Exhibit No.:	______________
Issue(s):	Bad Debt Expense/ Bad Debt Trackers/ Bad Debt in PGA/ Non-Qualified Pension (SERP)
Witness/Type of Exhibit:	Trippensee/Rebuttal
Sponsoring Party:	Public Counsel
Case No.:	GR-2010-0171

SURREBUTTAL TESTIMONY

OF

RUSSELL W. TRIPPENSEE

Submitted on Behalf of the Office of the Public Counsel

LACLEDE GAS

Case No. GR-2010-0171

July 20, 2010

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Tariff to Increase Its Annual Revenues for Natural Gas Service.	)))	Case No. GR-2010-0171

AFFIDAVIT OF RUSSELL W. TRIPPENSEE

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Russell W. Trippensee, of lawful age and being first duly sworn, deposes and states:

1. My name is Russell W. Trippensee. I am the Chief Public Utility Accountant for the Office of the Public Counsel.

2. Attached hereto and made a part hereof for all purposes is my surrebuttal testimony.

3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.

Russell W Trippensee

Russell W. Trippensee

Subscribed and sworn to me this 20th day of July 2010.

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

JERENE A. BUCKMAN
My Commission Expires
August 23, 2013
Cole County
Commission #09754037

Jerene A. Buckman

Jerene A. Buckman
Notary Public

My commission expires August 23, 2013.

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SURREBUTTAL TESTIMONY

OF

RUSSELL W. TRIPPENSEE

LACLEDE GAS COMPANY

CASE NO. GR-2010-0171

Q. PLEASE STATE YOUR NAME AND ADDRESS.

A. Russell W. Trippensee. I reside at 1020 Satinwood Court, Jefferson City, Missouri 65109, and my business address is P.O. Box 2230, Jefferson City, Missouri 65102.

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

A. I am the Chief Utility Accountant for the Missouri Office of the Public Counsel (OPC or Public Counsel).

Q. ARE YOU THE SAME RUSSELL W. TRIPPENSEE WHO HAS FILED DIRECT AND REBUTTAL TESTIMONY IN THIS CASE?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. I will respond to the rebuttal testimony of Laclede witness, James A. Fallert, on the issues of Uncollectible Accounts and Non-Qualified Pension Plan Expense which is commonly referred to as Supplemental Retirement Plan (SERP).

I will address the two alternative proposals for treatment of Uncollectible Accounts which is also referred to as Bad Debt Expense along with Laclede's attempt to double collect from ratepayers for bad debt expense resulting from revisions to the Cold Weather Rule.

The SERP issue is an attempt by Laclede to either incorporate forecasted data into the revenue requirement or set up a tracker mechanism. Public Counsel opposes either of these proposals.

BAD DEBT EXPENSE

Q. DID MR. FALLERT'S REBUTTAL TESTIMONY CHANGE LACLEDE'S RECOMMENDATION ON THE APPROPRIATE LEVEL OF BAD DEBT EXPENSE BASED ON A NORMALIZED LEVEL?

A. Yes. Mr Fallert moved from a 2-year analysis to a 3-year analysis in his rebuttal testimony. This reduced his "base bad debt recommendation" (as I referenced it in my rebuttal testimony, page 2, line 20 to page 3, line 2) by $757,600 prior to his adjustment to "gross-up" bad debt expense for additional revenue resulting from this case.

Q. DID MR. FALLERT'S REBUTTAL TESTIMONY IDENTIFY THIS CHANGE IN LACLEDE'S RECOMMENDATION FROM THE USE OF A 2-YEAR AVERAGE VERSUS A 3-YEAR AVERAGE?

A. No.

Q. MR. FALLERT CRITICIZES PUBLIC COUNSEL'S 5-YEAR ANALYSIS BECAUSE IT INCLUDES TWO YEARS THAT ARE NOT "FULLY IMPACTED" BY THE MOST RECENT REVISIONS TO THE COLD WEATHER RULE. DO YOU AGREE WITH HIS CHARACTERIZATION OF YOUR ANALYSIS?

A. No. Schedule RWT-3 to my rebuttal testimony clearly shows that Public Counsel looked at twelve years of data and then used a five-year period that captured both the highest and lowest levels of net uncollectible write-offs during the last six years. The year with the lowest level of actual net write-offs in Public Counsel's 5-year analysis is the most current year. I would note that the third highest level of net uncollectible write-offs during the last nine years occurred nine years ago, well before the revisions to the Cold Weather Rule.

There are a myriad of factors that impact net uncollectible write-offs. Mr. Fallert's attempt to identify specific factors as having a specific impact is not supported by any evidence.

Q. CAN YOU PROVIDE AN EXAMPLE OF MR. FALLERT'S IDENTIFICATION OF A SPECIFIC FACTOR?

A. Yes. Mr. Fallert asserts that the "relaxed" terms of the Cold Weather Rule impacted bad debts. Mr. Fallert provides no evidence, study, or analysis that supports this finding. In fact, as I discussed in my rebuttal testimony (page 12, line 15 to page 13, line 8), Laclede did not even file any study tracking the Cold Weather Rule customers despite being ordered to do so by the Commission. Public Counsel's analysis of data regarding the 8,440 customers who were to be tracked indicates that over 65% of these customers remain on the system as of March 31, 2010. These customers are paying on their accounts and have not been written off, thus no cost has been incurred. The actual cost of those CWR customers who have been written-off are accounted for in Public Counsel's analysis and recommendation.

