

Exhibit No.:
Issue: PGA revisions to address gas
cost portion of bad debt
write-offs
Witness: Glenn W. Buck
Type of Exhibit: Direct Testimony
Sponsoring Party: Laclede Gas Company
Case No.: GT-2009-0026
Date Testimony
Prepared: September 16, 2008

LACLEDE GAS COMPANY

GT-2009-0026

DIRECT TESTIMONY

OF

GLENN W. BUCK

SEPTEMBER 2008

Laclede Exhibit No. 3
Case No(s) GT-2009-0026
Date 1-05-09 F.pir KE

TABLE OF CONTENTS

Purpose of Testimony	2
The Gas Cost Portion of Bad Debt Write-Offs is More Appropriately Recovered through the PGA/ACA Mechanism Rather than Base Rates Because of the Volatility, Magnitude and Largely Uncontrollable Nature of Such Costs	3
The Company will Continue to have Powerful Incentives to Aggressively Pursue Collection Activities	8

DIRECT TESTIMONY OF GLENN W. BUCK

1 Q. Please state your name and business address.

2 A. My name is Glenn W. Buck, and my business address is 720 Olive St., St. Louis,
3 Missouri, 63101.

4 Q. What is your present position?

5 A. I am presently employed as Manager, Financial Services, for Laclede Gas Company
6 ("Laclede" or "Company").

7 Q. Please state how long you have held your position and briefly describe your
8 responsibilities.

9 A. I was appointed to my present position in March, 1999. In this position, I am responsible
10 for the financial aspects of rate matters generally, including financial analysis and
11 planning. I am also responsible for preparing various financial forecasts, overseeing the
12 Company's accounts payable functions, and monitoring regulatory trends and
13 developments.

14 Q. What was your experience with the Company prior to becoming Manager, Financial
15 Services?

16 A. I joined Laclede in August, 1986, as a Budget Analyst in the Budget Department. I was
17 promoted to Senior Budget Analyst in June, 1988, and transferred to the Financial
18 Planning Department in December, 1988 as an Analyst. I was promoted to Senior
19 Analyst in February, 1990, Assistant Manager in February, 1994, and Manager in January
20 1996. I acted in that capacity until being appointed to my current position.

21 Q. What is your educational background?

1 A. I graduated from the University of Missouri - Columbia, in 1984, with a Bachelor of
2 Science degree in Business Administration.

3 Q. Have you previously filed testimony before this Commission?

4 A. Yes, I have, in Case Nos. GR-94-220, GR-96-193, GR-99-315, GR-2001-629, GT-2001-
5 329, GR-2002-356, GO-2004-0443, GR-2005-0284, and GR-2007-0208. Further, I
6 provided oral testimony before the Commission regarding the Infrastructure System
7 Replacement Surcharge rulemaking in Case No. AX-2004-0090.

8 **Purpose of Testimony**

9 Q. What is the purpose of your testimony?

10 A. The purpose of my testimony is to address those provisions of the Company's tariff filing
11 in this case that would authorize Laclede to reflect in its Purchased Gas Adjustment
12 ("PGA")/Actual Cost Adjustment ("ACA") mechanism both increases and decreases in
13 the gas cost portion of the Company's net bad debt write-offs, also known as
14 uncollectible expense. Specifically, I will:

- 15 1. Demonstrate why the gas cost portion of bad debt write-offs is the kind of cost
16 item that the Commission has traditionally recognized as warranting a more
17 accurate and effective form of cost recovery than what is normally provided
18 through base rate treatment; and
- 19 2. Show that even with implementation of this more accurate form of cost recovery,
20 the Company would still retain a very powerful incentive to aggressively pursue
21 collection activities aggressively by virtue of the fact that it will still have to
22 absorb (or have the opportunity to retain) from 1/3 to 1/4 of any increase or
23 decrease in its bad debt write-offs between rate cases.

