 it was seeking Commission approval to defer and record expenditures
14 and costs incurred in connection with its gas safety projects from
15 January 1, 1989 to the effective date of rates established in the
16 Company's next general rate case. Subsequently, the Commission in
17 its Order dated January 12, 1990, granted the Company's
18 application.

19
20 On May 10, 1991, the Company again filed an application (Missouri
21 Public Service, Case No. GO-91-359) for issuance of an accounting
22 authority order to defer and book to Account 186 depreciation
23 expenses and carrying costs incurred in connection with its gas line
24 safety replacement project in the same manner as approved by the
25 Commission in Case No. GO-90-115, from January 1, 1991 through
26 the effective date of rates established in the Company's next general

Direct Testimony of
Ted Robertson

1 rate case. The Commission in its Order dated January 17, 1992
2 approved the Company's application.

3
4 Q. WHAT REASONS DID MOPUB PROVIDE FOR REQUESTING
5 APPLICATION OF THE TWO ACCOUNTING AUTHORITY ORDERS?

6 A. In its AAO applications, the Company stated that it is currently
7 involved with significant projects involving its natural gas
8 distribution operations; that said projects have been undertaken as
9 part of a major gas safety program initiated by the Company and
10 pursuant to rules of the Commission. The activities include gas leak
11 surveys of service lines and a gas main and services replacement
12 project that has caused it to incur and will continue to incur a
13 substantial increase in annual operating and maintenance expense as
14 well as a substantial increase in capital expenditures.

15
16 In addition, the Company described the expenditures as
17 extraordinary and material. That they have not previously been
18 fully reflected in the gas rates of Company and no additional revenue
19 will result to Company on completion of the projects.

20
21 Q. BY APPROVING THE AAO APPLICATIONS, HAS THE MPSC
22 ACQUIESCENCED AS TO VALUE OR REASONABLENESS OF MOPUB'S
23 ACCUMULATED DEFERRED EXPENSES?

24 A. No. The Order in Case No. GO-90-115 states on page 1:

Direct Testimony of
Ted Robertson

1 The Commission has determined it can grant the authority
2 without reaching a decision as to the appropriate ratemaking
3 treatment for the expenditures and costs in question. A
4 review of the appropriate ratemaking treatment in a general
5 rate case is necessary.

6
7 While the Order in Case No. GO-91-359 states on page 4:

8
9 That nothing in this order shall be considered a finding by the
10 Commission of the reasonableness of the expenditures involved
11 herein, nor as an acquiescence in the value placed upon said
12 properties by Missouri Public Service. Furthermore, the
13 Commission reserves the right to consider the ratemaking
14 treatment to be afforded these expenditures, and their
15 resulting cost of capital, in any later proceeding.

16
17 Q. WHAT IS THE OFFICE OF PUBLIC COUNSEL'S POSITION ON THE
18 PROPER RATEMAKING TREATMENT OF THE ACCOUNTING
19 AUTHORITY ORDERS RECEIVED BY MOPUB FROM THE MPSC?

20 A. The Public Counsel believes that the Commission should exclude from
21 the cost of service all rate base treatment and amortization relating
22 to the gas safety program accounting authority orders (AAOs). This
23 results in a elimination of \$1,927,040 from the Company's proposed
24 rate base and a reduction to amortization expense of \$102,491 (Both
25 are updated amounts provided by the Company in its response to
26 OPC Data Request No. 59).

27
28 Q. PLEASE EXPLAIN WHY THE PUBLIC COUNSEL BELIEVES THAT THE
29 MPSC SHOULD NOT ALLOW THE DEFERRED DEPRECIATION AND
30 PROPERTY TAX EXPENSE IN THE COST OF SERVICE?

Direct Testimony of
Ted Robertson

1 A. The Public Counsel believes that the proper application of test year
2 principles does not allow for the recovery of deferred depreciation
3 or property tax expense associated with the AAOs. The fundamental
4 principle of ratemaking is the concept of matching. This principle
5 requires a Commission "to fix rates that will produce revenues to
6 match costs of that period" (Accounting for Public Utilities, page 7-
7 3, Hahne & Aliff). Inclusion of deferred expenses along with a test
8 period expense for the plant, which is in service, would cause the
9 cost of service to be based on more than 12 months of test period
10 expense.

11
12 Q. WHEN USING THE TERM "DEFERRED" IN THIS TESTIMONY, TO
13 WHAT ARE YOU REFERRING?