Q. YOU USE THE TERM ACTUAL COSTS SEVERAL TIMES THROUGHOUT YOUR REBUTTAL AND SURREBUTTAL TESTIMONY, PLEASE EXPLAIN THE SIGNIFICANCE.

A. Laclede obtained Accounting Authority Orders (AAOs) from this Commission on the assertion that there were specific costs associated with the revisions to the Cold Weather Rule. Laclede asserted that the revisions did not allow them to collect monies owed by the customer to Laclede. Mr. Fallert in his surrebuttal testimony discusses the quantified amount on pages 6 and 7 of his rebuttal testimony. What Mr. Fallert ignores is that these quantifications of costs were not based on what the customer failed to pay Laclede but instead were based on what the customer owed Laclede.

Q. WHAT IS THE FINANCIAL OR ACCOUNTING TERM FOR AN AMOUNT OWED BY A CUSTOMER TO LACLEDE, AND IS IT A COST OR EXPENSE?

A. The amount owed by a customer is referred to as an accounts receivable of Laclede. An accounts receivable represents the total monies the customer owes and if paid, there is no cost to Laclede. When the customer pays, Laclede receives cash and the accounts receivable is eliminated. If the customer ultimately does not pay, the accounts receivable is "written off", thus becoming a cost to Laclede.

Q. DOES PUBLIC COUNSEL'S ANALYSIS OF NET UNCOLLECTIBLE WRITE-OFFS ACCOUNT FOR ALL OF THE WRITE-OFFS OF CUSTOMER ACCOUNT RECEIVABLES?

A. Yes, for the periods analyzed. Laclede's 3-year analysis also accounts for all write-offs of customer account receivables during that 3-year period.

Q. AN ANALYSIS OF NET UNCOLLECTIBLE WRITE-OFFS ACCOUNTS FOR ALL COSTS ASSOCIATED WITH THE WRITE-OFFS OF CUSTOMER ACCOUNTS RECEIVABLE. WHAT DOES THE DEFERRED AMOUNTS RESULTING FROM THE ACCOUNTING AUTHORITY ORDERS REPRESENT?

A. The deferred amounts are stockholder earnings from a prior period that resulted from the Commission order authorizing the AAO.

Q. PLEASE EXPLAIN HOW THE COMMISSION AUTHORIZATION OF THE AAO RESULTED IN INCREASED EARNINGS IN A PRIOR PERIOD.

A. Laclede recorded the AAO amounts by debiting the "regulatory asset" account on the balance sheet. For financial reporting purposes under Generally Accepted Accounting Principles (GAAP), for every debit entry there must be a credit entry. When the regulatory asset account was debited, the credit entry was to account 904, Bad Debt Expense. The credit to Bad Debt Expense reduced expense for that year by a like amount. This credit entry or reduction to account 904 thus increased earnings for financial reporting purposes during the year it was made. When the financial records including the income statement for the year was closed, retained earnings were increased due to the AAO.

The regulatory asset account provided the financial system asset support for the increased level of retained earnings. Laclede is now proposing to include in the revenue requirement as an amortization of this "regulatory asset" to an expense account for revenue requirement purposes, thus increasing rates to generate cash from the customers to support the increased retained earnings.

Laclede's proposal to amortize the AAO in the revenue requirement in this case, if approved, will result in a change in the financial system asset (Account 182, Other Regulatory Assets) that supports the increased retained earnings resulting from the AAO to the financial system asset account (Account 131, Cash). For financial purposes, the balance sheet must balance and asset are used to support (i.e. balance) liabilities and owner equity (retained earnings).

Q. IF THE COMMISSION ACCEPTS PUBLIC COUNSEL'S 5-YEAR AVERAGE PROPOSAL FOR BAD DEBT EXPENSE, WILL THE REVENUE REQUIREMENT RECOGNIZE ALL ACTUAL WRITE-OFFS ASSOCIATED WITH THE COLD WEATHER RULE CUSTOMERS?

A. Yes.

Q. IF THE COMMISSION ACCEPTS LACLEDE'S 3-YEAR AVERAGE PROPOSAL FOR BAD DEBT EXPENSE, WILL THE REVENUE REQUIREMENT ALSO

RECOGNIZE ALL ACTUAL WRITE-OFFS ASSOCIATED WITH THE COLD WEATHER RULE CUSTOMERS?

A. Yes.

Q. WHAT IS THE IMPACT OF INCLUDING BOTH AN ANALYSIS OF NET BAD DEBT WRITE-OFFS AND AN AMORTIZATION OF THE AAO?

A. Regardless of whether the Commission accepts Public Counsel's or Laclede's recommendation of a 5 or 3 year average of actual net write-offs as being appropriate reflection of bad debt expense, either recommendation incorporates all actual write-offs during the years analyzed resulting from the CWR revisions. To then include an amortization of the regulatory asset set up by the AAOs would result in bad debt costs attributed to the CWR revisions being counted and paid for by the ratepayers twice.

Q. IS THIS THE DOUBLE COUNTING POTENTIAL THAT PUBLIC COUNSEL INDICATED WOULD HAPPEN AND THAT THE COMMISSION RECOGNIZED THE POTENTIAL FOR IN CASE NO. GU-2007-0138?

A. Yes.

Q. DID THE RECORDING OF THE AAO IN ANY WAY IMPACT EITHER LACLEDE'S OR PUBLIC COUNSEL'S ANALYSIS OF NET ACTUAL WRITE-OFFS?

