Exhibit No.:
Issue(s): Year 2000 Compliance Cost; Y2k, SRP & MGP AAOs; AAO Continuance
Witness/Type of Exhibit: Robertson/Rebuttal
Sponsoring Party: Public Counsel
Case No.: GR-99-315

REBUTTAL TESTIMONY

OF

TED ROBERTSON

Submitted on Behalf of
the Office of the Public Counsel

LACLEDE GAS COMPANY

Case No. GR-99-315

August 5, 1999

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

AFFIDAVIT OF TED ROBERTSON

STATE OF MISSOURI	)	
	)	ss
COUNTY OF COLE	)	

Ted Robertson, of lawful age and being first duly sworn, deposes and states:

1. My name is Ted Robertson. I am a Public Utility Accountant for the Office of the Public Counsel.

2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony consisting of pages 1 through 58.

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.

Ted Robertson

Subscribed and sworn to me this 5th day of August, 1999.

Mary S. Koestner
Notary Public

My commission expires August 20, 2001.

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REBUTTAL TESTIMONY

OF

TED ROBERTSON

LACLEDE GAS COMPANY

CASE NO. GR-99-315

INTRODUCTION

Q. PLEASE STATE YOUR NAME AND ADDRESS.

A. Ted Robertson, PO Box 7800, Jefferson City, Missouri 65102.

Q. ARE YOU THE SAME TED ROBERTSON THAT HAS PREVIOUSLY TESTIFIED IN THIS CASE?

A. Yes, I am.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of this testimony is to support the Public Counsel's recommendations regarding the appropriate regulatory treatment of the Company's "Year 2000" compliance costs and costs deferred pursuant to the Y2K, the safety replacement program and the manufactured gas plant accounting authority orders. I will also present testimony rebutting the Company's position on the continuance of the current accounting authority orders.

YEAR 2000 COMPLIANCE COSTS

Q. WHAT IS THE ISSUE?

A. During the test year the Company expensed certain costs it incurred to become Year 2000 compliant. The Company's response to Public Counsel Data Request No. 1042 states:

> The Company's costs to modify existing systems for Year 2000 were expensed as incurred through June 30, 1998, and capitalized thereafter in accordance with the Stipulation and Agreement in Case No. GR-98-374. The amounts expensed were charged to maintenance work orders (50000 series) which closed to operating expense accounts.

Company further states in its response to Public Counsel Data Request No. 1081, that for the 12 months ended December 1998, the amount it expensed was $1,060,046.

Q. PLEASE EXPLAIN THE PURPOSE OF THE YEAR 2000 COMPLIANCE PROJECT.

A. Apparently, the Company's computer systems processed transactions based on storing two digits for the year of a transaction (for example, "96" for 1996), rather than a full four digits. Because the computer systems that are based on two-digit years are not programmed to consider the start of a new century they required modification. Essentially, the system modification requires only the expansion of the date field from

two digits to four digits. Systems that are not modified to process Year 2000 transactions with year "0000" rather than year "00" may encounter significant processing inaccuracies or even inoperability.

Q. WHY DID THE COMPANY EXPENSE THE COSTS IT INCURRED?

A. It's the Public Counsel's understanding that the costs were expensed in accordance with the Company's interpretation of the Emerging Issues Task Force ("EITF") Issue No. 96-14 statement. EITF Issue No. 96-14 states:

> The Task Force reached a consensus that external and internal costs specifically associated with modifying internal-use software for the Year 2000 should be charged to expense as incurred.

Q. WHAT IS THE EMERGING ISSUES TASK FORCE?

A. Under securities legislation enacted by Congress in the 1930's, the Securities and Exchange Commission ("SEC") has the responsibility for establishing accounting principles for entities whose securities are sold or traded in interstate commerce. The SEC has delegated primary responsibility for establishing Generally Accepted Accounting Principles ("GAAP") to the Financial Accounting Standards Board ("FASB"). The FASB instituted the Emerging Issues Task Force in 1984 to assist with the early identification of issues affecting financial reporting and of problems in

implementing authoritative pronouncements. There are thirteen voting members of the EITF and agreement among the members on an issue is recognized as a "consensus," if no more than two members disagree with a position.

Q. IS EITF ISSUE NO. 96-14 GAAP?

A. Yes. However, while the Emerging Issues Task Force, and its pronouncements (e.g., EITF Issue No. 96-14) are considered an authoritative accounting body, they are lower in status, in the accounting hierarchy, than the Financial Accounting Standards Board and its accounting statements.

Q. WHAT IS THE SIGNIFICANCE OF THE FINANCIAL ACCOUNTING STANDARDS BOARD BEING A HIGHER ACCOUNTING AUTHORITY THAN THE EMERGING ISSUES TASK FORCE?

A. The significance is, I believe, that the Commission can order the Company to capitalize and amortize the costs associated with the Year 2000 issue and still comply with GAAP. As long as the capitalization and amortization are compliant with the language contained within FASB Statement No. 71, the Company and the costs would be considered in compliance with GAAP.

Q. DOES PUBLIC COUNSEL BELIEVE THAT THE COSTS THE COMPANY INCURRED TO BECOME YEAR 2000 COMPLIANT SHOULD HAVE BEEN EXPENSED ACCORDING TO THE DIRECTIVE OF EITF ISSUE NO. 96-14?

A. No. Public Counsel believes that the costs incurred by the Company to modify its computer systems for the date field expansion should have been capitalized to the appropriate plant accounts and then amortized over a period representative of the usefulness or the service life of the respective plant. While the EITF Issue No. 96-14 statement is a consensus of an authoritative accounting body, the EITF is not the premier accounting body responsible for the promulgation of GAAP. The Financial Accounting Standards Board has that responsibility.

Q. IS IT THE PUBLIC COUNSEL'S RECOMMENDATION THAT ALL THE YEAR 2000 COSTS THAT WERE EXPENSED DURING THE TEST YEAR SHOULD BE CAPITALIZED AND AMORTIZED OVER THE USEFUL LIVES OF THE COMPUTER SYSTEMS?

A. No. Company's response to Public Counsel Data Request No. 1081 shows that during the Company's last general rate increase case test year, and known and measurable period, it included approximately $571,000 of Year 2000 expenses that were not adjusted out of the case or capitalized and amortized. The end date of the known and measurable period was February 1998 thus, during the months of January and February 1998 the Company

incurred costs which were ultimately built into its current rates. The costs incurred during these two months was $179,903.

The Public Counsel's recommendation is that the calendar year 1998 expense of $1,060,046 discussed earlier should be reversed and then reduced by the $179,903 with the remainder (i.e., $880,143) being capitalized and amortized over the useful life of the software modifications. If the Commission allows the Company to recover the entire $1,060,046, either as an expense or via capitalization and amortization, that would create a double recovery situation for ratepayers. The Company would recover the $179,903 twice; the first time in current rates and the second time in rates which will be set in the instant case. Public Counsel recommends that the Commission order the Company to capitalize and amortize the $880,143, that I identified above, and that no other Year 2000 costs be allowed in the expense structure of the Company's cost of service in the instant case.

