

STATE OF MISSOURI
PUBLIC SERVICE COMMISSION
TRANSCRIPT OF PROCEEDINGS

Hearing

Volume 12

In the Matter of Laclede Gas
Company's Tariff to Revise
Natural Gas Rate Schedules

CASE NO. GR-99-315

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9 September 23, 2004
10 Jefferson City, Missouri
11 Volume 12
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13 In the Matter of Laclede Gas) Case No.
14 Company's Tariff to Revise) GR-99-315
15 Natural Gas Rate Schedules.)
16

17 NANCY DIPPELL, Presiding
18 SENIOR REGULATORY LAW JUDGE
19 CONNIE MURRAY,
20 ROBERT M. CLAYTON III,
21 JEFF DAVIS,
22 LINWOOD APPLING,
23 COMMISSIONERS
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1 PROCEEDINGS

2 JUDGE DIPPELL: On the record. Good
3 morning. We're back on the record in GR-99-315,
4 and Mr. Stout has returned to the witness stand.

5 And I will remind you that you're
6 still under oath.

7 THE WITNESS: Understood.

8 JUDGE DIPPELL: Commissioner Clayton
9 was in the middle of asking questions, and I'll
10 let him resume.

11 COMMISSIONER CLAYTON: May it please
12 the Commission?

13 Q (BY COMMISSIONER CLAYTON) Good
14 morning, Mr. Stout. How are you today?

15 A I'm fine. How are you?

16 Q I first wanted to ask you how long
17 you've been in this racket?

18 A I've been conducting depreciation
19 studies since 1973.

20 Q So quite a while?

21 A Yes, sir.

22 Q And in part of that work since 1973,
23 have you had the occasion to review historical
24 treatment of depreciation and the accompanying
25 rates over the years prior to 1973?

1 A Yes, I have.

2 Q How far back does one have to look
3 to get a beginning of the establishment of this
4 issue of depreciation and dealing with this cost
5 of removal?

6 A I would say that it probably began
7 around 1910.

8 Q Okay. Basically when utilities
9 began, there was an issue associated with the cost
10 of removal --

11 A Yes.

12 Q -- and depreciation. Okay. And
13 there's been some evolution since 1910, has there
14 not, on how to deal with depreciation and the
15 accompanying cost of removal and the net salvage
16 issue?

17 A There's been an evolution in the
18 ability to analyze historical data. I would not
19 say that there's really been an evolution in the
20 basic concept of depreciation, which is that the
21 service value of an asset being its original cost
22 less its net salvage should be ratably accrued
23 during the life of the asset. That has been
24 consistent.

25 Q So the overall concept of

1 depreciation hasn't changed. It's been there with
2 a little tweaking here and there on how different
3 aspects of it should be treated. Is that a fair
4 statement?

5 A Yes.

6 Q Okay. Going back to 1910 and the
7 subsequent years from then, is it a fair statement
8 that the issue of cost of removal and net salvage
9 was a much different issue than it is today?

10 A It was a smaller issue than it is
11 today.

12 Q Okay. That's a fair answer. The
13 dollars were less, the infrastructure was less.
14 Any other differences?

15 A I think that's probably it. We were
16 dealing with a much smaller plant, we really had
17 very few amounts of plant coming out of service,
18 and we did not have the regulations and
19 requirements that we have now today.

20 Q Ouch.

21 A Not those that deal with dollars
22 necessarily, but, for example, you know, in the
23 1930s, we didn't have to deal with cutting into a
24 street in order to access a main.

25 Q You just picked up that plank board

1 that was out there and you put it down under the
2 plank board, right?

3 A Well, not quite that, but it was a
4 much simpler matter.

5 Q In 1910, it would probably -- or let
6 me ask you this. Is it a fair statement to say
7 that in 1910 and the subsequent years following
8 then, that that plant actually did have a positive
9 net salvage value?

10 A I don't know for certain. Most of
11 the historical information with respect to the
12 actual experience of utilities that I've been able
13 to review begins in the late 1930s with the
14 promulgation of the uniform system of accounts by
15 the then Federal Power Commission.

16 I know about the -- from literature
17 about the concepts that were employed prior to
18 that time, but actual data that I'm able to look
19 at begins in the late '30s. And I would say that
20 for distribution utility plant, that even in that
21 time, it tended to have a slight negative amount.

22 It was less, again, as I indicated,
23 because the amount of plant coming out of service
24 was less, the levels of inflation that had
25 occurred between installation and retirement had

1 been less than what we're seeing today, far less
2 than what we'll see in the future, and the utility
3 was better able to reuse that plant when it
4 removed it from service than it is today.

5 Q Okay. How far back does one have to
6 go to identify the traditional standard method in
7 dealing with the cost of removal and net salvage
8 issues associated with depreciation?

9 A That would begin in 1910 with the --
10 some of the initial -- the initial uniform system
11 of accounts actually by the Interstate Commerce
12 Commission in 1913 identified depreciation as
13 representing an amount that was recovering the
14 original cost less the net salvage of the
15 property.

16 Q And you mentioned that the uniform
17 system of accounts actually began in, what, 1930?
18 1932?

19 A The Federal Communications
20 Commission issued their uniform system of accounts
21 in 1934, I believe, and the Federal Power
22 Commission in 1938.

23 Q Well, are you aware, was it the --
24 was it one approach that was available to various
25 states in dealing with this issue, or were there

1 various approaches at that time that were
2 considered by states or, I suppose, accountants in
3 general in dealing with this issue?

4 A I am not aware of any other
5 approaches that were considered.

6 Q Okay. So is it your testimony that
7 the standard or traditional approach to this issue
8 has been the -- the method used consistently and
9 regularly by state commissions since commissions
10 started regulating?

11 A Yes, sir, it is.

12 Q Is it an accurate statement that the
13 1992 FERC uniform system of accounts prescribed
14 for gas companies does not require the net salvage
15 component of the depreciation rate calculation to
16 be derived according to the standard approach? Is
17 that a fair statement? True statement?

18 A I don't believe it's a fair
19 characterization of the uniform system of
20 accounts.

21 Q Why is that?

22 A Uniform system of accounts does not
23 specify a method of analysis for determining the
24 net salvage related to an asset. What the uniform
25 system of accounts does require is that

1 depreciation be the loss in an asset service
2 value, that the service value of that asset be
3 defined as its original cost less its net salvage,
4 and that that amount be accrued ratably during the
5 life of the asset.

6 Now, my conclusion from that is
7 that, therefore, the current depreciation expense
8 for the asset is to be a ratable allocation of its
9 original cost plus, in the case of a negative net
10 salvage, the future net salvage cost to retire
11 that same plant. Not the current cost to remove
12 other plant.

13 Q I'm going to need you to simplify
14 your answer. Did not help me. I need you to
15 simplify exactly what you're saying. Do they
16 mandate -- is the uniform system of accounts, is
17 that a requirement, is it a mandate, is it a
18 suggestion? Tell me what it is.

19 A I believe the uniform system of
20 accounts is a requirement. It requires --

21 Q So it's the law?

22 A It's a system of accounts
23 promulgated by the Federal Energy Regulatory
24 Commission and adopted by this Commission in its
25 regulations. Utilities under the regulation of

1 this Commission must maintain their books and
2 records in accordance with this uniform system of
3 accounts.

4 Q So it's a mandate. It's not a
5 guideline.

6 A Yes.

7 Q Okay. So does it mandate the
8 traditional or standard approach to net salvage
9 being recovered on the accrual basis as opposed to
10 on an actual basis?

11 A Yes, it does.

12 Q It does mandate it?

13 A That is the way I read the uniform
14 system of accounts.

15 Q Okay. So, then, the statement that
16 I made is false? That I started this line of
17 questioning that -- that the 1992 FERC uniform
18 system of accounts does not require the net
19 salvage component to be derived according to the
20 standard approach.

21 A That is false.

22 Q That's a false statement. If I make
23 the statement depreciation service value and net
24 salvage are all prescribed that no authorized
25 formula for the net salvage component of the

1 depreciation rate calculation is included, that's
2 a false statement?

3 A No, that's a true statement;
4 however, the -- the use of cash basis as a
5 substitute for the estimation of the net salvage
6 that will occur in the future for the plant today
7 in service is false, inconsistent with the uniform
8 system of accounts.

9 What your most recent statement said
10 is that the uniform system of accounts doesn't
11 prescribe the manner in which one estimates the
12 net salvage related to these assets, and that's
13 true. It doesn't prescribe how one should
14 estimate that future net salvage. But what it
15 reflects is the net salvage of the assets that are
16 in service today.

17 Q I asked a question yesterday whether
18 there would be -- if we were to approve of the
19 accrual method, whether there would be -- whether
20 there would be issues within the actual method,
21 meaning the different variables, different
22 components, would there be contested issues in the
23 accrual method if we were to approve that type of
24 method.

25 Do you believe there would be issues

1 in contested matters, service lives, depreciation
2 rates or -- or anything within the formula?

3 A Yes. I believe that in conducted
4 depreciation studies on behalf of utilities and on
5 behalf -- you know, Staff's review and conduct of
6 its own depreciation studies, that two
7 professionals can reach different conclusions as
8 to what the average service life should be, what
9 the net salvage percentage should be, and what the
10 depreciation rate should be all within the
11 standard approach.

12 Q So even if we decide the issue,
13 we're not really deciding the issue, there will be
14 a lot of work left to do in each case?

15 A There always has been and always
16 will be in determination of the appropriate
17 depreciation expense to be reflected in the cost
18 of service.

19 Q And the consultants say, whew, thank
20 goodness. NARUC, National Association of
21 Regulatory Utility Commissioners, does it endorse
22 or identify a method that should be used for this
23 issue?

24 A Yes, it does.

25 Q And what does it suggest or

1 recommend?

2 A The text Public Utility Depreciation
3 Practices published by NARUC endorses the standard
4 approach.

5 Q It does identify that there are
6 other methods that are available.

7 A It identifies that other methods are
8 used by some commissions, but it's very clear in
9 endorsing the merits of the standard approach.

10 Q Do you know the year of that
11 publication?

12 A 1996.

13 Q You mentioned at the start of our
14 conversation this morning that -- that the
15 traditional or standard approach that's been
16 referenced has been the prominent method used for
17 this issue since the beginning of utility
18 regulation; is that fair and accurate statement?

19 A Yes.

20 Q I want to make sure that I -- that I
21 make that proper reference. You had also agreed
22 that even though there may not be endorsements of
23 other methods, there are other options that are
24 available to commissions in evaluating this issue.

25 A Yes.

1 Q Okay. If -- if the standard method
2 has been utilized by the states, by the federal
3 government since 1910, how have these other
4 methods survived over the last 90 years if -- if
5 there's really been only one way of doing things?

6 A With respect to utilities, there has
7 always been the option to use the accrual basis or
8 the cash basis. And the selection of which is
9 most appropriate for a particular expense often,
10 you know, depends on the nature of the
11 expenditure.

12 If the expenditure is such that it
13 provides service over a long period of time,
14 utilities have traditionally opted for the accrual
15 approach, and that has been in accordance with the
16 system of accounts that have been promulgated and
17 with regulation until recent years.

18 The first use, to my knowledge, of
19 something other than the accrual basis for net
20 salvage was in 1962 in a Pennsylvania Superior
21 Court decision in which the Court interpreted the
22 Pennsylvania statutes as not permitting the
23 recovery of a cost that had yet to be incurred.
24 Thereby negating the ability of utilities in
25 Pennsylvania to use the accrual basis for those

1 future net salvage costs.