The Gas Cost Portion of Bad Debt Write-Offs is More Appropriately Recovered through the PGA/ACA Mechanism rather than Base Rates Because of the Volatility, Magnitude and Largely Uncontrollable Nature of Such Costs

Q. Historically, how have bad debt write-off levels been determined and recovered in rates?

A. In the past, an allowance for bad debt write-offs has traditionally been determined as one of a number of cost items that combine to make up the overall revenue requirement approved in a general rate case proceeding. Typically, that allowance will be based on an estimate of the bad debt write-off levels the utility may incur once new rates go into effect. This estimate might be based on a multi-year average of actual write-offs, or a multi-year average of the write-off percentage as compared to revenues. Or it might be derived based on a single year of data, particularly in those instances where there is an upward or downward trend in the cost item. In fact, because of the increasing trend in bad debts, Staff proposed using the write-offs from the 12 months ended March 2007 in Laclede's last rate case to estimate an allowance for this cost item. Whatever method is used to derive the allowance, however, the fact remains that under the current approach rates are based on an estimate of bad debt write-offs rather than on an ongoing tracking and reconciliation of the actual write-offs incurred by the utility. This, in turn, means that the rates charged customers for this expense item will almost always vary from what the utility actually incurs for the expense.

Q Are all utility costs determined and recovered in this manner?

A. No. Many of the costs incurred by Laclede to provide utility service are determined and recovered based on a tracking and reconciliation of actual costs. The most notable example, of course, is the gas costs that Laclede incurs to buy, transport and store the gas supplies used to serve its customers -- a cost that makes up from two thirds to three

1 fourths of the customer's bill. Rather than simply estimate what these costs may be and
2 then include an allowance for them in rates, the PGA/ACA mechanism tracks and
3 reconciles those costs as they increase and decrease over time so that customers end up
4 paying no more and no less than the actual gas costs incurred to serve them.

5 Q. Are other costs incurred to provide utility service also tracked and reconciled in a way
6 that ensures that customers will pay no more and no less than the actual costs to serve
7 them?

8 A. Yes, over the years various kinds of trackers have also been used by the Commission to
9 address increases and decreases in a number of other cost-of-service items, including
10 pension expenses, post-retirement medical benefit expenses, environmental costs and the
11 cost impact of prior Cold Weather Rule changes.

12 Q. Why have these various cost items been treated differently than others?

13 A. There are varied reasons as to why these costs have been tracked and reconciled to actual
14 costs rather than simply estimated and included in rates. However, most of these costs
15 share at least two of three characteristics which, in combination or alone, make it difficult
16 to rely on estimates as a reasonable means of establishing a representative level of costs
17 for setting rates. Specifically such costs are significant, volatile in nature and/or
18 significantly influenced by regulatory mandates or other factors that are largely beyond
19 the control of utility management. For example, as the Commission well knows, natural
20 gas commodity costs are extremely volatile in nature and account for a very large
21 percentage of the typical gas utility's cost of service. Such costs are also driven by
22 changes in the unregulated wholesale price of natural gas and other factors that are
23 beyond the control of the gas utility. Similarly, pension expense can be both a significant

1 component of a utility's cost of service and may vary widely from year to year based on
2 how well or how poorly the financial markets do – a factor that is also outside the control
3 of the utility. Expenses incurred in complying with changes in the Commission's Cold
4 Weather Rule are an example of a significant cost that the Commission has repeatedly
5 determined should be tracked and reconciled to actual costs largely because the cost arose
6 from an external regulatory mandate that, for obvious reasons, was beyond the control of
7 the utility.

8 Q. Do bad debt write-offs in general, and the gas cost portion of bad debt write-offs in
9 particular, share any of these characteristics?

