Exhibit No.:
Issues: *Income Taxes*
Rate Base
Rent, Lock box
Depreciation Expense
Witness: *DOYLE L. GIBBS*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Direct Testimony*
Case No.: *GR-99-315*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

DOYLE L. GIBBS

LACLEDE GAS COMPANY

CASE NO. GR-99-315

Jefferson City, Missouri
June, 1999

DIRECT TESTIMONY

OF

DOYLE L. GIBBS

LACLEDE GAS COMPANY

CASE NO. GR-99-315

Q. Please state your name and business address.

A. Doyle L. Gibbs, 815 Charter Commons Drive, Suite 100B, Chesterfield, Missouri 63017.

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

A. I am employed by the Missouri Public Service Commission (Commission) as a Regulatory Auditor.

Q. Please describe your educational background.

A. I attended the University of Missouri – St. Louis, where I received a Bachelor of Science degree in Business Administration with a major in Accounting in 1976. I passed the Uniform Certified Public Accountant examination in 1988. I have been licensed as a Certified Public Accountant in the state of Missouri since February 1989.

Q. What has been the nature of your duties while in the employ of this Commission?

A. I have conducted and assisted with the audits and examinations of the books and records of utility companies operating within the state of Missouri.

Q. Have you previously testified before the Commission?

A. Yes, I have. Please refer to Schedule 1, attached to this direct testimony, for a list of cases in which I have previously filed testimony.

Q. With reference to Case No. GR-99-315, have you made and investigation of the books and records of Laclede Gas Company (Laclede or Company)?

A. Yes, with the assistance of other members of the Commission Staff (Staff).

Q. With reference to Case No. GR-99-315, what are your primary areas of responsibility?

A. My primary responsibilities in this case are income taxes and all components of Rate Base, with the exception of cash working capital (CWC), prepaid pension asset and natural gas inventories stored underground. Additionally, I am responsible for interest related to Company sponsored loan programs and customer deposits, lock box expense, rent, the calculation of depreciation and amortization expense on utility plant, property tax and Laclede Pipeline Company net income. Although my responsibilities do not include CWC, I will be sponsoring the levels of expense for natural gas, rent, property tax, corporate franchise, gross receipts (GRT) and sales tax that are incorporated into the calculation of CWC on Accounting Schedule 8.

Q. What Accounting Schedules and Adjustments to the Income Statement are you sponsoring?

A. I am sponsoring the following Accounting Schedules:

Accounting Schedule 2	Rate Base
Accounting Schedule 3	Plant In Service
Accounting Schedule 4	Adjustments To Plant In Service

Accounting Schedule 5	Depreciation Reserve
Accounting Schedule 6	Adjustments To Depreciation Reserve
Accounting Schedule 7	Depreciation Expense
Accounting Schedule 11	Income Tax

I am also sponsoring the following adjustments in Accounting Schedule 10, Adjustments To Income Statement:

S-6.1	Interest revenue from Insulation Financing Program
S-6.2	Interest revenue from Energy Wise Program
S-12.3	Interest expense on customer deposits
S-12.6	Lock box expense
S-15.21	Rent
S-16.1	Depreciation expense on plant in service
S-16.2	Capitalized depreciation
S-17.1	Amortization of utility plant
S-17.3	Amortization of capitalized computer costs
S-18.3	Property tax
S-19.1	Laclede Pipeline Company net income
S-21.1	Current income tax expense
S-22.1	Deferred income tax expense – debit
S-23.1	Deferred income tax expense – credit
S-24.1	Amortization of investment tax credit (ITC)