A. No. Laclede made no entry on its financial records with regard to the AAOs that impacted the net actual write-offs recorded in Account 144, Reserve for Uncollectible Accounts. I would point out that I am unaware of any accounting entries which could even be made in conformance with GAAP that would result in the recording of the AAO impacting Account 144.

Q. DID THE ISSUANCE OF THE AAO RESULT IN INCREASED EARNINGS IN A PRIOR YEAR FOR LACLEDE WITH REGARD TO BAD DEBT EXPENSE?

A. Yes.

Q. UNDER THE RATE OF RETURN REGULATION FORMULA, DOES THE REVENUE REQUIREMENT INCLUDE AN EARNINGS COMPONENT FOR EXPENSES?

A. No. In its simplest form, the revenue requirement formula is:

> Revenue Requirement = (Rate Base * Return on Equity) + Expenses including interest + taxes

This formula clearly shows that Expenses do not have a Return on Equity component.

Laclede's proposal to include bad debt expense plus an amortization of the AAOs will result in not only a level of expense being built into the revenue requirement, but also a level of additional earnings related to that expense.

Q. DOES MR. FALLERT ASSERT THAT THE ACCOUNTING AUTHORITY ORDERS CALCULATED THE "COSTS" OF THE COLD WEATHER RULE REVISIONS?

A. Yes he does (Fallert rebuttal, page 6, lines 13 – 17).

Q. HOW WERE THE COSTS INCLUDED IN THE ACCOUNTING AUTHORITY ORDERS DETERMINED?

A. In both AAOs, changes to the levels of accounts receivable served as the basis for the assertion that "costs" were caused by the revision to the CWR. I discussed in my rebuttal testimony the fact that a change in the balance of accounts receivable is not a cost (Trippensee rebuttal, page 10, line 9 – page 11, line 10).

Q. DOES MR. FALLERT ACKNOWLEDGE IN HIS REBUTTAL TESTIMONY THAT IN FACT CHANGES IN ACCOUNTS RECEIVABLE BALANCES ARE NOT A COST?

A. Yes. Mr. Fallert states on page 4, lines 6 – 10 of his rebuttal;

> When these customers' accounts are reinstated, net write-offs are reduced as amounts previously written off are reinstated into accounts receivable. While these reinstatements provided a temporary reduction in net write-offs, the balances remain at risk and will tend to put upward pressure on write-off experience in the future.

This statement was made as part of Mr. Fallert's rebuttal testimony addressing the bad debt expense analysis. However, the characterization of changes in the balance of accounts receivable does not change. Either it is a cost or it is not. During the AAO process, Laclede asserted that changes in accounts receivable was a cost. In his statement cited above which addresses bad debt expense, Mr. Fallert acknowledges that the accounts receivable balances are only at risk of becoming a cost if and only if the customer does not pay.

There is no question that accounts receivable balances are not as valuable an asset as cash in hand. There is always a risk that a firm will not collect its receivable. However, a risk of not collecting or up-wards pressure on that risk is not an expense. The cost of not collecting is recognized when the accounts receivable is written-off. Then and only then can the bad debt cost be accurately measured. That is why the regulatory process in Missouri has utilized an analysis of net actual write-offs to determine the level of bad debt expense to include in the revenue requirement.

BAD DEBT TRACKER

Q. DOES PUBLIC COUNSEL OPPOSE LACLEDE'S PROPOSAL TO SET UP A BAD DEBT TRACKER MECHANISM THAT MR. FALLERT SUGGESTS IS AN

ALTERNATIVE WAY TO TREAT BAD DEBT EXPENSE (FALLERT REBUTTAL, PAGE 5, LINE 12 - PAGE 6, LINE 2)?

A. Yes.

Q. IS A BAD DEBT TRACKER AS PROPOSED BY LACLEDE ANALOGOUS TO INCLUSION OF BAD DEBT EXPENSE IN THE PGA?

A. Yes. Both methods effectively "track" an expense with any fluctuations from a base level used to subsequently adjust rates. The primary difference in the two alternative proposals by Laclede is the timing. Inclusion of bad debt expense in the PGA would result in rates being adjusted sooner rather than waiting for the next rate case as the tracker proposal would require.

Q. MR. FALLERT DISCUSSES THE SIGNIFICANTLY VOLATILITY OF BAD DEBTS AS BEING A BASIS FOR IMPLEMENTING A BAD DEBT TRACKER. EXTENDING HIS ARGUMENT TO ITS FINANCIAL END, DOES THE ALLEGED VOLATILITY IMPACT EARNINGS?

A. A change in any cost of service component will change earnings if all other components remain constant. However, utilities are dynamic entities and all other factors never remain constant. As I will discuss later in my testimony, the accumulated reserve for depreciation is always changing thus rate base is never constant.

Q. SHOULD THE CHANGE IN A SPECIFIC EXPENSE SUCH AS UNCOLLECTIBLE EXPENSE RESULT IN A CHANGE IN RATE SO THAT EARNINGS ARE NOT IMPACTED BY AN AMOUNT EQUAL TO THE SPECIFIC EXPENSE CHANGE?

