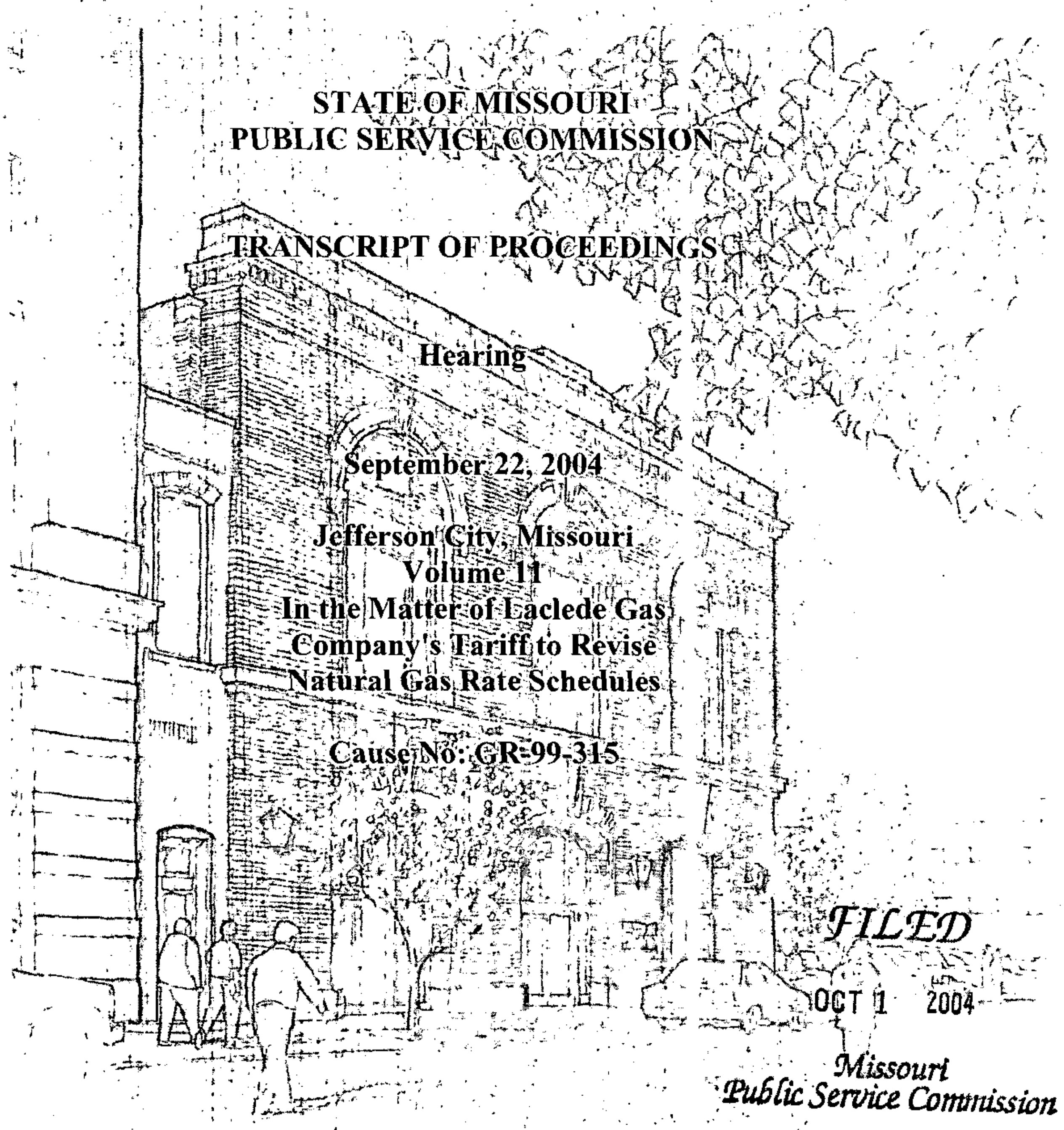

STATE OF MISSOURI
PUBLIC SERVICE COMMISSION

TRANSCRIPT OF PROCEEDINGS

Hearing

September 22, 2004

Jefferson City, Missouri
Volume 11
In the Matter of Laclede Gas
Company's Tariff to Revise
Natural Gas Rate Schedules

Cause No: GR-99-315

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NANCY DIPPELL, Presiding
SENIOR REGULATORY LAW JUDGE
CONNIE MURRAY,
ROBERT M. CLAYTON III,
JEFF DAVIS,
LINWOOD APPLING,
COMMISSIONERS

REPORTED BY: TARA SCHWAKE, RPR, CRR, CSR, CCR

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FOR THE STAFF OF THE MISSOURI PUBLIC SERVICE COMMISSION: (Below, Timothy or Thomas?)

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Deputy General Counsel
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PROCEEDINGS

JUDGE DIPPELL: Good morning. This is Case No. GR-99-315 in the matter of Laclede Gas Company's tariff sheets to revise natural gas rate schedules hearing on remand. I'm Nancy Dippell, I'm the Judge assigned to this matter. And we've come here today to, and for the next couple of days, to gather some additional information on the remand of this case.

We will be beginning, like I say, with Exhibit No. 134, I believe is the next available exhibit number, and I'm going to attempt to go by the order of witnesses and cross examination that the parties have proposed.

I told the parties before going on the record that I may have to leave myself for part of the hearing, and if I do, Judge Ruth will preside over the hearing in my absence.

I'll go ahead and let you begin with your oral entries of appearance. I assume Counsel has already made written entry, so if you want to state your name and who you represent, that's fine. If you want to give your whole address, that's fine, too. Begin with Staff.

MR. SCHWARZ: Tim Schwarz, P.O. Box

360, Jefferson City, Missouri, representing Staff of the Commission.

MS. O'NEILL: Yes, good morning, Ruth O'Neill representing the Office of Public Counsel.

MR. PENDERGAST: Michael C. Pendergast and Rick Zucker representing Laclede Gas Company.

MR. BYRNE: Yes, Your Honor, Tom Byrne and Jim Lowery representing Ameren UE.

JUDGE DIPPELL: And are there any other parties present that wish to make an entry of appearance? We do have some other intervenors that are still officially parties in this case, but they have not been participating in this latest round remand and I see none of them present here today.

So go ahead, are there any preliminary matters that need to be taken up before we go forward? Mr. Pendergast?

MR. PENDERGAST: Yes, thank you, Your Honor. I just wanted to alert you to the possibility that we might have an agreement, subject to some additional discussions, on admitting into the record, subject to subsequent written objections and resolution of those objections by you, the depositions that have been taken of each of the witnesses in this case.

We still have to go ahead and engage in a little bit more discussion before we can say whether or not we'll be able to jointly recommend that to you, but I wanted to alert you to the fact that that's a possibility.

JUDGE DIPPELL: Okay. I always like the sound of -- when I hear "agreement," but the thought of admitting a bunch of entire depositions does not sound very pleasant to me. So I would encourage you to try to limit that -- I mean, if you absolutely think it's necessary to have entire depositions, but, I mean, I was hoping that's why we had the witnesses here, to get -- to get that testimony in and allow people an opportunity to ask questions.

But I wouldn't want myself and the Commissioners and anyone else trying to read this record to have to read entire depositions of all of the witnesses.

MR. PENDERGAST: No, I -- and I -- we certainly understand that, Your Honor.

On the other hand, taking the

depositions was an effort to also cut down on some of the time that we would have to spend going over those various things here in the hearing room, and there has been some discussion as part of the rate case, efficiency round table of utilizing depositions more for that very purpose.

So this was an effort to not only do some discovery, but also sort of head towards that objective as well. But we'll certainly take those into consideration, get back to you on it. Thank you.

JUDGE DIPPELL: Mr. Lowery, did you have a comment?

MR. LOWERY: No, Your Honor.

JUDGE DIPPELL: I will remind you all to try to speak into the microphones when you talk and, if you haven't done so already, to please set your cell phones to vibrate or turn them off or -- and all of your other gadgets and gizmos that'll be making bells and whistles during the hearing. Try to remember to do that when you come in from break, too.

I didn't ask you all to propose an order of opening statements, I sort of assumed we would go in what was the order originally, which was Laclede, Ameren, Public Counsel, and Staff. Is that agreeable? Looks like that's going to work out.

And I understand that Mr. Fetter, one of the witnesses, will not be available until late Thursday or early Friday; is that correct?

MR. LOWERY: That's correct, Your Honor. He's in Georgia at the Georgia Public Service Commission this week and expects to get here sometime Thursday, but it may be later -- late in the day.

JUDGE DIPPELL: Okay. And are there any other witness schedule issues that I need to know about? Everyone else is going to be here?

Okay. Well, we'll try, like I say, to accommodate the proposed schedule, but, you know, we may get to those sooner or slower than anticipated, and depending on where we are in the day and the hearing, I may speed that up or slow that down.

Okay, then, what we'll do is we'll begin with opening statements and then we'll go into the witnesses in the order by the parties, and we'll do order of cross according to the parties' joint filing. And I think that's all we need to take care of.

Now, then, we'll go ahead and go off the record and premark the exhibits, and I will call the Commissioners and have them come down for opening statements. Thank you, we can go off the record.

(Off the record.)

JUDGE DIPPELL: We are ready, then, to begin with opening statements, and we will begin with Laclede.

MR. PENDERGAST: If it please the Commission. I'd like to pick up where I left off in my opening statement five years ago, but a lot has obviously transpired since then. And we are here today to address a depreciation related issue that has been before this Commission in one form or another for over five years, not only in this case, but in cases involving numerous other utilities.

Specifically we're here to address the issue of how did net salvage costs associated with removing or retiring the Company's facilities should be calculated and reflected in rates.

These facilities include mass property units like the mains and services that we install or renew every day to distribute gas to our customers, as well as the vehicles, equipment, and other mass property units that are necessary to provide utility service.

I note that the facilities at issue in this case do not include what are typically called life span facilities which are usually large standalone units, property like Laclede's natural gas holders, or in the case of an electric utility, like generating plants.

Before addressing the issue, I want to put in perspective by wrapping a few numbers around it. You've had some discussion in the testimony already about customers prepaying, if you will, or the Company precollecting for net salvage costs.

And while the traditional method does afford that sort of precollection in order to make sure that costs are equitably and ratably allocated over the life of the property, the fact remains that the Company fronts a lot more in dollars to the customer than the customer fronts to the Company.