Q. PLEASE LIST THE YEAR 2000 PROJECTS FOR WHICH THE COMPANY INCURRED COSTS.

A. The following is a listing of the projects for which the Company incurred Year 2000 compliance costs:

Work Order	Description	Total
52828	CIS System	$ 372,100.94
52841	Payroll System	$ 224,981.90
52842	Other Systems	$ 458,297.80
52843	LAN System	$ 4,664.94
Total		$1,060,045.50

(Source: Public Counsel Data Request No. 1081)

Q. PLEASE DESCRIBE THE PURPOSE OF THE CUSTOMER INFORMATION SYSTEM COSTS CHARGED TO WORK ORDER NO. 52828.

A. According to the Company's "Work Order Authorization - Capital Description And Necessity Statement", the costs were incurred to modify the customer information system applications to meet Year 2000 processing requirements. These modifications include but are not limited to date field expansion to four digits, reclaiming unused data fields, and other modifications required for new technologies or four digit year processing. These modifications will allow the customer information system to continue processing applications after year 2000.

Q. PLEASE DESCRIBE THE PURPOSE OF THE PAYROLL SYSTEM COSTS CHARGED TO WORK ORDER NO. 52841.

A. According to the Company's "Work Order Authorization - Capital Description And Necessity Statement", the payroll system will be modified to meet Year 2000 processing

requirements. These modifications include but are not limited to date field expansion to four digits, implementation of an upgraded payroll database, and other modifications required for new technologies or four digit year processing. These modifications will allow the payroll system to continue processing applications after year 2000.

Q. PLEASE DESCRIBE THE PURPOSE OF THE OTHER SYSTEM COSTS CHARGED TO WORK ORDER NO. 52842.

A. According to the Company's "Work Order Authorization - Capital Description And Necessity Statement", the costs were incurred to modify the material management system, service location system, leak control system and anode system to meet Year 2000 processing requirements. These modifications include but are not limited to date field expansion to four digits, reclaiming unused data fields, and other modifications required for new technologies or four digit year processing. These modifications will allow the these systems to continue processing applications after year 2000.

Q. PLEASE DESCRIBE THE PURPOSE OF THE LOCAL AREA NETWORK "LAN" SYSTEM COSTS CHARGED TO WORK ORDER NO. 52843.

A. According to the Company's "Work Order Authorization - Capital Description And Necessity Statement", the costs were incurred to modify the LAN system to meet Year 2000 processing requirements. These project modifications include, but are not limited to,

date field expansion to four digits, reclaiming unused data fields, and other modifications required for new technologies or four digit year processing. These modifications will allow the LAN system to continue processing applications after year 2000.

Q. HAVE ALL THE COSTS THE COMPANY INCURRED FOR ITS YEAR 2000 COMPLIANCE EFFORTS BEEN BOOKED TO EXPENSE ACCOUNTS DURING THE TEST YEAR?

A. No. Subsequent to the Commission's order in Laclede's last general rate increase case, the Company transferred the Year 2000 compliance costs it incurred after June 1998 from the series 50000 work orders to work order no. 60462. Work order no. 60462 is utilized for aggregating the costs for the Company's general ledger replacement project. It's the Public Counsel's understanding that as of the end of March 1999, the end of the known and measurable period, this project was still listed as construction work in progress and not plant in service. Since these Year 2000 costs are charged to a work order for plant that is not currently in-service they are not included in the cost of service in the instant case.

Furthermore, Company's response to OPC Data Request No. 1014 indicates that the Company may have charged a portion of or double-counted some actual Year 2000 compliance costs to work order nos. 60261 and 60262. Public Counsel is waiting for Company's response to data requests that should clarify the issue.

Q. WOULD CAPITALIZATION AND AMORTIZATION OF THE COMPUTER SOFTWARE COSTS RESULT IN THE COMPANY RECOVERING FROM RATEPAYERS ALL EXPENDITURES INCURRED BUT SIMPLY OVER A LONGER PERIOD?

A. Yes, it would. Amortization of the capitalized costs, if ordered by the Commission, would permit the Company to recover all undisputed expenditures it incurred.

Q. IF THE COMMISSION ORDERS THAT THE COSTS ARE TO BE CAPITALIZED WOULDN'T THEY THEN BE INCLUDED IN RATE BASE THUS ALLOWING THE COMPANY TO ALSO EARN A RETURN ON THE COSTS?

A. Yes, that is correct. If the Year 2000 compliance costs are capitalized, the Company would not only recover a "return of" the expenditures they would also recover a "return on" the expenditures. This means that the Company would earn an extra return on the costs it incurred to develop and implement the various computer projects.

Q. REGARDING THE PAYROLL SYSTEM, CUSTOMER SERVICE SYSTEM, OTHER SYSTEMS AND LAN SYSTEM ISN'T IT REASONABLE TO ASSUME THAT THE YEAR 2000 MODIFICATION OF EACH OF THESE SYSTEMS WILL ENABLE THE COMPANY TO CONTINUE THEIR UTILIZATION FOR MANY YEARS TO COME?

A. Yes, it is. Though I cannot tell you exactly how long each system will be operating, I believe that it is reasonable to assume they will be in existence and utilized by the Company for many years to come.

Q. IF THE SYSTEMS HAD NOT BEEN MODIFIED TO ACCEPT THE DATE FIELD EXPANSION WOULD THEY HAVE FAILED TO OPERATE?

A. The company Laclede hired to fix the problem apparently thinks they would have. In a 1998 press release I obtained from Walker Interactive Systems, Inc., it states:

> Laclede, a public utility that distributes natural gas to approximately two million people in eight Missouri counties, uses a massive customer information system containing over one million lines of code to invoice their customer base. Left unchanged, Laclede's invoicing system would have been rendered useless at the turn of the century, ultimately crippling the company's invoicing and billing practices and impacting revenues.
>
> (Emphasis added by Public Counsel)

Q. IF THE COMPUTER SYSTEMS ARE TO BE UTILIZED, FOR THE BENEFIT OF THE COMPANY AND RATEPAYERS, FOR MANY YEARS TO COME, ISN'T IT A FAIR ASSUMPTION THAT THE EXPENDITURES INCURRED FOR THE MODIFICATION OF THE SYSTEMS SHOULD BE MATCHED WITH THE

REVENUES THAT THEY PROVIDE FOR EACH YEAR THAT THE SYSTEMS ARE IN OPERATION?