Accounting Schedules

Rate Base

Q. Please discuss Accounting Schedule 2.

A. Accounting Schedule 2, Rate Base, delineates the net capital investment recommended by the Staff to determine the Company's revenue requirement. Net Plant In Service, shown on line 9, is the summarization of the respective March 31, 1999 balances for the plant and reserve components listed on lines 2 through 8. Utility Plant In Service on line 2 and the related depreciation reserve on line 6 are supported by Accounting Schedules 3 and 5, Plant In Service and Depreciation Reserve, respectively, and are discussed later in this testimony. In addition to Net Plant In Service, Insulation Financing Program Loans (line 18), Customer Advances For Construction (line 26) and Customer Deposits (line 27) reflect their respective recorded balances at March 31, 1999. Lines 12, 15 and 19, which are materials and supplies, propane gas inventory and Energy Wise respectively, reflect thirteen-month averages of recorded balances for the test year updated through March 31, 1999. Prepayments, listed on line 13, reflect an adjusted thirteen-month average for the test year updated through March. The balances of prepayments recorded on the Company's books have been adjusted to exclude the Missouri Public Service Commission (PSC) assessment and payments to professional sport franchises. The PSC assessment is excluded from the average prepayment balance because it's impact on rate base is specifically measured in the context of CWC. CWC, line 11 on the rate base schedule, is discussed in the testimony of Staff Accounting witness Mark D. Griggs. The prepayment balances attributable to professional sport franchises have been removed to reflect the Staff's disallowance of these types of expenditures, as discussed in the direct testimony of Accounting Staff witness John M. Boczkiewicz. Line 28, Deferred Income Taxes, is a hybrid of test year actual and imputed balances. Included in rate base are the actual recorded deferred income tax balances at March 31, 1999-related to depreciation, contributions in aid of construction (CIAC), pre-1971 investment tax credit (ITC), computer system upgrades and the Laclede Pipeline Company. Deferred tax balances were imputed on Prepaid Pension Asset, Staff's computer capitalization adjustment (P-74.1 on Accounting Schedule 4) and deferred safety related expenditures authorized as a result of an Accounting Authority Order (AAO) issued by the Commission in Case Nos. GR-96-193 and GR-98-374. The imputed deferred income tax balance related to the Prepaid Pension Asset was calculated by multiplying the composite current income tax rate by the amount of Prepaid Pension Asset included in rate base. Similarly, the imputed deferred tax balance related to the Staff's adjustment P-74.1 was determined by multiplying the composite current income tax rate by the amount of the adjustment. The deferred income tax balance related to the safety AAO was calculated by multiplying the composite current income tax rate by the accumulated balance of safety deferrals the Staff is proposing to amortize to expense in this proceeding. Prepaid Pension Asset, the computer capitalization adjustment and the safety AAO are discussed in the pre-filed testimony of Staff Accounting witness Stephen M. Rackers.

Q. Why was it necessary to impute the level of deferred income tax balances related to Prepaid Pension Asset, the Staff's computer capitalization adjustment and the safety AAO?

A. Although the Company had recorded deferred taxes on its books related to these items, differences exit between the Staff and Company regarding the underlying rate making bases that generate the deferred taxes. Imputation of the accumulated deferred income taxes puts the deferred taxes on a bases consistent with the amounts recognized by the Staff in the cost of service.

Q. Please finish your discussion of rate base.

A. The final items that complete the composition of rate base are the balances of natural gas stored underground at the Laclede and MRT storage fields. These amounts, reflected on lines 16 and 17 of Accounting Schedule 2, are discussed in the testimony of Staff witnesses Michael J. Wallis and James A. Busch of the Commission's Gas Procurement Department.

Plant in Service

Q. Please explain Accounting Schedule 3, Plant In Service.

A. Accounting Schedule 3, Plant In Service, provides the detail for the Staff's rate base component of utility gas plant in service, stated at original cost, as recorded and adjusted as of March 31, 1999. The sole adjustment to plant-in-service included in column (E) on Accounting Schedule 3, is described on Accounting Schedule 4, Adjustments To Plant In Service, and discussed in the testimony of Staff witness Rackers.

Depreciation Reserve

Q. Please discuss the accounting schedules supporting depreciation reserve.

Q. Accounting Schedule 5, Depreciation Reserve provides the detail of the accumulated depreciation related to the plant balances on Accounting Schedule 3. The purpose of Accounting Schedule 6, Adjustments To Depreciation Reserve, is to provide the detail of any adjustments made to the depreciation reserve. There are, however, no adjustments to depreciation reserve currently being proposed.