2 Until the 1990s, to the best of my
3 knowledge, the use of that cash basis approach was
4 limited to Pennsylvania. In the 1990s, I am aware
5 of several cases in this jurisdiction where Staff
6 proposed the use of the cash basis rather than the
7 accrual basis for net salvage based, in my view,
8 in large part on the initial decision in this
9 proceeding.

10 There are others who have now
11 proposed this approach to other states. Most have
12 rejected it, two that I am aware of have accepted
13 it.

14 Q What states are those?

15 A New Jersey and Georgia.

16 Q Are there other methods than the two
17 methods that are outlined in this proceeding here
18 that could be considered by this Commission?

19 A The only other --

20 Q Ignoring the fact that there may not
21 be facts to support it, but are there other
22 options that we would have available?

23 A The only other that occurs to me is
24 the method that is used for the decommissioning
25 costs of nuclear plants, which is the use of a

1 sinking fund in which the annuities would be
2 segregated, and whether I would recommend if such
3 an approach was considered, that it be an internal
4 segregation, and no return would be provided on
5 that accumulated fund, because the return on the
6 fund would be required in order to fund the
7 ultimate amount.

8 Q Is that your second choice?

9 A That would -- that would be my
10 second choice as compared to cash.

11 Q Did you review the testimony of
12 Rosella Schad, the Staff witness?

13 A I did.

14 Q Specifically the supplemental
15 rebuttal testimony?

16 A I have.

17 Q Okay. She sets out a great deal of
18 history associated with the State of Missouri and
19 with -- and nationally on this issue, and a number
20 of the questions that I've already asked, I think
21 that you answered, identifying at least you claim,
22 I believe, some errors.

23 I want to direct you to page 8. You
24 have testified today that since 1910, the accrual
25 method has been used, I am assuming in Missouri,

1 but there are several examples of cases in which
2 that method was not used that are cited by Miss
3 Schad. Have you had a chance to review those
4 orders, do you agree with the statement, or do you
5 dispute what she claims?

6 A I have not reviewed the orders. I
7 think what the history suggests is that until
8 approximately the 1960s or '70s, that the net
9 salvage component of depreciation was a relatively
10 minor portion given the experience to that time.
11 That because plant was still extremely young,
12 there was little being retired, little experience
13 with the costs of retiring plant.

14 I also believe, as we discussed
15 earlier, that subsequent to that time, with the
16 increased growth in the utility plant, increased
17 growth in the country in general, that the cost of
18 retiring plant has become a much more difficult
19 exercise and a much more costly exercise.

20 And so at that time the absence of
21 attention to the net salvage issue was based on
22 the history to date, which was that such amounts
23 were nominal.

24 Q Are you aware of when Missouri
25 started using this accrual method? Was it the

1 '60s when it became an issue?

2 A I don't know.

3 Q Don't know. Okay. So the -- the
4 time tested -- the decades of use, we could
5 identify as perhaps the period between 1960 and
6 1990 for looking at Missouri's history on this
7 issue?

8 A It's -- it's very clear that it's at
9 least that period of time that net salvage was
10 certainly an adjustment to the depreciation rate
11 under the standard approach. That it likely was
12 still the standard approach prior to that time,
13 but the amount of adjustment was so minor, if any,
14 that it's not clear.

15 Q Well, according to this, it says --
16 according to Miss Schad, it wasn't until the 1950s
17 in Missouri that for all utilities, depreciation
18 was allocated by plant account rather than by a
19 flat composite rate.

20 So, obviously, this -- with the
21 growth of the industry, there's been a change and
22 an evolution in policy on this issue. Would you
23 agree with that?

24 A Yes and no. There have been various
25 levels of attention paid to depreciation by

1 various utilities. Some utilities were quite
2 sophisticated about it very early on, others not
3 so until more recently.

4 Many utilities were estimating
5 service lives and net salvage values on an account
6 basis quite early; others, not having historical
7 record on which to base estimates of service life
8 and net salvage, made judgments as to what they
9 thought an appropriate rate was.

10 I think the important part is,
11 though, that the uniform system of accounts which
12 guided them in how they determined and set those
13 depreciation rates does define depreciation as the
14 loss in service value; and it was that service
15 value, original cost less net salvage, that those
16 rates were intended to ratably allocate over the
17 life of the asset.

18 Q In Missouri, you would agree that
19 Staff changed its position sometime in the 1990s?

20 A Several times.

21 Q Changed their position several times
22 during the 1990s and subsequent to that?

23 A Yes.

24 Q So this issue has been contested,
25 it's been argued about, for roughly 15 years

1 **Missouri?**

2 A Yes, I would agree with that. There
3 was a number of cases in the 1990s where it was
4 not an issue. Many of those cases were settled.

5 Q Did you review -- this is a broad
6 statement. Did you review all of the cases that
7 -- all of the rate cases that we've issued since
8 1990?

9 A I reviewed the issue that was
10 discussed.

11 Q Does that include settled cases?

12 A It includes some settled cases.

13 Q And in any of those cases, was the
14 standard or accrual method utilized?

15 A Yes.

16 Q And in any of those cases, was the
17 cash method utilized?

18 A In the 1990s?

19 Q And subsequent. You're going to --
20 we only have a few cases in the 2000s.

21 A I was actually not in school, 2000,
22 the cash basis was adopted. The previous
23 proposals of Staff that were accepted in 1990,
24 1993, and in this proceeding incorporated a rate
25 into the depreciation rate that resulted in an

1 accrual that was the same as the cash basis. So
2 it was effectively the cash basis.

3 But there -- there was also a
4 Missouri Public Service case in 1997 in which
5 Staff proposed the standard approach and it was
6 accepted.

7 Q I'm back in Ms. Schad's supplemental
8 rebuttal testimony, page 13. I'd like to read an
9 assertion made by her, and I was wondering if you
10 would respond to it. I'm on line 6.

11 She states, Mr. Stout's approach
12 uses assumptions that are -- that estimated future
13 costs of removal will actually be incurred at
14 precisely the levels indicated. These assumptions
15 have not proved to be true for any utility
16 operating in the State of Missouri, closed quote.
17 Could you respond to that?

18 A Certainly.

19 Q And if you need to read above or
20 below for context, feel free.

21 A Not necessary.

22 Q You get the gist of it, I guess.

23 A I have read it several times. Yes.
24 The approach does assume that those future costs
25 of removal will be incurred at precisely those

1 levels indicated. We can't recommend a range to
2 be used. There has to be an amount to be
3 determined and that has to be a precise amount.

4 Do I recognize that the actual
5 values will be within a range? Yes. But I have
6 to make an estimate of what it will be in order to
7 calculate the depreciation rate.

8 The second part, I actually have to
9 agree with. The assumption hasn't proved true, as
10 I indicated by reference to Schedule 1 attached to
11 the surrebuttal testimony of Mr. Codaman in this
12 proceeding. The net salvage costs in absolute
13 value and as a percent of the original cost
14 retired have been increasing steadily and
15 regularly over time. There's a number of factors
16 that have caused that and will continue to cause
17 it. That is the growth in plant and inflation.

18 So I agree. The assumptions haven't
19 proved true. The assumptions typically have
20 proved to be inadequate. The assumptions have
21 typically understated the future net salvage costs
22 that we then realized.

23 Q Does the accrual method repair that
24 inaccuracy over time?

25 A Yes, it does. The use of the

1 accumulated depreciation account for both the
2 accrual amounts and the actual net salvage costs
3 permits monitoring of the level of those
4 accumulations and costs and a review of those in
5 comparison with current experience and future
6 expectations so that the amount recovered over the
7 life of the asset is equal to its total service
8 value, original cost less net salvage, no more and
9 no less.

10 Q Is there a way to -- other than just
11 answering the question that there are safeguards,
12 can you delineate or list out safeguards that
13 would protect for a scenario of overaccrual, or
14 over receipt of funds on this issue to the
15 Company?

16 A Yes. I mean, I could refer back to
17 Exhibit 146, which is still on the white board, in
18 which --

19 Q Is this -- this is 146?

20 A That's -- yes. In which --

21 Q Maybe someone could write 146 on it.
22 Not now. Go ahead. I'm sorry, Mr. Stout.

23 A In this -- in the particular
24 example, the estimate was that the asset would
25 have a ten year life and experience \$10,000 of net

1 salvage cost at the end of its life. After a five
2 year period, a new depreciation study was
3 conducted and based on experience with other
4 similar assets, it's now estimated that only
5 \$8,000 of net salvage will be incurred at the end
6 of the life.

7 And so for the remaining five years
8 of the asset, through both the reduced accrual
9 rate and the amortization of the \$1,000 over
10 recovered at year five, the net accruals for that
11 remaining five years would be at \$600 per year.
12 So that at the end of year ten, 8,000 was all
13 that's recovered.

14 Q In a rate case setting, if we assume
15 that the accrual method is being used, would there
16 be a -- some sort of prudence review on the
17 amounts that are within that formula?

18 A The actual net salvage costs that
19 have been incurred, as to whether or not they were
20 incurred prudently?

21 Q I suppose you could look at prudence
22 for the actual costs, and then you would still
23 have potential disagreement on estimating the
24 future speculative costs, would you not?

25 A Yes, although I would disagree with

1 the speculative characterization.

2 Q Why?

3 A I don't think it's speculative that
4 we will incur costs to retire plant in the future.
5 We've seen it happening in increasing amounts over
6 the last 40, 50 years. So it's -- it's not a
7 speculation that net salvage costs will be
8 incurred to retire plant.

9 Q Well, let's say estimated. Would
10 you feel more comfortable with estimated?

11 A I would.

12 Q Lots of loaded words in all this
13 testimony.

14 A I just want the record to be clear.

15 Q We appreciate it. Did you
16 participate in the original case? The original
17 rate case for Laclede? I think it was like ten
18 years ago? Six years ago? Five years ago. Were
19 you involved in that case?

20 A I was not.

21 Q You were not. I had some questions,
22 and I'm having difficulty locating the question,
23 so I'm going to cut to the chase and I'm going to
24 spell out my biggest concern, deal with that, and
25 then we'll go to somebody else if there's time.

1 On your Schedule WMS-1, we talked
2 about this yesterday, and on this you have set out
3 your average of previous ten years' net salvage
4 costs as well as the annual net salvage costs of
5 recent retirement. And I asked you to help draw a
6 line that would indicate the amount of money on
7 the accrual method over the life.

8 And I drew a line in 1971, with the
9 year being on the X axis. On the Y axis was
10 roughly \$5 million and that grew to some \$50
11 million to the year 2000. And then going beyond
12 on the graph, you indicated that at some point in
13 2020, the lines would intersect and that the
14 accrual -- the accrual method would actually be
15 recovering less money than what the actual
16 retirements would be.

17 First of all, let me make sure that
18 what I've said so far is accurate.

19 A It -- it actually, um, is probably
20 close to accurate, but I need to point out that
21 the 2020 crossover was for a particular account
22 for Laclede Gas.

23 Q Well, could we do a total? Is it
24 possible to do total accounts? Will there be an
25 intersection of lines, or will there simply be an

1 over recovery in perpetuity?

2 A There hasn't been and will not be an
3 over recovery. The level of recovery is at the
4 appropriate level under the standard approach. I
5 think -- I understand your reaction to the 50
6 million level of accrual under the standard
7 approach versus the current level of about 14
8 million in costs. I think that has to be put into
9 context. That is just one piece of the regulatory
10 formula.