To put that in perspective, every year Laclede incurs approximately $50 million in capital expenditures. Now, that's real cash money that Laclede pays out of pocket for the wages and salaries, benefits, equipment, and everything else that's necessary to go ahead and install our facilities.

Of that $50 million that we spend each year, Laclede receives in depreciation approximately 2.5 percent per year, or between 1 and $1.5 million of that back each year.

And even if you look at all of the property that we receive depreciation on from the time we started investing in facilities, it's only $22 million per year, which is significantly less than what we spend in one year to make sure that our system is running and it has the facilities it needs to continue to do so.

As a result of that, we have a rate base of around $700 million. And what that means is since the rate base already is figured on a net basis that has taken into account things like net salvage, precollections, that's where we are at a point in time in the overall amount of money that we've got out there in excess of anything that our customers have provided us in connection with these facilities.

So when you start hearing about who's prepaying what and who's preinvesting what, the numbers show that utilities, and Laclede's not unusual in this regard, have a lot more hanging out there to be collected in the future than the customer has to make sure is spent on capital projects.

So what are net salvage costs and how do they figure in? As I said before, the purpose of depreciation rates, and I don't believe anybody in this room would disagree, is to ratably allocate recovery of a facility over the years if that facility is used to provide service so that customers are charged for the cost of that facility in proportion to the benefits they receive from its use.

So if, for example, we have a main that cost $10,000 to install and has a useful service life of 50 years, depreciation theory would say you should only recover 2 percent, or 150 [sic] of that cost each year. In other words, the utility spends $10,000 of real money today and gets it back over 50 years in increments of about $200 per year.

In order for this time driven

allocation process to work properly, however, it is essential that all of the costs associated with that facility be recognized and spread over its useful life from the very beginning, and that's where the concept of net salvage comes in.

Specifically the net salvage concept recognizes that at the end of a useful life of a facility, there will be certain salvage costs incurred or revenues realized by the utility in taking that facility out of service. In some instances, this salvage amount will be positive.

For example, if a utility has a fleet of trucks that are used to provide service, it can usually sell those vehicles at the end of their useful service life and pick up some money return that exceeds the cost of selling it.

Because this salvage revenue is available at the end of the useful life of the vehicle, traditional or standard depreciation accounting will recognize that the true cost of the vehicle was actually something less than what it originally cost the utility to acquire it.

It will, therefore, factor this positive salvage amount into the calculation of the depreciation rate from the very beginning so that customers who are being served by the vehicle will only pay its true costs.

Most of the facilities to provide utility service, however, have a negative net salvage value. In other words, the cost to retire or take the facility out of service will exceed any value that the facility has at the end of its service life.

For example, in some instances, it's not even feasible to take a main that's no longer being used out of the ground. The costs will still have to be incurred to cap the main and separate it from the remaining part of the system for safety and other reasons.

In other instances, facilities may have to be dug up and moved out of the right-of-way, and in that situation, the labor cost associated with removing the facility will far exceed any scrap value that the main might have.

Once again, under the standard approach, an effort is made to estimate what these costs will be and reflect them in the calculation of the depreciation rates from the start so the customers using the facility will pay its full and true cost over the period that the facility is being used.

And the standard approach does so by looking at reams of historical data showing how the cost to retire various facilities compare to what it originally cost to install those facilities 30, 40, or 50 years ago and expressing that as a percentage of the original cost.

By doing that, the standard method captures how the cost to retire the facility has increased over time. This historically derived relationship is then applied to current facilities to estimate how much it will cost to retire them when they are at the end of their useful service life.

And if it would be helpful, if I could just provide two examples up here on the board of how this works. With your permission, Your Honor?

JUDGE DIPPELL: Go ahead.

MR. PENDERGAST: And this may be a little simplified, but it gets across the general idea.

I talked to you about vehicles before, and let's say that you have acquired vehicles in the past for an average cost of $10,000. But then when it comes time to sell the vehicle, you get a thousand dollars back. Book value, you make that money.

That would be -- equate to a 10 percent positive net salvage amount. So you figure that up and you see that you've got a positive net salvage amount of 10 percent.

Now, when you go later on to look at how you're going to spread out the cost of vehicles at a later point in time, let's say inflation has worked its magic and vehicles now cost an average of $25,000, you're going to take that 10 percent and you're going to go ahead and apply it to that and go ahead and assume, estimate that you'll have a positive net salvage of $2,500.

And so what you will do is instead of allocating, say, $25,000 over five years, you'll go ahead and allocate $25,000 minus $2,500 over five years so that the customer is only paying the cost of that vehicle once this net salvage value is taken into consideration.

If you look at it on the other side, and let's take, for example, a main. Let's say that mains cost $10,000 to install, and it has a

$2,000 removal cost at the end of its service life. That would be a 20 percent net salvage amount.

And, of course, since mains are in the ground and in service for a lot longer than your typical vehicle, inflation's going to have a significantly greater amount of time to operate on that, so you would generally expect it to have a more significant negative net salvage amount.

But you derive your 20 percent negative net salvage amount, which means to recover the entire cost of that and ratably allocate it, you've got to recover not 10,000, but the 12,000 over the 30 or 40 or 50 year useful life.

Now, what you do is you move on a couple decades. Now, instead of having just one main providing service, you've got five mains providing service. And let's say those five mains, instead of costing $10,000 to install, cost $20,000 to install. That's five times 20,000, and you now have $100,000 worth of main.

And what you want to do is you want to say how can I ratably allocate the cost of that main, the full cost of it, over time so that I recapture it and its removal cost from the customers? Well, you determine what's the removal cost going to be? Historical experience has shown you that it's going to be about 20 percent compared to the original cost.

You take 20 percent of the $100,000, that's, I believe, somewhere around $20,000, and what you try and do then is recover $120,000 over the life of the asset. And so by the time the asset is retired and it's out of service, you have recovered a charge to customers the entire cost of that facility, no more and no less. And that in general terms is how it works.

And I think to most folks, that would seem like a pretty reasonable approach. After all, one of the oldest concepts in rate making, or any other pricing structure for that matter, is the customers benefiting from the use of a facility should pay its cost as that facility is being consumed.

That doesn't mean, of course, that you can allocate cost with absolute precision to each customer. You can't do that in any endeavor. But what it does mean, I think, is that regulatory policy should be generally designed to achieve that goal as reasonably as practical, and that's exactly what we believe the standard method of addressing that salvage cost does.

So why do we have an issue? Well, it's because the Staff has chosen to pursue a method for addressing net salvage cost that varies significantly from the standard approach.

In short, Staff's method simply reflects the level of net salvage that has been incurred by the utility in the recent past in connection with facilities that have already been retired and are, therefore, no longer serving customers.

As a result, the Staff's method does not make an effort to estimate or reflect in rates the net salvage cost that decades worth of data, like the examples I was going over there, indicate will be experienced in connection with the retirement of those facilities that are actually providing service today.

And because of that, we end up with current customers paying the cost to retire facilities that were used to serve prior customers; no one paying the cost, at least not now, for the costs that will be incurred to retire the facilities that are serving customers today; and with future customers presumably being required at some distant point many years from now to pay for the cost of retiring facilities that they never used either.

At first blush, that doesn't seem to make a lot of sense. And I would submit to you that the flaws inherent in Staff's method only become more apparent as you look at it more closely.

Indeed, we think there are six major reasons why the standard approach for addressing net salvage cost is vastly preferable to the one proposed by the Staff. They are addressed in my testimony, I will touch on them briefly.

First, there is an abundance of authority that supports the efficacy and the reasonableness of the standard method as a means of determining what level of net salvage costs should be included in rates.

In addition to its long use by this Commission and utilities regulated by this Commission, the standard method is and continues to be used by the vast majority of regulatory jurisdictions in the United States. As a result, the standard method reflects the collective judgment and long experience of a broad array of regulatory authorities regarding how net salvage costs should be handled for public utilities.

Bill Stout, himself has decades of experience in performing depreciation studies and teaching depreciation principles to others, will tell you more about that when he testifies.

In contrast, the Staff method appears to have been developed with very little analysis of its suitability of addressing net salvage cost and without any evidence to show that the standard approach was not producing an appropriate estimate of such costs.

In fact, I think it's because of that flaw that the Commission has found it somewhat difficult over the past five years to provide a judicially acceptable explanation of why it adopted Staff's method.

Now, in response to these criticisms, Staff has attempted to suggest in its testimony that the method it's proposing isn't so new after all, methods like it have been proposed by Staff before, indeed as early as 1990.

The fact is, however, that the

method Staff proposed in 1990 MO cut rate case was significantly different than these proceedings in that it included an allowance for inflation to basically mark up the net salvage cost to an estimated level and kept net salvage as part of the depreciation rate.

Even this less radical departure from the traditional method, however, was ultimately deemed inappropriate by the very Staff member, Mr. Gilbert, who I believe has recently been hired to supervise your depreciation department. And that was in the 1997 case.

Second, Staff's method is premised almost entirely on the proposition that the standard method does not result in an estimate of net salvage cost that's certain enough to be used for rate making purposes, as the evidence in this case will show; however, the standard method is based on decades worth of historical data that captures the impact of inflation and other factors on the net salvage cost incurred to retire facilities.

Indeed, as Mr. Stout has testified from his many years of evaluating scores of depreciation studies, the net salvage estimates arrived under the standard approach understate the level of net salvage costs incurred by utilities since that percentage has been increasing and that increase is somewhat muted by the use of historical data.

Moreover, Mr. Stout goes on to provide a number of real life examples of how this underestimation of net salvage cost occurs using data involving plan accounts at Laclede.

In short, experience has shown that the standard approach produces a very conservative estimate of net salvage costs that, like virtually every other regulatory jurisdiction in the United States of America, you should feel comfortable relying on.

In contrast, by only recognizing the net salvage costs associated with plant that has been retired in the past, Staff's method produces an amount of net salvage cost that, as a matter of mathematical certainty, will not even come close to reflecting the level of the net salvage costs that will be incurred in the future to retire plant that is in service today.

In fact, Staff's method is really nothing more than a wholesale rejection of use of estimates period for this one cost item. A rejection that we believe is based on a series of conclusionary assertions rather than any analysis of the actual quality of the net salvage estimates derived under the standard method.

Staff has said you shouldn't permit the use of net salvage estimates, but, just as it did in the 2001 St. Louis Water Company case, it has not been able to provide you with any evidence showing how or in what way those estimates are flawed.