A. No. This argument could be made for other expense categories as they can have dramatic changes especially when measured as a percentage of change in that specific cost category. In fact, all cost of service components including revenues and customer levels are always in flux. A change in a single category of expense, investment, revenue, or customer levels without a change in any other of the components of the overall cost of service will impact earnings. The result is that the relationship between all the cost of service components has been altered to a degree that the level of earnings may no longer be appropriate. It must be recognized that when looked at in total, the changes in cost of service components may net out so that no rate change is necessary. Without looking at all relevant factors, there can be no determination that rates need to be adjusted.

Q. WHAT IS REGULATORY LAG?

A. The time period from the change in earnings until a change in rates occurs is referred to as regulatory lag. It must be recognized that regulatory lag can provide both for retention by the utility of earnings above a reasonable level and a period where earnings, while positive, are not at the authorized level. Regulatory Lag is the term that refers to the period between the imbalance occurring and the time rates are adjusted to reflect the imbalance. Regulatory Lag is an integral part of the incentive procedures built into the regulatory process to ensure customers have just and reasonable rates and utilities operate in a prudent manner.

Q. HAS THIS COMMISSION ADDRESSED REGULATORY LAG?

A. Yes. This Commission has held that it is **<u>not</u>** reasonable to protect shareholders from all regulatory lag. In Missouri Public Service Company, Cases Nos. EO-91-358 and EO-91-360, the Commission stated in its Report and Order:

> Lessening the effect of regulatory lag by deferring costs is beneficial to a company but not particularly beneficial to ratepayers. Companies do not propose to defer profits to subsequent rate cases to lessen the effects of regulatory lag, but insist it is a benefit to defer costs. Regulatory lag is a part of the regulatory process and can be a benefit as well as a detriment. <u>Lessening regulatory lag by deferring costs is not a reasonable goal unless the costs are associated with an extraordinary event</u>.

> Maintaining the financial integrity of a utility is also a reasonable goal. The deferral of costs to maintain current financial integrity though is of questionable benefit. If a utility's financial integrity is threatened by high costs so that its ability to provide service is threatened, then it should seek interim rate relief. If maintaining financial integrity means sustaining a specific return on equity, this is not the purpose of regulation. <u>It is not reasonable to defer costs to insulate shareholders from any risks. If costs are such that a utility considers its return on equity unreasonably low, the proper approach is to file a rate case so that a new revenue requirement can be developed which allows the company the opportunity to earn its authorized rate of return. Deferral of costs just to support the current financial picture distorts the balancing process used by the Commission to establish just and reasonable rates.</u> Rates are set to recover ongoing operating expenses plus a reasonable return on investment. Only when an extraordinary event occurs should this balance be adjusted and costs deferred for consideration in a later period (Emphasis added).

Laclede is not proposing to go through the formal accounting steps of deferring uncollectible expense in this case as was the deferral issue in the Commission case cited above. However, the impact on earnings of Laclede's proposal would have the same impact on earnings. Laclede proposes to increase future rates to reflect a past expense. An Accounting Authority Order also anticipates a future rate adjustment plus it takes the formal accounting step of deferring the expense in the period it was incurred.

Q. YOU DISCUSSED OTHER EXPENSES THAT COULD HAVE AN IMPACT ON EARNINGS IF THEY EXPERIENCED CHANGES. CAN YOU PROVIDE AN EXAMPLE?

A. Yes, Laclede experienced $83,575,761 of payroll expense for its utility operations per its publically filed annual report with the MPSC (Laclede's FERC Form 2, 2007, page 355). A reasonable cost of living adjustment to the pay scale of 3% would result in a $2,507,272 change in earnings if all other factors remained equal in the subsequent year. This possible change in earnings is approximately equal to the largest change in net write-offs as shown in the table on page 10 of my direct testimony in this case.

Q. PLEASE DEFINE THE TERM "COST" AS USED IN YOUR TESTIMONY.

A. I use the term "cost" to refer to each component of the total revenue requirement of the utility. Cost includes all expenses along with the earnings and interest expense associated with the rate base. The total revenue requirement is also called the overall cost of service.

Q. WHAT IS AN EXPENSE?

A. Expense is the use of assets and services in the creation of revenue during a specified period. Expenses are recorded on the income statement and are subtracted from revenues in order to determine net income (earnings) for the period.

Q. DOES UTILITY REGULATORY THEORY ANTICIPATE THAT THERE WILL BE CHANGES IN THE COST COMPONENTS THAT MAKE UP THE OVERALL COST OF SERVICE?

A. Yes, I believe that would be a fair characterization. Rate of Return regulation anticipates overages and underages with respect to any specific cost component, the level of customers, sales and the resulting revenues. However, the critical point to recognize is that the determination as to whether rates are adequate or not is the measurement of the rate of return on equity, not an individual cost component, level of customers, or level of sales. It should also be noted that the courts have found that the regulatory process also provides the stockholder the opportunity, not a guarantee, to earn a rate of return. That opportunity involves business risk. Absent risk, authorized returns would reflect a risk-free return such as US government securities (T-bills).

Any event such as an abnormally cool summer or warm or cold winter would have a significant impact on revenues and thus earnings. Other significant impacts could occur from any event in the normal course of utility operations that had a material impact on earnings. Other cyclical costs that are normalized for ratemaking treatment but expensed on the utilities financial records include tree-trimming expenses for electric utilities, tank painting for water utilities, and over-time hours for all types of utilities. All of these events are part of the normal business risks faced by a utility. The traditional regulatory process has procedures, which are normally used in ratemaking proceedings, which address these variable factors, and provides the utilities with an opportunity but not a guarantee to earn its rate of return.