A. Yes, it is. While it may not be possible to match exactly the cost of the system modifications with the revenues achieved via the benefits the systems provide the Company, the accounting matching principle does require that an attempt to do so should be made. A simple analogy would be a company's purchase of a service vehicle. Once purchased it is expected that the vehicle will provide a service and benefit to the company for a number of years so the company capitalizes its costs and depreciates it over its expected life. The theory behind the Public Counsel and Staff recommendations are no different than that provided in the simple purchased vehicle example. The computer systems that were modified are expected to provide an operating benefit for a significant number of years. Given that they are expected to exist for a number of years, it is only reasonable that the costs incurred to extend their lives should be allocated to the years that they are in service.

Q. PLEASE EXPLAIN THE MATCHING PRINCIPLE AND ITS PURPOSE.

A. The matching principle states, that for any reporting period, consistent with the recognition criteria, revenues should be determined according to the revenue principle, then the expenses incurred in generating the revenue of the period should be recognized for that period. The essence of the matching principle is that, as revenues are earned, certain assets

are consumed (e.g., supplies) or sold (e.g., inventory) and services are used (e.g., salaries). The cost of those assets and services used up should be recognized and reported as expense of the period during which the related revenue is recognized. If the costs incurred provide benefits in more than one year they should be recorded as an asset. Public Counsel believes it likely that the Company's Year 2000 project costs will provide a benefit to customers and shareholders for many years beyond the current year. Therefore, Public Counsel believes that it is appropriate, for regulatory purposes, to capitalize the costs incurred and then amortize them over the expected lives of the systems which were modified.

Q. OVER WHAT TIME PERIOD SHOULD THE COMPANY BE ORDERED TO AMORTIZE THE CAPITALIZED YEAR 2000 COSTS?

A. Based on our experiences in the recent Missouri Gas Energy rate cases, Case No. GR-96-285 and GR-98-140, and the Missouri Public Service Case No. ER-97-394, the Public Counsel believes that a ten year amortization of the capitalized costs is a reasonable time period over which to amortize the Year 2000 compliance costs.

Q. COMPANY 'S ACTIONS IMPLY THAT THE COSTS INCURRED TO INSURE IT IS YEAR 2000 COMPLIANT WERE BASICALLY A NORMAL EVERYDAY MAINTENANCE EXPENSE. DO YOU AGREE WITH HIS ASSESSMENT?

A. No.

Q. IF THE YEAR 2000 COSTS WERE JUST A NORMAL EVERYDAY "FIXING" OF SOMETHING GONE WRONG OR MINOR MAINTENANCE OF SOMETHING SUCH AS A BILLING SYSTEM WOULD PUBLIC COUNSEL OPPOSE INCLUDING THE ASSOCIATED COSTS AS A NORMAL EXPENSE IN THE FINAL EARNINGS REPORT?

A. Probably not, but Public Counsel believes that the decision to accept or to oppose test year expensing for maintenance expenditures should be made after a through review on a case by case basis. However, the expenditures at issue, in this proceeding, were not incurred to "fix" a minor problem or as an everyday normal modification (e.g., a city tax rate change) of an operating system program. Public Counsel believes that the Y2K costs were incurred to mitigate and/or prevent the possibility of a major malfunction of one or more of the Company's computer operating systems when the next calendar year begins. As such, Public Counsel believes that the lives of the respective systems have been extended because of the modifications. Therefore, the costs incurred to extend the programs lives should be capitalized and amortized.

Q. COMPANY'S ACTIONS REGARDING ITS EXPENSING OF THE YEAR 2000 COSTS IMPLIES THAT THE COSTS ARE RECURRING ON A GOING FORWARD BASIS. DO YOU AGREE WITH THAT ASSESSMENT?

A. No. While Public Counsel does agree that the Year 2000 compliance issue is a unique item we do not believe that the costs the Company has incurred for this project should be treated as a part of the annual operating expenses of the Company. The costs incurred for this project are simply not a normal everyday maintenance item.

Q. HAS THE MPSC STAFF ALSO RECOMMENDED THAT THE YEAR 2000 COSTS YOU'VE IDENTIFIED SHOULD BE CAPITALIZED AND AMORTIZED?

A. Yes, it has. Beginning on page 7, line 17, and continuing through to page 9, line 2, of the direct testimony of MPSC Staff witness, Mr. Stephen M. Rackers, he makes the same recommendation as the Public Counsel.

Q. PLEASE SUMMARIZE THE PUBLIC COUNSEL'S POSITION ON THIS ISSUE.

A. The Public Counsel recommends that the Commission order the Company to reverse the accounting entries it utilized to expense the Year 2000 compliance costs it incurred during the period March through June of 1998. The expenditures should be capitalized and amortized over the lives of the respective computer operating systems to which the modification of the date field occurred. Public Counsel believes also that there is

precedence for utilizing a ten year amortization period for the costs incurred and recommends that this time period be approved by the Commission.

YEAR 2000 AAO

Q. WHAT IS THE ISSUE?

A. Essentially, The Company was involved in the purchase and replacement, enhancement, development and implementation of several large computer hardware and software projects during the test year and months prior. Once an individual project was transferred from construction work in progress to in-service status, Company began booking a deferral for depreciation expense, carrying costs and property taxes pursuant to what it believes was a Commission approved accounting authority order.

Q. PLEASE CONTINUE.

A. Company's response to Public Counsel Data Request No. 1042 states:

> The computer project costs identified in OPC Data Request No. 1014 represent costs for replacements which are capitalized in work orders (60000 series) which close to work in progress and eventually plant accounts for hardware or software.
>
> (Emphasis added by OPC)

Q. WHAT IS THE PUBLIC COUNSEL'S POSITION ON THIS ISSUE?

A. It is Public Counsel's position that most, if not all, of the deferred costs the Company booked via the AAO are not related to projects which support the Year 2000 compliance issue. The Company's **wholesale** replacement of various computer hardware and software systems is not relevant to the Year 2000 compliance costs discussed in the EITF Issue No. 96-14 nor are they items of costs upon which the AAO allowed the Company to calculate deferred costs.

Most of the computer projects upon which the Company calculated the deferred costs should have simply been capitalized as investment to plant accounts, once placed in-service, just as any normal investment would have been. No deferrals of any other costs should have even been calculated much less allowed. Essentially, the Company incorrectly characterized the various projects and their costs as items which were to receive AAO treatment.

Q. PLEASE DESCRIBE THE COMPUTER PROJECTS UPON WHICH THE COMPANY CALCULATED THE REQUESTED DEFERRED COSTS.

A. As of the end of the known and measurable period, March 31, 1999, the Company had transferred $221,338.70 and $929,494.99 from construction work in progress to plant

accounts 391.11 and 391.30, respectively. The sum of the two amounts is $1,150,833.69. The costs of the individual projects are:

Work Order	Description	Total
60064	Payroll System	$ 427,753.15
60065	Other Systems	$ 27,414.89
60261	Payroll System	$ 212,141.62
60262	Other Systems	$ 77,152.44
60325	OS/390 System	$ 279,266.04
60865	CIS System	$ 35,827.50
60957	Database Controls	$ 91,278.05
Total		$1,150,833.69

(Source OPC Data Request No. 1084)

Q. PLEASE DESCRIBE THE PAYROLL SYSTEM COSTS CHARGED TO WORK ORDER NO. 60064.

A. According to the Company's "Work Order Authorization - Capital Description And Necessity Statement", this project will implement payroll systems that will provide enhanced payroll functions and improve work flow and data flow. The existing payroll systems were implemented in 1967. Although there have been changes to these systems as required, the basic principles have remained in place. The system enhancements will eliminate duplication of effort in terms of processing data. They will also provide for timely updating of master payroll records.