Depreciation

Q. Please explain Accounting Schedule 7, Depreciation Expense.

A. This schedule calculates the annual depreciation expense on the Company's utility plant in service as reflected on Accounting Schedule 3. The rates used in this schedule are the current depreciation rates prescribed by the Commission. The result of the depreciation calculation on Accounting Schedule 7 is compared to the recorded depreciation expense for the historical test year shown at line 22, column B, on Accounting Schedule 9, Income Statement. The difference is reflected as Adjustment S-16.1 to depreciation expense found on Accounting Schedule 10, Adjustments To Income Statement.

Income Tax Calculation

Q. Please discuss Accounting Schedule 11.

A. Accounting Schedule 11, Income Tax, is the calculation of the Missouri jurisdictional current income tax expense for the test year, as adjusted through March 31, 1999, and the current income tax requirements for the range of equity returns sponsored by Staff witness David P. Broadwater of the Financial Analysis Department.

Q. Please explain the mechanics employed in Accounting Schedule 11 to calculate current income tax expense.

A. Net operating income (NOI), as calculated on Accounting Schedule 9, Income Statement, is the starting point of the test year income tax calculation (column B) on Accounting Schedule 11. The NOI for each rate of return (Line 1, columns C, D and E) was calculated on Accounting Schedule 1, Revenue Requirement. The applicable current and deferred income taxes are added back to NOI to determine the NOI before income taxes (NOIBT). NOIBT is then adjusted for various tax-timing differences to determine the amount of taxable income. The Federal, State and City of St. Louis income taxes are calculated based on current statutory rates applied to the taxable income after allowances for applicable income tax deductions and credits. City and State income taxes are deductible in the determination of Federal taxable income. City and one-half of Federal income taxes are deductible for State taxable income. Federal and State income taxes are not deductible for City income tax purposes, but a tax credit is granted for the lesser of: 1) 25 percent of the City income tax before any tax credit; or 2) 20 percent of payroll earnings tax (PET).

Q. What is the justification for the additions and subtractions that were used to adjust NOIBT?

A. In general, the justification for any difference between NOIBT (as reported on the books and adjusted by the Staff) and taxable income is dictated by the Internal Revenue Code (Code). These differences are referred to as tax-timing differences or Schedule M items. Schedule M is the Federal tax form on which the Company annually reconciles the difference between book income and taxable income. The Staff has added or subtracted the Schedule M items from NOIBT that are necessary for ratemaking purposes.

Q. Please discuss the depreciation adjustments to NOIBT.

A. Tax depreciation is the appropriate expense for tax purposes. Therefore, to properly state taxable income, book depreciation is added back and tax depreciation is deducted from NOIBT. A difference exists between book and tax depreciation because the depreciable tax basis for plant is normally less than the book basis due to expenditures historically capitalized for book purposes, but expensed in the year incurred for tax purposes. In addition, the Code provides for a quicker recovery of the tax basis plant investment through the use of accelerated depreciation methods. Total tax depreciation is the sum of the two components entitled "Tax straight-line depreciation" and "Excess tax depreciation," lines 17 and 18, on Accounting Schedule 11.

Q. Why is tax depreciation presented in two components; tax straight-line and excess?

A. Each of these components of tax depreciation has a distinct impact on total income tax expense. Straight-line is the equivalent of book depreciation, restated to reflect the tax basis of the plant in service, and is provided "flow-through" rate treatment. The difference between total tax depreciation and tax straight-line depreciation, identified as excess tax depreciation, is required by the Code to be "normalized."

Q. What is the meaning of the terms "flow-through" and "normalization?"

A. Flow-through is the tax treatment that equates the amount provided by the ratepayer for income tax expense with the amount paid to the taxing authority. Under normalization, the impact of a tax timing difference on current income tax expense is offset by deferred income tax expense. The ratepayer provides the funds to the Company as if the tax timing difference does not exist.

Q. How were the two components of tax depreciation determined?

A. The Company provided the tax basis of plant for each class of property by vintage year and the applicable accelerated and straight-line depreciation rates were applied. The tax straight-line depreciation was calculated using the open-ended method. The open-ended method of depreciation calculates tax straight-line depreciation by property account without regard to its vintage until the book rate is set to zero.