Nor has Staff provided you with any explanation of why it's inappropriate to use estimates for deriving the relatively modest level of net salvage costs to be reflected in rates, but perfectly acceptable to use estimates in deriving a return on equity, level of pension expenses to be reflected in rates, and most importantly, the estimated service lives that are used to defer recovery of the Company's current capital expenditures over many decades.

I would respectfully suggest that such information has not been forthcoming because there is no real problem with the net salvage estimates derived under the standard approach;

that the only problem we really have is a desire by Staff to lower revenue requirements by selectively applying an entirely different set of criteria to these estimates, and these estimates only, that tend to increase revenue requirement at least over the short term.

Third, to the extent you do have any concerns over whether the estimates used for determining net salvage costs will vary from the actual net salvage costs experienced by the utility, then the standard method is the one you want to go with, given its inherent safeguards.

By including net salvage as a component, it ensures that the utility will never over or under collect its net salvage costs. Or put another way, that the rate payer will never over or under pay for such costs.

This is due to the fact that as a component of depreciation rates, any difference between estimated and actual net salvage experience will be tracked and ultimately reconciled back to zero through periodic adjustments in the depreciation rates.

And in addition to this safeguard, any temporary difference between estimated and actual net salvage costs is also reflected in the depreciation reserve which, in turn, is deducted from the utility's rate base pursuant to standard Commission practice.

As a result, rate payers are compensated at the utility's overall rate of return for the use of their money during those times when the utility's outlay for net salvage costs are less than what has been included in depreciation rates.

In contrast, the Staff's method really has none of these safeguards. Instead, any difference between its backward looking estimate of net salvage costs and actual net salvage costs by the utility are either absorbed by the utility or performed by the customer.

In short, uncertainty is inherent in any method by making certain that there will be winners and losers if estimates do indeed vary from actual experience, while the standard method ensures that everyone will be made whole under such a scenario.

As our witnesses will testify, we think the long-term impact of Staff's method is that there will be losers and losers. Nobody's going to win because of its impact on capital costs.

You've heard a lot about intergenerational equity. We've already talked about why the standard method makes sure that customers pay for the entire cost of the facility, no more and no less as they consume it. I think the intergenerational equity aspects of that, I think the costing principles of that, benefits should flow, and costs are so obvious that I don't need to comment on those further.

Fifth, by grossly understating the net salvage costs associated with the facilities that are in service today, the Staff's method significantly decreases the cash flow supporting the Company's investment in utility facilities.

This reduction in cash flow increases costs for customers in two ways. Number one, it requires that Laclede finance an ever greater proportion of its capital requirements through external financing rather than internally generated funds. Each of these financings impose an added cost on both Laclede and its customers.

And just to give you an example of that, the value of this issue back in 1999 was about $7 million in cash flow. $7 million, and you got to remember this continues to accumulate over six or seven years, it is going to approach the $50 million that we spend on a capital budget in an entire year. So it's not an insignificant impact and it adds up over time.

Second, by contributing to an ongoing decline in the amount of cash available to cover such investment, the Staff's method has a negative impact on whether to invest in Laclede and at what price, and virtually guarantees that Missouri utilities will pay more for debt financing than non-Missouri utilities that are competing for the same investment dollars.

Staff Witness Oligschlaeger has recognized that these are all potential impacts of implementing Staff's approach. Unfortunately, however, they are more than just a hypothetical concern. Laclede and other Missouri utilities have already received downgrades in their credit ratings due in part to the cash flow effects of the Staff's method. And that is an effect, as I said before, that will continue to accumulate and grow ever larger over time unless the Commission takes action now.

Mr. Barry Cooper, our Chief Financial Officer, will be more than happy to answer any questions you have on this important aspect of the issue.

Sixth, because the Staff's method also involves a second step under which rates and cash flow are eventually reduced even further to return moneys that were supposedly collected to recover the level of net salvage costs arrived at under the method, they will tend to exacerbate all of the shortcomings we just described to the detriment of both the utility and the customer.

Finally, Staff has proposed that should you decide that the standard method is the appropriate one for addressing that salvage cost, that you should require that any accrued net salvage amounts be segregated and placed in a separate fund.

The theory is that if rate payers are paying this now, we want to make sure that the money is available later on to actually pay for the net salvage costs that they are being reserved for. We disagree with that recommendation because we believe it is both unnecessary and counterproductive.

Why unnecessary? Well, for Laclede's part, and I'm sure Ameren UE will be able to tell you the same thing, we've been in business for decades and decades and decades, and there has never been an issue of our ability or willingness to meet our public utility obligations in terms of actually removing facilities.

And we submit to you that given that historical record, that this isn't a concern that the Commission should have, and certainly not a concern they should have with Laclede or Ameren UE. The past should be taken as a good indicator.

Why is it counterproductive? Because if you put it in a special fund, you're going to put it in a fund that's going to have relatively safe investments, it's going to have a relatively low return, and you're not going to be able to do that and also deduct it from Laclede's rate base, as you do today, where you give the customer the benefit of our overall return.

So we think that would go ahead and tend to increase costs for customers compared to what the current practice before the Commission is.

And also one of our main concerns is

that because of the reduction in cash flow, Staff's approach has had a negative impact on perceptions of Missouri utilities by rating agencies and others to the extent that you're taking that money and you're putting it in a segregated fund and its use is being restricted.

It's not the kind of free cash flow that is going to go ahead and address that concern and hopefully have a favorable impact on how we're rated and what our cost of capital that must be borne by our customers is.

For all of these reasons, we respectfully request that you find, as the vast majority of regulatory jurisdictions have found, that the standard method for addressing net salvage costs is indeed the appropriate one. Thank you.

JUDGE DIPPELL: Before you sit down, Mr. Pendergast, Commissioner Clayton had a question.

Commissioner Murray, did you have any questions?

COMMISSIONER CLAYTON: I had two legal questions I wanted to pose for the attorneys in these opening statements.

First of all, I wanted you to assess exactly the type of relief we could actually grant in this case. As you mentioned, this case does have some age on it and many of us were doing other things five years ago. So if you could address exactly what relief that we can grant to Laclede specifically; and then if there is other relief or policy issues, if you would address that.

And my second question is, I think I know your answer to this, who carries the burden in between all the parties in making this decision?

MR. PENDERGAST: Certainly I'll be happy to address both of those. As far as the relief that is available for the Commission to provide, I think one thing you could do is you could direct under appropriate circumstances that depreciation rates be changed to reflect the standard method. Obviously, that's the approach that we hope the Commission will take.

I will tell you that from a timing standpoint, unless you increase rates at the same time, changing the depreciation rates alone would have a negative earnings impact on Laclede, and we don't believe that that would be appropriate.

But at the same time, we're not requesting that the Commission increase rates now either. You know, we're willing to wait until an appropriate time, be it our next rate case, to actually go ahead and implement the rates that would be reflective of the net salvage traditional approach. And we think that makes sense for our customers and that makes sense for us.

But what you could do is order that standard approach to be used. We'd know what we were dealing with when we filed our next rate case. It would provide meaningful relief to us, allow us to go to the investment community and say the Commission has revisited this issue and determined that the net salvage approach is appropriate.

Would allow the parties to hopefully save on some resources in the next case because they'd know what the Commission policy would be. And I think for all those reasons, it would be meaningful relief certainly to us.

As far as the second question is concerned, I think I'd like to begin by asking you to repeat it?

COMMISSIONER CLAYTON: Since this case -- I assume this case -- I think this case started as just a general rate increase, did it not? In that sense, who carries the burden of proof of persuasion in -- in pushing either method on this -- on the cost of removal and net salvage issue?

MR. PENDERGAST: Sure. And, Commissioner, I think as a general matter --

COMMISSIONER CLAYTON: I guess part of the reason I ask is because there is a departure from the traditional approach. I guess in light of that, is there a shift in burden or not, or -- you have more experience at this Commission, I think, so if you would just identify that best you can.

MR. PENDERGAST: And that's an excellent question. I think as a general rule, if you're coming in for a rate increase under the statutes, the utility bears the burden of proof to show that whatever it's proposing is just and reasonable.

But I do think that there are instances where there is some shifting of that particular burden, and I think one of those instances is where the Commission is deviating from what we believe is a longstanding policy and pursuing a new approach towards things.

And under those circumstances, I believe that the party who is coming in and proposing that policy change has an obligation to provide cogent, understandable, and compelling reasons as to why the existing policy is no longer reasonable and is no longer the best alternative, and why their particular approach is a better one.

And, furthermore, I believe that the Commission has an obligation to, if it ultimately adopts that departure from policy, to explain in a reasonable and thorough fashion why it has determined that it is an appropriate and superior approach, or at least just as good an approach as the existing policy that it had.

I think the best expression of that is probably the case law at the federal level that has talked in terms of FERC having to engage in reasoned decision making and providing reasoned analysis whenever it departs from a particular policy.

And while it may not be expressed in exactly those terms in Missouri law, I think the requirement to provide adequate funding is fact based on competent, substantial evidence, and to explain your decision in a manner that's understandable to a reviewing board requires the same thing here.

JUDGE DIPPELL: Are there any other questions for Mr. Pendergast? Mr. Davis?

COMMISSIONER DAVIS: Mr. Pendergast, can you cite any cases out there that would support your position with regard to Commissioner Clayton's question regarding what the standard of review would be in this case?

MR. PENDERGAST: I certainly could. I don't have those cases on my fingertips with the cites, but I would be happy to provide that to you if you'll give me a day or so to do so.

COMMISSIONER DAVIS: That's sufficient.

JUDGE DIPPELL: Thank you, Mr. Pendergast.

MR. PENDERGAST: Thank you very much.

JUDGE DIPPELL: Okay, then, Ameren? Make an opening statement?

MR. BYRNE: Thank you, Your Honor.

May it please the Commission. As some of you know, my name is Tom Byrne, and along with my co-counsel, Jim Lowery, I am the attorney representing Ameren UE in this proceeding.

As Mr. Pendergast has already explained, this case involves the net salvage component of depreciation for mass property capital assets. Mass property assets consist of capital items that are added and retired every year such as gas mains, gas service lines, and electric wires, poles, and transformers. Mass property does not include large items such as buildings or electric generation plants.

The subject matter of this case is somewhat technical, and I am not a depreciation expert, so I thought I should take this opportunity to try to explain in non-technical terms exactly what Ameren UE believes that the evidence will show.

Ameren UE believes, first of all, that this case affords the Commission an excellent opportunity to focus its attention on the important policy issue of how net salvage should be treated in a docket where there are no other issues in dispute.