Q. PLEASE DESCRIBE THE OTHER SYSTEMS COSTS CHARGED TO WORK ORDER NO. 60065.

A. According to the Company's "Work Order Authorization - Capital Description And Necessity Statement", this project will enhance the material management system, service location system, leak control system and anode system to allow end users the capability of ad hoc query reporting. These modifications will also utilize the new OS/390 platform. These expenses will extend the life cycles of these applications as well as provide more rapid access to data.

Q. PLEASE DESCRIBE THE PAYROLL SYSTEM COSTS CHARGED TO WORK ORDER NO. 60261.

A. No work order authorization was found for these costs. The amounts charged to this work order appear to be either actual Year 2000 compliance costs or duplicates of Year 2000 compliance costs transferred to work order 60462. Public Counsel has several data requests outstanding that when answered should clarify the purpose and activities associated with the costs charged to this work order.

Q. PLEASE DESCRIBE THE OTHER SYSTEMS COSTS CHARGED TO WORK ORDER NO. 60262.

A. No work order authorization was found for these costs. . The amounts charged to this work order appear to be either actual Year 2000 compliance costs or duplicates of Year 2000 compliance costs transferred to work order 60462. Public Counsel has several data requests outstanding that when answered should clarify the purpose and activities associated with the costs charged to this work order.

Q. PLEASE DESCRIBE THE OS/390 SYSTEM COSTS CHARGED TO WORK ORDER NO. 60325.

A. According to the Company's "Work Order Authorization - Capital Description And Necessity Statement", the costs of this project make necessary changes to applications and data files for installation of new mainframe and personal computer network hardware and platform. These applications and data base changes will allow the implementation of new practices and technologies on both the mainframe and the personal computer network. It will remove existing constraints and reduce the dependency on manual controls.

Q. PLEASE DESCRIBE THE CUSTOMER INFORMATION SYSTEM COSTS CHARGED TO WORK ORDER NO. 60865.

A. According to the Company's "Work Order Authorization - Capital Description And Necessity Statement", this project will modify the CIS system to allow an alphanumeric

premise account number. This modification will allow the premise database to expand beyond 999,999 entries. This expansion is required for proper database processing.

Q. PLEASE DESCRIBE THE DATABASE CONTROLS (IMS) COSTS CHARGED TO WORK ORDER NO. 60957.

A. According to the Company's "Work Order Authorization - Capital Description And Necessity Statement", the project will make necessary changes to applications and data files for installation of mainframe database controls (IMS). These database controls will replace existing IMS DL/1 controls which are no longer supported and which are not compatible with OS/390 requirements. The new control package will take advantage of OS/390 technologies and will meet new mainframe system requirements.

Q. WERE ALL OF THE CHARGES BOOKED VIA THE WORK ORDERS DESCRIBED PREVIOUSLY INCURRED FOR YEAR 2000 DATE FIELD EXPANSION?

A. No. Based on the information that Public Counsel has reviewed not all of the costs of the projects upon which the Company calculated deferred costs pursuant to the AAO were incurred for Year 2000 data field expansion. As I discussed earlier, the Company transferred some Year 2000 compliance costs from the 50000 series work orders to work order no. 60462; however, as of the end of March 1999 the project associated with work order no. 60462 was still categorized as construction work in progress and not as plant in

service. Furthermore, the charges to work order nos. 60261 and 60262 still require clarification as to whether they are actually Year 2000 compliance costs or duplicate entries of costs charged to different work orders.

Q. IF SOME OF THE EXPENDITURES INCURRED TURN OUT TO BE ACTUAL YEAR 2000 COMPLIANCE COSTS SHOULD THESE COSTS HAVE RECEIVED THE SPECIALIZED ACCOUNTING TREATMENT AFFORDED BY AN ACCOUNTING AUTHORITY ORDER?

A. No. Public Counsel does not believe that any of the Year 2000 compliance costs should be treated as extraordinary expenses. These expenditures are not unpredictable. They were not suddenly sprung upon management. The Company has been aware of the activities and tasks necessary to resolve the compliance issue since at least the middle of 1997 or longer. Also, the expenditures may or may not meet the guidelines set by this Commission for extraordinary expenses.

I believe that it is Laclede's responsibility to clearly demonstrate that deviation from normal accounting and ratemaking practices is justified based on extraordinary circumstances, i.e., Laclede was unable to adequately plan for the event, the impact on financial results is material, and the accounting treatment sought is necessary to maintain financial integrity. Absent proof, to be provided by the Company, that during the years

in question it was not recovering its Commission approved expenses through earnings because of the compliance project, the costs deferred by the Company pursuant to the Y2K compliance project should not be categorized as extraordinary nor, should they be construed as material.

Q. WHAT IS THE SIGNIFICANCE OF PROJECTS UNRELATED TO YEAR 2000 DATE EXPANSION EFFORTS BEING INCLUDED IN THE COSTS UPON WHICH THE COMPANY HAS CALCULATED AN AAO DEFERRAL?

A. The fallacy of the Company position is that not all, if any, of the costs upon which it has calculated its AAO deferral relates to or is even associated with the Year 2000 date field expansion issue. The purpose of the Year 2000 accounting authority order was to allow the Company the opportunity to resolve its Year 2000 compliance situation without the added pressure of concurrently arguing whether or not it would be allowed to recover the expenditures in rates. The AAO did not guarantee the Company that it would recover the carrying costs, depreciation and property taxes associated with actual Year 2000 costs incurred, but it did provide the Company with a certain amount of valuable time to fix any compliance issue before coming before the Commission to seek recovery of the costs.

Q. WHY DO YOU BELIEVE THAT THE COMPANY INCORRECTLY INTERPRETED THE ACCOUNTING AUTHORITY ORDER?

A. The Company did not need an AAO to be in compliance with GAAP for projects not caused by Year 2000 concerns. Most, if not all, of the projects have absolutely nothing to do with the Year 2000 compliance for date field expansion discussed earlier. Replacement and/or updating of computer hardware and software is an ongoing normal aspect of business that regulated and unregulated companies deal with continually. These projects should not be considered extraordinary. The projects and their costs are not unusual in nature and they can be expected to occur again in the normal course of the Company's business. A company's management may attempt to hold off incurring the costs of updating its operating hardware and systems for as long as possible, but it a certainty that to remain efficient and competitive companies have to replace or enhance their operating processes and/or computer systems on an irregular if not regular basis.