Q. Please describe the other adjustments to NOIBT to compute taxable income on Accounting Schedule 11.

A. Additions to NOIBT include:

1. **Contributions in Aid of Construction** - The Company receives CIAC from customers to provide services in areas where it would otherwise be uneconomical for the Company to expend its own funds. For tax purposes, Laclede is required to report CIAC as revenue when received from customers. For book purposes, CIAC is recorded as a credit to plant and reduces rate base.

2. **Miscellaneous Non-deductible Expenses** - This category includes such items as travel, meals, dues, gifts and lobbying expenses and are only 50% deductible for tax purposes. Therefore, one-half must be added back to NOIBT to reflect the limit imposed by the IRS. The Staff amount reflects only the addition of those expenses considered allowable for ratemaking ignoring such items as lobbying, gifts and other expenses ordinarily disallowed.

3. **Inventory Overheads Capitalized** - Some costs related to storage gas must be recognized in inventory for tax purposes but are

expended on the books. The amount expended on the books must be added back to properly reflect taxable income.

Subtractions from NOIBT include:

1. **Interest expense** - Interest is a deduction for tax purposes that is not reflected as an expense in the Staff's Income Statement, Accounting Schedule 9. Interest expense is calculated by multiplying rate base by the Staff's weighted cost of debt component included in the overall rate of return sponsored by Staff witness Broadwater. This method of determining interest expense is referred to as interest synchronization because the interest used in the calculation of income tax expense is matched with the interest expense the ratepayers are required to provide to the Company in rates. Interest synchronization has been consistently used by the Staff and adopted by the Commission in past orders.

2. **Administrative and General (A&G) Costs Capitalized** - The Company is allowed to expense a portion of A&G costs for tax purposes which are capitalized on the books. The Staff's deduction in the tax calculation reflects the test year A&G expenses capitalized on the books that are deductible for income tax purposes adjusted for the changes reflected in the A&G expense adjustment S-15 contained in Accounting Schedule 9, Income Statement.

3. **Transfer of Services** - The cost of certain main replacements are capitalized on the books but can be expensed for tax purposes. The deduction reflects the test year amount capitalized on the books that is tax deductible for tax purposes.

4. **Cost of Removal** - These costs are included in depreciation expense over the life of the depreciable property on the books but are deductible on the tax return in the year incurred.

Q. Regarding the adjustments to arrive at taxable income, you indicated that the excess tax depreciation was normalized. What treatment is being proposed by the Staff for the other additions or subtractions made to NOIBT?

A. In addition to excess depreciation, the only other timing difference listed on Accounting Schedule 11 that is being normalized is CIAC.

Cash Working Capital Expense Levels

Q. Please discuss the level of expense for the items of CWC you are sponsoring.

A. The amount of corporate franchise included in CWC is the test year recorded expense. Rent and property taxes reflect the annualized level of expenses included in utility operating income reflected on Accounting Schedule 9, Income Statement, and are discussed later in this testimony. Natural gas expense, GRT and sales tax also reflect annualized levels, but are not incorporated into the calculation of net income on Accounting Schedule 9.

Q. Why are annualized amounts included in CWC but omitted from the income statement?

A. For any level of natural gas cost or GRT included in expense, there would be a corresponding amount in revenue thus leaving net operating income unaffected. Although they have no bearing on the determination of net income, there is a CWC requirement associated with them. The same is true for sales tax where the Company acts as an agent by collecting the tax and then remitting it to the taxing the authority.

Q. How were the annualized CWC amounts for natural gas, GRT and sales tax determined?

A. Natural gas cost was calculated by multiplying the unit cost of gas by the adjusted level of therm sales used to determine annualized revenues. To determine the annualized level of GRT, a composite GRT rate was developed by dividing the test year level of GRT by the test year level of revenue excluding GRT. That rate was then applied to the sum of the annualized level of revenue and the annualized level of natural gas costs. Similar to GRT, a ratio of sales tax to revenue was developed for the test year and applied to the annualized level of revenue that included the annualized level of natural gas costs. For purposes of presentation, so that total taxes other than income taxes on the CWC schedule agrees with taxes other on the Income Statement, the annualized level of GRT is being presented on two lines in Accounting Schedule 8, CWC. Line 19 reflects the actual test year level of GRT recorded as an expense by the Company. Line 26 is the adjustment to GRT to reflect the Staff's adjustments to revenue and the associated gas costs.