Rate of Return Regulation is not cost recovery regulation. Utilities are dynamic entities that are constantly changing and face constantly changing operating environments. Rate of return regulation looks at the relationship of all relevant factors and determines if the resulting return is appropriate. A cost component could change 100% and earnings may or may not be impacted, just as new investments may or may not generate sufficient revenues to maintain earnings. Only a review of all relevant factors can make that determination.

Q. IF MEASURABLE FINANCIAL IMPACT IS THE ONLY CONSIDERATION IN DETERMINING WHETHER OR NOT TO AUTHORIZE A TRACKER, WOULD THAT OPEN A FLOODGATE OF OPPORTUNITY FOR A UTILITY TO MANAGE ITS EARNINGS THROUGH THE USE A TRACKER MECHANISM AS PROPOSED BY LACLEDE IN THIS CASE?

A. Yes. An event such as an abnormally cool summer or warm or cold winter would have a significant impact on revenues and thus earnings. Other significant impacts could occur from any event in the normal course of utility operations that had a material impact on earnings such as the impact of an annual cost of living adjustment for payroll. Other cyclical costs that are normalized for ratemaking treatment but expensed on the utilities' financial records include tree-trimming expenses for electric utilities, tank painting for water utilities, and over-time hours for all types of utilities. All of these events are part of the normal business risks faced by a utility. The traditional regulatory process has procedures, which are normally used in ratemaking proceedings, which address these variable factors, and provides the utilities with an opportunity but not a guarantee to earn its rate of return.

Q. IS THE PROPOSAL BY LACLEDE RETROACTIVE RATEMAKING IN PUBLIC COUNSEL'S OPINION?

A. Yes. Laclede is proposing to single out a past expense (and the resulting decrease in earnings) and factor that amount into a rate that is effective in the future. This treatment perfectly describes retroactive ratemaking.

Q. IS IT YOUR UNDERSTANDING THAT RETROACTIVE RATEMAKING IS PROHIBITED IN MISSOURI?

A. Yes. As stated by the Missouri Supreme Court:

> [p]ast expenses are used as a basis for determining what rate is reasonable to be charged in the future in order to avoid further excess profits or future losses, but under the prospective language of the statutes, Sections 393.270(3) and 393.140(5) they cannot be used to set future rates to recover for past losses due to imperfect matching of rates with expenses.
>
> State ex rel. Utility Consumers Council v. Public Service Commission, 585 S.W.2d 41, 59 (Mo. Banc 1979) (citations omitted)

BAD DEBT EXPENSE IN THE PURCHASE GAS ADJUSTMENT CLAUSE

Q. PLEASE EXPLAIN LACLEDE'S PROPOSAL AS YOU UNDERSTAND IT.

A. Laclede witness Fallert's rebuttal testimony continues to advocate that the Purchased Gas Adjustment Clause (PGA) reflect alleged uncollectible revenues. Staff witness David Sommerer's rebuttal testimony addresses several problems with Laclede's proposal.

Q. DOES PUBLIC COUNSEL OPPOSE LACLEDE'S PROPOSAL AND AGREE WITH STAFF'S OPPOSITION TO INCLUSION OF UNCOLLECTIBLE COSTS IN THE PGA?

A. Yes.

Q. PLEASE SET OUT THE REASONS PUBLIC COUNSEL OPPOSES THE PROPOSAL AS PRESENTED IN THIS CASE?

A. Public Counsel believes the proposal has several problems, specifically;

1. Uncollectible Expense is not a gas cost and as such should not be included in the PGA/ACA process.

2. The proposal constitutes single issue ratemaking without consideration of all other relevant factors.

3. The proposal constitutes retro-active ratemaking which counsel has advised is prohibited in the state of Missouri.

4. Reduces incentive to implement appropriate collection processes with respect to bills rendered thus placing additional risk on other customers' rates to reflect increased bad debt costs.

Q. YOU ASSERT THAT UNCOLLECTIBLE EXPENSE IS NOT A GAS COST. CAN YOU POINT TO ANY AUTHORITATIVE SOURCE THAT SUPPORTS YOUR POSITION?

A. Yes. Laclede is required to maintain it books and records in conformance with the Uniform System of Accounts (USOA) as set out by the Federal Energy Regulatory Commission (FERC). A review of the USOA proves without any ambiguity that the FERC does not classify uncollectible expense as a gas cost. USOA account 904 has the following definition for uncollectible expense;

> This account shall be charged with amounts sufficient to provide for losses from uncollectible utility revenues. Concurrent credits shall be made to account 144,

> Accumulated Provision for Uncollectible Accounts—Credit. Losses from uncollectible accounts shall be charged to account 144.

USOA account 144 has the following definition;

> This account shall be credited with amounts provided for losses on accounts receivable which may become uncollectible, and also with collections on accounts previously charged hereto. Concurrent charges shall be made to account 904, Uncollectible Accounts, for amounts applicable to utility operations, and to corresponding accounts for other operations. Records shall be maintained so as to show the write-offs of accounts receivable for each utility department.

These definitions clearly do not define uncollectible expense as a gas cost. An estimate of a utilities inability to collect revenue is recorded as uncollectible expense and thus earnings are reduced in that period in which the revenues are recorded. At the same time, a reserve account is set up, USOA account 144, to account for the actual failure to receive cash from the customer for the billed revenues.