The Year 2000 compliance issue is centered solely on the size of the date field not the total replacement or enhancement of numerous computer hardware and software systems. Public Counsel believes the primary reason that the Company even required an AAO for its Year 2000 costs is that if it did not have an order from the Commission that the Year 2000 costs incurred would be recovered via the requirements of FASB 71, it had to follow the language of the EITF Issue No. 96-14 consensus. The AAO allowed

the Company some leeway in the way it recorded its Year 2000 compliance costs until such time as the Commission was able to schedule a hearing to review and make a determination as to the reasonableness of recovery of the costs incurred.

Q. PLEASE SUMMARIZE THE PUBLIC COUNSEL'S POSITION ON THIS ISSUE.

A. Public Counsel believes that the Company has inappropriately characterized most, if not all, of the computer hardware/software replacement and enhancement costs it has incurred as Year 2000 date field expansion costs which are subject to the accounting authority order approved in its last general rate increase case. Our investigation indicates that most, if not all, of the expenditures upon which the Company calculated the proposed AAO deferral and amortization were not actually incurred for Year 2000 date field expansion purposes. The expenditures were incurred for various projects the Company undertook to replace and/or enhance its computer hardware and software operating systems. Public Counsel believes that these projects are not extraordinary and are not subject to the specialized accounting provided by the accounting authority order. The Public Counsel recommends that the Commission disallow Laclede recovery of its proposed AAO deferred costs because they are either based on expenditures for projects that are not Year 2000 compliance costs and/or are actual Year 2000 compliance costs that are not extraordinary. The actual Year 2000 compliance costs should be capitalized and amortized over the useful lives of the projects for which they were incurred.

SAFETY REPLACEMENT PROGRAM AAO

Q. WHAT IS THE ISSUE?

A. Pursuant to Commission order the Company is authorized to defer carrying costs, property tax, and depreciation expense on projects related to its safety replacement program. At issue is length of the amortization period for the accumulated deferred costs and whether or not the deferred cost balance should be afforded rate base treatment.

Q. WHAT ARE THE AMOUNTS THE COMPANY IS REQUESTING?

A. Company has calculated a total SRP deferral cost balance of $1,360,531 (per Company workpaper Section C: Schedule #20) which it has included as an addition to rate base. The Company also proposes that the deferral balance be amortized to expense over five years (i.e., $272,106 per year).

Q. WHAT DOES THE COMPANY MEAN WHEN IT USES THE TERM "DEFER"?

A. When a cost (expense) has been deferred, it is either removed from the income statement and entered on the balance sheet or directly entered to the balance sheet (e.g., Account 186, Miscellaneous Deferred Debits), pending the final disposition of these costs at some future point, usually a rate case. The Federal Energy Regulatory Commission USOA Account No. 186 Miscellaneous Deferred Debits states:

A. This account shall include all debits not elsewhere provided for, such as miscellaneous work in progress, construction certificate application fees paid prior to final disposition of the application as provided for in gas plant instruction 15A, and unusual or extraordinary expenses not included in other accounts which are in process of amortization, and items the final disposition of which is uncertain.

B. The records supporting the entries to this account shall be so kept that the utility can furnish full information as to each deferred debit included herein.

Q. IS THE FIVE-YEAR AMORTIZATION PERIOD PROPOSED BY THE COMPANY THE APPROPRIATE PERIOD TO USE IN DETERMINING THE ANNUAL AMORTIZATION OF THE AAO DEFERRED BALANCE?

A. No, a five-year amortization period of the deferred balance in not a reasonable time period. The Public Counsel believes that the deferred balance should be amortized over a period of time that is more representative of the plant lives to which the deferred costs are related. Since the associated plant could be expected to have a service life of thirty years or more the five-year amortization proposed by the Company is irrational (based on Company's current depreciation rates main lives approximate 41 to 78 years and services lives approximate 28 to 38 years). Public Counsel believes that as a compromise, at a minimum, a twenty-year amortization period is more reasonable than the five-year amortization period proposed by the Company.

Q. DIDN'T A RECENT COMMISSION DECISION ORDER A TEN-YEAR AMORTIZATION OF BALANCES DEFERRED PURSUANT TO A SAFETY REPLACEMENT PROGRAM ACCOUNTING AUTHORITY ORDER?

A. Yes, in Missouri Gas Energy, Case No. GR-98-140, the Commission approved a ten-year amortization of the deferred balances associated with the Company's gas safety line replacement program. The Commission also ordered that the deferred balances would not be included in the determination of the Company's rate base.

Q. DOES THE PUBLIC COUNSEL BELIEVE THAT THE COMMISSION ERRED IN ALLOWING THE COMPANY A TEN-YEAR AMORTIZATION OF THE DEFERRED BALANCES?

A. Yes. Public Counsel believes that the twenty-year amortization of the deferred balances recommended by both the MPSC Staff and the OPC would have resulted in a more equitable sharing of regulatory lag effects between shareholders and ratepayers. The twenty-year amortization period was viewed as a compromise between the position taken by the Company and the likely timeframe that the associated plant, upon which the AAO deferral were calculated, would remain in-service. If it is a correct assumption that the plant associated with the safety replacement program will remain in-service for thirty to seventy years or more (as stated earlier the approximate life of Company's mains investment is 41 to 78 years and the approximate live of its services investment is 28 to 38

years) then allowing the Company the opportunity to amortize the deferred balances over ten years does not appear to be a reasonable conclusion.

Q. PLEASE CONTINUE.

A. Intrinsic to the Public Counsel's position that the deferred balances should be amortized over twenty years is the fact that the costs are the result of a Commission ordered aberration or accounting variance from normal regulatory ratemaking. Absent the AAO procedure the Company would not have been allowed to even aggregate the deferred costs for later Commission review. The deferred costs are solely a product of the accounting authority order and the accounting authority order is solely related to investment in the replacement, for safety reasons, of gas lines and appurtenances. In fact, many of the same costs (i.e., interest, property taxes) are directly charged to the plant investment during the period it is accounted for as construction work in progress. These same costs are then depreciated in their entirety over the lives of the respective plant investments. To separate the lives of the plant investment from the AAO deferred costs (which are interest, depreciation and property taxes aggregated between the period the plant is placed in-service and the plant investment is included in rates) is illogical.

Q. YOU STATED EARLIER THAT THE COMPANY HAS INCLUDED THE SAFETY REPLACEMENT PROGRAM DEFERRED BALANCE IN RATE BASE, DOES THE PUBLIC COUNSEL AGREE WITH THIS ADJUSTMENT?

A. No, it's the Public Counsel's position that the SRP deferred balance not be included in the determination of the Company's rate base. The rationale for this position is based on the view that the Company is being given a guaranteed "return of" the deferrals associated with the safety replacement program; therefore, it should not be also provided with a guaranteed "return on" those same amounts.

