

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In Re the Matter of Laclede Gas Company's Tariff)
To Revise Natural Gas Rate Schedules) Case No. GR-99-315

Opinion of Commissioner Robert M. Clayton III

This Commissioner respectfully concurs in part and dissents in part from the majority opinion in this matter. Although this Commissioner generally agrees that the accrual method as proposed by Laclede and AmerenUE should have been utilized in the underlying rate case in deciding the issue of mass account net salvage recovery, there is no real relief that can be afforded the utility and the matter is, therefore, moot. Because this decision will have no practical effect upon any live controversy, any Report and Order by this Commission would constitute little more than a declaratory ruling or general statement of policy, which, despite this Commissioner's wishes, is not authorized by Missouri law. In addition, some clarification of the issues discussed in the Report and Order is appropriate, especially in regard to burden of proof and the need for further study and review of the issue.

This remand relates to the issue of depreciation and how best to account for a component known as net salvage value of mass account plant, or the estimated cost of removal of mass account plant less any amount recovered in selling the removed

materials.¹ There are two competing proposals for how best to account for this issue. Staff has recommended using a "Cash" or "Expense" method of accounting for this component of depreciation. Laclede has suggested the use of an accrual method of accounting and has made reference to this method as the "Traditional" or "Standard" method. This Commissioner finds the use of such language argumentative and conclusory and a more thorough analysis of the issue's history is required.

Depreciation is the loss in value incurred by consumption or prospective retirement of plant in the course of service from such known causes as wear and tear, obsolescence and decay.² "Depreciation accrual rates are used to match all revenues earned during a given time period with all the expenses incurred during that same time period to produce those revenues. In each year of service customers are charged with the portion of the asset that it or they consume or use."³ "Net salvage value" means the salvage value of property retired less the cost of removal.⁴ If the salvage value of the retired property is greater than the cost of removing and disposing of the property, then the net salvage value is a positive number. That value is recognized in rates and reduces the depreciation recovery during the plant's life. If the salvage value of the property is less than the cost of removing and disposing of the property, then the net salvage value is a negative number,

1 *State of Missouri ex. rel. Laclede Gas Company and Union Electric Company d/b/a AmerenUE v. Public Service Commission of the State of Missouri*, Missouri Court of Appeals, Western District, Case No. WD61486, March 4, 2003. This matter dealt with the net salvage value of mass accounts. Life span accounts were not at issue.

2 See *Public Utility Depreciation Practices*, National Association of Regulatory Utility Commissioners, August 1996, p.318.

3 See generally, *Depreciation Systems*, Frank K. Wolf and W. Chester Fitch, 1994, pp.4-6.

4 18 CFR Part 101 (36) Uniform System of Accounts Prescribed for Public Utilities and Licensees Subject to the Federal Power Act.

and that net cost is referred to as "negative net salvage."⁵ The question presented in this matter is whether an anticipated negative net salvage value should be included in the depreciation rates so that such cost is recovered in rates over the service life, or whether it should be recovered only if and when it actually occurs.⁶

In the early days of utility regulatory accounting, net salvage was not considered a significant issue because, 1) the plant in service was a fraction of the value of plant in service today, 2) there was little thought of removing plant because the industry was brand new, and 3) the plant in service actually had a positive net salvage value rather than a negative net salvage value. At least until the 1950s, depreciation rates were simply a flat percentage applied to plant in service; in the 1960s, depreciation rates by account were established for Laclede.⁷ As late as the mid-1990s, state regulatory commissions addressed the issue of net salvage in a variety of ways, including both the accrual and expense methods described above and some combining parts of both.⁸ As Ms. Schad discusses, in 1960, Laclede's depreciation accrual rate was increased due to increased net salvage costs.⁹ Subsequent to the late 1970's, Laclede's rate cases, including the depreciation rates, settled pursuant to Stipulation and Agreement. There is no way to know whether or to what extent Laclede's depreciation rates reflected positive or negative

5 Wolf and Fitch, *supra* note 3, at 7- 8.

6 As noted above, this matter does not pertain to "Life Span" accounts, but only with "mass accounts." A life span account relates to the final retirement of a major structure. Mass accounts are accounts "consisting of large numbers of similar units, the life of any one of which is not, in general dependent upon the life of any of the other units. For such classes of plant, the retirement of a group of units occurs gradually until the last unit is retired. The retirements and additions to the account occur more or less continually and systematically." NARUC, *supra* note 2, at 321-322.