14 A. When a cost (expense) has been deferred, it is removed from the
15 income statement and entered on the balance sheet (in Account 186,
16 Miscellaneous Deferred Debits), pending the final disposition of
17 these costs at some future point, usually a rate case.

18
19 The National Association of Regulatory Utility Commissioners
20 (NARUC), Uniform System Of Accounts For Class A and B Gas
21 Utilities 1976, approved by the Commission for use by MoPub states
22 on page 63:

23
24 This account shall include all debits not elsewhere provided
25 for, such as miscellaneous work in progress, losses on
26 disposition of property, net of income taxes, deferred by
27 authorization of the Commission, and unusual or extraordinary
28 expenses, not included in other accounts, which are in

Direct Testimony of
Ted Robertson

process of amortization and items the proper final disposition
of which is uncertain.

Q. HAVE YOU REVIEWED MOPUB'S DETERMINATION OF ITS PROPOSED
GAS SAFETY PROGRAM DEFERRED EXPENSE?

A. Yes. The Company has deferred AAO expenses and carrying costs
through September 30, 1993, the total expenses included in the cost
of service are \$102,491. The \$102,491 can be broken down as the
amortized cost of service expense for deferrals related to Case Nos.
GO-90-115 (leak survey expenses \$4,560, depreciation \$11,054 and
carrying costs \$25,316 = \$40,929) and GO-91-359 (depreciation
\$13,434 and carrying costs \$48,128 = \$61,562).

A rate base adjustment of \$1,927,040 has also been proposed by the
Company. The adjustment represents the sum of the total
unamortized deferrals, Case Nos. GO-90-115 (\$695,791) and GO-91-
359 (\$1,231,249), reduced by deferred taxes. The Company
proposal includes an amortization period of twenty (20) years for the
unamortized costs of each AAO.

Q. HAS MOPUB MET ITS "BURDEN OF PROOF" THAT THE
IMPLEMENTATION OF THE GAS SAFETY PROGRAM PLAN DID NOT
ALLOW IT TO EARN ITS COMMISSION ALLOWED RATE OF RETURN?

A. No. Public Counsel believes that it is the Company's responsibility
to clearly demonstrate that deviation from normal accounting and
ratemaking practices is justified based on extraordinary

Direct Testimony of
Ted Robertson

1 circumstances, i.e., the impact of the program on financial results
2 is material and the accounting treatment sought is necessary to
3 maintain financial integrity. Absent proof, to be provided by the
4 Company, that during the years in question it was not earning an
5 adequate rate of return, the expenses deferred pursuant to
6 satisfying the Commission's gas safety rules should not be
7 categorized as extraordinary, nor should they be construed as
8 material.

9
10 Q. HAVE MISSOURI COURTS HEARD AND RULED ON ISSUES
11 REGARDING A COMPANY'S COLLECTION OF REVENUES OBTAINED
12 WITHOUT BENEFIT OF A RATE CASE?

13 A. Yes. In State ex rel. Util. Consumers Council, etc. v. P.S.C. Mo.,
14 the Supreme Court of Missouri said:

15
16 This does not mean that the utilities have received a windfall
17 profit of the amounts illegally collected. If no fuel adjustment
18 clause or roll-in had been in effect, the utilities would have
19 had a right to file for an increased rate, in order to allow them
20 to recover their increased fuel costs and to maintain a just and
21 reasonable rate. While the amounts they would have collected
22 may not exactly match those collected under the fuel
23 adjustment clause, to order a refund of the latter amounts
24 would clearly be confiscatory, and to order an offset of this
25 refund by what a "reasonable rate" would have been would be
26 (retroactive) rate making at the order of this court, something
27 we cannot do. [State ex rel. Util. Consumers Council, Etc. v.
28 P.S.C. Mo.(1979), 585 S.W. 2d 41 (Missouri Supreme Court)]

29
30 It would also be appropriate that the exact reverse of the above
31 situation would be true. If a company does not collect additional
32 revenues by abdicating its right to file for an increased rate, any

Direct Testimony of
Ted Robertson

1 order that would grant additional revenue would also be retroactive
2 rate making.