The failure to receive the cash does not change uncollectible expense (the failure to collect revenues) into gas costs as Laclede asserts. Gas costs are also addressed in the USOA and found in accounts 800 through 813. A review of the USOA definitions of these respective categories of gas costs does not contain any reference to revenues or uncollectible expense. Laclede's continued efforts to redefine gas cost are in conflict with the USOA and Generally Accepted Accounting Principles. I am aware of no GAAP that would require that the expense reflecting payments to third party vendors be increased to reflect a company's inability to collect revenue from its own customers.

Q. IS THERE ANOTHER DISTINCTION BETWEEN GAS COST EXPENSE AND UNCOLLECTIBLE EXPENSE?

A. Yes. Uncollectible expense does not require Laclede to pay a third party that provides goods or service, whereas Laclede does pay third parties for its gas costs. Uncollectible expense is simply a journal entry on the Company's financial records that at no time represents the outflow of cash or other assets to a third party. Outside of its gas acquisition policies and procedures, a utility has been deemed to have minimal if any control over the actual cost of gas and the resulting payments to third parties. In contrast, a utility has operational control over its policies and procedures to collect bad debts. The Commission has recognized the value of incentives and that prudence review are not a good substitute for the company's own desire to improve its bottom line.

> Although the Fund would be subject to audit by Staff and Public Counsel and they could seek a prudence adjustment, the need for a prudence adjustment is difficult to prove and is not a good substitute for the company's own desire to prudently minimize its costs to improve its bottom line.
>
> (MPSC, Report and Order, GR-2006-0422, page 19, issued March 22, 2007)
>
> The Fund would be subject to audit by Staff and Public Counsel and they could seek a prudence adjustment if necessary. But the need for a prudence adjustment is difficult to prove and is not a good substitute for the company's own desire to prudently minimize its costs to improve its bottom line.
>
> (MPSC, Report and Order, GR-2004-0209, page 38, issued September 21, 2004)

Q. PLEASE EXPLAIN WHY LACLEDE'S PROPOSAL WOULD CONSTITUTE SINGLE ISSUE RATEMAKING.

A. Laclede is proposing to change the PGA tariff in a manner that allows rates charged to customers to fluctuate based on the increase or decrease in uncollectible write-offs without considering all other relevant factors. Absent consideration of all other relevant factors, it cannot be determined if the resulting rates will result in a just and reasonable return on equity.

Q. WOULD CHANGES IN UNCOLLECTIBLE EXPENSE HAPPEN IN A VACUUM WITH RESPECT TO OTHER POSSIBLE CHANGES IN THE OPERATIONS OF THE UTILITY?

A. No. The overall cost of service is made up of a multitude of factors. Isolating or focusing on only one component, such as uncollectibles, fails to look at all relevant factors in determining the overall cost of service. Other factors may have changed that have a corresponding decrease or increase on the overall cost of service. Unless all factors are analyzed, it is not appropriate to single out one specific event. The effect of singling out a normal on-going cost for special treatment without consideration of all relevant factors is commonly referred to as single-issue ratemaking.

Q. DOES LACLEDE'S PROPOSAL ALSO CHANGE THE UNDERLYING FOUNDATION OF THE PGA?

A. Yes. Laclede wishes to include costs other than gas costs in the rates it is allowed to bill under the PGA which changes the very essence of the PGA process from a billed revenue basis to a cash collection basis. This moves the regulatory process from an opportunity to earn a return on equity toward a regulatory regime that would guarantee a return on equity.

Q. HAS THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES APPROVED A RESOLUTION IN OPPOSITION TO THE TREATMENT OF BAD DEBT EXPENSE IN PURCHASE GAS ADJUSTMENT CLAUSES?

A. Yes. I have attached that resolution as Schedule RWT-4 to my rebuttal testimony.

NON-QUALIFIED PENSION PLAN EXPENSE

Q. DOES PUBLIC COUNSEL OPPOSE THE TRACKER MECHANISM LACLEDE PROPOSED WITH REGARD TO NON-QUALIFIED PENSION EXPENSE AS DISCUSSED IN MR. FALLERT'S REBUTTAL TESTIMONY?

A. Yes, Public Counsel opposes the proposal to implement a tracker mechanism for these projected and primarily lump-sum payments to select employees.

Q. WHAT IS THE BASIS FOR PUBLIC COUNSEL'S OPPOSITION?

A. Public Counsel opposes implementing tracker mechanisms for normal cost of service components such as employee compensation. SERP costs are part of employee compensation for a select group of employees. Laclede's proposal for a SERP Tracker is premised on projected increases to SERP costs over the next three years. These costs are budgeted and dependent on retirement decisions of employees over which Laclede may or may not have any control. Further, there has been no determination that these costs are prudent and in the public interest. SERP costs are unlike qualified pension plan expenses. Mr. Fallert asserts that SERP costs should be treated consistently with qualified pension plans (Fallert rebuttal, page 13, lines 15 – 18). Unlike qualified pension plans, SERP costs are not covered by federal regulations (ERISA) and obligations that arise from those regulations.

Q. PLEASE EXPLAIN YOUR UNDERSTANDING OF LACLEDE'S REQUEST FOR AN SERP TRACKER?

A. Laclede proposes to adjust future rates to collect over a three-year period, the marginal difference between the level of SERP costs built into the revenue requirement in this case and the SERP costs incurred subsequent to this case. This tracker purports to match revenues received with expenses incurred. This request could be classified as a classic single issue ratemaking mechanism whose sole purpose is to eliminate all risk and incentive with managing a normal operating expense of the business.