Income Statement Adjustments

Interest Revenue for Loan Programs

Q. Please explain adjustments S-6.1 and S-6.2 to the income statement.

A. Adjustments S-6.1 and S-6.2 impute interest revenue from the Company's Insulation Financing and Energy Wise programs, respectively. The Insulation Financing program permits a residential customer to borrow up to $2,000 from the Company at a 3% annual rate for the purpose of insulating their home. Energy Wise is a program similar to Insulation Financing except that its focus is the financing of gas heating/cooling systems and appliances and is available to commercial customers in addition to residential customers. Financing terms are up to 5 years at interest rates ranging from 7.5% to 8.5% depending on the equipment package purchased. The Staff adjustments reflect a 3% rate for Insulation Financing and 8% for Energy Wise.

Interest on Customer Deposits

Q. Please explain adjustment S-12.3.

A. Adjustment S-12.3 calculates the interest expense associated with the customer deposit balance included in rate base. The interest rate used to calculate this adjustment was 8.75% and is based on the Stipulation and Agreement from Case No. GR-94-220, which stated that the interest rate paid by the Company on customer deposits should be equal to the prime bank lending rate plus one as published in The Wall Street Journal for the last business day of the preceding calendar year. The prime lending rate as of December 31, 1998 was 7.75%.

Lock Box Expense

Q. Please explain adjustment S-12.6.

A. Adjustment S-12.6 annualizes lock box expense to reflect an increase in the contractual fee for processing customer bills.

Rent Expense

Q. Please explain adjustment S-12.21.

A. Adjustment S-12. 21 annualizes rent expense to reflect the additional cost to be incurred associated with the contractual escalation that is contained in the Company's lease agreement for office space. The annualized level of rent expense is reflected in CWC on line, column of Accounting Schedule 8.

Depreciation and Amortization

Q. Please explain the adjustments to depreciation expense.

A. As discussed previously, with regards to Accounting Schedule 7, Deprecation Expense, Adjustment S-16.1 adjusts depreciation expense to reflect an annual level of depreciation expense based on the current approved depreciation rates and March 31, 1999 plant balances. Adjustment S-16.2 capitalizes a portion of the annualized depreciation expense calculated on Accounting Schedule 7 related to vehicles and power operated equipment. The actual test year percentage of depreciation capitalized was applied to the annualized depreciation for vehicles and power operated equipment to calculate adjustment S-16.2.

Q. Please explain the adjustments to amortization expense you are sponsoring.

A. Adjustment S-17.1 annualizes amortization expense related to underground storage land rights and other limited term gas plant balances as of March 31, 1999. Adjustment S-17.3 calculates an annual level of amortization expense related to the adjustment to plant, adjustment P-74.1 on Accounting Schedule 4, sponsored by Staff witness Rackers.

Property Taxes

Q. Please describe Adjustment S-18.3.

A. Adjustment S-18.3 annualizes property tax expense to reflect the latest known assessed values and effective tax rates as of March 31, 1999. The annualized level of property tax is included in the calculation of CWC at line 17, column B on Accounting Schedule 8.

Laclede Pipeline Company

Q. Please describe adjustment S-20.1.

A. Adjustment S-20.1 moves the test year net income of Laclede Pipeline Company (LPC) above the line. LPC is a wholly owned subsidiary of the Company that owns and operates a pipeline for the transportation of liquid propane gas and is the principle supplier of the liquid propane the Company uses for peak shaving. The Company's expenses include the markup on liquid propane purchased from LPC. Adjustment S-20.1 eliminates the impact of any LPC income on Laclede's cost of service.

Income Taxes

Q. How was the income tax adjustment you are sponsoring for current income tax expense quantified?

A. The adjustment to current income tax expense, adjustment S-22.1, was determined by subtracting the test year recorded income tax expense from the current income tax calculated on Accounting Schedule 11.