10 A. Yes. In fact, this cost item shares all of them. In terms of volatility, the following table
11 demonstrates how significantly the Company's total bad-debt write-off levels have varied
12 from year to year over the past decade:

<u>Fiscal</u> <u>Year</u>	<u>Actual</u> <u>Write-offs</u>	<u>Percentage</u> <u>Change</u>
1998	7,584,521	
1999	5,377,844	-29%
2000	4,583,253	-15%
2001	5,379,383	17%
2002	11,294,193	110%
2003	7,481,477	-34%
2004	9,139,788	22%
2005	10,547,022	15%
2006	10,724,707	2%
2007	11,352,394	6%

13
14 As the data shows, bad debt write-offs declined by double digit percentage amounts in
15 each year between 1998 and 2000, only to more than double from 2001 to 2002. They
16 then declined again by more than 30% in 2003 only to rise by double digit percentage
17 amounts in 2003 and again in 2004. While year to year changes in bad debt write-off

1 levels have not been as significant in the last few years, history strongly suggests that this
2 cost item will continue to be subject to significant volatility in the years ahead. As a
3 consequence, the use of base rate estimates or allowances to recover such costs is a
4 singularly poor and ineffective substitute for the kind of actual cost tracking and
5 reconciling mechanism that is afforded by the Company's PGA/ACA mechanism.

6 Q. Are bad debt write-offs a significant cost item?

7 A. They clearly are to the Company. While a 50% percent increase or decrease in bad debt
8 write-offs might affect a residential customer's bill by less than 50 cents a month, the \$5
9 million or so in added or reduced bad debt costs for the Company can equate to 10% or
10 more of its entire net income for a given year. By any measure, this is a significant cost
11 impact.

12 Q. Are the level of bad debt write-offs experienced by the Company largely beyond its
13 control?

14 A. Yes. While an unregulated business could exercise a significant amount of control over
15 its bad debt write-off levels within the constraints of applicable credit and collection
16 laws, utilities, including Laclede, are limited in the degree to which they can control bad
17 debts because they must work within the narrower service, credit and payment constraints
18 imposed by regulation. Accordingly, bad debt write-off levels are predominantly driven
19 by factors outside the control of the utility. For example, write-offs are, in part, a
20 function of billed revenues, and the largest portion of a gas utility's billed revenues is gas
21 costs. The cost of natural gas is highly volatile and effectively beyond the utility's
22 control, as the Commission has acknowledged in the recent Empire and Aquila rate cases
23 where fuel adjustment clauses have been authorized. The relationship between revenue

1 and bad debt levels has also been recently recognized by the Commission, and its Staff,
2 in their practice of adjusting the allowance for bad debt write-offs up to reflect the
3 increase in authorized revenue levels in general rate proceedings.

4 Q. Are bad debt write-off levels also driven by other factors beyond the Company's control?

5 A. Yes, as discussed in greater detail in the Direct Testimony of Michael Cline, write-off
6 levels can be significantly influenced by changes in regulatory policies, such as changes
7 in Cold Weather Rule payment requirements. Indeed, a review of the historical write-off
8 data presented above show significant increases in bad debt write-off levels coinciding
9 with changes in Cold Weather Rule provisions, both in 2001-2002 and again in 2005-
10 2007. Other factors beyond the utility's control, including the economy and weather, can
11 also have some effect.

12 Q. In view of these considerations, do you believe it is more appropriate to recover the gas
13 cost portion of bad debt write-offs through the PGA/ACA mechanism rather than base
14 rates?

15 A. Yes, I think the case for doing so is very persuasive. Without question, this cost item
16 shares all of the attributes of those other cost items that the Commission has traditionally
17 recognized should be tracked and reconciled to actual costs in the interests of accuracy
18 and fairness to both the utility and the customer. Indeed, the gas costs associated with
19 bad debt write-offs are identical in every respect to other gas costs that Laclede has been
20 permitted to recover through the PGA/ACA mechanism for more than four decades now.
21 For all of these reasons I have discussed, the same treatment should be afforded these gas
22 costs.

1 Q. Does this mean that the amounts paid by customers for bad debt write-offs will
2 necessarily increase?

3 A. Absolutely not. Over the long term, one could only conclude that the Company's
4 proposal would have that effect if one were to also conclude that base rate treatment is
5 designed to and has the effect of chronically shorting the Company on its recovery of
6 such costs -- a result that would not be at all appropriate in any event. And even over the
7 short term, as gas costs hopefully continue to come down from historically high levels,
8 the resultant write-offs will also be relieved and result in lower rates being flowed back to
9 customers through the PGA, than would otherwise have been the case. At the same time,
10 unlike with past ratemaking treatment, the tariff will ensure that the total customer bill is
11 at least 75% more accurate than it was in the past when it comes to bad debt write offs.