Q. IS LACLEDE'S REQUEST FOR SERP TRACKER THE ONLY SIMILAR REQUEST IN THIS CASE?

A. No. Laclede's request for an SERP Tracker along with the request for either a Bad Debt Tracker or Bad Debt in the PGA mechanism is an attempt to change the regulatory paradigm from rate of return regulation to a guaranteed cost recovery model of regulation. Both of these proposed mechanisms are based on a guaranteed cost recovery ratemaking concept, wherein costs incurred in a prior period for the provision of service are paid for by customers in a period subsequent to the period. Both mechanisms accumulate costs and subsequently adjust rates charged the customer so as to provide revenues equal to those costs.

Q. PLEASE PROVIDE YOUR DEFINITION OF A GUARANTEED COST RECOVERY RATEMAKING CONCEPT.

A. By use of the term guaranteed cost recovery, I am referring to a model in which costs are incurred in one period and the customers would be required to pay those costs in a subsequent period. The "guaranteed" portion would be an addition to future rates that would represent a level of earnings. A guaranteed cost recovery model removes the incentives inherent in rate of return regulation to manage costs and revenues so that actual earnings realized are maximized for the firm's investors.

Q. MR. FALLERT REFERS TO THE "RECOVERY" OF COSTS IN HIS REBUTTAL TESTIMONY, PAGE 13, LINES 15 - 16. DO YOU HAVE ANY COMMENTS ON HIS USE OF THE TERM "RECOVERY"?

A. Yes. As previously stated, a guaranteed cost recovery regulatory model looks at costs previously incurred and sets a future rate sufficient to "recover" those costs. Therefore, the level of revenues is specifically tied to a specific nominal level of costs. In contrast, the focus of rate of return regulation is on earnings, not a specific level of costs. The nominal level of revenues and costs can vary significantly, so long as the level of earnings (derived by subtracting costs from expenses) results in an earnings rate (earnings / rate base) that is reflective of current market conditions. Rate of Return regulation is not a cost "recovery" process.

It can be said under rate of return regulation that revenues were sufficient to "cover" costs and thus generate a level of earnings. Thus, when used properly, the terms cover and recovery have two entirely different meanings in regulation.

Q. IS THE TERM "RECOVERY" THE BASIS FOR ANY TRADITIONAL RATE OF RETURN REGULATORY PROCESS?

A. No.

Q. DOES THE TERM "RECOVERY" HAVE ANY REGULATORY PROCESS USE?

A. An Accounting Authority Order (AAO) accounts for a past specific event and then adjusts future rates to generate revenues sufficient to "recover" the earnings that did not occur because of those prior period costs. An AAO is a non-traditional regulatory process that has been used to address extraordinary events that if left unaddressed would threaten service to customers and/or the financial integrity of the utility. They require special applications to and orders from the MPSC and in general apply only to an unusual event.

Earlier in my surrebuttal testimony, I have addressed problems with AAOs when they are used for normal expenses. A tracker mechanism is simply an AAO in a different "wrapper".

Q. IS THERE A DIRECT FINANCIAL INCENTIVE TO MANAGE COSTS EFFICIENTLY IN A GUARANTEED COST RECOVERY MODEL?

A. No. The only incentive that would be available is an "after the fact" review by the various parties in the regulatory proceeding. Those employees responsible for the cost management decisions or the information necessary to evaluate those decisions could easily be long gone by the time a review occurs. It should also be noted that the level of earnings under a guaranteed cost recovery model is an "adder" to the costs. This greatly reduces financial risk since the return is predetermined and then billed to the customers.

Q. HOW DOES RATE OF RETURN REGULATION ADDRESS THE INCENTIVE TO MANAGE COSTS?

A. The impact of all decisions made by the utility impact the level of incurred costs and revenues for the utility. Thus the level of earnings (revenues – costs) is directly and immediately impacted in either a positive or negative manner. This provides a very immediate financial incentive for making the best decision possible because earnings will be increased or maximized with good decisions. In contrast, a guaranteed cost recovery model treats costs separately from earnings. The linkage between revenues, costs, and earnings is severed under a guaranteed cost recovery model.

It should also be noted that the level of earnings can be monitored by utility management, utility investors, and the regulatory bodies. Thus these groups have the opportunity to respond to changes in earnings as appropriate. Reduced earnings can result in a review of management procedures and abilities or the need to file a general rate proceeding if internal efforts cannot materially impact earnings. The regulatory entities can review earnings to determine if rate adjustments are necessary to reflect current operational results and market conditions in order to adequately balance the needs of customers with those of investors. Regulatory review of earnings with a general rate case only as needed is a significantly more efficient use of resources than the on-going review activities necessary when single-issue rate mechanisms are used.

Q. WOULD THE PROPOSED SERP TRACKER LOOK AT ALL RELEVANT FACTORS IN DETERMINING THE OVERALL COST OF SERVICE OR REVENUE REQUIREMENT?

A. No. The SERP Tracker would only look at SERP costs and not all the components of the overall cost of service. Any changes in other components and the resulting impact on earnings would not be evaluated. This fact underscores that a single-issue rate mechanism severs the linkage between revenues, costs, and earnings.