3
4 The Missouri Supreme Court also said,

5
6 The utilities take the risk that rates filed by them will be
7 inadequate, or excessive, each time they seek rate approval.
8 To permit them to collect additional amounts simply because
9 they had additional past expenses not covered by either clause
10 is retroactive rate making, i.e., the setting of rate which
11 permit a utility to recover past losses or which require it to
12 refund past excess profits collected under a rate that did not
13 perfectly match expenses plus rate-of-return with the rate
14 actual established; and

15 Past expenses are used as a basis for determining what rate is
16 reasonable to be charged in the future in order to avoid
17 further excess profits or future losses, but under the
18 prospective language of the statutes, and they cannot be used
19 to set future rate to recover for past losses due to imperfect
20 matching of rates with expenses. [State ex rel. Util.
21 Consumers Council, Etc. v. P.S.C. Mo. (1979), 585 S.W. 2d 41
22 (Missouri Supreme Court)]

23
24 Q. HAVE MISSOURI COURTS RULED ON ATTEMPTS BY A COMPANY TO
25 OBTAIN RATE MAKING TREATMENT OF PERCEIVED PAST
26 DEFICITS?

27 A. Yes. In State v. Public Service Commission, the Supreme Court of
28 Missouri cited Galveston Electric Company v. Galveston, 258 U. S.
29 388, 42 Sup. Ct. 351, 66 L. Ed. 678, decided by the United States
30 Supreme Court on April 10, 1922:

31
32 The fact that a utility may reach financial success only in time,
33 or not at all, is a reason for allowing a liberal return on the
34 money invested in the enterprise; but it does not make past
35 losses an element to be considered in deciding what the base

Direct Testimony of
Ted Robertson

1 value is and whether the rate is confiscatory. A company
2 which has failed to secure from year to year sufficient
3 earnings to keep the investment unimpaired and to pay a fair
4 return, whether its failure was the result of imprudence in
5 engaging in the enterprise, or of errors in management, or of
6 omission to exact proper prices for its output, cannot erect
7 out of past deficits a legal basis for holding confiscatory for
8 the future rates which would on the basis of present
9 reproduction value, otherwise be compensatory. [State v.
10 Public Service Commission, (1922), 252 S.W. 449 (Missouri
11 Supreme Court)]
12
13
14

15 Q. DOES PUBLIC COUNSEL BELIEVE THAT MOPUB'S DEFERRED
16 DEPRECIATION OR PROPERTY TAX EXPENSE SHOULD BE
17 INCLUDED IN THE INSTANT CASE?

18 A. No. OPC believes that the proper application of test year principles
19 does not allow for the recovery of deferred depreciation or property
20 tax expense associated with the Company's accounting authority
21 orders. A fundamental principle of ratemaking is that of matching.
22 This principle as quoted in the regulatory accounting guide,
23 Accounting for Public Utilities, page 7-2, Hahne & Aliff, states,
24

25 "The approach most often used by regulators has been to
26 measure the total costs incurred in conducting operations over
27 a twelve-month period (i.e., the test period cost of service)
28 and to fix rates that will produce revenues to match costs of
29 that period."
30

31 Inclusion of deferred depreciation or property tax expense in the
32 cost of service with a test period depreciation expense and property
33 tax expense for plant in service violates the "matching" of test
34 period expenses and revenues.

Direct Testimony of
Ted Robertson

1 Q. PLEASE EXPLAIN HOW A FULL YEAR OF DEPRECIATION AND
2 PROPERTY TAX EXPENSE ASSOCIATED WITH MOPUB'S GAS
3 SAFETY PROGRAM WOULD BE INCLUDED IN THE CURRENT CASE
4 COST OF SERVICE.

5 A. The plant related to the gas safety program is recorded on the
6 accounting records as current plant in service, from which the
7 annual depreciation and property tax expenses will be calculated.
8 This calculation causes a full year of depreciation and property tax
9 expense to be included in the cost of service. Allowing deferred
10 expenses, related to the same plant investment results in a
11 mismatching of those expenses.

12
13 Q. HAVE OTHER COMMISSIONS RECOGNIZED THAT THE INCLUSION
14 OF DEFERRED DEPRECIATION EXPENSE VIOLATES THE TEST
15 YEAR PRINCIPLES EMBODIED IN THE MATCHING CONCEPT?