As far as the evidence goes, first of all, we believe the evidence will show that the purpose of depreciation is to allocate the full cost of the capital asset ratably over the asset's useful life so that the costs are allocated to the periods when the asset is used and they are paid by the customers who use the asset, or consume their share of the asset each year.

In other words, if a gas main or an electric pole is in service on average for 50 years, one-fiftieth of the full cost of the asset should be allocated to customers each year.

In this case all of the parties agree that net salvage cost is a component of the cost, and it's the cost of removing the asset from service less any associated net salvage.

Everyone agrees that net salvage costs should be recovered from customers and rates. Where we fundamentally and significantly differ is in what net salvage costs should be collected and when those costs should be collected.

Ameren UE and Laclede advocate the retention of the standard approach for calculating net salvage costs that has been used for decades in Missouri and almost every other jurisdiction in the United States.

Under this approach, depreciation experts developed estimates of the costs that will have to be incurred for net salvage for the utility's existing plant. And the way they do that is they develop these estimates based on a statistical analysis of past retirements of property that produces a very conservative net salvage percent for each plant account.

Then, as Mr. Pendergast explained, this net salvage percent is multiplied by the current plant balance. So you're multiplying it by the plant that's currently in service to derive the amount of net salvage to be included in the depreciation rates.

The Staff's proposed treatment of net salvage, in contrast, does not even attempt to estimate the net salvage costs for the plant that is currently in service. Instead, Staff has simply included in the depreciation formula an average of the raw dollars that are spent for net salvage costs over the past several years associated with plant that's already been taken out of service and no longer is serving customers.

We believe that the evidence will show that the amount of net salvage incurred to retire plant in the past is demonstrably less and far less than the amount of net salvage costs that the utility will have to incur to retire the plant that's currently in service.

And there are basically two reasons for that. One is due to the substantial growth in the asset base that the utilities have experienced over time, and the substantial impact of inflation over the long lives of utility assets.

At the outset, I would like to point out that there are several facts about the Staff's approach that should immediately raise red flags in the Commission's mind.

First of all, the Staff's treatment is not endorsed by any of the authoritative experts in the field of depreciation engineering or any of the authoritative texts on the subject. It is an approach that is far outside the mainstream of experts' views on this issue.

Company Witness Bill Stout, who is a jointly sponsored witness between Laclede and Ameren UE, will be testifying later in this proceeding and he can answer any questions that you may have about that.

Mr. Stout is one of the foremost experts in depreciation in the country. He has spent over 30 years in the field of depreciation, and he is the President of the company that developed the computer program that's used by the Staff and by a lot of utilities, including Ameren UE, to calculate depreciation. He's also a teacher who has taught almost all the Staff depreciation experts and, for that matter, the Company depreciation experts about depreciation.

A second major red flag is that the Staff's proposed approach is inconsistent with the uniform system of accounts. And this is a big red flag in my mind. The uniform system of accounts is a standard set of accounting rules that has been developed and adopted by the Federal Energy Regulatory and a lot of other state commissions, including the Missouri Public Service Commission.

And the idea behind the uniform system of accounts is to put all the utilities on the same footing from an accounting standpoint. And the fact that the uniform system of accounts requires the standard treatment of net salvage and not the Staff's proposed treatment is -- is a clear problem.

Ameren UE's controller, Martin Lyons, will be testifying later in this proceeding, and I encourage you to ask him about the inconsistency between the Staff's approach and the uniform system of accounts.

A third red flag, which Mr. Pendergast and I have both mentioned previously, is the fact that almost all the other jurisdictions in the United States use the standard approach. That would suggest that the collective wisdom of a lot of regulators has taken a look at this issue and decided that the standard approach is correct.

Since the Staff's treatment of net salvage is so completely outside the mainstream, as you might predict, it produces depreciation rates that are far outside the mainstream of those required by other -- for other utilities and other jurisdictions.

And I have -- this is a blowup of a -- of a -- an attachment to Mr. Stout's testimony that was filed in this proceeding, and it -- basically it shows the depreciation rates for gas distribution systems. And the white line in the middle of the -- the middle of the chart is the median depreciation rate. And then the dark blue area around the median is the 25th percentile to the 75th percentile. And the red dots at the bottom of the chart show where the Staff's proposed depreciation rates were for Laclede Gas Company in this case and in a subsequent case.

In this case, GR-99-315, they're at about 2.5 percent, 2.6 percent compared to the median of 3, maybe 3.25 percent; and in the subsequent case, GR-2002-356, it's even lower, approaching the 5th percentile in the country. In the case of electric utilities, the Staff's record is even worse.

MS. O'NEILL: Your Honor, I'm going to object to discussion of electric utilities. This is a gas rate case.

MR. BYRNE: Well, Your Honor, this is an exhibit that's attached to Mr. Stout's testimony, and I -- you know, I think it's appropriate.

JUDGE DIPPELL: I'm going to allow him to discuss it in his opening statement. And if you want to renew your objection when Mr. Stout's testimony is offered, I'll let you do that, Miss O'Neill.

MS. O'NEILL: Thank you.

MR. BYRNE: The Staff's record with regard to electric utilities is similar, but even worse. Again, same kind of chart. The white line is the median at about, oh, maybe 3.3 percent. At Ameren UE's last electric rate case, EC-2002-1, Staff was off the chart, below the 5th percentile in recommending depreciation rates. This is not consistent with what's being done around the country.

Adopting depreciation rates like that would be the equivalent of adopting a return on equity in the neighborhood of 7 percent if the median return on equity in the country, which I think it is, was 11 percent. So that's the equivalent of what Staff is doing here.

Staff will say comparisons with other jurisdictions are not relevant because there could be differences in how utilities account for different things from company to company and from jurisdiction to jurisdiction.

But utilities are generally subject to the same accounting rules, the uniform system of accounts, and any minor differences that might exist do not explain material differences in depreciation rates like those shown on Mr. Stout's charts.

And, moreover, some other jurisdictions -- well, I -- you know, differences in jurisdictions can cut both ways. Some other jurisdictions, for example, allow future test years whereas Missouri has a historical test year. Some other jurisdictions allow plant under construction to be put in rate base. So to the extent there are differences in jurisdictions, the point is they can cut both ways. And we believe these comparisons are very relevant.

Now, the Staff will probably say that it doesn't matter, that the authoritative experts and texts and the overwhelming majority of the other states support the standard approach or that their approach produces results far outside of the mainstream. They will say the Commission must adopt their approach to net salvage simply because it is based on known and measurable past net salvage costs which are the best indicator of net salvage.

But the evidence will show that that contention is simply not true. The net salvage costs that were incurred in the past for items that have already been retired are very poor indicators of the net salvage costs the utility will have to incur to retire property in service today.

And there are two reasons for that, again, the -- that these charts will show. And these two are out of Mr. Stout's testimony. One chart, the chart on the far right, shows one reason that the Staff's calculations don't provide a reasonable estimate of net salvage, and it's the growth of plant.

This chart shows the growth of Ameren UE's distribution plant from 1950 to 2003. In 1950, we had $30 million worth of distribution plant, which is almost zero on the chart, on the scale of the chart. In 2003, we had 3 -- almost $3.5 billion worth of distribution plant. And that's a huge growth in plant.

And the problem is because utility assets are so long lived. There's evidence in this case that the average service life of a gas main, for example, is 70 years. So if you're retiring gas mains in 2000 or 2001 or 2002, those gas mains come out of a universe of plant from the

1920s or 1930s or 1940s that is far, far less than the universe of plant that's in service today.

The retirement costs for those gas mains from the 1920s and '30s and '40s are not representative of the fair amount of retirement costs of today's plant. The amount of plant's just so much greater today.

And part of the issue, too, is inflation. You know, inflation, you know, especially nowadays isn't too much year to year, but when you look at inflation over the long life of a utility asset over 70 years, it accumulates to a huge amount.

And this is, again, a schedule attached to Mr. Stout's testimony. It's a Handy-Whitman index which is a measure of inflation that would apply to -- we believe would apply to retirement or removal of gas plant. And you can see from -- you know, it starts in 1912, and it's, you know, kind of low inflation up until about 1960, and then, boom, it goes off the chart.

And, again, Staff's method by just looking at the raw dollars of net salvage incurred in the past years does not take into account that inflation, and that's why it's not the right amount of net salvage.

Staff will argue that both the Staff's approach and the standard approach rely on historical data, and that's true. You know, our approach does develop net salvage percents, as Mr. Pendergast explained, based on historical data, but we also take into account the growth of plant and the inflation by multiplying that net salvage percent by the current plant balances. That's how ours takes those -- our approach takes that into account. And Staff's doesn't.

Staff will argue that even if statistically based estimates of future net salvage are more reliable than past costs, it is inappropriate to use such estimates in the rate making process simply because they are estimates. However, the evidence will show that the Commission uses similar estimates in the rate making process all the time.

For example, in calculating the depreciation expense, both the Staff and the Company estimate average service lives out 60, 70 years for some types of property. And then it's based on statistical data and expert opinion, just like the net salvage costs are.

In addition, in calculating -- or in developing the return on equity, the Commission historically has used the discounted cash flow method, and that incorporates a lot of estimates of future things. Future growth in earnings for utility companies, future inflation, those are all factors that are considered in the DCF method which is commonly used by the Commission.

The fact is there's nothing wrong with using estimates in the rate making process. But the Staff might say, what if the estimates used in calculating net salvage turn out to be wrong? Which, like all estimates, I -- presumably, they won't be exactly right.

And I guess the beauty of the standard depreciation process is there are some safeguards in effect. Mr. Pendergast touched on these, but I thought I also ought to.

The first safeguard that we've listed in testimony is, you know, to the extent that any net salvage costs are paid by customers in advance of the utility actually paying out the money, there's rate base treatment.

They increase the depreciation reserve and the depreciation reserve is deducted from rate base, and so basically the customers get a return on that advance equal to the overall return earned by the utility. So that keeps them whole to the extent that any money is advanced ahead of time.

Secondly, the second safeguard is there are periodic depreciation studies. The Commission rules require utilities to submit a depreciation study no less frequently than every five years. So to the extent new data comes in, estimates can be refined, there's a procedure in effect every five years to do that. Every five years at least.

Finally, Mr. Pendergast touched on this, the fact that you have a depreciation reserve means that there's a true-up so that the utility will never get any more or any less dollars than it actually expends in the end. There are no winners and losers under the standard approach.

You might ask yourself, what harm is there in adopting the Staff's proposal? After all, it will, in fact, lower rates in the short run. I guess the primary reason we believe you should not adopt the Staff's approach is because it is simply poor regulatory policy.