7 Supplemental Rebuttal Testimony of Staff Witness Rosella L. Schad, p. 4.

8 Schad, *id.* at 7.

9 Schad, *id.* at 17.

net salvage value.¹⁰ Since various methods of depreciation calculation have been used over the years, the terms "Traditional" or "Standard" should not be used.

As the projected costs associated with negative net salvage continued to grow, a fairness issue arose. As discussed above, the reason for setting depreciation rates is to recover the cost of the use of plant over the time it is in service. If a large portion of those costs comes from retiring plant, then customers that use it should contribute to the cost of removing it. Each party addresses the question of "intergenerational equity" arguing that their own proposed depreciation treatment more closely assigns the costs of plant to those customers who benefit from it.¹¹

The Staff became concerned that current customers were paying more in rates than should be reasonably attributed to them. Unsatisfied that using past retirements as a guide to future needs or simply estimating future costs or averaging the two could yield a reliable result, in the early 1990s, the Staff began advocating its current position that net salvage value should be expensed, rather than accrued.¹² Staff felt that if the company were not incurring retirement costs commensurate with the amounts it was recovering in rates, it would receive a windfall of extra revenue.¹³ Further, at some point the company would likely incur the costs of removing plant but the funds could have been spent already and no

10 Schad, *id* at 5.

11 Schad, *id.* at 11-15; Supplemental Direct Testimony of Laclede Witness William E. Stout, at pp. 12-17. This principle of "intergenerational equity" is also called a "matching principle." According to Wolf and Fitch, *supra* note 3, at 7-8, "[t]he matching principle specifies that all costs incurred to produce a service should be matched against the revenue produced. Estimated future costs of retiring of an asset currently in service must be accrued and allocated as part of the current expenses. *** The accounting treatment of these future costs is clear. They are part of the current cost of using the asset and must be matched against revenue."

12 Schad, *supra* at Schedule 8-4.

13 See the Direct, Rebuttal and Surrebuttal Testimony of Staff Witness Paul W. Adam, adopted by Staff Witness Rosella L. Schad, in which Mr. Adam discusses the inaccurate projections to remove the "Gas Holders" from service by 2006.

longer available as the collections would have occurred years before.¹⁴ On the other hand, AmerenUE and Laclede assert that the accrual method, while not perfect, addresses the issue better, because current customers are paying for the full costs of plant that might cost more to take out of service than it cost to put into service.¹⁵

The record indicates that the accrual method has been used in Missouri since the early 1960's, and continues to be used by the vast majority of state regulatory commissions today. The exceptions to the rule include the sovereign states of New Jersey and Pennsylvania, which are required by applicable state law to use the expense method, and Georgia.¹⁶ Some commissions, such as Delaware and Arkansas, experimented with the expense method and later returned to the accrual method. Other states have approved the use of the expense method when the parties stipulate to it in a larger comprehensive settlement, a category in which Missouri falls. Suffice it to say, however, that the accrual method is far more widely used, and had been used almost exclusively in Missouri in contested cases until the present dispute.¹⁷

As noted above, Staff's position is that the accrual method cannot accurately estimate the costs, conditions or timing of removal. Plant may remain in service longer than originally anticipated or may not be removed at all. As technology and environmental concerns change, the estimated cost of removal may change. Staff asserts that estimating the future cost of a future event that may or may not take place is vague at best, and

¹⁴ Schad, *supra* at 15-18, Schedule 8-8 – 8-11.