11 You have to look at a couple others.
12 First you need to look at, under the standard
13 approach, the extent to which past accruals have
14 exceeded net salvage costs is reflected in the
15 accumulated depreciation count. And that amount
16 is being deducted from rate base.

17 Now, the amount for Ameren UE as of
18 2000 was approximately \$350 million as determined
19 by Staff's witness in that proceeding. Now, the
20 return on that is, say, approximately 35 million.
21 So the standard approach's net revenue requirement
22 related to net salvage is 15 million. Very close
23 to the 14 million on a cash basis.

24 The other part of the equation is
25 the other part of depreciation, the original cost,

1 the amount -- and now I need to switch to Laclede
2 in order to make sure that I have the right
3 numbers in mind --

4 Q Well, before you do that, help me
5 understand why -- I know you're adjusting the
6 numbers and I'll be the first to admit that I -- I
7 can't identify and describe each element that is
8 within the rate making formula.

9 But going back with your chart
10 WMS-1, I'm not sure if we're talking rate base
11 treatment or if we're actually talking actual
12 costs. I want to compare apples to apples. I
13 want to compare what the accrual method would
14 determine in comparison to these figures.

15 A And that's --

16 Q And when you say in the year 2000,
17 that the difference between the actual salvage
18 costs, which looks like a little under 14 million,
19 compared to 50 million, and that comparison seems
20 way out of line, does it not?

21 A Not to me.

22 Q Okay. Is that a fair comparison?
23 Because then you adjusted the numbers, came back
24 and said, well, once you come through, the revenue
25 requirement is actually significantly -- you know,

1 it reduces down and is only a million dollars off.
2 So on this chart with this example, this is a
3 Laclede case, but using this chart, unless there's
4 a chart that is -- that is additionally attached,
5 how is that reconciled? How is that explained?

6 A It's explained in several ways.
7 First off, the amount being accrued today is this
8 year's portion of the total net salvage costs
9 being allocated ratably over the life of a plant.

10 Now, the plant today, in this case
11 for Ameren, is several -- I think over a million
12 customers. So the ratable portion of that plant
13 in one year, if the net salvage piece for that
14 very large plant serving over a million customers
15 is much greater than the net salvage costs that
16 we're experiencing today for a plant being retired
17 today that served customers in the past, the plant
18 being retired today is coming out of a much
19 smaller base. It's coming out of a base that
20 served maybe 200,000 customers.

21 We have not reached a steady state
22 condition in utility plant. Until we would reach
23 a steady state condition, these two won't match.

24 Q Where would the revenue requirement
25 under the accrual method be for the year 2000 on

1 your chart? Would it be at 50 million?

2 A No. The total revenue requirement

3 --

4 Q I mean, that's what we're comparing.

5 The net -- the cash amount paid in the year 2000

6 for actual retirements versus an estimated portion

7 -- or portion of the estimated amount for

8 retirement in the future. What would be the

9 corresponding dollar amount for the year 2000 on

10 this chart?

11 A For the total revenue requirement

12 related to net salvage, it would be approximately

13 \$15 million consisting of a \$50 million accrual

14 less a return credit of \$35 million on the \$350

15 million that's been accumulated in the

16 depreciation reserve.

17 Q So the actual -- the actual proper

18 comparison to place a third line on this chart

19 would be at 15 million, not 50 million?

20 A I believe so. Because under the

21 cash basis, if it had been used all along, there

22 would not be anything in the accumulated

23 depreciation account and there would be no return

24 on such under the cash basis.

25 Q Okay. So the accrual method will

1 bring an amount in revenue requirement that is
2 greater than, but it's not going to be -- is it --
3 will it be two or three times what the actual
4 retirements would be? Is there a ratio in
5 comparison that is a fair judge of what --

6 A The relationship between the amount
7 being accrued for today's plant versus what's
8 being experienced for yesterday's plant?

9 Q I think -- I think so.

10 A It depends on the growth in that
11 plant base. The retirements that we're making
12 today, let's just say, are coming out of plant
13 that was installed in 1950. Well, in 1950, in
14 this case for Ameren, it had maybe one-fifth as
15 many customers. So it's coming out of a plant
16 that was much, much smaller.

17 So just say -- just using that, you
18 would think it would be five times because we have
19 five times as many customers today, perhaps.

20 Q If we looked at Laclede having a
21 date when it would stop -- or in this case Ameren,
22 a date when they would stop providing service, at
23 some point the lines would intersect and that
24 would be the end? The accrual would meet the
25 actual requirements?

1 A They would cross and the actual
2 costs would exceed the accrual.

3 Q And then at the end date it would be
4 a sum zero?

5 A Yes.

6 Q In theory. In perpetuity, which
7 we're assuming these companies will be operating,
8 you will always have -- the accrual method will
9 always be more than the cash method because of the
10 -- the assumption that customers and the plant
11 size will grow?

12 A If indeed we have continued growth
13 in plant and continued inflation, the accrual
14 portion of the revenue requirement will be
15 greater, but the deduction for the accumulated
16 accruals will offset that significantly.

17 Q All right. Last question. Using
18 your example on Exhibit 146, you've suggested that
19 there is a method of reconciling if the estimates
20 for future retirement are not accurate. Say, for
21 example, and let's use an extreme just to
22 illustrate the point, you have \$10,000 in -- in
23 retirement costs over a ten year life. Let's say
24 you get to -- you use the accrual method and you
25 accrue that \$10,000.

1 Let's say in year 15, that plant is
2 still in service. Now, you've stopped accruing
3 and that money's just being held in the -- I guess
4 the reserve account. And let's say that the --
5 the retirement cost is negligible, either it's not
6 actually -- there's no cost of removal or say it's
7 a thousand dollars.

8 Now, that would be reconciled in --
9 in the overall -- the overall cost of removal
10 accrual. Correct?

11 A Yes. The -- the overaccrual would
12 be amortized back to customers at the time that we
13 recognized that it wasn't overaccrual. And until
14 it was returned, a return on that amount would
15 continue to be provided.

16 Q How do you address the inequity for
17 the people who paid in that thousand dollars per
18 year for that ten year, and in year 15 you decide
19 that the amount will be reduced? How do you
20 address that intergenerational equity?

21 A I can't do that. All I can do is
22 make the best estimate in year one that I can.
23 And I think that that's one of -- in my view,
24 supports what I'm trying to do, which is to make
25 the best estimate of what that will be and begin

1 accruing for it now as opposed to not bothering
2 and not accruing anything towards that cost.

3 COMMISSIONER CLAYTON: All right. I
4 thank you for your patience and I'm sorry to go on
5 for so long. Thank you.

6 JUDGE DIPPELL: Thank you.

7 Commissioner Davis, did you have
8 questions for Mr. Stout?

9 COMMISSIONER DAVIS: No questions at
10 this time.

11 JUDGE DIPPELL: Commissioner
12 Applling, did you have questions? All right, then.

13 Commissioner Murray, did you have
14 anything else?

15 COMMISSIONER MURRAY: I don't
16 believe so. Thank you.

17 JUDGE DIPPELL: All right, then. I
18 guess we're ready to move on to further cross
19 examination based on those questions from the
20 bench. Is there anything further from Public
21 Counsel?

22 MS. O'NEILL: No, Your Honor.

23 JUDGE DIPPELL: Staff?

24 MR. SCHWARZ: Yes, ma'am.

25 RECROSS EXAMINATION BY MR. SCHWARZ:

1 Q Mr. Stout, when you talk about the
2 standard approach or the standard method, are you
3 talking about the incorporation of determination
4 of future net salvage by the formula cost of
5 removal divided by original cost of the property
6 retired?

7 A No. What I am talking about is
8 ratably allocating the net salvage related to an
9 asset during its service life.

10 Q So in -- in your use of the term,
11 the particular approach that's been used by
12 Laclede falls within the standard approach, but it
13 is certainly nothing that has been considered part
14 of a standard approach by the industry? I mean,
15 it -- there could be other approaches?

16 A The standard approach that I have
17 described ratably recovers the net salvage of an
18 asset during its life. Therefore, it requires an
19 estimate of that net salvage at the beginning of
20 its life. And that is the approach that Laclede
21 has used, which is to estimate the net salvage
22 related to the assets that are currently in
23 service.

24 Q But in -- but the use of the
25 particular estimator that Laclede has employed has

1 -- is -- is not part of anything that is referred
2 to in the industry as a standard approach? It's
3 simply one example of what might be used in the --
4 in the estimation of future cost of removal; is
5 that correct?

6 A No, I wouldn't go that far. The
7 statistical analysis that Laclede conducted in
8 support of its estimates of net salvage were based
9 on observations of historical net salvage costs as
10 related to the original cost of the property to
11 which that net salvage related. That is, it's a
12 statistic that is the same statistic that we were
13 trying to estimate net salvage cost as related to
14 original cost.

15 Now, the approach that they've used
16 is the same approach that I've used, it's the same
17 approach that's described in NARUC's Public
18 Utility Depreciation Practices and other texts on
19 the subject.

20 The difference that comes between
21 analysts conducting such analyses as a method for
22 forecasting future net salvage is the extent to
23 which they then modify those historical net
24 salvage percentages in trying to arrive at
25 estimates of the future given the levels of past

1 growth and inflation reflected in the historic
2 data versus their expectations for the future.

3 Q But, again, my question is not
4 directed to the formula that Laclede used. My
5 question is when people in the industry, in the
6 business, when people in the Society of
7 Depreciation Professionals use the term "standard
8 approach" or "standard method," are they referring
9 to a formula cost of removal divided by historical
10 costs?

11 A No. That is -- that formula is for
12 determining the historic statistic. The standard
13 approach refers to the future statistic, which is
14 what will future net salvage be as a percent of
15 today's original cost? Because that is what the
16 standard approach requires.

17 Q So the standard approach does not
18 require an estimate of actual future net salvage?

19 A Yes, it does.

20 Q And if I understood your statement
21 in response to my last question, you said that the
22 standard approach merely requires application of
23 historical patterns. Is that --

24 A No. I've indicated what the
25 standard approach requires is the ratable

1 allocation of the net salvage cost of today's
2 assets over their service lives. And in order to
3 do that, we must estimate what that future net
4 salvage will be.

5 The typical approach as described in
6 texts and used by most experts is to look at
7 history as a basis for forecasting what that
8 future net salvage will be. Those analyses of
9 history relate the net salvage cost in a
10 particular year to the original cost of plant
11 retired in that same year.

12 Q Okay. What do you mean when you
13 say, use the word, and Commissioner Clayton used
14 it, I think you used it in response to a question,
15 what do you mean by the word "endorse"?

16 A I don't have my Webster's with me,
17 but it -- endorse to me indicates a support of a
18 discussion of the merits of that method and why
19 it's appropriate.

20 Q Does it mean recommend or urge the
21 use of or support of? In the common parlance?

22 A I would say it includes recommend,
23 yes.

24 MR. SCHWARZ: May I approach the
25 witness?

1 JUDGE DIPPELL: Yes.

2 Q (BY MR. SCHWARZ) I have here the
3 NARUC Public Utility Depreciation Practices. Its
4 discussion of net salvage begins on page 157. And
5 I would ask you to point out to the Commission
6 where in the succeeding pages that publication
7 recommends or urges commissions to use any
8 particular approach?