16 A. Yes. The Illinois Commerce Commission in Case No. 91-0147 cited the
17 following Illinois Supreme Court decision in finding that depreciation
18 expense should not be deferred:

19
20 Because the entire cost of the plants is amortized over less
21 than the full useful life of the plants, the variance increases
22 the annual depreciation expense to be recognized in each of
23 the years following the deferral period. For this reason we
24 find that recovery of deferred depreciation violates the test-
25 year principle. [Public Utilities Reports, 135 PUR4th, page
26 460]

27
28 The Illinois Supreme Court went on to define the nature of
29 depreciation expense as:

Direct Testimony of
Ted Robertson

1 Depreciation recognizes the cost of that portion of the asset
2 which is expended in a given year, regardless of the time
3 period in which the construction costs were actually paid.
4 Thus, even though there is no cash outlay in the current
5 year, depreciation is treated as an operating expense for
6 financial reporting purposes, and more importantly for
7 purposes of determining Edison's revenue requirement. For
8 this reason, we hold that depreciation is an expense subject to
9 test-year principles. [Business & Pro. People v. Commerce
10 Com'n, N.E.2d 1032 (Ill. 1991), page 1059]

11
12 Q. DOES THE UNIFORM SYSTEM OF ACCOUNTS DESCRIBE SPECIFIC
13 ACCOUNTS IN WHICH DEPRECIATION EXPENSE AND PROPERTY
14 TAX EXPENSE IS TO BE RECORDED?

15 A. Yes. The Uniform System of Accounts (USOA) states that all
16 depreciation expense shall be recorded in Account 403, with two
17 exceptions. The exceptions are depreciation expense chargeable to
18 clearing accounts or to Account 416, Costs and Expenses of
19 Merchandising, Jobbing and Contract Work. It also states that
20 Account 408.1, Taxes Other Than Income Taxes, Utility Operating
21 Income, shall be utilized to record property tax expense.
22

23 Q. WHY IS IT RELEVANT TO UNDERSTAND THE DIFFERENT USOA
24 ACCOUNTS AND THEIR FUNCTIONS WHEN DECIDING THE PROPER
25 TREATMENT OF DEFERRED DEPRECIATION AND PROPERTY TAX
26 EXPENSE?

27 A. The MPSC has traditionally utilized historic data as a starting point
28 in setting rates. This data is maintained consistent with USOA
29 procedures and if applied properly should assist the regulator in
30 matching an annual level of revenue with an annual level of expense

Direct Testimony of
Ted Robertson

1 and investment in order to determine the appropriate level of
2 revenue on a going forward basis. Inclusion of depreciation expense
3 in excess of an annualized level that will be recorded in Account 403
4 or property tax expense in excess of an annualized level that will be
5 recorded in Account 408.1, results in more than a year's worth of
6 depreciation and property tax expense being included in the cost of
7 service.

8
9 Q. PLEASE EXPLAIN HOW "MATCHING" WOULD NOT OCCUR SHOULD
10 THE MPSC ALLOW RECOVERY OF THE DEFERRED DEPRECIATION
11 OR PROPERTY TAX EXPENSE.

12 A. Allowing deferred depreciation and property tax expense in addition
13 to annualized depreciation and property tax expense on the same
14 property provides the Company with a larger revenue requirement
15 than would have occurred if synchronization of the in-service date
16 and rate change had occurred.

17
18 Q. CAN THE TREATMENT OF DEFERRED CARRYING CHARGES BE
19 REVIEWED IN A MANNER DIFFERENT TO DEFERRED DEPRECIATION
20 AND PROPERTY TAX EXPENSE?

21 A. Yes. The USOA does not specifically provide for the recording of
22 deferred carrying charges such as those the Company was allowed to
23 record in Account 186, Miscellaneous Deferred Debits. Account 186
24 states:

25
26 This account shall include all debits not elsewhere provided
27 for such as miscellaneous work in progress, and unusual or
28

Direct Testimony of
Ted Robertson

1 extraordinary expenses, not included in other accounts,
2 which are in the process of amortization and items the proper
3 final disposition of which is uncertain.
4

5
6 Since carrying charges on plant in service is not provided for
7 elsewhere in the USOA, this would be the appropriate account in
8 which to record the expense until the final disposition of its effect on
9 the income statement is decided.
10

11 Q. ARE CARRYING CHARGES AN EXPENSE SUCH AS FUEL OR
12 PAYROLL?

13 A. No. Carrying charges represent a lost economic cost on funds that
14 have been invested in a utilities' plant, and as proposed by the
15 Company cause a decrease in the earnings level. Under normal
16 circumstances, the Commission approved rate of return is the
17 carrying cost applicable to in-service investment, while the
18 Allowance For Funds Used During Construction (AFUDC) rate is the
19 carrying cost applied to plant in the process of being constructed
20 (Construction Work in Progress or CWIP). The Company's proposal
21 is that it be allowed to recover the economic cost of the gas safety
22 program plant, when in fact, that opportunity was provided in
23 current and past rates or through the regulatory process.
24

25 Q. HOW WOULD THE PUBLIC COUNSEL DESCRIBE AN ACCOUNTING
26 AUTHORITY ORDER THAT ALLOWS A COMPANY TO RECORD
27 DEFERRED CARRYING COSTS?