¹⁵ Supplemental Direct Testimony of Ameren UE Witness Martin J. Lyons, p.8.

¹⁶ Tr. at 2009.

¹⁷ Schad, *supra* at Schedule 8.

cannot reach the standard of "known and measurable."¹⁸

In cases before the Commission in which a rate increase is sought, the company seeking the rate increase bears the burden of proof.¹⁹ Commission policy or procedure must be promulgated in a rule,²⁰ and *stare decisis* does not apply to Commission decisions,²¹ no matter how often or consistently a Commission decision is made.

Each rate case stands on its own and is decided by its respective Commission. Laclede established that the accrual method has a significant history in this state and is relied upon frequently, if not exclusively, by the vast majority of state Commissions. The utility showed that the accrual method is a reasonable method, relied on in Missouri in past cases, which yields reasonably reliable information on which to establish "just and reasonable" rates. This method purports to have safeguards to protect the interests of ratepayers and maintain a minimum level of accuracy. This Commissioner believes that Laclede made a *prima facie* showing that this method is one method that would lead to "just and reasonable" rates.

This Commissioner believes that it is up to the Staff to rebut or refute that *prima facie* showing. It is up to the Staff to show that the accrual method is no longer suitable or, at the very least, is vastly inferior to the expense method or any other method, with specific evidence and proof. Although the Staff did establish that the accrual method does have certain inherent imperfections, it never satisfactorily established that the expense method

18 Schad, *supra* at 12 and 13.

19 §393.150, RSMo. 2000.

20 See §536.010(4), RSMo. 2000.

21 *State ex. rel. GTE North, Inc. v. Mo. Pub. Serv. Comm'n*, 835 SW2d 356,371 (MoApp 1992); *Cent. Hardware Co., Inc. v. Dir. Of Revenue*, 887 SW2d 593,596 (Mo. banc 1994); *State ex. rel. AG Processing, Inc. v. Mo. Pub. Serv. Comm'n*, 120 SW3d 356,371 (Mo. banc 2003) 356,371 (MoApp 1992).

was so superior to the accrual method that a change in accounting practices and departure from the Uniform System of Accounts was warranted. It was the inability to articulate a sufficient reason for the departure from an established norm that caused this case to be remanded on two different occasions by the Court.²²

Staff argued in its brief that, "There is no evidence in this record that the formula accurately predicts actual cost of removal." Staff further argues that there is no empirical study to prove the accuracy of the accrual method.²³ In turn, Staff does not offer any studies or specific evidence that the method is not an accurate method of determining the proper amount to be included in the depreciation schedule. Rather than demand the company to show a study that the method is accurate, Staff should produce a study proving the inaccuracy of the method or provide evidence of specific failures that have occurred in Missouri or elsewhere because of the method's use.

Notwithstanding the conclusion reached in this Opinion, this Commissioner is mindful of the concerns that have been raised about the accrual method. The accrual method may not completely address questions of intergenerational equity, a point the utilities make throughout the case. There are valid concerns about mass account plant not being retired as anticipated or plant costing less to remove than was accrued in the depreciation reserve. In addition, the accrual method will always accrue a greater amount in the depreciation reserve than what is spent to retire plant, and ratepayers will never be

22 The Court stated: The Commission's findings of fact also imply that the Staff's depreciation method of calculating net salvage is less likely to result in Laclede overrecovering from its customers than Laclede's depreciation method. The Commission's findings of fact fail, however, to support such a contention. No evidence or facts of any nature are cited by the Commission to support this conclusion. *** Similarly, the Commission's findings of fact stating that the Staff's depreciation method is less likely to result in overrecovery from Laclede's customers are conclusory for failing to provide any support of this finding." Note 1, *supra* at 5.

made completely whole. Because of the pooling of assets for depreciation purposes, the customer can only be made whole when there is no more growth in the system and all assets are fully depreciated. These concerns should be evaluated and considered in future cases.