9 A It does not do so on page 157.
10 However, on page 18 of the same publication, it
11 states as follows. Under presently accepted
12 concepts, the amount of depreciation to be accrued
13 over the life of an asset is its original cost
14 less net salvage. Net salvage is the difference
15 between the gross salvage that will be realized
16 when the asset is disposed of and the cost of
17 retiring it. Positive net salvage occurs when
18 gross salvage exceeds cost of retirement and
19 negative net salvage occurs when cost of
20 retirement exceeds gross salvage.

21 Net salvage is expressed as a
22 percentage of plant retired by dividing the
23 dollars of net salvage by the dollars of original
24 cost of plant retired. The goal of accounting for
25 net salvage is to allocate the net cost of an

1 asset to accounting periods, making due allowance
2 for the net salvage, positive or negative, that
3 will be obtained when the asset is retired.

4 The concept carries with it the
5 premise that property ownership includes the
6 responsibility for the property's ultimate
7 abandonment or removal. Hence, if current users
8 benefit from its use, they should pay their pro
9 rata share of the costs involved in the
10 abandonment or removal of the property and also
11 receive their pro rata share of the benefits of
12 the proceeds realized.

13 Q And, in your mind, that's an
14 endorsement of the standard approach?

15 A It's a pretty absolute statement of
16 the standard approach and its merits.

17 Q Okay. Now, again, turning back to
18 pages 157 and following when the committee
19 specifically talks about net salvage, can you find
20 an endorsement in those pages of a specific
21 approach?

22 A At the end of the section to which
23 you directed me, it states as follows. Today few
24 utility plant categories experience positive net
25 salvage. This means that most depreciation rates

1 must be designed to recover more than the original
2 cost of plant.

3 The predominance of this
4 circumstance is another reason why some utility
5 commissions have switched to current period
6 accounting for gross salvage and particularly cost
7 of removal.

8 That is, they haven't been willing
9 to accept the fact that depreciation rates must be
10 designed to recover more than the original cost of
11 plant. It doesn't say should or maybe, it says
12 must.

13 Q So the endorsement also contains the
14 caveat that not all commissions follow the --

15 A It so states in that book that some
16 commissions have not followed the standard
17 approach.

18 Q You talked with Commissioner Clayton
19 about requirements for following the USOA. Do you
20 recall?

21 A Yes.

22 Q Are you aware that the rule of the
23 Missouri Commission adopting the USOA specifically
24 states that it need not be followed by the
25 Commission in rate making proceedings?

1 A Not aware of that, but there are
2 exceptions to the uniform system of accounts made
3 at times. I think they need to be very seriously
4 considered when they do occur.

5 Q You are a member of the Society of
6 Depreciation Professionals? Is that it?

7 A Yes, it is, Mr. Schwarz.

8 Q Are you familiar with the letter to
9 that society that was authored by John Ferguson
10 and is appended to Ms. Schad's rebuttal testimony
11 in this case?

12 A Yes, I am.

13 Q And did you become aware of that
14 letter by its posting or dissemination by the SDP?

15 A I became aware of it when I
16 discussed it with Mr. Ferguson prior to its
17 publication and provided him some of the
18 information set forth in it.

19 Q You mentioned to Commissioner
20 Clayton that other methods than the accrual method
21 under the USOA might be available, and mentioned a
22 -- decommissioning sinking funds; is that --

23 A I said that was -- he was looking
24 for what all the possibilities were, and that's --

25 Q But that is an accrual approach, is

1 it not?

2 A I don't believe I would call that an
3 accrual approach.

4 Q So it would be your contention,
5 then, that, for instance, in the decommissioning
6 sinking fund for the Callaway nuclear plant here
7 in Missouri, and let's just assume for the moment
8 that the contributions to that sinking fund are
9 \$40 million a year toward the ultimate retirement
10 of that plant, is it your contention that those
11 \$40 million are being currently expended?

12 A No.

13 Q So the expense is being accrued, is
14 it not?

15 A Yes, it's -- it's being accrued, but
16 it's relying on the interest on the fund in
17 addition to the accruals. And the accruals in and
18 of themselves are inadequate to accrue the
19 expense.

20 Q Commissioner Clayton asked you some
21 questions about Exhibit 146. Do you recall those
22 questions?

23 A I do.

24 Q In the first year, if you're -- if
25 you're setting the rates for this and there have

1 been no retirements, what would the standard
2 approach formula indicate as the accrual? That
3 is, if there -- if the numerator is the cost of
4 removal is zero, what -- what's the -- the value
5 of the accrual for that plant?

6 A I'm not sure I understand your
7 question, because you switched from the standard
8 approach, which is a depreciation formula that
9 incorporates the net -- future net salvage percent
10 estimate, to a numerator ratio which implied to me
11 you were talking about historical analysis.

12 Q Well, the formula that we're talking
13 about here that's been applied by Laclede is
14 calculated with the cost of -- by the cost of
15 removal divided by original cost of the plant
16 removed; is that correct?

17 A No.

18 Q Is that the formula?

19 A No, it is not. That is the way in
20 which depreciation professionals analyze
21 historical net salvage. Those analyses are used
22 as a basis for estimating the future net salvage,
23 but the key element, and what really defines the
24 standard approach, is not how one gets to that
25 estimate, but the fact that it -- the net salvage

1 related to that asset today in service is ratably
2 allocated over the life of that asset.

3 Q So it -- in this example, you would
4 not rely on the formula in the standard approach
5 to estimate the accrual for cost of removal of the
6 plant; is that correct?

7 A No. I -- there is -- it is not
8 formulaic to take the history and based on that
9 history just run it right into the depreciation
10 rate formula. History is used in order to get an
11 indication of the level of net salvage
12 historically. But what we are estimating is
13 what's in the future so that we can ratably accrue
14 it during the life of today's assets.

15 Q Okay. So in this example, you would
16 not rely on an indicator that gave you a zero
17 indicator for cost of removal; is that correct?

18 A I don't understand your question.

19 Q Well, if there -- if you're -- and
20 the example that we have is this is new property,
21 it's not part of a mass asset account, there's no
22 analysis, there's no reliance on the average
23 service life or cost of removal, this is free
24 standing plant, new account, so there is no
25 retirement history.

1 And in the absence of retirement
2 history, I think your suggestion is that the
3 formula is not anything on which you would pin
4 your estimate of future net salvage, but there are
5 other factors which, in your informed judgment,
6 would permit you to make that estimate; is that
7 correct?

8 A If I had a brand new asset for which
9 I had no related experience and, therefore, could
10 not conduct any historical analyses of the
11 relationship between net salvage costs and the
12 original cost to the related property retired, I
13 would have to make an informed judgment in the
14 absence of such data of what the net salvage for
15 that property would be.

16 Q And would you expect Staff to do the
17 same thing?

18 A I used to.

19 Q You no longer do?

20 A No.

21 Q And on what do you base that?

22 A Based on Staff's testimony in this
23 proceeding and other proceedings, in the first
24 year of that asset's life, Staff would recommend
25 zero because there's no net salvage costs being

1 incurred.

2 Q If it's part of a standalone -- so
3 you're --

4 A That's what you defined -- you
5 defined the hypothetical that way.

6 Q That's fine. Your answer is -- your
7 answer is sufficient. And Commissioner Clayton
8 asked you what if it turns out that the life is
9 actually 15 years. Do you recall that?

10 A Yes.

11 Q Now, let me ask you this as well.
12 Does the reduction in the accrual to \$600 take
13 place if there is no rate case at that time?

14 A If there is a depreciation rate
15 order, it would.

16 Q But it -- the depreciation rate
17 order would not affect customer rates, would it?

18 A It would not.

19 Q So that customers, in the absence of
20 a rate case, customers would continue to pay a
21 thousand dollars a year; is that --

22 A That's true, and the corollary would
23 also be true if we realized that the net salvage
24 cost was now going to be \$15,000 and begin to
25 accrue at a higher level, that would not be

1 reflected in customer rates either absent a rate
2 case.

3 Q All right. Thank you. And, again,
4 in years ten through 15, if there were no rate
5 case, then -- if there had not been a rate case in
6 year five and there were no rate case in year ten,
7 customers would continue to pay a thousand dollars
8 a year, would they not?

9 A Yes. And that would be recorded to
10 the accumulated depreciation. It would be tracked
11 and it would be trued up over time.

12 Q But, in the meantime, these
13 customers would -- would be overpaying and the
14 overpayment would be refunded to customers who
15 hadn't made that overpayment?

16 A Yes, but I would suggest that it's
17 still far closer to the service value rendered to
18 those customers than them paying nothing for that
19 asset and only the future customers after year 15
20 paying something for it.

21 Q In discussions with Commissioner
22 Clayton concerning your Schedule 1, he asked you
23 about there being an over recovery if the accruals
24 were greater, and you indicated that there would
25 not be an over recovery. Do you recall that

1 series of questions?

2 A Yes.

3 Q And is your answer premised on the
4 fact that the accruals and the estimates of net
5 salvage upon which the accruals are based are
6 accurate predictors or estimators of the future
7 net salvage?

8 A As I've indicated several times in
9 my testimony, it's my contention that the current
10 estimates of future net salvage understate what
11 those net salvage costs will be.

12 The future estimates will be
13 adjusted accordingly under the standard approach,
14 and the amounts accrued and the amounts incurred
15 will be tracked in the accumulated depreciation in
16 order to ensure that the amount accrued and
17 collected from the customers matches the costs
18 expended.

19 Q But the -- the proposition that the
20 accruals are not a current overstatement is based
21 on the premise that the estimated future actual
22 costs of -- the estimates of the future cost of
23 removal are accurate. Is that correct?

24 A It's based on the premise, in my
25 mind, that they are -- represent an understatement

1 of the likely future net salvage cost so that the
2 current level doesn't represent an over recovery,
3 but rather likely an under recovery.

4 Q So -- but in order for the accruals
5 to currently match over time, the -- the estimates
6 of future net salvage have to be accurate;
7 otherwise, you need corrections later on. Is that
8 correct?

9 A I have no doubt that there will be
10 corrections later on. What I am comfortable with
11 stating is that the current level cannot possibly
12 be an over recovery, but is most likely an under
13 recovery.

14 Q But my question is not about over
15 recovery. My question is -- is the premise. If
16 you look at Exhibit 4-1, this is all premised on
17 the fact that the estimate in -- in the fourth
18 column is accurate relative to the accrual in the
19 -- in the column that's two over. Is that
20 correct?

21 A Yes, it is premised on the estimate
22 being accurate.

23 Q Commissioner Clayton inquired about
24 -- in response to a question from Commissioner
25 Clayton, you indicated that rate payers' return on

1 the net salvage accrual offsets the -- or can be
2 viewed or used to offset the size of the current
3 accrual that's in excess of current costs. And
4 I'm not sure that I'm expressing that accurately,
5 but that's -- do you recall that?

6 A I recall discussing those things
7 with Commissioner Clayton.

8 Q Would you refresh my recollection as
9 -- as to what that -- what your position was on
10 that?

11 A My position was that under the
12 standard approach, in order to properly consider
13 its impact on revenue requirement, one should
14 consider not only the amount of the accrual, but
15 also the accumulated amount of accruals in excess
16 of the costs and the return that's provided on
17 that accumulation.

18 Q Would it be -- and -- and that's
19 when you're considering things from the rate
20 payers' perspective; is that correct?

21 A No, I think that's when I'm
22 considering things from the perspective of how the
23 standard approach under today's regulatory
24 framework determines a revenue requirement related
25 to those net salvage accruals.