It violates the fundamental principle of depreciation that customers should pay their fair share of the costs the utility incurs in providing service, including a ratable share of the full cost of capital assets.

The evidence will show that the adoption of Staff's method would cause real harm to utilities, customers, and the State of Missouri in the long run, and that the costs will far exceed any temporary benefits that the Staff's approach might provide.

With regard to customers, which ought to be the Commission's -- maybe the Commission's primary consideration, the evidence will show that customers' rates will be subject to unnecessary instability due to fluctuations in utility retirement activity which occur from time to time.

Moreover, even under the most favorable assumption to the Staff of steadily increasing retirement costs, rates will be higher under the Staff's approach in approximately ten years. And the reason for that is because of the rate base impact of the standard approach. After ten years, the impact on the rate base will more than offset the reduction in depreciation expenses that the Staff's method produces.

Perhaps the aspect of Staff's method that is most damaging to rate payers is its impact on intergenerational equity. Staff only achieves a short-term rate reduction by deferring net salvage costs that are properly allocated to today's customers to future generations of customers. Those future customers will be unfairly penalized by paying net salvage costs that should be paid today.

The impact of Staff's approach on utilities is also severe. The evidence will show that without the cash flows provided by fair depreciation rates, the utilities will have to rely more and more on external sources of capital to finance infrastructure improvements, and the cost of obtaining this capital will increase.

Moreover, credit rating agencies will view Missouri utilities more negatively than utilities throughout most of the rest of the country and making it more difficult for Missouri utilities to compete for the limited amount of capital dollars that are available.

In fact, the evidence will show that the only two utilities that this Commission has ever ordered to adopt the Staff approach, Empire and Laclede, both suffered an unusual two notch downgrade in their credit ratings. In both instances, the credit rating agency specifically mentioned the Commission's treatment of depreciation as a reason for the downgrade.

These are -- these are real results that have happened. It's not something we're speculating about.

Due to these factors, Staff's approach to net salvage results in higher cost to customers and increases the risk that utilities may be unable to make timely and cost effective additions to their infrastructure. The Chief Financial Officers of both Ameren UE and Laclede, Warner Baxter and Barry Cooper, are here to testify on this issue.

Also Steve Fetter is appearing as a witness for Ameren UE. Mr. Fetter is the former Chairman of the Michigan Public Service Commission, and for ten years he was Managing Director of utility credit ratings for Fitch, one of the major credit rating agencies. Please take advantage of his expertise and ask him questions about the impact of Staff's proposal on the credit ratings of Missouri utilities.

The Staff's approach to net salvage also could be harmful to the economic development of the State of Missouri because it creates financially weaker utilities that will be less able to provide future investment in infrastructure and less able to provide a stable environment for business development.

The bottom line is that Laclede and Ameren UE are not asking for any favors in this proceeding. We are simply asking the Commission to maintain the standard treatment of net salvage costs that it and almost all other states have employed for many years.

The standard approach fostered financially stable utilities able to make needed investments in infrastructure on a timely basis. Has provided customers with low rates and a high degree of reliability and a utility system that is favorable to economic growth.

I guess, finally, I would like to ask you to take a look at an attachment to Mr. Baxter's testimony which summarizes our position on this issue. And I have -- it's just a couple of pages long, and we hope it will help you in your deliberations on this issue. Thank you.

JUDGE DIPPELL: Ms. O'Neill?

MS. O'NEILL: Yes. I would object to this being admitted at this time. I may have -- I have some other objections related to Mr. Baxter that I will make at the time that he's scheduled to testify, but I -- this is not in evidence, I believe it would be inappropriate to distribute this at this time.

MR. BYRNE: I'm not asking it be admitted into evidence at this time. She can make her objection when Mr. Baxter's testimony is offered.

JUDGE DIPPELL: Is this the exact appendix to Mr. Baxter's testimony?

MR. BYRNE: Yes, Your Honor.

JUDGE DIPPELL: All right. I see -- being that it's the exact appendix, I will accept it to be distributed, but I don't -- I mean, it's attached to Mr. Baxter's testimony, which we previously marked, and that was Exhibit No. 135.

MS. O'NEILL: Your Honor, just for the record, I object to the admission -- I'm going to object to the admission of that Exhibit 135 in its entirety. I believe at this time to allow distribution of part of that exhibit is improper and inappropriate and -- because it contains irrelevant information related to the Laclede Gas rate case.

MR. BYRNE: Your Honor, maybe if you could wait -- I wouldn't have any objection if you want to wait until after you rule on her objection on Mr. Baxter's testimony, don't distribute it until you rule on the objection. That'll be fine.

JUDGE DIPPELL: That's what we will do. However, nothing that was said in opening statements is evidence in this case, so I just want to make that clear. That nothing has been admitted into evidence at this time. With regard to those opening statements.

Mr. Byrne, I believe there are some questions from the Commissioners for you as well. Commissioner Murray, did you have any?

COMMISSIONER MURRAY: No.

JUDGE DIPPELL: Commissioner Clayton, did you want to ask?

COMMISSIONER CLAYTON: Mr. Byrne, I just wanted to see what relief you were requesting for Laclede here today.

MR. BYRNE: Well, I guess we're an intervenor in this case, and so, you know, I -- I think it's Laclede that's requesting the relief --

COMMISSIONER CLAYTON: I understand, but what relief do you think can be afforded in this case versus three Commissioners writing a letter indicating their policy? What can we do in this case, since we can't -- we're not changing rates, I don't believe --

MR. BYRNE: That's true.

COMMISSIONER CLAYTON: What can we do outside of three Commissioners stating their opinion?

MR. BYRNE: Okay. It's true that I guess, because of the intervening rate cases, you can't change rates. I do think, though, that you can decide this issue. You can decide what depreciation rates Laclede could have, you know, literally it would be possible for you to change their depreciation rates right now.

That wouldn't be very fair to Laclede because it would -- it would create an immediate cash shortfall compared to the rates that are in effect now. So I don't think that would be very fair to Laclede, but you could do that. You have the power to do that.

I -- I guess my thought is there are a lot of dockets that this Commission rules on that don't change rates. For example, the Commission has a long history of examining rate design outside of the context of rate cases that are rate design dockets. And those don't immediately change the rates, but what it does is it -- is it makes a decision on rate design that then can be implemented in the next rate case.

So I think this docket is very similar to dockets on rate design, and -- and so I guess that's what you could decide.

COMMISSIONER CLAYTON: So would it be Ameren's position that this is little more than an investigation, that there is no underlying legal issue to be decided in this case? It almost sounds like the case at hand is moot from what you just said.

MR. BYRNE: No, no, I don't believe it is moot. The Commission has the power to afford relief, in my opinion. And that, you know, the other problem with the mootness argument is I think the Court directed the -- the Court of

Appeals directed the Commission to --

COMMISSIONER CLAYTON: Who? Who did?

MR. BYRNE: The Western District Court of Appeals.

COMMISSIONER CLAYTON: Oh, that Court. Okay.

MR. BYRNE: So I think that what you can do is follow the directions of the Court of Appeals. I mean, in my opinion, this is an opportunity to address an issue that the Commission ought to want to address.

COMMISSIONER CLAYTON: I'm not saying I don't want to address the issue, but legally what relief can we afford in this case if we're not going to change the books or --

MR. BYRNE: You legally have the power to change Laclede's depreciation rates.

COMMISSIONER CLAYTON: Also I wanted to ask you, you put up a chart making reference to safeguards. Who is the witness that will be discussing for Ameren those safeguards?

MR. BYRNE: For Ameren, I believe it's Mr. Lyons.

COMMISSIONER CLAYTON: Thank you

very much.

MR. BYRNE: And Mr. Baxter maybe as well.

COMMISSIONER DAVIS: Mr. Byrne, earlier in your opening statement you referenced, I believe it was two instances where this Commission issued decisions regarding depreciation, and those utilities subsequently had their credit rating downgraded. You mentioned that was in writing. Will you be putting those -- putting those documents into evidence, or --

MR. BYRNE: Yes, I -- you know, we have testimony from Mr. Fetter specifically on that subject. There are -- and we also have the opinions from the rating agencies that we can put into evidence.

COMMISSIONER DAVIS: Okay. I would appreciate that. Next question, it is my recollection that Missouri's -- or that this -- the Staff of the Missouri Public Service Commission, that their position is very similar to that of a -- of Pennsylvania.

I think they are the only other -- to my -- to the best of my knowledge, they are the only other state in the union that has a similar depreciation policy; is that correct?

MR. BYRNE: There -- there may be a couple of other ones. There's less than four, to my knowledge. I have pretty good knowledge of it, but Pennsylvania is one of them.

COMMISSIONER DAVIS: Okay. Are you aware of any other states that do?

MR. BYRNE: Yes, Your Honor, I believe New Jersey is one state, and -- I know New Jersey, and it's possible, possible that Georgia has it, and that's -- those are all the states.

Pennsylvania has a specific statute, and there was -- I believe there was a 1962 ruling by their Superior Court, which is like the Missouri Supreme Court, that requires them to use this treatment. So Pennsylvania has been doing it for -- since 1962.

COMMISSIONER DAVIS: Okay. Now, you may not be the most qualified Ameren person to answer this question, but with regard to a nuclear power plant, for instance, obviously you have depreciation and then you have, I guess, you know, sort of closing costs that are -- that are built into the rate base separately.

I mean, I guess what I'm trying to

figure out is, you know, in terms of net salvage, I mean, you know, where do you -- where do you draw the line in terms of if you've got nuclear waste laying around, is that part of a decommissioning cost, or is that -- does that go into net salvage?

MR. BYRNE: I think there are two kinds of net salvage that would apply to the Callaway nuclear plant. One is the decommissioning cost, and that would be when the plant is finally taken out of service and all the nuclear material is taken away, and there's a federal law that requires us to have a fund for decommissioning that.

So every year we contribute the required amount to the fund. And, of course, you have to make estimates of how much the fund's going to earn between now and when the plant is retired, you have to make estimates of what the decommissioning costs will be. But because of federal law, that's in a separate fund.

And the other kind of retirements are interim retirements. Sometimes they replace a turbine or anything at the Callaway plant before the final retirement. And those type of items would be just treated in the normal method. You know, whatever that ends up being. The net salvage costs associated with those interim retirements.

COMMISSIONER DAVIS: All right. Thank you.

JUDGE DIPPELL: Commissioner Appling, did you have any questions?