12 **The Company will Continue to have**
13 **Powerful Incentives to Aggressively Pursue Collection Activities**
14

15 Q. Please describe why the Company will still have powerful incentives to aggressively
16 pursue collection activities in the event its proposal to recover the gas cost portion of its
17 bad debt write-offs is approved by the Commission.

18 A. As described in greater detail in the Direct Testimony of Company Witness Michael T.
19 Cline, the mechanics behind the tariff is that the Company would compare actual net
20 write-offs to the amount embedded in current rates. To the extent that these actual write-
21 offs were greater than, or less than, the amount embedded in current rates, approximately
22 75% of the difference would be flowed through the PGA/ACA process based on the
23 current ratio of gas costs to non-gas costs. In other words, the Company would retain
24 25% of the savings, or absorb 25% of the cost of any decrease or increase in bad debt
25 write-off levels.

1 Q. Will a 25% retention create an adequate incentive to the Company to continue
2 maintaining an aggressive approach towards customer collection activity?

3 A. Absolutely. Since 2000, write-offs have ranged from \$4.6 million to \$11.4 million.
4 Based on the difference between these two extremes, and assuming rates were set on
5 either one, the Company's retention at 25% would be equal to approximately \$1.7 million
6 on an after-tax basis, or a change in return on equity of approximately 40 basis points.
7 Further, within that same timeframe, the largest year-over-year variation in write-offs
8 was almost \$6.0 million, with a Company retention at 25% approximating \$1.5 million.

9 Q. Are there other reasons why you believe the Commission should consider a 25%
10 absorption/retention percentage to be an adequate incentive?

11 A. Several examples demonstrate that the Commission, as well as the Commission Staff,
12 believes that 25% represents an adequate incentive to the Company. One only has to
13 look to the Company's off-system sales sharing mechanism approved as part of the
14 Stipulation and Agreement in our last rate case, GR-2007-0208. The mechanism allows
15 the Company to retain anywhere between 15% - 30% of all off-system sales and capacity
16 release revenue, in a progressive grid:

<u>Off-System Sales Level</u>	<u>Company Sharing %</u>
1 st \$2 million	15%
Next \$2 Million	20%
Next \$2 Million	25%
Over \$6 Million	30%

1 Q. Please continue.

2 A. Other examples included the recently approved fuel adjustment clauses approved by the
3 Commission for both Empire and Aquila, where the Commission found that a 5% sharing
4 mechanism provided adequate incentive. Significantly, in the Empire case, the Staff was
5 advocating a sharing mechanism of 20% to 30%. There are also numerous other
6 examples of incentive mechanisms that have been approved by the Commission over the
7 years where equivalent incentive percentages have been deemed adequate and
8 appropriate.

9 Q. Does this complete your direct testimony?

10 A. Yes.

11

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**


In the Matter of Laclede Gas Company's)	
tariffs designed to permit early)	
implementation of Cold Weather Rule)	Case No. GT-2009-0026
provisions and to permit Laclede to collect)	Tariff number JG-2009-0033
the gas cost portion of its write-off's)	
through the PGA)	

AFFIDAVIT

STATE OF MISSOURI)
) SS.
CITY OF ST. LOUIS)

Glenn W. Buck, of lawful age, being first duly sworn, deposes and states:

1. My name is Glenn W. Buck. My business address is 720 Olive Street, St. Louis, Missouri 63101; and I am Manager, Financial Services for Laclede Gas Company.
2. Attached hereto and made part hereof for all purposes is my direct testimony, consisting of pages 1 to 10.
3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.



Glenn W. Buck

Subscribed and sworn to before me this 16th day of September, 2008.

M. D. WILSON
Notary Public — Notary Seal
STATE OF MISSOURI
St. Louis County
My Commission Expires: Feb. 27, 2012
Commission #: 05668298