Q. ISN'T IT TRUE THAT THE SRP DEFERRED CARRYING COST AND DEPRECIATION EXPENSE ARE NOT ACTUALLY FUNDED BY THE COMPANY?

A. Yes, that is a true statement. The carrying cost and depreciation expense associated with the SRP deferral are not actual dollars of investment funded by the Company, they are merely accounting entries on the financial books. Neither the carrying cost nor the depreciation expense causes the Company to forego any **actual outlay** of cash. However, the dollars associated with these book entries will be recovered from ratepayers through the SRP amortization included in the Company's cost of service .

Q. IF THE SRP DEFERRAL BALANCE IS INCLUDED IN RATE BASE WOULDN'T THAT PERMIT THE COMPANY TO EARN A RETURN ON FICTITIOUS

INVESTMENTS FOR WHICH THERE WAS NO ACTUAL INVESTMENT MADE BY THE COMPANY?

A. Yes, it would. In fact, allowing the Company to earn a "return on" the SRP deferrals has the same effect of allowing it to earn a "return on" a "return of." Stated another way, the Company will recover (receive a "return of") the deferred carrying cost, depreciation and property tax expense by way of the amortization included in rates and then will earn a "return on" those same amounts.

Q. PLEASE EXPLAIN THE TERMS "RETURN OF" AND "RETURN ON."

A. When an expenditure is recorded on the income statement as an expense it is compared dollar for dollar to revenues. This comparison is referred to as a "return of" because a dollar of expense is matched by a dollar of revenue. A "return on" occurs when an expenditure is capitalized with the balance sheet and then included in the calculation of rate base. This calculation is a preliminary step in determining the earnings a company achieves on its total regulatory investment.

Q. WHAT IS THE TRUE PURPOSE OF THE COMPANY'S SAFETY REPLACEMENT PROGRAM ACCOUNTING AUTHORITY ORDER?

A. The Commission's authorization of AAO treatment for the Company's SRP insulates Laclede shareholders from some of the risks associated with regulatory lag that occurs if

the SRP construction projects are completed, and placed in service, before the operation law date of a general rate increase case.

Q. PLEASE EXPLAIN THE CONCEPT OF REGULATORY LAG.

A. This concept is based on a difference in timing of a decision by management and the Commission's recognition of that decision and its effect on the rate base rate of return relationship in the determination of a company's revenue requirement. Management decisions that reduce or increase the cost of service without changing rates result in a change in the rate base rate of return relationship. This change either increases or decreases the profitability of the Company in the short-run until such time as the Commission reestablishes rates to properly match the new level of service cost. Companies are allowed to retain cost savings (i.e., excess profits during the lag period between rate cases) and are forced to absorb cost increases. When faced with escalating costs regulatory lag places pressure on management to minimize the change in the relationship because it cannot be recognized in a rate increase until the Commission approves such in a general rate proceeding.

Q. HAS THIS COMMISSION RULED THAT IT IS NOT REASONABLE TO PROVIDE SUCH PROTECTION TO SHAREHOLDERS?

A. Yes, it has. In Missouri Public Service Co., Case Nos. EO-91-358 & EO-91-360, the Commission stated:

> 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. Lessening regulatory lag by deferring costs is not a reasonable goal unless the costs are associated with an extraordinary event.
>
> 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. It is not reasonable to defer costs to insulate shareholders from any risks. 1 Mo. P.S.C. 3d 200, 207 (1991).

Q. HAS THE COMMISSION MADE A DETERMINATION THAT THE SAFETY REPLACEMENT PROGRAM IS AN EXTRAORDINARY EVENT?

A. Yes, it has. The Commission, however, qualified what an extraordinary event is when it stated on page 13 of its Report and Order in St. Louis County Water Company, Case No. WR-96-263:

> As both the OPC and the Staff point out, the Commission has to date, granted AAO accounting treatment exclusively for one-time outlays or capital caused by unpredictable events, acts of government, and other matters outside the control of the utility or the Commission. It is also pointed out that the terms "infrequent, unusual and extraordinary" connote occurrences which are unpredictable in nature.
>
> (Emphasis added by OPC)

Q. ARE THE SAFETY REPLACEMENT PROGRAM COSTS UNPREDICTABLE IN NATURE?

A. No, they are not. The SRP project is a continuing construction project that has existed for many years and it is my understanding that it is expected to last for many more. It would be unrealistic to believe that a construction project that has lasted as long as the SRP could not be predicted and planned for by management with a minimum of error in their results.

Q. SHOULD RATEPAYERS BE REQUIRED TO PROVIDE LACLEDE WITH A GUARANTEED RETURN ON THE SAFETY REPLACEMENT PROGRAM EXPENDITURES JUST BECAUSE THE COMPANY'S MANAGEMENT CHOOSES NOT TO EXERCISE ITS PLANNING AND OPERATING RESPONSIBILITIES?

A. No, ratepayers should not be required to fund such a return. Planning and operation of the Company's construction projects are a fundamental responsibility of Laclede's management. Only management has complete access to the data and resources necessary

to fulfill these responsibilities, and as such, management should be able to implement a SRP construction program that minimizes the effects of regulatory lag on the Company finances. To the extent regulatory lag moves against the Company, the Commission has already decided, as mentioned earlier, that lessening regulatory lag by deferring costs is not a reasonable goal.

Q. PLEASE CONTINUE.

A. The purpose of the accounting variance is to protect Laclede from adverse financial impact caused by regulatory lag by providing it with a vehicle that allows it the opportunity to capture and recover costs it normally would not have explicitly received. The accounting variance should not be used to place the Company in a better position than it would have been in had plant investment and rate synchronization been achieved. Just as it would be unfair to deny Laclede recovery of its reasonable and prudent investment due to regulatory delays which the Company could not control, it would be unfair if Laclede were allowed to reap a windfall, at ratepayer expense, due to a regulatory delay that ratepayers could not control. Public Counsel's position is that issues caused by regulatory lag must be treated in a fair manner for both ratepayers and the Company.

Q. PLEASE SUMMARIZE THE PUBLIC COUNSEL'S RECOMMENDATION REGARDING LACLEDE'S SAFETY REPLACEMENT PROGRAM ACCOUNTING AUTHORITY ORDER DEFERRALS.

A. The Public Counsel has reviewed the Company's proposal for the SRP deferred balance, and its annual amortization, and we do not believe its position to be reasonable. Public Counsel recommends that the Company's rate base determination exclude the SRP balance so that Laclede does not earn a "return on" the deferred balance. Guaranteeing the Company a "return of" and "return on" the SRP deferred balance is not a fair allocation of regulatory lag resulting from the Company's on-going construction project. This view is based on the fact that management is responsible for planning and operating the activities of the Company. If management is unable to or chooses not to implement processes and procedures which would limit the effect of regulatory lag on its finances, the Company should not be protected by the Commission with a guaranteed earnings opportunity. Therefore, in order that ratepayers and shareholders both share in the effect of regulatory lag, the Public Counsel is recommending that the Commission allow the Company to earn a "return of" the SRP deferred balance, over a period representative of the life of the plant to which the deferrals relate, but not a "return on" the SRP deferred balance.