1 Q Could the same -- should the same
2 consideration be made when the Commission is
3 considering the company's need for depreciation?
4 That is, consumers, rate payers are providing a
5 return on investment, so that should -- should be
6 kept in mind when considering the return of the
7 investment?

8 A I think if one were -- wants to look
9 at the total revenue requirement related to gross
10 plant in service, it would include not only the
11 depreciation accrual for that plant in service,
12 but the return being provided to the company for
13 those amounts that it has invested in plant.

14 Q Well, isn't the rate base offset
15 made to provide rate payers a return on the funds
16 that they have advanced to the company for work
17 that has not yet been done?

18 A Yes. Or to recognize amounts that
19 they've returned to the company that the company
20 had previously invested.

21 Q But that's on the other side of the
22 -- that's the other factor in depreciation which
23 is not at issue in this case; is that correct?

24 A Yes.

25 Q Which is no longer an issue in this

1 case?

2 A We were talking about both, so.

3 Q So the rate base offset is a
4 mechanism to provide rate payers with the cost of
5 money that they have advanced to the company under
6 the accrual method for work not yet done?

7 A That's right. And if we don't use
8 the accrual method, then we shouldn't do that
9 either.

10 Q Correct.

11 JUDGE DIPPELL: Mr. Schwarz, do you
12 have quite a bit of questioning yet to go, or are
13 you --

14 MR. SCHWARZ: I don't think so.

15 JUDGE DIPPELL: Okay. I want to
16 take a break, but if you're going to be finished
17 in a few minutes, you go ahead.

18 Q (BY MR. SCHWARZ) I think that you
19 stated to Commissioner Clayton that -- you know,
20 that we have experienced far less inflation than
21 we will see in the future. At least that's the
22 note that I have. Is that -- it was -- it was in
23 the discussion of the history of net salvage.

24 A I recall discussing both growth in
25 plant and inflation, and indicating that the rate

1 of inflation that had been experienced up until,
2 say, the 1950s for plant that had been in service
3 for relatively short period of time was less than
4 the level of inflation that we're now seeing with
5 property coming out of service.

6 Q Let me ask you this. Do you think
7 that the rate of inflation that we have
8 experienced between the 1970s and now is -- is
9 going to be -- will we experience that same
10 pattern in the next 30 years?

11 A I think it's reasonable to expect
12 that the average rate of inflation over the last
13 30 years will be similar in the next 30 years.

14 Q And what is your basis for that?

15 A Simply looking at inflation over the
16 past 100 years and the levels that have, you know,
17 basically been in the 3 to 4 percent range over
18 that entire period.

19 Q But that period includes the Great
20 Depression?

21 A It includes periods of both
22 deflation and periods of significant inflation,
23 but, overall, it's always been there, it
24 continues, and I would -- you know, over long
25 periods of time, it's been averaging about 3 to 4

1 percent.

2 MR. SCHWARZ: I think that's all I
3 have.

4 JUDGE DIPPELL: Thank you. We're
5 going ahead and take a short break. We're going
6 to take about a 15 minute break and come back at
7 10 after. Thank you, we can go off the record.

8 (Off the record.)

9 JUDGE DIPPELL: Let's go ahead and
10 get started. Let's go ahead and go back on the
11 record.

12 Mr. Schwarz, you were finished with
13 your cross examination; is that correct?

14 MR. SCHWARZ: Yes, ma'am.

15 JUDGE DIPPELL: Is there any
16 redirect?

17 MR. LOWERY: Yes, Your Honor.

18 REDIRECT EXAMINATION BY MR. LOWERY:

19 Q Mr. Stout, Mr. Schwarz asked you
20 about growth in plant in some of his questions,
21 actually I think from yesterday. Please explain
22 for the Commission how the standard approach
23 differs from Staff's approach with respect to the
24 issue of taking into account the growth in plant.

25 A The standard approach recognizes the

1 plant currently in service, and includes in the
2 cost of service a ratable allocation of the net
3 salvage cost related to that plant.

4 Staff's approach only considers the
5 net salvage costs currently being incurred which
6 relate to a plant base many, many years ago that
7 was much smaller. And so it does not recognize
8 the current level of plant and the extent to which
9 it has grown in the past.

10 Q So put another way, it doesn't
11 recognize the fact that plant has grown
12 significantly from the base of plant that's being
13 retired today, from that time until today?

14 A That's correct.

15 Q Is that the same scenario, that the
16 standard approach takes, for example, inflation
17 into account, but the Staff's approach does not,
18 does that also regard to inflation in contrasting
19 the two methods?

20 A Yes, it does. The standard
21 approach, in estimating what the future net
22 salvage will be, does consider that it will take
23 place at a higher price level than today. Whereas
24 Staff's approach only puts in today's costs and
25 does not recognize that inflation is indeed a fact

1 of life.

2 Q I think Mr. Schwarz also asked you
3 about environmental regulations. Do you recall
4 that discussion?

5 A Yes, I do.

6 Q Let's say that environmental costs
7 do not escalate as rapidly over the next 25 years
8 as they have over the past 25 years. You've
9 testified, have you not, that the net salvage
10 estimates derived from the standard approach
11 produce conservative estimates? In other words,
12 they tend, if anything, to understate what the
13 cost will be.

14 Would any reduction in the rate of
15 the escalation of environmental costs in the
16 future change that conclusion on your part?

17 A No, it wouldn't. The net salvage
18 costs that are forecast based on the traditional
19 analyses of historic net salvage, in my view,
20 understate what those levels will be. And so the
21 extent to which there is any escalation in price,
22 whether due to inflation or additional
23 environmental requirements, is substantially less
24 than the historic increase in those requirements.

25 Q Commissioner Murray also, I believe,

1 asked you about the conservative nature of the net
2 salvage information process estimates that you
3 derived from the standard approach. Does your
4 supplemental rebuttal testimony, page 5, around
5 line 10, to page 8, line 6, does that illustrate
6 essentially the principle that Commissioner Murray
7 was asking you about?

8 A Yes, it does. What I've shown on
9 pages 5 through 8 of my supplemental rebuttal
10 testimony is that the historic indications of net
11 salvage percent for Laclede steel services, for
12 example, have been indicating levels of net
13 salvage costs in recent years that are between 112
14 and 117 percent of the original cost of the assets
15 being retired.

16 The conservative nature of that
17 indication is demonstrated by taking the current
18 average cost to retire a foot of service line and
19 applying that to the current number of feet in
20 service.

21 For example, with respect to steel
22 services, over the past ten years or so, it has
23 cost, on average, \$4.20 per foot to remove those
24 services. There are now over 10 million feet of
25 service in place. It would cost almost \$45

1 million, or 118 percent of the original cost of
2 those services, to remove them at the average
3 price level during the past ten years.

4 And it's for that reason that I
5 believe that the historical indication of 112 to
6 117 percent is conservative because it's
7 indicating about the same level as the recent
8 average cost per foot would indicate when applied
9 to the plant in service today. Any amount of
10 future inflation will only make that percentage
11 more negative.

12 Q It's already indicating today that
13 we are at that number, that cost per foot, but we
14 know that the plant in service today is going to
15 be retired many years into the future after we
16 have experienced further inflation. Correct?

17 A Yes.

18 Q You were asked about Mrs. Schad's
19 hypothetical at page 9 of her supplemental
20 rebuttal testimony. She seemed to be suggesting
21 that the original cost of the plant retired was
22 determined on a FIFO basis which she then seems to
23 suggest caused overstated net salvage percentages.
24 Why is her suggestion inappropriate?

25 A It's inappropriate for several

1 years. First off, first in/first out is only used
2 by Laclede for two very small accounts, where net
3 salvage is not material at all. For the mains and
4 services that are the primary accounts at issue,
5 the retirements are determined based on the actual
6 in service date of the plant being retired.

7 In the case of the Company's steel
8 mains, as I have indicated in my testimony, the
9 average age of the retirements on a dollar
10 weighted basis during the period 1972 to 1998 was
11 only 23.4 years. So the indications of negative
12 salvage are based on the amount of inflation
13 that's incurred during that period, not during a
14 period of 70 or more years as suggested by Mrs.
15 Schad in her FIFO example, and certainly not
16 indicative of negative 200 percent net salvage.

17 Q So if I understand -- understand
18 your answer, both because Mrs. Schad focused on
19 the FIFO method, which really doesn't apply to the
20 vast majority of the plant that's at issue, and
21 because she used a 75 year average service life
22 when, in fact, the real facts are that we're
23 talking about something on the order of 23 years,
24 her example grossly overstates the negative effect
25 that she was trying to illustrate?

1 A Yes.

2 Q Commissioner Clayton was discussing
3 with you whether or not if the Commission were to
4 continue or return to, however you might want to
5 characterize it, the accrual method, or standard
6 approach, whether or not there would be contested
7 issues nevertheless remaining in future rate cases
8 where that method was applied. Do you remember
9 that discussion?

10 A I do.

11 Q Are there also contested issues if
12 the cash treatment -- Staff's cash expense
13 treatment were used?

14 A Yes, there will still be issues with
15 that. Those issues would continue to include the
16 estimation of average service lives, they would
17 include the -- continue to include the
18 appropriateness of Staff's approach as compared to
19 the standard approach, and they would also include
20 the level of allowance under the cash basis as to
21 whether it should be the most recent year, the
22 last five, the last ten, or some type of forecast
23 of the near term future.

24 Q You've been involved in -- you've
25 been involved in a number of rate proceedings

1 where the standard approach has been proposed by
2 both sides. Is that true?

3 A The vast majority of the proceedings
4 that I've been involved in, that was the instance.

5 Q What's your sense of the level of
6 contention or the level of disputes or potential
7 disputes that existed in those cases versus cases
8 like this where Staff has proposed this cash or
9 expense based method?

10 MR. SCHWARZ: I'm going to object.
11 I'm not sure how that relates to any questions
12 that were asked either on cross or direct, and I
13 certainly think it calls for speculation on the
14 part of this witness.

15 MR. LOWERY: Your Honor,
16 Commissioner Clayton specifically asked Mr. Stout
17 whether or not if the standard approach was
18 adopted, whether in effect that would remove the
19 contest related to these net salvage issues, but
20 reduce those, and followed up with questions that
21 suggested that perhaps it might or might not.

22 And my question goes to whether or
23 not, in his experience, when the standard approach
24 has been in place by both Staff and the utilities
25 in a particular jurisdiction, whether, in fact, we

1 do see a reduction in the level of contest, the
2 complication of the issues. It's directly related
3 to the questions that Commissioner Clayton asked
4 Mr. Stout.

5 MR. SCHWARZ: I don't believe so.
6 Obviously, if -- if both parties are using the
7 same approach, there's no conflict on the
8 approach. I don't think Commissioner Clayton's
9 question went to that.

10 JUDGE DIPPELL: Mr. Lowery, would
11 you repeat your question for me?

12 MR. LOWERY: I'll do my best. In
13 your experience, when both sides -- if you're in a
14 jurisdiction where both sides use the standard
15 approach, the standard approach is in place, the
16 Staff comes in, for example, and uses the standard
17 approach in its depreciation rates, the company
18 does the same, there may be variations in the
19 actual depreciation rates that they each recommend
20 because there are some variations in average
21 service lives and other things, but, in your
22 experience, when that set of circumstances exists,
23 what is the level of contest, the level of
24 contention, the number of disputed issues that
25 you've seen as opposed to the proceedings that

1 you've been involved in when Staff proposes one
2 method and the companies propose a different
3 method? For example, the cash method versus the
4 standard approach.