This Commissioner concurs with the majority in this case that the appropriate method of accounting for mass account net salvage is the accrual method. This method is used around the country and conforms to the Uniform System of Accounts. A departure from it could profoundly affect the utility; such a change should not be made lightly. The increased cash flow generated by the accrual method is of a great benefit to the utility. It enables it to invest in new plant and keep existing plant in good repair. While the Commission strives to keep rates low for energy consumers, it has an obligation to the industry it regulates to see that operations are sufficiently funded to provide safe and adequate service and to allow an opportunity for a reasonable return on investment. This method also properly assigns a share of cost to ratepayers who benefit from the plant.

This Commissioner believes further study and discussion are necessary among the Office of the Public Counsel, the Staff, the regulated utilities in this state and their customers. The parties in the matter have raised valid concerns about the shortcomings of both methods and further work may result in changes that ameliorate those shortcomings. As the net salvage value component continues to grow, the issue will only continue to increase in importance. A generic docket or rulemaking discussion would provide an additional forum for discussion in arriving at a method that will satisfy the concerns of the parties and the Commission.

This Commissioner believes that it is imperative to follow Staff's recommendation that a separate accounting be made by the utility of the accrued depreciation for net salvage. Staff asserts that, "[I]f allowances recorded in the depreciation reserve attributable to cost of removal accruals are separately identified, regulatory analysis and more accurate rates will be easier."²⁴ There was extensive testimony about the various "safeguards" in place to protect current and future ratepayers under the accrual method, but those need to be reviewed and adjusted regularly so that intergenerational equity and accuracy of recovery is maintained.²⁵ Staff continued in its argument that, "[a]bsent such information, it would be difficult at best to effectuate any customer safeguards against overcharges for cost of removal."²⁶ Lastly, this Commissioner also believes that the analysis must include a regularly scheduled comparison and historical tracking of the accrued amounts for removal costs versus the actual amounts spent on removing plant. Since the customer is advancing the funds for future estimated expenses, it is critical to monitor the actual plant retirement costs to verify that annual accruals do not deviate on an increasing basis over time from the actual retirement expenditures.

However, contrary to the different accounting treatment and tracking mechanism suggested above, the suggestion that these funds be separated from general funds of the company would be counter-productive and that proposal is not well taken.

The Commission majority believes that resolving this question will make an impact and a decision is necessary in the case. Despite my agreement about the use of the accrual method, I believe the entire matter is moot. No rate can or will be changed as a result of the

²⁴ Staff Brief at p. 10.

²⁵ Lyons, *supra* at 10-19.

Report and Order. The outcome of no future rate proceeding or tariff filing will be predetermined as a result of the Report and Order nor will the decision have binding effect.

I agree with the majority that "[a] case is moot when a tribunal's decision would not have any practical effect upon any live controversy."²⁷ Further, I agree that "[w]ith respect to utility matters, the general rule is that 'issues under old, superseded tariffs are moot and therefore not subject to consideration.'"²⁸ However, there are limited exceptions to the mootness doctrine, and "a court has discretion to review a moot case where the case presents a recurring unsettled legal issue of public interest and importance that will escape review unless the court exercises its discretionary jurisdiction."²⁹ I believe this exception applies only to judicial review and does not apply to this Commission, as the Commission has no authority to issue a policy statement that can bind itself or future Commissions, and therefore cannot "settle" an unsettled area of the law.

In conclusion, this Commissioner argues that this matter is moot and should be dismissed as such. It is for this reason that this Commissioner cannot support the majority's Report and Order.

Respectfully submitted,



Robert M. Clayton III
Commissioner

Dated at Jefferson City, Missouri,
on this 14th day of January, 2005.

²⁶ Staff Brief at p. 10.

²⁷ *Third Report and Order*, Missouri Public Service Commission, Case No. GR-99-315, Issued January 11, 2005, at 17.

²⁸ *Id.* at 18.

²⁹ *State ex. Rel. Jackson County v. Missouri Public Service Commission*, 985 SW2d 400 (MoApp WD 1999).