MANUFACTURED GAS PLANT AAO

Q. WHAT IS THE ISSUE?

A. The issue concerns whether or not the Company shall obtain ratemaking treatment of remediation expenditures incurred for sites where it formerly owned and operated manufactured gas plants. The Company's proposal is that it recover all MGP remediation expenditures incurred since May 1996 (Company response to Public Counsel Data Request No. 1040). The proposed recovery would occur by amortizing the deferred costs balance to the Company's cost of service over five years and by including the unamortized deferred cost balance in rate base. It's Public Counsel's position that the remediation expenditures incurred should receive neither expense nor rate base treatment.

Q. WHAT ARE THE REMEDIATION COSTS?

A. As I stated in my instant case direct testimony, remediation costs can be defined as all investigations, testing, land acquisition if appropriate, remediation and/or litigation costs/expenses or other liabilities excluding personal injury claims and specifically relating to gas manufacturing facility sites, disposal sites, or sites to which material may have migrated, as a result of the operation or decommissioning of gas manufacturing facilities.

Q. HOW HAS THE COMPANY BEEN TRACKING THE REMEDIATION COSTS?

A. In the Company's last general rate increase case, Case No. GR-98-374, the Commission approved the Company's use of an accounting authority order to aggregate and separate for later Commission review remediation costs incurred subsequent to April 1996.

Q. WHAT IS THE PUBLIC COUNSEL'S POSITION REGARDING LACLEDE'S PROPOSED MANUFACTURED GAS SITE REMEDIATION COST RECOVERY?

A. As I stated earlier, Public Counsel takes the position that the Company should not be allowed recovery of the remediation costs it has incurred. Our recommendation is that the Commission disallow all recovery of the MGP site remediation costs for the reasons discussed in the following testimony.

Q. IS LACLEDE POTENTIALLY LIABLE FOR EXPENSES RELATED TO THE INVESTIGATION AND CLEANUP OF THE FORMER MGP SITES?

A. Yes, it would appear that the Company is, at least partially and possibly fully, liable for the costs. Two federal statues have the greatest environmental regulatory impact with respect to former MGP. They are, the 1976 Resource Conservation and Recovery Act enacted to address the treatment, storage, management and disposal of solid wastes and the 1980 Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA" or "Superfund"). Under the provisions of CERCLA, the Company falls under one or more of the identified potentially responsible parties ("PRP") categories and therefore may be held

strictly, jointly, and severally liable for all cleanup costs. CERCLA specifically includes in its PRP classifications the present owner and operator of a site, past owners of a site and transporter of hazardous substances disposed of at a site when the transporter selected the site.

Q. LACLEDE IS A POTENTIALLY RESPONSIBLE PARTY FOR HOW MANY MGP SITES?

A. The Company states that there are two MGP sites in which it has a PRP interest. That is, the Company either currently owns, or formerly owned, each of the sites and, therefore, contends it is responsible (or partially responsible) for any necessary remediation. The two sites the Company has determined to-date that it is potentially responsible for are the Shrewsbury MGP plant site and the Carondelet Coke MGP plant site. The Shrewsbury plant site is still owned by the Company but the Company has no ownership interest in the Carondelet Coke plant site.

Q. HAS ANY ACTUAL CLEANUP ACTION OCCURRED TO DATE?

A. No. Expenditures, however, have been incurred relating to the MGP site identifications, consultant investigations, attorney fees and personnel training. Laclede's response to Public Counsel Data Request No. 1020, which requested the current status of MGP investigations states:

With regard to the Shrewsbury site, the EPA has approved the proposed Engineering Evaluation/Cost Analysis (EE/CA) provided by Laclede in February, 1998. Laclede and the EPA are currently negotiating a new Administrative Order on Consent, and Laclede is preparing a work plant to implement the actions required by the EE/CA. With regards to the Carondelet Coke site, Laclede is conducting a comprehensive investigation of the site pursuant to a work plant approved by the Missouri Department of Natural Resources.

It's my understanding that while the Company has disclosed some estimates of the future costs it expects to incur (Company's response to MPSC Staff Data Request No. 118 states that the estimated liability remaining is $768,616), the actual costs have not been finalized at this time. All costs incurred, for the instant case, have been deferred to FERC USOA Account No. 182 - Extraordinary Property Losses.

Q. IS THE MANUFACTURED GAS PLANT USED AND USEFUL IN PROVIDING SERVICE TO CURRENT CUSTOMERS?

A. It's my understanding that the Company does not currently own or operate any manufactured gas plants. Company does still own the Shrewsbury plant site where manufactured gas plant was formerly operated, but no coal gas is manufactured there now. Therefore, current and future ratepayers did not and will not receive service from any MGP. The actual MGPs are not and will not be used and useful.

Q. PLEASE EXPLAIN THE CONCEPT "USED AND USEFUL".

A. One of the Public Counsel's main objections to the Company proposed treatment of this issue is that we believe that it violates the regulatory "used and useful" standard. The general rule is that, "the rate base on which a return may be earned is the amount of property used and useful, at the time of the rate inquiry, in rendering a designated utility service." (A.J.G. Priest, Principles of Public Utility Regulation (1969), p. 139, vol. 1). This principle is certainly grounded in common sense. In dividing the responsibility for a utility's operations between ratepayers and stockholders, regulators have traditionally required that stockholders rather than ratepayers be required to bear the costs of any utility investment which is not used and useful to provide service to the ratepayers.

In a recent discussion of the policy in Missouri, State ex rel. Union Electric v. Public Service of the State of Missouri, 765 S.W. 2d 618 (Mo. App. 1988), the Court of Appeals for the Western District endorsed the used and useful policy. That case involved Union Electric's appeal of the Commission's denial of the costs of cancellation of its Callaway II nuclear unit. The Commission ruled that the risk of cancellation should be borne by the shareholder, since if it was not, the shareholder's investment would be practically risk free. The Court, in upholding the Commission's decision, stated:

The utility property upon which a rate of return can be earned must be utilized to provide service to its customers. That is, it must be used and useful. This used and useful concept provides a well-defined standard for determining what properties of a utility can be included in its rate base.

Q. SHOULD RATEPAYERS BE HELD RESPONSIBLE FOR COSTS ASSOCIATED WITH ASSETS THAT ARE NO LONGER IN SERVICE?

A. No. Current ratepayers should not be held responsible for costs that do not increase service capabilities or provide cost benefits. The MGP site remediation costs being incurred are associated with plant that is no longer in service and therefore no longer used and useful. The Company is asking the Commission to have the customer pay for plant that does not operate to provide current utility service. I don't believe this is a normal practice of this Commission, and it is unreasonable to force a consumer to pay for something they are not using. Laclede is entitled to the opportunity to earn a fair rate of return only upon monies prudently invested in property used and useful in rendering utility service.