Q. Please discuss adjustment S-22.1.

A. Adjustment S-22.1 reflects an annual level of deferred income tax expense - debit for the tax-timing differences related to tax depreciation, the reversal of prior year CIAC tax deferrals, and an amortization of the imputed deferred tax balances included in rate base previously discussed.

Q. Please describe adjustment S-23.1.

A. Adjustment S-23.1 adjusts deferred income tax expense - credit to reflect the current provision for the deferral of the timing difference related to CIAC and the amortization, or reversal, of prior years tax deferrals related to depreciation. The deferred tax amortization (reversals) of prior deferrals contained in both adjustments S-22.1 and S-23.1 reflect the composite tax rate at which the timing differences were originally deferred.

Q. Please describe adjustment S-24.1 to amortize ITC.

A. The Staff has made no adjustment to the test year recorded level of ITC amortization.

Q. Does this conclude your pre-filed direct testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

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

AFFIDAVIT OF DOYLE L. GIBBS

STATE OF MISSOURI	)	
	)	ss.
COUNTY OF COLE	)	

Doyle L. Gibbs, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Direct Testimony in question and answer form, consisting of 17 pages to be presented in the above case; that the answers in the foregoing Direct Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Doyle L. Gibbs

Doyle L. Gibbs

Subscribed and sworn to before me this 25th day of June 1999.

Toni M. Willmeno

Toni M. Willmeno
Notary Public, State of Missouri
County of Callaway
My Commission Expires June 24, 2000

TONI M. WILLMENO
NOTARY SEAL
NOTARY PUBLIC
STATE OF MISSOURI

RATE CASE PROCEEDINGS
DOYLE L. GIBBS

Company	**Case Number**
Arkansas Power & Light Company	ER-85-20
Arkansas Power & Light Company	ER-85-265
Associated Natural Gas Company	GR-79-126
Atmos Energy Corporation/United Gas Company	GM-97-70
Capital City Water Company	WR-82-117
Citizens Electric Cooperative	ER-79-102
Citizens Electric Cooperative	ER-81-79
Empire District Electric Company	ER-95-279
Laclede Gas Company	GR-77-33
Laclede Gas Company	GR-78-148
Laclede Gas Company	GR-80-210
Laclede Gas Company	GR-81-245
Laclede Gas Company	GR-82-200
Laclede Gas Company	GR-96-193
Laclede Gas Company	GR-98-374
Lake St. Louis Sewer Company	SR-80-189
Missouri-American Water Company	WR-89-265
Missouri-American Water Company	WM-93-255
Missouri-American Water Company	WR-93-212
Missouri-American Water Company	WR-97-237
Missouri-American Water Company	SR-97-238
Missouri-American Water Company	WO-98-204
Missouri Cities Water Company	WR-78-107
Missouri Cities Water Company	SR-78-108
Missouri Cities Water Company	WR-83-14
Missouri Cities Water Company	SR-83-15
Missouri Cities Water Company	WR-85-157
Missouri Cities Water Company	SR-85-158
Missouri Cities Water Company	WR-86-111
Missouri Cities Water Company	SR-86-112
Missouri Cities Water Company	WR-89-178
Missouri Cities Water Company	SR-89-179
St. Joseph Water Company	WR-77-226
St. Louis County Water Company	WR-78-276
St. Louis County Water Company	WR-83-264
St. Louis County Water Company	WR-87-2
St. Louis County Water Company	WR-88-5
St. Louis County Water Company	WR-94-166
Southwestern Bell Telephone Company	TR-79-213
Southwestern Bell Telephone Company	TR-80-256
Southwestern Bell Telephone Company	TR-86-84

RATE CASE PROCEEDINGS
DOYLE L. GIBBS

Company	**Case Number**
Union Electric Company	ER-77-154
Union Electric Company	ER-80-17
Union Electric Company	ER-81-180
Union Electric Company	HR-81-259
Union Electric Company	ER-82-52
Union Electric Company	ER-83-163
Union Electric Company	ER-84-168