Direct Testimony of
Ted Robertson

1 A. The Public Counsel believes that any accounting authority order that
2 allows a company to defer carrying costs as proposed is not in
3 conformity with the Uniform System of Accounts. Once an
4 investment in a capital project is placed in service the carrying costs
5 are reflected in actual earnings. Granted, the rates charged
6 ratepayers would not automatically increase to reflect the marginal
7 change in revenue requirement related to that specific investment,
8 but neither do rates automatically decrease when a new customer is
9 added or expenses decrease. If the investment's effect on earnings
10 is such that a insufficient level of revenue exists to satisfy the
11 allowed rate of return, the Company can, at its option, request a
12 rate change sufficient to satisfy the return on its new investment
13 base.

14
15 Q. DOES THE PUBLIC COUNSEL BELIEVE THAT A VARIANCE FROM
16 THE UNIFORM SYSTEM OF ACCOUNTS IS APPROPRIATE FOR
17 DEFERRED CARRYING COSTS?

18 A. No. If MoPub expected the implementation of the gas safety rules to
19 reduce its earnings below Commission approved levels then it should
20 have requested a complete review of (then current) revenues,
21 expenses and investment, so as to allow the Commission the
22 opportunity to set rates at level commensurate with the new
23 investment levels and its approved rate of return.

24
25 Public Counsel submits that such variances should only be granted
26 in circumstances in which the financial health of a Company is

Direct Testimony of
Ted Robertson

1 significantly threatened. A company should be required to take all
2 measures reasonably possible to assure the Commission that its
3 financial position will be impaired prior to receiving a variance.
4 Evidence indicates that the Company has already recovered the
5 additional depreciation and property tax expense associated with the
6 gas safety program expenditures. The record also shows that the
7 Company was provided with ample opportunity to recover the
8 additional carrying costs proposed. The Company did not take
9 advantage of the opportunity to file a rate change request that would
10 have synchronized the in-service date of the facilities with a change
11 in rates, reflecting not only the new investment but also all other
12 relevant factors. Instead, it sought accounting authority orders
13 that have the practical effect of guaranteeing a return on a specific
14 investment.

15
16 Q. HOW HAVE OTHER STATES RULED REGARDING THE CRITERIA
17 THAT SHOULD BE MET IN ORDER TO OBTAIN ACCOUNTING
18 AUTHORITY ORDERS SUCH AS THOSE RECEIVED BY MOPUB?

19 A. In the state of Illinois, the Illinois Supreme Court stated:

20
21 The purpose of the accounting variance is to protect Edison
22 from adverse financial impact caused by the regulatory delay
23 period, and to afford Edison the opportunity to recover these
24 charges. The accounting variance should not be used to place
25 Edison in a better position than it would have been in had
26 synchronization been achieved. Just as it would be unfair to
27 deny Edison recovery of its reasonable and prudent
28 investment due to regulatory delays which the Company could
29 not control, so, too, would it be unfair if Edison were allowed
30 to reap a windfall, at ratepayer expense, due to a regulatory

Direct Testimony of
Ted Robertson

1 delay that ratepayers could not control. [Public Utilities
2 Reports, 135 PUR4th, page 461]

3
4 The Court basically reiterated Public Counsel's position that issues
5 caused by regulatory lag must be treated in a fair manner for both
6 ratepayers and the Company.

7
8 Q. PLEASE EXPLAIN THE RELEVANCE OF THE TERM
9 "SYNCHRONIZATION" AS USED IN THE ILLINOIS SUPREME COURT
10 DECISION.

11 A. Synchronization deals with the theoretical possibility of having rate
12 orders concurrent with in-service dates. While not mentioned by the
13 Illinois Supreme Court, I would point out that the need for a rate
14 change due to new plant being placed in service occurs only if a
15 change in the relationship between revenues, expenses and
16 investment occurs that causes the Company's return to be below that
17 approved by the Commission. If this relationship does not change,
18 then there is no need to change rates because rates are adequate to
19 cover its allowed return.

20
21 Q. WHAT IS THE EFFECT ON RATEPAYERS IF A COMPANY IS
22 ALLOWED TO RECORD DEFERRED CARRYING CHARGES DURING A
23 PERIOD IN WHICH IT IS EXPERIENCING A RETURN THAT EQUALS
24 OR EXCEEDS ITS AUTHORIZED RETURN?