Q. CAN THE CHANGES IN THESE REVENUE REQUIREMENT COMPONENTS CHANGE BUT THE RESULTING EARNINGS REMAIN CONSTANT?

A. Yes, as I previously have discussed.

Q. DOES RATE OF RETURN REGULATION ANTICIPATE THAT THE COMPONENTS OF THE REVENUE REQUIREMENT WILL CHANGE OVER TIME?

A. Yes. This is especially true if one focuses only on the nominal dollar basis of costs included in the utility revenue requirement. The utility industry is very dynamic and there is no question that costs, especially on a nominal basis, will vary with the passage of time due to multiple factors. Likewise the revenues a utility earns also vary with time. What is important is the comparison of the actual costs to the actual revenues to determine if the utility was able to achieve an adequate rate of return. Focusing on individual components of the cost structure of a utility is not representative of the overall operations of the utility. Failure to look at all relevant factors (revenues, expenses, investment, and capital costs) will provide minimal if any insight into the actual earnings of the utility.

Q. CAN YOU PROVIDE SOME EXAMPLES OF CHANGES THAT WOULD IMPACT A UTILITY'S EARNINGS IF YOU LOOKED AT THOSE CHANGES IN ISOLATION?

A. Yes. Increased overtime and cost of living increases would cause payroll expense to increase. Conversely, a voluntary separation plan would decrease the number of employees as compared to the revenue requirement determination. Declining customer levels or usage would have a detrimental impact on earnings to the extent the utility is unable to sell the displaced gas to other customers or the wholesale market. I could go through each and every line item included in the Staff's Accounting Schedules to provide similar examples.

The isolation of any actual expense subsequent to the determination of revenue requirement will undoubtedly have a change in nominal dollars from the expense "built" into the revenue requirement. However, it does not follow that actual earnings have been affected either positively or negatively. The determination of return on equity is the only financial measure of the relationship between revenues, expenses, investment, and capital costs.

Q. IF YOU ASSUME THAT ACTUAL EXPERIENCE IN THE YEAR SUBSEQUENT TO A GENERAL RATE PROCEEDING DOES IN FACT EXACTLY REFLECT THE REVENUE REQUIREMENT LEVELS OF ALL COSTS AND REVENUES; WILL THE ACTUAL EARNINGS BE THE SAME AS THE RETURN ON EQUITY LEVEL FOUND TO BE JUST AND REASONABLE?

A. No. The level of actual earnings for the period will be higher than the return on equity level in the general rate proceeding. This occurs because during the period the ratepayer will have paid a "return of" the utility's investment and this payment is reflected through the recording of depreciation expense which will result in a lower net plant-in-service, thus a lower rate base on which to calculate return on equity. This upwards influence on earnings is always present each and every month the utility operates. This does not mean that earnings will always grow as other revenue requirement components will change. However this should highlight the requirement under rate of return regulation to review and determine the relationship between all relevant factors and not to simply pick and choose individual components that achieve a goal of increasing earnings.

Q. HAS THE COMPANY ASSERTED THAT THESE SERP COSTS ARE SIGNIFICANT ENOUGH TO THREATEN ITS FINANCIAL INTEGRITY?

A. No. Based on my experience in regulatory matters over the past 30 years, I would assert that a management decision to incur discretionary expenses that would threaten the utilities financial integrity would be imprudent.

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes.

RESOLUTION

Calling Upon State Regulatory Authorities to resist the efforts of Local Gas Distribution Companies to expand the interpretation of gas cost to include a calculated portion of their uncollectible accounts expense or other non-gas costs in purchased gas cost recovery mechanisms.

Whereas, many natural gas Local Distribution Companies (LDCs) are permitted by State laws or regulations to change rates from time to time to track changes in the cost of natural gas supply and transportation through gas cost adjustments without a review of general rates;

Whereas, many such gas cost adjustment mechanisms provide for the periodic adjustment of rates to true up the difference between gas costs billed to consumers and gas costs incurred;

Whereas, the gas cost adjustment mechanisms have been found justified due to characteristics of the costs associated with purchasing and transporting gas to an LDC's distribution system; i.e., that such cost may make up a sizable portion of the total rate for natural gas service, that such costs are affected by many market conditions that are not within the control of the LDC, that such gas costs are volatile and may change significantly in a short time;

Whereas, some State regulatory authorities have been petitioned by LDCs to broaden the sort of expenses that may be recovered through gas cost adjustment mechanisms to include a portion of the expenses associated with uncollectible charges experienced by the LDC;

Whereas, the characteristics of uncollectible accounts are materially different from gas costs; i.e., while they are somewhat affected by variations in rates caused by changes in gas costs, uncollectible accounts expenses do not make up a sizeable portion of the total rate for natural gas service, they are affected by factors such as staffing and procedures within the control of the LDC, and the changes in uncollectible costs do not tend to be volatile;

Whereas, an expanded definition of gas costs would shift more risk to ratepayers and may remove traditional or performance based incentives for utilities to minimize costs;

THEREFORE BE IT RESOLVED, that NASUCA encourages state regulatory authorities to limit the use of gas cost adjustment mechanisms to the cost of purchasing and transporting natural gas supply to the LDC's distribution system.

BE IT FURTHER RESOLVED, that the Gas Committee of NASUCA, with the approval of the Executive Committee of NASUCA, is authorized to take all steps consistent with this Resolution in order to secure its implementation.

Approved by NASUCA:

Place: Austin, Texas

Date: June 15, 2004