COMMISSIONER APPLING: No questions, Judge.

JUDGE DIPPELL: I wanted to identify the exhibits you were referring to earlier in your opening statement. You were referring to a gas schedule that was attached to Mr. Stout's testimony; is that correct?

MR. BYRNE: Yes. Can I get these and I'll be able to tell you exactly.

JUDGE DIPPELL: I believe it was Schedule WMS-6-1, and that's an attachment to Exhibit 136.

MR. BYRNE: Yes, Your Honor, the first chart was a blowup of Schedule WMS-6-1.

JUDGE DIPPELL: The second one, then, was a blowup of WMS-6-2 which is also attached to Exhibit 136?

MR. BYRNE: That's correct.

JUDGE DIPPELL: That has been marked as 136. And then the third one was information from WMS-3-2; is that exhibit actually attached to --

MR. BYRNE: No, Your Honor. It's -- my understanding is WMS-3-2 is a table of data, and this is a chart showing some of the data on that table.

JUDGE DIPPELL: Okay. I would like to mark that just for demonstrative purposes so that it's clear in the record.

MR. BYRNE: Okay.

JUDGE DIPPELL: As Exhibit No. 144?

MR. BYRNE: Okay.

JUDGE DIPPELL: And I would ask Ameren to reduce that to a manageable size and provide it to the court reporter and the parties and myself so that the record is clear as to what you're referring to.

And then the last one was WMS-8, and I believe that that is a schedule attached to Exhibit 137; is that correct?

MR. BYRNE: That's correct. And that's an exact copy.

JUDGE DIPPELL: And then you had the last one you had titled Safeguards in the Standard Approach, and I don't believe that that is actually attached to anyone's testimony; is that correct?

MR. BYRNE: That's correct.

JUDGE DIPPELL: So I will mark that just for demonstrative -- as a demonstrative exhibit as Exhibit No. 145 just to clarify the record.

MR. BYRNE: Okay.

JUDGE DIPPELL: Okay. I think that's all. Thank you, Mr. Byrne.

MR. BYRNE: Thank you, Your Honor.

JUDGE DIPPELL: We're going to take just a short ten minute break before we begin with the next opening statement from Public Counsel. We can go off the record.

(Off the record.)

JUDGE DIPPELL: Okay, I think we're going to go ahead and get going here. Back on the record.

Before I have Public Counsel come up to do their opening statement, I have one more question for Laclede from the Chairman. And so, Mr. Pendergast? I just want to -- it's kind of a follow-up to what Commissioner Clayton was asking about what relief can be granted to Laclede, and so would you agree that in order to avoid any mootness issue in this case, the Commission would have to order Laclede's depreciation rates changed? Is that your position?

MR. PENDERGAST: To avoid any mootness, no, I don't think the Commission would have to go ahead and order a change in depreciation rates in order to avoid a mootness issue. I mean, I think the viewpoint that everything that the Commission does has to go ahead and result in an immediate rate change in order for it not to be moot is just not true.

I mean, as Mr. Byrne indicated, the Commission has rate design proceedings in which it decides principles that are going to be applied in a rate case and, to my knowledge, nobody has argued that it's moot because they're not making an immediate change in rates.

The Commission grants accounting authority orders that don't result in immediate change in rates, but are explicitly reserving costs for later consideration in a rate case. To my knowledge, nobody has ever indicated that those particular accounting authority order applications are moot because it's not resulting in immediate rate change.

And, thirdly, you know, I'm not convinced that if the Commission were to change depreciation rates, it wouldn't be appropriate to change rates at the same time if the Commission was so inclined to do that so that we would avoid any kind of earnings impact.

But the long and short of it is I don't think that the Commission's power to consider issues is so limited that it has to either make an immediate rate change or decide that an issue is moot because it decides that making an immediate rate change is not appropriate.

JUDGE DIPPELL: Okay. Thank you. Okay. Miss O'Neill, would you like to give an opening statement?

MS. O'NEILL: Thank you, Your Honor. Good morning, Commissioners, Your Honor, and Counsel. As you know, my name is Ruth O'Neill, and I represent the Office of the Public Counsel and the public in this matter.

We're here today for what is basically a limited reopening of the testimonial part of a rather ancient rate case for Laclede Gas Company. And that would be in the matter of Laclede Gas Company's tariff to revise natural gas rate schedules, Case No. GR-99-315.

This matter is back before you today because it has been remanded for the second time, not because a Court disagreed with the Commission's decision on the merits in any issue, but the manner in which the original decision was advanced.

In fact, the most recent remand, if I look at the head notes from the case remanding this matter down to the Commission, it says at issue in this case was how one public utility should recover the costs incurred in retiring assets at the end of their useful lives, or what we commonly refer to and have been talking about as net salvage value.

The reason this came back was not a reversal on the merits, but a dismissal of the case, the appellate case, remanding this Commission's second order, report and order, for more detailed findings of fact, to provide clearer, more -- clearer, more detailed findings of fact that include the rationale for the findings and comply with the mandatory statutory sections.

Now, since the original hearing in this case, Laclede Gas Company has twice applied to the Commission for rate increases in subsequent rate cases. In both of those cases, there were settlements that resulted in Laclede's rates that it charges its customers being changed. The rates set in the original report and order in this case are no longer in effect.

Public Counsel continues to urge this Commission to conclude that this matter is moot and that no further action is required.

MR. PENDERGAST: Your Honor, I have to take this opportunity to object to that request, and I have to take this opportunity to object to it because it is directly inconsistent and in conflict with the stipulations and agreements that Miss O'Neill is relying upon to support her mootness argument.

In those stipulations and agreements, the parties, including Public Counsel, specifically agreed that they would not reference those stipulations or what happened with those depreciation outcomes in those cases to in any way hinder our appeal or pursuit of the appeal or hinder our position in any other proceeding, and that's precisely what Miss O'Neill is doing.

So I have to object in the strongest possible terms to her raising those arguments in direct violation of what they agreed to do in both of the stipulations and agreements that she is now citing.

MS. O'NEILL: May I respond, Your Honor?

JUDGE DIPPELL: Yes.

MS. O'NEILL: First of all, I'm not raising the issue of the two subsequent rate cases to discuss anything about depreciation or net salvage or anything -- or anything that affected Laclede Gas' ability to file an appeal, which they did. There is nothing in the second stipulation that says that mootness may not become an issue.

I disagree with the interpretation Mr. Pendergast has, and I think that when we filed our pleadings regarding this issue, you saw that there is disagreement among the parties about the content of those statements. I do believe that this Commission has explicitly asked the parties to address the issue of mootness and I believe it's appropriate for me to do this at this time.

JUDGE DIPPELL: Mr. Pendergast? You have another remark?

MR. PENDERGAST: A final remark, and it's a remark we've already made in our pleadings that, to my knowledge, haven't been disputed.

The second stipulation agreement was actually broader in language and had a larger reservation of rights as far as protecting Laclede's opportunity to pursue its position not only on appeal, but in any proceeding than the first one did.

We have compared the language in those two, put them side by side, we have told you why that's the case. To my knowledge, Miss O'Neill has never come back and explained how any interpretation other than the one we've urged is possible given what the language of those two provisions are, and I continue to object to her raising these sorts of issues in direct violation of those stipulations and agreements. Thank you.

JUDGE DIPPELL: The Commission has asked the parties to brief it on the issue of mootness that was raised in one of Public Counsel's pleadings, and has not made a determination on that, but instead decided to go forward with this hearing. And, therefore, the Commission is not going to make a ruling on that at this time either.

So, Ms. O'Neill, we have your pleadings, we have the briefs, we appreciate your position, and for now we're going to hear this issue.

MS. O'NEILL: And I understand that, and my purpose in bringing this up was not to ask you to make a ruling at this time, Your Honor. In fact, we understand that the Commission's intention is to thoroughly consider this matter on remand and that's why we're here today.

But Public Counsel does submit that it's important to keep in mind what this case is not about. This case is not about whether the Commission should or should not adopt any specific policy. This case is about whether the Commission can announce findings of fact that will support its earlier decision regarding net salvage for the Laclede Gas Company in that rate case, 99-315.

The fact of the matter is the

Commission decided on a particular method in the case. There was substantial competent evidence of the facts in the record to support that decision. Reopening the record does not transform this case into some sort of policy forum or generic docket or separate spin-off proceeding like we sometimes have done in cases regarding rate design.

The purpose of this -- of a rate case is to set rates a utility's authorized to charge its customers on a going forward basis in exchange for providing service. And the rates remain in effect until such time as those rates change through another rate case determination.

Nothing the Commission decides on this remand is going to affect customer rates since the Commission's decided -- even though the Commission's decided to continue to receive evidence in this case.

At most, the Commission could revise its findings of fact in support of its earlier decision regarding depreciation issues set forth in the 1999 rate case, or determine that there are no findings of fact that it can make. And in the subsequent report and order that it issues in this case, if one is issued, should clearly state the basis for whatever conclusion the Commission draws.

On the other hand, Laclede and the intervenor, Ameren UE, have asked the Commission to reverse its earlier decision on the merits, even though that is not the directive of the Court of Appeals. If the Commission does agree to do that, it's going to have to set forth specific findings of fact and conclusions in support of that decision.

We believe the Companies have the burden of proving to the Commission that its earlier decision regarding Laclede's former rates was in error and should be changed.

Now, back in August and September of 1999, at the time of the original rate case hearing, Public Counsel did not sponsor testimony related to the issue of depreciation. As you are aware, we are a very small office, limited budget, limited resources, and we can't sponsor witnesses on every issue in every case.

With those constraints, Public Counsel has not sponsored a depreciation witness or a net salvage witness in this case either. However, Public Counsel recognizes the fact that the treatment of net salvage is an issue of contention in a number of recent cases and continues to be in contention.

We believe that it would be appropriate for the Commission to consider those cases on their merits at the time they come forward for hearing. And we've chosen to expend what limited resources we have in those cases that are still going forward without any report and orders setting rates.

We do not believe that the Court of Appeals intended for this case to be a stage for the Commission to announce as a matter of public policy on the net salvage issue. We believe this proceeding is merely about finding facts in the record of this case that support the Commission's decision to treat net salvage in a particular way in a particular case.

Public Counsel asks the Commission to keep the scope of the remand in mind as it sees additional evidence in this case over the next several days. The close of this chapter of Laclede's 1999 rate case.

Public Counsel will respectfully suggest the Commission will have sufficient facts it can rely on to support its longstanding decision regarding net salvage in this case. Thank you.