5 JUDGE DIPPELL: Okay, I'm going to
6 overrule your objection, Mr. Schwarz. I believe
7 it does relate to questions that Commissioner
8 Clayton asked; furthermore, I think he has maybe
9 changed the question just a little bit to say, in
10 your experience, what is the level of contention.
11 So I'll let the witness answer that.

12 THE WITNESS: It's been my
13 experience that in proceedings involving
14 depreciation, when the only issues are the
15 parameters to be used, that is, the average
16 service life and the net salvage percent, that
17 there is far less litigation related to those
18 differences, that they can often result in a
19 settlement.

20 Whereas when the depreciation issue
21 is a matter of principle, such as the standard
22 approach versus Staff's approach or perhaps the
23 use of whole life versus remaining life
24 depreciation or the use of the equal life group
25 procedure as opposed to the average life group

1 procedures, that those differences in principle
2 create far more contention in litigation on the
3 issue.

4 Q (BY MR. LOWERY) Would it be your
5 opinion, then, that a decision in this case that
6 would adopt the standard approach would give
7 greater certainty to both parties in terms of the
8 rate making process in general as it relates to
9 depreciation?

10 A That would be my hope.

11 Q I think Commissioner Clayton
12 discussed with you use of the standard approach,
13 and you -- you were, I believe, confident that it
14 had been used in Missouri, at least back to the
15 1960s and probably beyond. Staff also used the
16 standard approach in 1997, did they not?

17 A Yes, they did.

18 Q And that was recommended by Mr.
19 Gilbert in the 1997 MoPub case?

20 A Yes, it was.

21 Q And the standard approach was
22 followed by this Commission in the 2001 case
23 involving St. Louis County Water; is that correct?

24 A Yes, it was.

25 Q How is depreciation of net salvage

1 accrued on Union Electric's books? Is it in
2 accordance with the standard approach or in
3 accordance with the Staff's approach?

4 A Standard approach.

5 Q How was it accrued prior to 1998,
6 1999, when this current rate case came about on
7 Laclede's books?

8 A In accordance with the standard
9 approach.

10 Q Commissioner Clayton asked you about
11 some testimony that Mrs. Schad gave in, I believe,
12 her supplemental rebuttal testimony on page 13,
13 line 6, and I think the premise of Mrs. Schad's
14 testimony was that there isn't data that shows
15 that the estimates of net salvage that we use
16 exactly match the actual experience later. Do you
17 remember that?

18 A Yes.

19 Q Is there anything different about
20 the estimates used in determining the net salvage
21 percentages under the standard approach and the
22 many other estimating -- estimates that are used
23 in the rate making process at this and other
24 commissions?

25 A I think that the -- the difference

1 is that the estimates of net salvage are far more
2 conservative estimates than others in the rate
3 process. All one has to do is look at the
4 historical data as shown in Schedule 1 attached to
5 Mr. Codaman's surrebuttal testimony to see that
6 the net salvage cost as a percent of the original
7 cost retired had been increasing regularly over
8 time.

9 And given the average age of those
10 historical retirements as compared to the far
11 greater age of the future retirements, that that
12 trend will continue, and, therefore, estimates
13 based on those historical indications tend to
14 understate, which I have called conservative, the
15 future level of net salvage costs.

16 Q I think Commissioner Murray asked
17 you some questions about intergenerational equity,
18 and I'm pretty sure that Commissioner Clayton did
19 as well. In your opinion, is it more or less
20 equitable to use the best available data and
21 judgment in estimating techniques that you have to
22 estimate the future net salvage as opposed to not
23 attempting to estimate it at all?

24 A It is by far more equitable to make
25 the very best estimate you can of the future net

1 salvage and ratably accrue towards that as opposed
2 to ignore it and accrue only what's currently
3 being experienced.

4 In doing so, if Staff's approach is
5 used, the value of the service that's being
6 received by customers today from that plant is
7 going to be borne by tomorrow's customers when it
8 is retired. Further, today's customers are
9 receiving a return benefit for the past service
10 rendered to past customers.

11 In Staff's approach, nothing is
12 being asked from today's customers. It's all
13 being taken from the past customers or transferred
14 to tomorrow's customers.

15 In my view, Staff has changed
16 courses in midstream in switching from the accrual
17 method to the cash method, and when you're dealing
18 with long life utility property, it's far more
19 equitable to have a consistent approach over that
20 property's life. That requires us to make
21 estimates of what that net salvage will be and
22 accrue towards it as opposed to stick our heads in
23 the sand.

24 Q A number of Commissioner Clayton's
25 questions, in fact, I think a lot of your

1 discussion with Commissioner Clayton today focused
2 on WMS 1 and the discussion about the current
3 level of accruals versus the recent actual net
4 salvage experience, and you discussed with him the
5 revenue requirement impact of the offset to rate
6 base. Do you recall that rather lengthy
7 discussion?

8 A Yes.

9 Q Does Schedule WMS-2 shed any light
10 on those same issues?

11 A Schedule WMS-2 is an illustration of
12 what I was talking about. Schedule WMS-2 shows
13 that even though the annual depreciation
14 throughout the life of the example asset remains
15 higher under the standard approach than under
16 Staff's approach, that the total revenue
17 requirement is in total much less under the
18 standard approach and is less on an annual basis
19 beginning in this example in year eight out of a
20 20 year life.

21 So that the -- the standard
22 approach, even though the annual accrual amount is
23 greater than the annual depreciation amount under
24 Staff's approach, the total revenue requirements
25 are much less and are less on an annual basis

1 relatively early in the life of an asset.

2 Q And this case began in 1999; is that
3 your understanding?

4 A Yes.

5 Q So to the extent this example
6 represents -- is a proxy for what might happen in
7 this case, by 2006, 2007, that crossover very well
8 might take place?

9 A It would occur in 2006.

10 MR. LOWERY: That's all I have.

11 JUDGE DIPPELL: Thank you. Mr.

12 Zucker, you had some further redirect?

13 MR. ZUCKER: Yes, Your Honor. I
14 will try not to repeat anything Mr. Lowery just
15 asked.

16 REDIRECT EXAMINATION BY MR. ZUCKER:

17 Q Good morning, Mr. Stout.

18 A Good morning.

19 Q Yesterday Mr. Schwarz asked you if
20 you ever tracked net salvage cost for a single
21 vintage to be sure that the net salvage accruals
22 match the actual net salvage costs. Do you recall
23 that?

24 A Yes, I do.

25 Q And you stated that you have not

1 done that, nor can it be done. Is that correct?

2 A Yes.

3 Q And why can't you perform such an
4 analysis for a vintage?

5 A The analysis suggested by Mr.
6 Schwarz cannot be conducted for a single vintage
7 because it's not practical to track net salvage
8 costs at the vintage level. Net salvage costs are
9 incurred for specific job orders or work orders in
10 the field that involve multiple vintages of plant,
11 and the cost of removal or cost of retiring that
12 plant is only recorded for that entire work order.

13 And so it would require an
14 additional process of allocating such costs to
15 vintages in order to track it at that level, plus
16 it would require tracking depreciation accruals at
17 the vintage level. I don't believe that's
18 practical.

19 What is practical, and I believe
20 provides sufficient safeguards to the rate payer,
21 is to do such tracking at the account level. We
22 do track the accumulated depreciation at the
23 account level. We accumulate the accruals related
24 to original cost of net salvage, we accumulate the
25 original cost retired and the net salvage costs

1 related to it, and regularly monitor and measure
2 whether or not that is on track with our current
3 estimates of average service life and net salvage
4 percents.

5 Q And out of these analyses, is that
6 where your testimony came from that your
7 experience has been that net salvage accruals have
8 actually conservatively understated actual
9 experience?

10 A Yes.

11 Q Yesterday you and Mr. Schwarz also
12 discussed the issue of whether -- until you file a
13 rate case, the customer -- until the utility files
14 a rate case, the customer doesn't get the benefit
15 of the lowered rate base. Do you recall that?

16 A Yes.

17 Q And you added that the customer also
18 doesn't pay for added capital until that happens.

19 A I did.

20 Q And Mr. Schwarz responded that there
21 is an IS -- an opportunity to have an ISRS where
22 some of that capital can be recovered. Do you
23 recall that?

24 A Yes, I do.

25 Q Are you aware that under the ISRS

1 statute, in order to maintain the ISRS, you must
2 file a rate case within three years?

3 A I am now.

4 Q Okay. Commissioner Murray asked you
5 some questions about the original 1999 case and
6 what were Staff's concerns in that case that led
7 them to -- led them to advocate the Staff method.
8 Do you recall that?

9 A Yes.

10 Q And I believe your response was that
11 the Staff's concern was that net salvage accruals
12 were greater than actual net salvage costs.

13 A Yes.

14 Q And does that surprise you that that
15 would be a concern?

16 A Yes, it does. I think it shows a
17 lack of understanding of the depreciation model,
18 and a lack of understanding of the impacts that
19 growth and inflation can have on that model.

20 That just as the additions to the
21 plant today are far greater than the amount of
22 original cost that's being reflected in the
23 depreciation accrual, in the case of Laclede, the
24 addition of 50 million as compared to the
25 depreciation of original cost of approximately 20

1 million, the flip side of that is that the
2 accruals for future net salvage costs are greater
3 than the current net salvage costs being incurred.

4 Q So given system growth and
5 inflation, you would expect that net salvage
6 accruals under the standard method would exceed
7 the current net salvage costs?

8 A Absolutely.

9 Q And so that's not a flaw in the
10 standard method?

11 A Not at all.

12 Q And no reason to depart from the
13 standard method?

14 A Not in my view.

15 Q You also discussed with Commissioner
16 Murray, Mr. Codaman's, Laclede Witness Codaman's
17 surrebuttal Schedule 1 on page 3. Do you recall
18 that?

19 A Yes, I do.

20 Q And that is a -- it appears to be a
21 study of the percent net salvage for steel
22 services?

23 A Yes, it is.

24 Q And is this study based on actual
25 amounts?

1 A Yes, it is.

2 Q So this is actual data?

3 A It is the actual net salvage costs
4 incurred by Laclede, expressed as a percent of the
5 original cost retired in the same year that the
6 net salvage costs were incurred.

7 Q And these are not estimates?

8 A No.

9 Q This morning you discussed with
10 Commissioner Clayton the USOA accounts. Do you
11 recall that?

12 A Yes.

13 Q And you said that USOA does require
14 accrual of current client for net salvage?

15 A Yes.

16 Q And the standard method does that?

17 A Yes. That's the standard approach
18 to accrue for net salvage during the life of the
19 related asset.

20 Q And does Staff's method do that?

21 A No. The Staff's method is a cash
22 basis.

23 Q So Staff's method is not in
24 conformance with USOA?

25 A It is not.

1 Q This morning you and Mr. Schwarz
2 also discussed Exhibit 146. Do you recall that?

3 A Yes, I do.

4 Q And Mr. Schwarz said that if -- and
5 you said that given no previous history, you would
6 have to try to make your best estimate on what a
7 net salvage accrual should be.

8 A Yes, I did.

9 Q And Mr. Schwarz asked would you
10 expect Staff to make that estimate.

11 A And my response was no, under
12 Staff's cash basis approach, there would be no
13 recognition of net salvage costs on that asset
14 until after it was retired.

15 Q But would you support Staff making
16 such an estimate?

17 A I would support Staff's making an
18 estimate of the future net salvage for that asset
19 and ratably accruing it during its life.