25 A. The ratepayers would be required to pay the carrying costs, i.e.,
26 earnings, twice; once in actual rates paid in the historic period and

Direct Testimony of
Ted Robertson

1 then a second time in the future when the deferred charges are
2 amortized to the cost of service. This results in a double-recovery
3 of these earnings from the ratepayer. The deferral would then have
4 the effect of placing the Company in a better position than it would
5 have been had a rate change been synchronized with the new
6 investment.

7
8 Q. PLEASE EXPLAIN HOW THE COMPANY WOULD BE IN A BETTER
9 POSITION THAN IF A RATE CHANGE HAD BEEN SYNCHRONIZED
10 WITH THE INVESTMENTS IN-SERVICE DATE.

11 A. In a period of overearnings, the synchronization would have
12 recognized not only the new investment which would have marginally
13 raised the revenue requirement, but also the overearnings status
14 would have been accounted for in the revenue requirement
15 determination. The overearnings would have the marginal effect of
16 lowering the revenue requirement. The Company would be in a
17 better position using the deferral because the new investment's
18 marginal increase in revenue requirement is accounted for and will
19 be collected from ratepayers at a later date. However, the marginal
20 decrease related to the overearnings would not be reflected in the
21 accounting authority order and the ratepayer is adversely affected
22 with no recourse.

23
24 Q. HAVE OTHER COMMISSIONS OR COURTS RECOGNIZED THE NEED
25 TO LOOK AT ACTUAL DATA WHEN EVALUATING THE WHETHER OR
26 NOT COSTS WERE PREVIOUSLY RECOVERED?

Direct Testimony of
Ted Robertson

1 A. Yes. The Illinois Supreme Court found that the ICC had failed to
2 properly evaluate cost recovery in a similar situation when it stated:

3
4 In determining whether electric utility's earnings and costs of
5 capital were significantly and adversely affected during
6 regulatory delay period, for purposes of accounting variance
7 permitting recording of deferred charges on new nuclear
8 plant, decision of Commerce Commission to use financial
9 projections made in 1987, rather than actual historical data
10 available, was arbitrary. [585 N.E.2d 1032 (Ill. 1991) at page
11 1035]

12
13 Q. WHAT IS THE PUBLIC COUNSEL'S RECOMMENDATION REGARDING
14 MOPUB'S RECOVERY OF DEFERRED EXPENSES ASSOCIATED WITH
15 ITS TWO ACCOUNTING AUTHORITY ORDERS?

16 A. The Company's failure to address its revenues, expenses and
17 investment highlights the fact that accounting authority orders
18 constitute single issue ratemaking. The use of an accounting
19 authority order, absent evidence that a company's financial integrity
20 will be impaired, creates a situation where "Heads, the company
21 wins, and Tails, the ratepayer loses".

22
23 Instead of filing a rate case that would have reviewed all elements of
24 the Company's financial position, it sought and received accounting
25 authority orders that allowed it to defer expenses and carrying costs
26 for plant implemented pursuant to satisfying the requirements of the
27 Commission's gas safety rules. The orders isolated one set of events
28 from the entire cost of service determination and preserved the
29 expenses for possible recovery from future ratepayers.

Direct Testimony of
Ted Robertson

1 Only if the Commission considers all relevant factors will the
2 ratepayer be dealt with fairly. Regulatory lag can benefit either the
3 Company or the ratepayer. The use of accounting authority orders
4 circumvents the normal regulatory rate setting process and allows a
5 company the opportunity to manipulate the system to its advantage.
6 Public Counsel recommends that all expenses associated with the
7 Company's two accounting authority orders be disallowed from its
8 cost of service and rate base. Commission acceptance of Public
9 Counsel's recommendation would reduce the Company's cost of
10 service and its proposed rate base by \$102,491 and \$1,927,040,
11 respectively.

12
13 Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

14 A. Yes.

CASE PARTICIPATION
OF
T. ROBERTSON

<u>Company Name</u>	<u>Case No.</u>
Missouri Public Service Company	GR-90-198
Missouri Cities Water Company	WR-91-172
United Cities Gas Company	GR-91-249
St. Louis County Water Company	WR-91-361
United Telephone Company of Missouri	TR-90-273
Imperial Utility Corporation	SR-92-290
Expanded Calling Scopes	TO-92-306
Missouri Cities Water Company	WR-92-207
Southwestern Bell Telephone Company	TO-93-192
United Cities Gas Company	GR-93-47

NARUC NEWS



NATIONAL
ASSOCIATION
OF
REGULATORY
UTILITY
COMMISSIONERS

1102 L.C.C. Building • P.O. Box 684 • Washington, D.C. 20044-0684 • Telephone 202/898-2200

FOR IMMEDIATE RELEASE

No. 99-92

CONTACT: Tom Choman (202) 898-2206

December 2, 1992

NARUC CONVENTION ADOPTS RESOLUTION ON FASB STANDARD

Washington, D.C.— At its 104th Annual Convention and Regulatory Symposium in Los Angeles, California, the National Association of Regulatory Utility Commissioners (NARUC) recently adopted a resolution concerning the Financial Accounting Standards Board ruling regarding post-retirement benefits other than pensions. This resolution appears below.