JUDGE DIPPELL: Are there any questions for Ms. O'Neill?

COMMISSIONER MURRAY: Yes. Miss O'Neill, in that this case was remanded for further findings of fact and conclusions of law, if the record that we had at the time in the '99 case did not have sufficient facts to support its conclusion, is it appropriate to reopen that record to take additional facts to support that?

MS. O'NEILL: That's a really good question. We believe that there -- that generally, when there's a remand, and I believe the Commission has different practices with different cases that have been remanded and has done this in more than one way, sometimes it's reopened for argument, sometimes there are written pleadings that are filed, sometimes in a few cases I think that the record has been opened to allow additional evidence.

I think that's probably not the most likely way that these cases are addressed on -- after they've been remanded; however, I do recognize that four of the five Commissioners that are currently on the Commission were not here during the '99 case. I wasn't here.

I'm -- and that there are witnesses who testified in that prior proceeding who -- specifically a Staff witness I know who is no longer with the Staff and I don't believe probably lives in Missouri anymore, I think he lives out of state.

So there may have been some reason for some further testimony to be filed in order to put witnesses before this Commission who could answer the questions the Commissioners may have regarding this proceeding. But it's -- but it's probably a relatively unusual way to handle this type of a remand.

COMMISSIONER MURRAY: And then in doing that, this Commission has to address that issue as a completely open issue and look at all of the evidence that is presented and weigh it all appropriately, does it not?

In other words, we can't just come in with the preconceived goal of taking additional evidence to support the prior findings and conclusions, can we?

MS. O'NEILL: Well, I think that if you reopen the record to put additional evidence in, you need to consider the evidence that was initially put forward plus whatever additional evidence comes in.

COMMISSIONER MURRAY: And make a decision based on all of that evidence and not just make a decision that says here are further facts to support the decision that was previously made. Isn't that accurate?

MS. O'NEILL: I think that probably the -- since there's not ever been a decision that says that the prior decision was in error, that may affect a burden of proof issue, but I do think if you're going to open to take additional evidence, then all the evidence should probably be considered in making the decision of the case.

COMMISSIONER MURRAY: Thank you.

JUDGE DIPPELL: Mr. Clayton, did you want to ask Public Counsel any questions at this time?

COMMISSIONER CLAYTON: No.

JUDGE DIPPELL: Mr. Davis?

COMMISSIONER DAVIS: Just a couple. Miss O'Neill, with your regard to the mootness argument, is there one particular case or series of cases that you feel is particularly on point?

MS. O'NEILL: I think that I cited some cases in my written pleadings to the Commission on that issue. I don't have that document with me right now. There may be some others, but I can point you to those cases that I cited there.

COMMISSIONER DAVIS: With regard to the Western District's remand back to this Court, I mean, it's certainly -- I'm trying to think of a way to phrase this question here.

If -- and obviously it was remanded for insufficient findings of fact and conclusions of law, and if there is not sufficient evidence in the record to support those previous findings of fact and conclusions of law, then isn't it -- isn't the burden on the parties who were proffering that issue to bolster their case?

MS. O'NEILL: Generally in a rate case, and this is a rate case, the burden of proof is on the party seeking to change the rates. That would be Laclede Gas. The -- the Court of Appeals specifically refused to decide whether or not on the merits there were sufficient facts in the record that would support the Commission's decision. So there's also --

COMMISSIONER DAVIS: I guess in your opinion, Judge Ruth [sic], I mean, what -- what do you think the Western District Court of Appeals said? Why are we back here again?

MS. O'NEILL: Thank you for the promotion, but -- maybe it's a promotion. Well, what they said was the case was dismissed and the Commission's second order is remanded to the Commission with instructions to provide clearer, more detailed findings of fact that include the rationale for the findings, and comply with sections 386.420 and 536.090 RSMO 2000.

That's what they said. Assuming for the sake of argument that the Court of Appeals says what they mean, they sent it back to the Commission to find facts in the record in support of its original decision.

COMMISSIONER DAVIS: And if there are insufficient facts to support that decision, then what?

MS. O'NEILL: Well, as -- you know, that, again, goes to the issue of what happens when the Commission makes a decision to reopen the record and take additional evidence. I suppose you look at the evidence that's presented on the issue in total and determine whether or not you have now sufficient facts to make those findings of fact.

COMMISSIONER DAVIS: Thank you.

JUDGE DIPPELL: Commissioner Appling, did you have a question?

COMMISSIONER APPLING: No questions.

JUDGE DIPPELL: I just have one for you, Ms. O'Neill. Did Public Counsel take a position one way or the other as to this issue?

MS. O'NEILL: In the original rate case, in reviewing -- in reviewing the testimony and the pleadings in that, it appears that on -- and I haven't reviewed all the pleadings, but I have reviewed the testimony. Public Counsel sponsored witnesses in about six issues that remained to be heard at the evidentiary hearing in this rate case. Depreciation was not one of those issues.

Mr. Micheel, who had the case at that time, did not actively participate in the examination and cross examination of the depreciation witnesses in that case. We were not a party to the appeal, the second report, and order. I don't remember if we were part of -- at the Court of Appeals. I'm not sure where we dropped out on the appellate process.

JUDGE DIPPELL: Okay. Thank you. Would Staff like to give an opening statement?

MR. SCHWARZ: Yes. May it please the Commission. After a hearing, the Commission issued a report and order on December 14th, 1999, in this case on ten contested issues. Laclede Gas and Ameren UE appealed one of those issues. The Circuit Court reversed the -- excuse me, remanded the Commission's original report and order for insufficient findings of fact.

The Commission issued a second report and order in -- at the end of June 2001. The Circuit Court affirmed that decision on appeal; however, on appeal of further review, as noted, the Western District remanded this case to the Commission for findings of fact and conclusions of law, having found the Commission's second report and order deficient in that respect.

Thus, it is incumbent on the Commission now and in the near future to find the facts in this case. It is Staff's view that the

Commission must find adequate facts to explain its decision supported by the evidence on the whole record. The Commission decides this case, the posture of the case is as though the case is undecided.

The Commission can -- is not bound by a prior holding, it's not bound -- certainly the Western District made no suggestions on the merits in this case at all. I would further suggest that if the Commission finds as a fact that this case is moot, that that would comply with the Court's mandate. I am not suggesting necessarily at this time that the Commission do so, that was addressed earlier in the briefs of all parties.

And I think the Commission needs to focus on finding facts in this case as opposed to being led to believe that its purpose at this stage of the proceedings is to make some grand policy pronouncement. The Commission does not and cannot set policy, general policy in contested cases.

Why, you ask? There are two reasons. First of all, the requirements of Chapter 536 are that policy statements of general application be made by promulgating administrative rules. If the Commission wants to make a binding statement of policy, that's the required course.

Secondly, and despite Mr. Pendergast's statement to the contrary, Commission case decisions are not precedential or binding on future commissions. There is no requirement of this Commission as there is under federal law, the Federal Administrative Procedure Act for the FERC, that this Commission distinguish in any detail or to any extent the decision in a particular contested case from the decision -- a decision of a prior Commission in a prior contested case. That is the law in Missouri.

And I think that -- I think that if the Commission focuses on finding facts from the evidence in this case, that it will find that the results will be much the same as before. I would point out that -- and I prefer to use the term "burden of persuasion." The burden of persuasion never shifts in a case. The burdens of going forward with the evidence does, but the burden of persuasion stays with the proponent of a particular proposition.

And in this case there can be no

doubt that it is Laclede Gas Company that is proposing to change depreciation rates. Mr. Codaman [phonetic] says so in his testimony, and in his testimony notes that the value of the issues that are in front of the Commission today is $2.3 million. Not the $7 million that was suggested by Mr. Pendergast.

In its report and order, its first report and order in this case, the Commission itself at page 23 notes Staff Witness Adam testified that the rate payers will pay $2.3 million more in depreciation annually under Laclede's method of calculation.

And, finally, in Laclede Gas Company's response to Commission order directing scenarios filed December 10, 1999, in this case, Laclede noted at page 2 of that document Staff's recommended net salvage has no impact on the revenue requirement. Use of the Company's recommended net salvage will increase the revenue requirement by 2 point 2 million, 162 thousand dollars [sic].

Unlike the other variables in the scenarios, this increase in revenue requirement only increases cash flow to the Company because any changes in depreciation rate of recovery will result in a commensurate change in the Company's booked expense levels.

So it is Laclede that is proposing change in this case and it is Laclede that has the burden of persuasion on these issues.

It is suggested that Staff proposes all estimates. That is not the case. Staff, as observed even by the parties themselves, uses estimates when use of those estimates are reliable and supported by other evidence.

And I think that the focus in this case is very narrow, and there are two estimates in particular that are applied in discussing depreciation. The first is the estimation of average service lives, of plant in service. And that estimate is made by estimating retirement patterns of known and measurable levels of plant investment on the Company's books and records, and estimating the pattern of retirement that the property will experience.

And the basis for those estimates is what's known as the Iowa curves, which were developed through an empirical study of retirement patterns of industrial property, hundreds and hundreds of them, in the 1930s.

On the other hand, in the net salvage area, the parties probably don't dispute the pattern over which retirements are going to occur because the parties, by using the empirical studies of retirement patterns from Iowa State University, are generally pretty close on average service lives of property. So the predicted retirement patterns aren't at issue.

What is at issue is what will the Company actually experience as cost of removal ten years, 20 years, 50 years from now. Because that is not known. We know how much the Company has invested in plant, we know when that plant was placed, and we have indications over time of the initial patterns of retirement.

We compare those to the empirical curves, and that gives us an estimate that Staff believes is reasonably accurate, to estimate the remaining life, the average service life of the account as a whole.

But there is no such study to support the accuracy of the formula used to estimate what the cost in the future of net salvage is going to be. And I think that's what causes concern to Staff, that's why Staff is not comfortable relying on such estimates.

Rather, Staff says that on a cash basis, recent expenditures can predict for the recent near -- or the near future what the cash cost of retiring property's going to be. And that's the approach that Staff takes. It's not that Staff retires all estimates, it's just that Staff is estimating for a much shorter period of time and using a much more recent historical pattern to make that estimation.

The other important fact that the -- this Commission needs to address, in Staff's opinion, is under the method proposed by Laclede to be implemented, where will the cash come from in the future? That is, the Company is collecting cash now which it says will need to be spent decades in the future to remove a plant that's in service now. Okay?