20 Q And, in fact, that would be a return
21 to the standard approach?

22 A Yes, it would.

23 Q Finally, you talked with Mr. Schwarz
24 about an issue we just touched on a minute ago,
25 that until there's a rate case, there's a delay in

1 credit to customers for their accruals that
2 decrease the rate base.

3 A Yes.

4 Q And Mr. Schwarz asked that if there
5 were no rate cases, then such credit would be
6 delayed.

7 A He did ask that, yes, and it would.

8 Q Do you recall that Mr. Adam's
9 testimony in the 1999 case, adopted by Ms. Schad
10 here, was premised on the fact that Laclede Gas
11 filed regular rate cases?

12 A Yes, it was. His expectation was
13 that there would be a regular adjustment of the
14 cash basis amount being allowed.

15 Q If there -- if there were not rate
16 cases regularly filed, which approach would you
17 say is preferable? The standard approach or
18 Staff's approach?

19 A The standard approach is far
20 preferable in that it would, first off, provide
21 for net salvage much closer to the appropriate
22 ratable level; but, secondly, and perhaps more
23 importantly, it would do so by recording those
24 accruals to the accumulated depreciation, tracking
25 those accruals, and ensuring that the total

1 accruals would match the total costs at the end of
2 life.

3 MR. ZUCKER: Thank you very much,
4 Mr. Stout.

5 JUDGE DIPPELL: Thank you, Mr.
6 Stout, I believe that's all the questions for you,
7 and you may be excused. We appreciate your
8 testimony.

9 THE WITNESS: Thank you, Your Honor.

10 JUDGE DIPPELL: Okay. Let's take
11 care of just a few housekeeping things before we
12 move on to the next witness, and that was that Mr.
13 Pendergast and Mr. Lowery gave me copies this
14 morning of the things I marked as exhibits during
15 opening statements and in the testimony.

16 And so I'm going to ask -- I believe
17 they also distributed copies to each of the
18 parties. And I just want to ask, on Exhibit 146,
19 if -- if everyone is in agreement that that's an
20 accurate reproduction of Exhibit 146 as it appears
21 on the large note pad in front of the hearing
22 room, and, if so, we'll use that as the official
23 Exhibit No. 146 in the record. Does anyone have
24 any objection to that?

25 MS. O'NEILL: No.

1 JUDGE DIPPELL: All right. And also
2 I will give you all a little advance warning. I
3 am going to have to leave tomorrow at about 10
4 o'clock, and if we're still going at that point,
5 one of the other judges will take over presiding
6 on the hearing. And so in order to try to get in
7 as much as we can, we may stay a little bit late
8 tonight if -- if the court reporter is able and
9 that is agreeable. We also may start earlier on
10 Friday, we may start at 8 instead of 8:30.

11 All right. Then I think we're ready
12 for the next witness, which is Laclede's witness,
13 Mr. Sherwin?

14 (Witness sworn.)

15 R. LAWRENCE SHERWIN, testified as follows:

16 DIRECT EXAMINATION BY MR. PENDERGAST:

17 Q Mr. Sherwin, would you please state
18 your name and business address for the record?

19 A R. Lawrence Sherwin, 720 Olive
20 Street, St. Louis, Missouri, 63101.

21 Q And are you the same R. Lawrence
22 Sherwin who has previously caused to be filed in
23 this proceeding supplemental direct testimony
24 consisting of 23 pages that has previously been
25 marked as, I believe, Exhibit 138?

1 A I am.

2 Q Do you have any corrections to make
3 to your supplemental direct testimony?

4 A I have two corrections on page 3.
5 The first is the very first line there is a
6 caption B period, which is a word processing error
7 that shouldn't be there, that's just a
8 continuation of the sentence from page 2. So
9 delete the B at the first part of line 1 on page
10 3.

11 The second item on that page is on
12 line 21, the word "method" should be
13 "explanation."

14 Q Do you have any further corrections?

15 A No.

16 Q With those corrections, if I were to
17 ask you today the same questions that appear in
18 your supplemental direct testimony, would your
19 answers be the same?

20 A Yes.

21 Q And are those answers true and
22 correct, to the best of your knowledge and belief?

23 A Yes.

24 MR. PENDERGAST: With that, I would
25 offer 138 into evidence, and I would tender Mr.

1 Sherwin for cross examination.

2 JUDGE DIPPELL: Are there any
3 objections to Exhibit No. 138?

4 MS. O'NEILL: No.

5 JUDGE DIPPELL: All right, then, I
6 will admit Exhibit 138 into evidence.

7 Is there cross examination from
8 Ameren UE?

9 MR. BYRNE: No, Your Honor.

10 JUDGE DIPPELL: Public Counsel?

11 MS. O'NEILL: Thank you.

12 CROSS EXAMINATION BY MS. O'NEILL:

13 Q Mr. Sherwin, you almost got away
14 with me not asking any questions, but then you
15 changed one of your words on page 3 and it raised
16 a question for me.

17 You say, according to the correction
18 that you just made -- I'll ask you to refer to
19 your page 3, that sentence that begins on line 19,
20 and the change that you made is on line 21, about
21 no judicially acceptable explanation has yet been
22 provided as to why a departure from the standard
23 method for addressing this matter is appropriate
24 or reasonable. Do you see that?

25 A Yes.

1 Q When you say, no judicial
2 explanation has yet been provided, is it your
3 opinion that courts that have looked at this
4 decision have rejected it on the merits?

5 A It's my understanding that the
6 courts have not accepted the reports and orders in
7 this case and remanded those orders in succession
8 back to the Commission.

9 Q And you understand that none of
10 those orders have been orders on the merits
11 regarding the issue? Do you know what that means?

12 MR. PENDERGAST: I'm going to
13 object. I think that calls for a legal
14 conclusion.

15 JUDGE DIPPELL: I will sustain that.

16 MS. O'NEILL: Your Honor, if I can
17 be heard. He's making a legal conclusion in his
18 testimony, and I'm just trying to check the basis
19 for it. Perhaps it would be more advisable if
20 that sentence was just removed from his testimony.
21 Then I don't have any other questions.

22 I would move to strike the sentence
23 that begins on page 3, line 19 of Exhibit 138, and
24 ends at the word "reasonable" on line 23 as a
25 legal opinion that, according to Mr. Pendergast,

1 this witness isn't qualified to make.

2 JUDGE DIPPELL: Mr. Pendergast, do
3 you have a response?

4 MR. PENDERGAST: Yeah. I -- my
5 response to that would be that we are here because
6 the Court has told the Commission that they have
7 not yet explained -- or were provided a suitable
8 explanation for why they did what they did in this
9 particular case.

10 I think that's a clear enough and
11 reasonable enough hallmark of an understandable
12 judicial pronouncement, since we wouldn't be here
13 without it, that Mr. Sherwin can at least opine on
14 that.

15 JUDGE DIPPELL: I don't believe that
16 the witness in that sentence is giving a legal
17 conclusion. I think he's -- it says, where no
18 judicially acceptable explanation has yet been
19 provided as to why a departure from the standard
20 method for addressing the matter is appropriate or
21 reasonable. I don't see that as a legal
22 conclusion, so I'll allow it.

23 MS. O'NEILL: Okay. My concern,
24 Your Honor, just to make the record clear, is that
25 he's talking about and referring to that last

1 portion of the sentence that you just read, a
2 judicially acceptable explanation, but when I ask
3 him what he means by that, I get an objection that
4 he's not qualified to answer.

5 JUDGE DIPPELL: You didn't ask him
6 what he meant by that, that wasn't your question.
7 So if you ask him what he means by that, I'll
8 allow him to explain.

9 Q (BY MS. O'NEILL) Can you please
10 tell me what you mean by no judicially acceptable
11 explanation?

12 A Yes. I think, as I just stated, the
13 reports and orders that have been successively
14 issued in this case have each been remanded back
15 to the Commission.

16 Q And is it your understanding they
17 were remanded with any particular direction
18 regarding how this issue should be decided?

19 A No, I don't recall that that was
20 part of the remand.

21 MS. O'NEILL: No further questions.

22 JUDGE DIPPELL: Is there cross
23 examination by Staff?

24 CROSS EXAMINATION BY MR. SCHWARZ:

25 Q Mr. Sherwin, if the Commission

1 adopts Staff's approach in this proceeding, will
2 Laclede accept that and observe it in its future
3 rate cases?

4 A I -- I'm not authorized to say
5 either way what our future rate filings may
6 contain.

7 Q But your position is Assistant Vice
8 President, regulatory administration?

9 A Yes.

10 Q And you don't --

11 A You're asking can I commit now how
12 I'll file future rate cases.

13 Q Yes.

14 A And what I'm saying is I'm not
15 authorized to commit to a particular method for
16 future rate cases.

17 Q Well, what will your recommendation
18 to the Company be?

19 A Should the -- should the Commission
20 continue to use the Staff approach in this case, I
21 would recommend that we would continue to fight
22 that.

23 Q And do you have an opinion, of the
24 persons to whom you report, do you have an opinion
25 as to what their position might be?

1 A I would be surprised if they would
2 accept that without fighting it.

3 MR. SCHWARZ: On page 13 --
4 nevermind. Nevermind. I think that's all I have.

5 JUDGE DIPPELL: Okay. Mr. Sherwin,
6 I'm sure that there are some Commission questions
7 for you; unfortunately, the Commissioners are in
8 their regularly scheduled agenda meeting. So what
9 I will do is go ahead and ask if there's any
10 redirect based on regular cross examination, and
11 then we'll bring Mr. Sherwin back if there are
12 Commission questions and go through the recross
13 and redirect again on that.

14 THE WITNESS: That would be fine
15 with me.

16 JUDGE DIPPELL: Mr. Pendergast?

17 MR. PENDERGAST: I just have about
18 five minutes of redirect.

19 JUDGE DIPPELL: Okay.

20 REDIRECT EXAMINATION BY MR. PENDERGAST:

21 Q Mr. Sherwin, you were asked some
22 questions by Mr. Schwarz about whether or not the
23 Company would continue to oppose Staff's method in
24 the event that the Commission were to adopt it as
25 a result of this proceeding. In giving that

1 particular answer, you're aware that the Company
2 has attempted to seek judicial review of this
3 issue for five years; is that correct?

4 A Yes, I am.

5 Q And did you mean to imply by your
6 answer that the Company would not be abrogating
7 its rights or relinquishing its rights to continue
8 to seek judicial review if it disagreed with the
9 Commission's order?

10 A No, I didn't think his question
11 related to whether we would appeal the case in
12 question. I was answering it about another case.

13 Q Okay. Well, assume for me that the
14 Commission adopted Staff's approach, we appealed
15 it, the Court said that the Commission's adoption
16 of that Staff's approach was fine. In your view,
17 would Laclede be more likely to follow that
18 approach in the future under those circumstances?

19 A More likely yes.

20 MR. PENDERGAST: Thank you.

21 JUDGE DIPPELL: Okay. Thank you,
22 Mr. Sherwin, I'll let you step down for now, but
23 I'll ask you to remain to be recalled later.

24 THE WITNESS: Sure.

25 JUDGE DIPPELL: Thank you. I guess

1 we can move ahead, then, with Ameren's next
2 witness, Mr. Lyons.

3 (Witness sworn.)

4 MARTIN J. LYONS, JR., testified as follows:

5 DIRECT EXAMINATION BY MR. BYRNE:

6 Q Could you please state your name?

7 A My name is Martin J. Lyons, Jr.

8 Q And, Mr. Lyons, are you the same
9 Martin J. Lyons, Jr. that caused to be filed in
10 this proceeding supplemental direct testimony
11 that's been marked as Exhibit 139?