Resolution Regarding the Preservation of Regulatory Flexibility in Accounting for Postretirement Benefits Other than Pensions

WHEREAS, The Financial Accounting Standards Board (FASB) has promulgated financial accounting standard number 106 (FAS # 106) relating to the accounting for postretirement benefits other than pensions; and

WHEREAS, The Emerging Issues Task Force (EITF) of the Financial Accounting Standards Board, the U.S. Securities and Exchange Commission, and State and Federal regulatory commissions are now considering the implications of various regulatory accounting and ratemaking treatments of postretirement benefits vis-a-vis FAS # 106; and

WHEREAS, Historically, most regulated industries accounted for these expenses on a cash or pay-as-you-go basis in conformity with generally accepted accounting principles (GAAP); and

WHEREAS, FAS # 106 now requires the accrual of postretirement expenses for financial reporting purposes; and

WHEREAS, The U.S. Securities and Exchange Commission and the accounting profession have raised questions and concerns regarding the continued use of pay-as-you-go accounting for postretirement

(over)

No. 99-92

-2-

benefits and the ability of regulated enterprises to comply with generally accepted accounting principles; and

WHEREAS, The effective regulation of public utility companies requires that regulators have wide flexibility to account for all expenses associated with cost of service; and

WHEREAS, Some regulatory bodies may determine that postretirement benefits costs should remain at the pay-as-you-go level resulting in cost deferral and creation of a regulatory asset to reflect the future economic benefit of cost recovery in accordance with the provisions of FAS # 71; and

WHEREAS, The creation of regulatory assets reflecting the difference in accounting and ratemaking is a time honored practice which comports with generally accepted accounting principles as applied to rate-regulated enterprises; and

WHEREAS, If the SEC and the accounting profession do not recognize the propriety of regulatory created assets for future recovery of costs associated with postretirement benefits, then the utility's financial statements could be significantly impaired thus increasing the cost of service to the company's customers; now, therefore, be it

RESOLVED, That the National Association of Regulatory Utility Commissioners, assembled at its 104th Annual Convention in Los Angeles, California urges the emerging issues task force of the Financial Accounting Standards Board and the U.S. Securities and Exchange Commission to continue to recognize the propriety of regulatory created assets so as to allow the appropriate latitude to regulatory bodies in the ratesetting process as it relates to the recognition of postretirement benefits; and be it further

RESOLVED, That copies of this resolution be promptly forwarded to the emerging issues task force (EITF) of the FASB and appropriate officials of the U.S. Securities and Exchange Commission.

Sponsored by Committee on Finance and Technology
Adopted November 18, 1992

NATIONAL ASSOCIATION OF STATE CONSUMER ADVOCATES

R E S O L U T I O N

Urging State and Federal Utility Regulatory Commissions
To Reject for Ratemaking Purposes the Accounting
Changes Required By Statement of Financial
Standards (SFAS) No. 106

- WHEREAS, In December, 1990, the Financial Accounting Standards Board (FASB) issued SFAS No. 106, Employer's Accounting for Postretirement Benefits Other than Pensions, requiring for financial accounting purposes employers to recognize postretirement benefits and related costs during the period employees provide the service that entitles them to these benefits;
- WHEREAS, SFAS No. 106 essentially requires utilities to reflect post retirement benefits other than pensions on an accrual rather than on a cash basis for accounting purposes;
- WHEREAS, FASB, at the urging of the National Association of State Utility Consumer Advocates (NASUCA) specifically recognized in Paragraph No. 364 of SFAS No. 106 that, pursuant to SFAS No. 71, Accounting for the Effects of Certain Types of Regulation, regulators may choose not to change the treatment of postretirement benefits for ratemaking purposes;
- WHEREAS, Paragraph No. 364 of SFAS No. 106 provides regulatory commissions with the flexibility to retain the cash, or "pay-as-you-go", basis of reflecting postretirement benefits other pensions for rate recovery purposes so long as the regulatory commissions indicate an intent that future recovery of the difference in costs between the accrual basis for accounting purposes and the cash basis for rate purposes is probable;
- WHEREAS, Reflecting the SFAS accrual basis of treating postretirement benefits other than pensions for rate purposes would result in a substantial increase in rates for consumers of utility services;