Currently no -- no records at Laclede clearly indicate how much is already -- you know, the reserve for depreciation does not reflect how much has been collected for that purpose. But the real crux, the real problem will come when the cash flow is reversed. When the

Company is collecting less from rate payers than it's currently spending.

And where will that cash come from? The only sources that Staff can conceive of is shareholders, creditors, and rate payers. When the cash has to go out the door, where will it come from?

There are other arguments that the -- Laclede and Ameren have raised that we will deal with during the course of the hearing, but I think those are probably the salient points the Commission needs to keep in mind as it addresses this case. I'd be pleased to answer any questions that you might have.

JUDGE DIPPELL: Thank you. Commissioner Murray, did you have questions?

COMMISSIONER MURRAY: I don't believe so, thank you.

JUDGE DIPPELL: Commissioner Clayton?

COMMISSIONER CLAYTON: Just one. Do you believe any relief can be granted to the Company in this case? In this proceeding?

MR. SCHWARZ: I don't think there's any practical relief that can be given. That is, the evidence that -- the factors that you're considering -- and the Commission has to consider all relevant factors when it sets customer rates. The only relevant factors relevant to this particular time, this particular study are the customer rates that were in effect between the rate setting in 1999 and the rate setting in the next case.

So, from my perspective, the Commission could order Laclede to go back and change the depreciation expense on its books and records for the period of time that the 99-315 rates were in effect. And that seems a rather -- I would not consider that would be a substantial relief.

I don't think they can change depreciation rates currently based on this, because this study is five years old. The studies that were done, and -- and I think that the evidence is probably pretty stale from a current perspective. But, of course, my opinion doesn't bind the Commission in any way, shape, or form.

COMMISSIONER CLAYTON: Right. Were you the lead attorney in this case many moons ago?

MR. SCHWARZ: I frankly don't

remember. It's possible.

COMMISSIONER CLAYTON: I mean, you were here.

MR. SCHWARZ: I was here, and I'm sure I worked on the case.

COMMISSIONER CLAYTON: Will the Staff witnesses that will be presenting evidence in this case or testimony in this case, were they the witnesses involved in the original rate --

MR. SCHWARZ: No. Paul Adam was Staff's original witness, as you know, Paul left recently to pursue other opportunities.

COMMISSIONER CLAYTON: Okay. So he was the depreciation witness at the time?

MR. SCHWARZ: Yes.

COMMISSIONER CLAYTON: And who were your witnesses again?

MR. SCHWARZ: Miss Schad, Rosella Schad has adopted Mr. Adam's original testimony in this case, and Mr. Oligschlaeger has filed some supplemental rebuttal to address some of the items that were raised by the Company witnesses in their supplemental direct.

COMMISSIONER CLAYTON: Okay. To the best of your knowledge, was this the first case where Staff changed its -- its method of determining the value of this depreciation issue?

MR. SCHWARZ: No, it was not.

COMMISSIONER CLAYTON: What was the first departure from the traditional standard method?

MR. SCHWARZ: Although it was a settled case, I believe the prior case adopted those methodologies, which is why Laclede is seeking to change the rates in this case as opposed to the Staff.

COMMISSIONER CLAYTON: So the prior case -- you mean prior for Laclede or prior in time?

MR. SCHWARZ: Prior for Laclede.

COMMISSIONER CLAYTON: So what year would that have been?

MR. SCHWARZ: '98.

COMMISSIONER CLAYTON: '98, okay. And, to the best of your knowledge, prior to 1998, the Staff had taken the position of using the accrual or standard or traditional method of this cost of removal issue?

MR. SCHWARZ: I think that Miss Schad's testimony indicates that in the early

1990s, Staff began to have questions about the accruals under the standard method and -- and it's been a work in progress, I think, since.

COMMISSIONER CLAYTON: Okay. Thank you.

MR. PENDERGAST: Your Honor?

JUDGE DIPPELL: Mr. Pendergast?

MR. PENDERGAST: If I could interject for just a moment here, because it's a point similar to the one I was making with Mrs. O'Neill. The case that Mr. Schwarz refers to, the 1998 case, as he indicated, it was a settled case, and I just want to make it clear that as part of that settlement, there was very explicit language in there saying nobody was agreeing to any method of depreciation.

So to the extent you may have gotten the impression that Staff's method was adopted in that particular case and endorsed by any of the parties in that particular case other than Staff, that's an impression I believe you should not have.

MR. SCHWARZ: I agree.

JUDGE DIPPELL: Thank you. Commissioner Davis, did you have questions?

COMMISSIONER DAVIS: Yes, I did.
Mr. Schwarz, earlier in your opening argument, you stated that under the method, I guess, proposed by Laclede to be implemented, you know, where will -- where will the cash come from in the future to -- to pay for this, you know, net salvage or whatever, and it's either got to come from the shareholders, creditors, or rate payers.
Now, obviously the -- doesn't the Commission have the authority to set rates?
MR. SCHWARZ: Yes, sir.
COMMISSIONER DAVIS: And don't we have the authority to -- to discount that if they come in here and make a request and say that, you know, you've already been allowed to recover your depreciation costs?
MR. SCHWARZ: That's -- yes. You do. But I think that the Commission needs to realize the practical problem of, you know, 20 or 30 years hence when the Company's -- needs to be making expenditures to remove property and it needs cash to do so.
What's the source of cash going to be? Will it -- will it -- what will be the regulatory climate if a utility comes in and says,

I need cash, and I know that I've already collected it from rate payers before, but I need cash to incur this expense?

What kind of regulatory climate will be perceived if the Commission says no? What kind of regulatory climate will be perceived if the Commission says yes? I think that -- that it's important for this Commission to consider the future ramifications that its actions will have.

Yes, the Commission can say, no, you shall not recover additional moneys and rates, but what does -- what posture does that put the utility in when it's facing expenditures and scrabbling for cash? It's not so much the inability of the Commission to say it shall not be rate payers, but then you're focusing on the ability of the utility to convince creditors or shareholders to provide cash to pay for an expense the cash has already been provided by rate payers.

It's -- I -- do I have an answer? No. But I think that it's a considerable problem that should figure in to the Commission's deliberations in this case.

COMMISSIONER DAVIS: And you say that if we want to set policy for depreciation, that that should be done at a rule making?

MR. SCHWARZ: If you want to set a binding policy, that should be done at a rule making. Now, that's not to gainsay the effectiveness of well reasoned and supported findings of fact in a rate case.

I think the example that comes to my mind is how the Commission treats advertising expense. That -- ever -- all parties reference the 1985 case where the Commission considered advertising expense in a KCPL rate case. It's not binding on this Commission. It's not, therefore, I don't believe binding on the parties necessarily, but it was well reasoned. It set out succinctly and understandably, and people simply used that as a point of reference.

So I'm not suggesting that resolution of these issues in rate cases is not an important undertaking. But if you want to bind parties who aren't -- excuse me -- persons who aren't parties to this case, if you want to bind future commissions, if you want to bind presentations in future cases, yes, you need a rule making.

COMMISSIONER DAVIS: Mr. Schwarz,

how do you respond to the argument that 46 other states do things differently?

MR. SCHWARZ: Well, the -- I'm not sure that the other states have considered these issues. I would suggest to you that you have a Staff that is -- is presenting you with cutting edge arguments, they are considering things that perhaps other states don't have. I don't believe very many other states have even the four or five persons that this Commission does that regularly do depreciation rate studies. I don't know the factors that effect those other states.

I do know that for centuries it was on the best authority that the Earth was the center of the universe. Arguments from authority --

COMMISSIONER DAVIS: All right. Let's switch gears here for a second. You've been around here for a long time. Who thought this up?

MR. SCHWARZ: Well, from what Ms. Schad's testimony indicates, Pete Love did in the early '90s. Now, I knew Pete and our time here overlapped several years. I never was involved in the depreciation area.

When I first became aware of it, it

was with Mr. Adam, and it would have been probably not this Laclede case, but the prior Laclede case where it really came into focus. And I'm not sure that Mr. Adam was aware of Mr. Love's position either.

COMMISSIONER DAVIS: Okay. And Mr. Adam is no longer here, but Mrs. Schad has now adopted Mr. Adam's position, so is it just, you know -- so it's your -- what you're saying is that just from one engineer expert to another, they just -- you know, everyone comes in here and says, wow, this is, you know, this is the way they've been doing it and this is it? Is that what you're -- is that you're -- is that what you're telling me?

MR. SCHWARZ: Well, I certainly don't know what other states are doing. Certainly the witnesses in this case have testified very carefully, but I don't believe there's any witness in this case that has said that if you take the historical -- if you take the cost of removal in a particular period and divide it by the historical cost of the property retired, that that is an accurate and -- that that's an accurate predictor of future net salvage. I don't think there's anyone who has said that it's an accurate estimator or predictor of future net salvage.

And I -- I think that's important, that that's something the Commission needs to find if it's going to be charging customers for the next 40 years for those costs of removal.

COMMISSIONER DAVIS: Okay. So, Mr. Schwarz, let's say that this Commission goes in a different direction and decides that a company like Laclede Gas needs to replace all their pipe because it's not safe enough.

You know, where pipe -- some of that pipe may have been replaced this year, some of it may have been replaced two years ago, some of it may have been replaced 40 years ago, but we have come in and made a regulatory decision, say, no, you know, all that pipe needs to be replaced, needs to be, you know, thicker steel, what have you. How does your methodology treat that?

MR. SCHWARZ: Well, the -- and in point of fact, Laclede is currently under a replacement program for copper service lines. They have -- I think they may still be finishing up on a cast iron replacement program. But Staff basically looks at the recent cost of removal expense to predict the cost of future expense that will be incurred while the next -- while the set of rates are in place that the Commission is considering.

COMMISSIONER DAVIS: Okay, but that's recent cost of removal. What if it just becomes obsolete due to new technology?

MR. SCHWARZ: If it's -- if the Company is replacing plant and experiencing cost of removal to remove the old plant, I think the Staff's position has been that it should be permitted to recover that.

I think that specifically with replacement of or retirement of the old St. Joe water plant that was -- if you look at those records, you'll find the Staff recommended that those be -- now, that was -- that was life span property as opposed to mass asset, but --

COMMISSIONER DAVIS: Mr. Schwarz, is there a scenario that you could ever conceive of where the rate payers would suffer under your -- under Staff's proposal as opposed to Laclede and Ameren's proposal for calculating depreciation?

MR. SCHWARZ: I think some of those issues are addressed in Mr. Oligschlaeger's