12 A I am.

13 Q And do you have any corrections to
14 make to that prefiled testimony?

15 A I do not.

16 Q And is the information contained in
17 that prefiled supplemental direct testimony true
18 and correct, to the best of your knowledge and
19 belief?

20 A Yes.

21 Q And if I was to ask you the
22 questions contained in that prefiled testimony
23 when you're under oath here today, would your
24 answers be the same?

25 A Yes, they would.

1 MR. BYRNE: Your Honor, I'd tender
2 Exhibit 139 -- or offer Exhibit 139, and tender
3 Mr. Lyons for cross examination.

4 JUDGE DIPPELL: Are there any
5 objections to Exhibit No. 139?

6 MS. O'NEILL: No, Your Honor.

7 JUDGE DIPPELL: All right. Then I
8 will receive Exhibit 139 into evidence, and ask if
9 there's any cross examination from Laclede?

10 MR. ZUCKER: No, Your Honor.

11 JUDGE DIPPELL: Office of Public
12 Counsel?

13 MS. O'NEILL: Thank you.

14 CROSS EXAMINATION BY MS. O'NEILL:

15 Q Mr. Lyons, you're not employed by
16 Laclede Gas Company?

17 A I am not.

18 Q Have you ever been employed by them?

19 A I have not.

20 Q Have you ever performed any
21 depreciation studies for Laclede Gas?

22 A I have not.

23 Q Have you ever, other than in this
24 proceeding, have you ever filed testimony on
25 behalf of Laclede Gas on issues regarding

1 **depreciation or net salvage?**

2 A No, I have not.

3 MS. O'NEILL: Have you reviewed --
4 strike that. No further questions.

5 JUDGE DIPPELL: Thank you. Staff?

6 CROSS EXAMINATION BY MR. SCHWARZ:

7 Q **Good morning, sir.**

8 A Good morning.

9 Q **Are you familiar with a statement of**
10 **financial accounting standard No. 143, accounting**
11 **for asset retirement obligations?**

12 A Yes, I am.

13 Q **What is an ARO?**

14 A An asset retirement obligation as
15 defined by FAS-143 is a legal obligation to expend
16 moneys in the future related to asset retirement
17 obligations.

18 Q **Are -- what's a liability?**

19 A A liability is a requirement to
20 expend cash in the future.

21 Q **Are AROs liabilities?**

22 A Yes, they are.

23 Q **Does UE currently have AROs?**

24 A Yes, it does.

25 Q **What are they?**

1 A They are obligations to expend cash
2 in the future for the retirement of assets.

3 Q Are you finished?

4 A Yes. That's adequate.

5 Q Specifically what -- what are the
6 AROs that UE has reported?

7 A Oh, I'm sorry, I don't think I
8 understood your question earlier. Examples of
9 AROs would be our obligation to decommission the
10 Callaway nuclear plant at the end of its life. We
11 have certain other asset retirement obligations as
12 defined by FAS-143 related to obligations to
13 remove certain structures like water intake
14 structures at power plants at the end of their
15 lives.

16 MR. SCHWARZ: May I approach the
17 witness?

18 JUDGE DIPPELL: Yes.

19 Q (BY MR. SCHWARZ) Mr. Lyons, I have
20 handed you three sheets of paper which I will
21 suggest are portions of Ameren's 2003 annual
22 report. Would you take a look at those pages for
23 me?

24 A I'm familiar with the pages.

25 Q Thank you. These pages -- the

1 second two pages suggest that an accounting
2 reclassification was made. Would you agree with
3 that?

4 A That is correct.

5 Q Is the \$694 million at December 31
6 of 2003 Union Electric's estimate of its rate
7 collections to date for net salvage that it has
8 yet to expend?

9 A That is an estimate that was
10 prepared at the time we adopted FAS-143, and it
11 relates to all of Ameren's rate regulated
12 entities.

13 Q Well, how much of that amount is
14 Missouri jurisdictional?

15 A Approximately 400 million. I'd like
16 to note that that reclassification was only made
17 for SEC reporting purposes. The pages that you
18 have taken here are from Ameren's annual report to
19 shareholders which conforms to SEC reporting
20 requirements. A similar reclassification was made
21 in our FERC Form 1 filing, it was made with the
22 Federal Energy Regulatory Commission.

23 MR. SCHWARZ: Fair enough. I would
24 ask that this document be marked as an exhibit and
25 entered into the record.

1 JUDGE DIPPELL: We'll mark that as
2 Exhibit No. 147. Would there be any objection to
3 Exhibit 147?

4 MR. BYRNE: No, Your Honor.

5 MS. O'NEILL: No objection, but I
6 would like to get a copy of it.

7 MR. SCHWARZ: Oh, I'm sorry.

8 JUDGE DIPPELL: All right. I will
9 admit Exhibit No. 147.

10 Q (BY MR. SCHWARZ) What is the
11 current average depreciation rate applicable to
12 all of UE's depreciable plant?

13 A Well, the rates vary by property
14 group, but generally they're in the 2 to 4 percent
15 range.

16 Q Do you know what the corresponding
17 average composite service life of UE's plant is?

18 A Well, that would translate into an
19 average life of 30 to 35 years, I suppose.

20 Q Okay. With respect to the net
21 salvage issue, can you tell me the approximate
22 value of the difference in revenue requirement
23 between the Staff and UE in the last earnings
24 complaint case?

25 A Not off the top of my head, I

1 cannot.

2 Q If the Public Service Commission
3 adopts Staff's approach in this case, will Union
4 Electric accept and observe that, for instance, in
5 the pending Empire rate case?

6 A I cannot solely make that
7 determination. I would -- could -- could you
8 repeat the question?

9 Q I'll rephrase it, if I might. If
10 the PSC reaffirms or adopts the Staff's approach
11 in this case, will you recommend to Union Electric
12 that it accept that approach for purposes of its
13 intervention in the Empire rate case?

14 A I would not. I believe that my
15 testimony speaks to my belief that the standard
16 method is the most appropriate method for the
17 recognition of retirement costs for net salvage
18 costs as we've discussed in this hearing. My
19 personal recommendation would be to continue to
20 support and recommend the standard approach.

21 Q And would it be -- is it your
22 opinion, if you have one -- well, what is your
23 opinion of the position of those to whom you
24 report, should the PSC adopt the Staff's approach
25 in this case?

1 MR. BYRNE: I'm going to object to
2 the question because it calls for speculation.

3 MR. SCHWARZ: I asked for his
4 opinion. If he has one. Of those to whom he
5 reports.

6 MR. BYRNE: He obviously can't know
7 what other people think on a --

8 MR. SCHWARZ: I understand that. I
9 didn't ask him what other people think. I asked
10 him of his opinion.

11 JUDGE DIPPELL: You're asking him of
12 his opinion of what his superiors believe?

13 MR. SCHWARZ: Of what they will do.

14 MR. BYRNE: That's even more
15 speculative than what they believe.

16 MR. SCHWARZ: Well, I asked him if
17 he has an opinion. And whether or not he has an
18 opinion is not speculative. Let me rephrase --

19 JUDGE DIPPELL: I will let him tell
20 you if he has an opinion, but I will not let him
21 tell you what he thinks others will do.

22 MR. SCHWARZ: Fair enough.

23 Q (BY MR. SCHWARZ) Do you have an
24 opinion as to what your superiors might do?

25 A I do not.

1 MR. SCHWARZ: That's all I have for
2 Mr. Lyons.

3 JUDGE DIPPELL: Thank you, Mr.
4 Schwarz. Okay. Mr. Lyons, we're in the same
5 situation that we were with Mr. Sherwin. I think
6 some of the Commissioners may have questions for
7 you, so I'm going to hold you for those questions.
8 But for now, we'll go ahead and go to see if
9 there's any redirect based on the cross
10 examination from Laclede? I'm sorry, from Ameren?

11 MR. BYRNE: I don't have any
12 redirect, Your Honor. So far.

13 JUDGE DIPPELL: All right. All
14 right, then, Mr. Lyons, I'll let you step down and
15 ask you to remain to be recalled if there are
16 further Commission questions. Thank you.

17 THE WITNESS: Thank you.

18 JUDGE DIPPELL: Okay. Let's go
19 ahead and take just a five minute break to regroup
20 here, and then we'll go back on the record at 20
21 after. Thank you. We can go off the record.

22 (Off the record.)

23 JUDGE DIPPELL: Let's go ahead and
24 get started again. Okay. Um, I think what we'll
25 go ahead and do is go ahead and go to Miss Schad

1 and wait for all of the Commissioners who may have
2 questions for the other witnesses to come in
3 before we call them back up to the stand. So can
4 we move on, then, to Miss Schad for Staff?

5 MR. SCHWARZ: Yes. I think.

6 (Witness sworn.)

7 JUDGE DIPPELL: Whenever you're
8 ready, Mr. Schwarz.

9 ROSELLA SCHAD, testified as follows:

10 DIRECT EXAMINATION BY MR. SCHWARZ:

11 Q Would you state your name for the
12 record, please?

13 A My name is Rosella Schad.

14 Q And by whom are you employed?

15 A The Missouri Public Service
16 Commission.

17 Q And are you the same Rosella Schad
18 that has caused to be filed and marked as exhibits
19 in this case the supplemental direct testimony and
20 supplemental rebuttal testimony both NP and HC in
21 this case?

22 A Yes.

23 Q Do you have any corrections to make
24 to those prefiled testimonies?

25 A No.

1 Q If I asked you the same questions
2 today as in your prefiled testimonies, would your
3 answers be the same?

4 A Yes.

5 Q Are those answers true and correct,
6 to the best of your information and belief?

7 A Yes.

8 MR. SCHWARZ: I would offer Miss
9 Schad's testimony into the record, and tender her
10 for cross examination.

11 JUDGE DIPPELL: Okay, Ms. Schad,
12 I'll ask you to speak into the microphone a little
13 bit better when you speak.

14 THE WITNESS: Okay.

15 JUDGE DIPPELL: Are there any
16 objections, then, to -- I'm sorry, did you offer
17 both exhibits, Mr. Schwarz?

18 MR. SCHWARZ: Yes, ma'am.

19 JUDGE DIPPELL: Are there any
20 objections to Exhibit No. 140?

21 MS. O'NEILL: No.

22 MR. LOWERY: No objection.

23 JUDGE DIPPELL: Then I will receive
24 Exhibit 140 into the record.

25 Is there any objection to Exhibit

1 No. 141, both the non-proprietary and the highly
2 confidential version?

3 MR. LOWERY: None.

4 MS. O'NEILL: No.

5 MR. PENDERGAST: Your Honor, the
6 only thing that I would note on that is that we do
7 have some objections to testimony that has been
8 submitted that addresses Ameren UE that you have
9 not yet ruled upon.

10 And the only cautionary note I would
11 have is that should that be an unfavorable ruling,
12 which I hope it will not be, that to the extent
13 that there's other testimony that also addresses
14 those kind of items that's been provided by Staff,
15 that she be subject to the same kind of
16 limitations.

17 JUDGE DIPPELL: Okay. Do you have
18 -- can -- can you point me to specific parts of
19 the testimony, or at least more than which --
20 which kind of items are you talking about? Are
21 you talking about where Miss Schad discusses that
22 testimony --

23 MR. PENDERGAST: Other utilities and
24 what other people in other cases have recommended
25 as far as various kinds of depreciation