- WHEREAS, Reflecting the SFAS accrual basis of treating postretirement benefits other than pensions for rate purposes would require estimates of future health care costs, medical inflation rates, medical care use and changes in health care delivery systems;
- WHEREAS, Estimates concerning such future health and medical care costs and use patterns entail a great deal of uncertainty and speculation;
- WHEREAS, SFAS No. 106 requires that use of the accrual method of treating postretirement benefits other than pensions be based only on current levels of employer obligations and current state and federal laws regarding the provision of such medical benefits such as the medicare program;
- WHEREAS, Many utilities have no legal obligation to continue providing these postretirement benefits other than pensions, under existing laws;
- WHEREAS, Numerous studies by the financial accounting community reveal that even small errors in any of the estimates necessary for calculating the accrual basis for reflecting postretirement benefits other than pensions can lead to substantial overestimates of future costs;
- WHEREAS, The speculative and uncertain nature of the estimates necessary to calculate the accrual amounts pursuant to SFAS No. 106 do not satisfy regulatory criteria that utility rates be based on known and measurable changes in cost levels;
- WHEREAS, Reflection of the SFAS No. 106 accrual basis for rate recovery purposes would likely result in utilities substantially overrecovering actual costs associated with the provision of postretirement benefits other than pensions;
- WHEREAS, Establishment of a trust mechanism to redress the cost overrecovery problem provides an ineffective remedy for ensuring that consumers do not end up providing cost free capital to the utilities for a number of reasons, including the fact that only a portion of the accruals will qualify for tax advantaged treatment (i.e., the portion of benefits associated with collective bargaining employees);

- WHEREAS, Under the accrual basis of reflecting postretirement benefits other than pensions, rates would likely be higher than the continued cash basis in both the short term and the long term since the accrual amount recovered in rates would always be based on estimates of future costs, which generally tend to be higher than current costs due to inflationary impacts;
- WHEREAS, Continuation of the cash basis of reflecting postretirement benefits other than pensions for rate recovery purposes would impose no adverse financial or economic impacts on utilities;
- WHEREAS, Reflecting the SFAS 106 accrual basis of treating postretirement benefits other than pensions for rate purposes would not require any change in actual cash outlays by utilities from actual payments made under the cash basis;
- WHEREAS, Switching to the accrual basis for rate recovery purposes imposes a substantial transition cost obligation on consumers over a substantial period of time requiring these consumers to pay two generations of costs in order to pay the transition obligation and consequently resulting in discriminatory treatment of current consumers as opposed to past and future consumers;
- WHEREAS, Switching to the accrual basis for rate recovery of postretirement benefits other than pensions raises substantial retroactive ratemaking and filed rate doctrine concerns with respect to requiring today's consumers to pay the transition obligation for costs attributable under SFAS No. 106 to past periods;
- WHEREAS, Consumers have no assurances that utilities will or can be required to refund any overcollections of rates attributable to postretirement benefits other than pensions in the future;

THEREFORE, BE IT RESOLVED, that NASUCA urges federal and state regulatory commissions to reject use of the SFAS No. 106 accrual method of reflecting postretirement benefits other than pensions for ratemaking purposes and to adopt or continue use of the cash or pay-as-you-go basis of reflecting postretirement benefits other than pensions for ratemaking purposes.

BE IT FURTHER RESOLVED, that NASUCA authorizes the Executive Committee to develop positions and take further actions consistent with the contents of this resolution. The Executive Committee shall inform the membership of such positions and action prior to proceeding with them, if at all possible. In any event, the Executive Committee will advise the membership of any actions taken consistent with the recommendations contained herein.

Approved by NASUCA

Los Angeles, California
Place

November 18, 1992
Date

Submitted and Favorably Reported by:

NASUCA Accounting & Tax Committee

Committee Members:

Russ Trippensee, (MO) Chair.
Naunihal Singh Gumer (DC)
Russ Needler (TX)
James Armstrong (AZ)
James Fout (OH)
Marilyn Kraus (PA)
Curt Nelson (MN)
Terry Redmon (NV)
Tim Robb (IN)
Gary Steward (IA)
Joseph Thorne (NY)