The purpose of the regulatory ratemaking process is to identify a reasonable monetary return that the monopoly enterprise has the opportunity to earn. Regulation does not guarantee that level of earnings, nor does it force a company to return any overearnings retroactively, in the event overearnings occur. Even if the former MGPs are assumed to have been used and useful utility property at the time the pollution of the land occurred,

and the cleanup costs had not been anticipated while the plant was in use, current ratepayers should not be held captive to their recovery. In simplistic terms, the ratepayers part of the regulatory bargain is to provide the company with a level of revenues that allow it to earn the Commission approved rate of return on current used and useful investment along with the costs of operating and maintaining that investment, and no more. Ratepayers do not assume, willing or implied, any risk assumed by the stockholders.

Laclede's proposal implicitly states that because federal statutes, unrelated to its provision of utility service to customers, will cause the Company's expenditures to increase, ratepayers and not stockholders should be held responsible for those costs. The Company is attempting to pass the natural risks associated with a business that is a continuing enterprise, a "going-concern", entirely from stockholders to ratepayers. Stockholders, not ratepayers, are the actual risk-takers and for assumption of risk they receive a market determined return on their investment. If an unexpected event occurs that affects the Company either in a negative or positive manner then stockholders, not ratepayers, should weather the effects.

Q. ARE THERE ANY OTHER REASONS WHY RATEPAYERS SHOULD NOT BE FORCED TO COMPENSATE THE COMPANY FOR THE REMEDIATION COSTS AT THIS TIME?

A. Yes, there are. Other reasons include:

1. It is likely that prior ratepayers have already provided the Company with a return "on" and a return "of" its investment in the MGP operations. This return "of" or depreciation included costs to dismantle and decommission the plant, current and future ratepayers bear no responsibility for the contamination which exists at the sites.

2. Future costs espoused by the Company are not sufficiently fixed, or known and measurable, and should not be relied on for ratemaking purposes.

3. The costs to analyze, study, remediate, and litigate MGP contamination are not a current or future cost of providing safe and adequate, and reliable gas service to ratepayers.

4. Guaranteeing full recovery of the costs from ratepayers removes the incentive for the Company to control costs and may lessen other PRPs willingness to contribute to clean-up efforts.

5. The Company has not completed its pursuit of recovery of the costs incurred from its insurers and other PRPs consequently full recovery of these costs from ratepayers would likely lessen the incentive to aggressively pursue and maximize recovery from insurers and PRPs.

6. Implicit in Company's rate of return is a risk factor for unknown and unanticipated expenditures such as environmental compliance costs. The "return on" component of prior rates included recognition of this risk factor. Company stockholders have therefore already been compensated for the costs.

Q. ARE THE MGP REMEDIATION COSTS POTENTIALLY RECOVERABLE FROM THE COMPANY'S INSURERS?

A. Yes, they are. Company's response to MPSC Staff Data Request No. 118 states:

> At this time, Laclede is unable to estimate what current or future remediation costs, if any, will be recovered from each insurer. The Company has notified its insurers that it intends to seek reimbursement from them of its costs at both these sites. None of the Company's insurers have agreed that its insurance covers the costs for which the Company intends to seek reimbursement. The majority of the insurers have sent Laclede letters reserving their rights with respect to the manufactured gas plant issues addressed in the Company's notices to them. While some of the insurers have denied coverage with respect to these issues, the Company continues to seek reimbursement from them.
>
> (Emphasis added by OPC)

The Company's position on the issue of MGP remediation cost reimbursement from insurers is reiterated in the its responses to Public Counsel Data Request Nos. 1017, 1022 and 1023. The response to OPC Data Request No. 1017 states:

> Laclede is unable to estimate at this time how much, if any, insurance recovery it may receive related to its manufactured gas plant remediation efforts. Once actual remediation has occurred, an estimate of potential reimbursement can be developed.

Company's responses to Public Counsel Data Request Nos. 1022 and 1023 restate essentially the same comments as Company's response to Public Counsel Data Request No. 1017.

Q. ARE MANUFACTURE GAS PLANT REMEDIATION COSTS POTENTIALLY RECOVERABLE FROM OTHER POTENTIALLY RESPONSIBLE PARTIES?

A. Yes, they are. Public Counsel Data Request No. 1018 requested, "A listing of all identified PRPs, by specific MGP site." The Company's response provided the identify of known PRPs associated with the Carondelet Coke site and the Shrewsbury MGP site. Further investigation yielded information that Laclede is on the verge of or has already entered into a cost sharing agreement with a former owner of the Carondelet Coke site. This first cost sharing agreement has the potential of substantially lowering the amount of expenditures Laclede actually incurs.

Q. IS IT REASONABLE TO ASSUME THAT BASED ON CURRENT KNOWLEDGE LACLEDE CAN EXPECT TO ENTER INTO FUTURE COST SHARING AGREEMENTS WITH OTHER POTENTIALLY RESPONSIBLE PARTY'S AND/OR RECEIVE COST REIMBURSEMENTS FROM ITS INSURERS?

A. Yes, that is a possibility.

Q. WOULD IT BE APPROPRIATE TO ORDER RATEPAYERS TO REIMBURSE LACLEDE FOR THE REMEDIATION EXPENDITURES IT HAS INCURRED GIVEN THAT IN TIME OTHER POTENTIALLY RESPONSIBLE PARTIES AND/OR COMPANY'S INSURERS MAY TAKE RESPONSIBILITY FOR PAYING THE COSTS?

A. No, it is not appropriate that ratepayers be required to reimburse the Company for the remediation expenditures. Until such time as the Commission can accurately gauge the cost reimbursement or recovery Laclede will receive from its insurers and other PRPs, it is inappropriate to ask ratepayers to finance the Company's expenditures for these projects. The lack of information for potential cost recovery from other PRPs and insurance claims increases substantially the impossibility of accurately determining the level of MGP site remediation costs Laclede is or will eventually be responsible for.

Q. WHAT IS THE TRUE NATURE OF THE REMEDIATION COSTS?

A. The remediation and any future cleanup costs are in actuality a legal requirement that must be met in order to satisfy federal statutes on the proper handling of hazardous wastes in order to alleviate adverse environmental effects. The expenditures Laclede has incurred were to identify and assess MGP sites that may require further action. They are not expenditures related to the providing of utility service to current or future Laclede ratepayers.

Q. HOW IS RISK DEFINED?

A. Business or investment risk can be defined as, "The probability that the expected return will not be earned because of the impact of some risky (unplanned) event occurring."

Q. IS IT POSSIBLE THAT STOCKHOLDERS HAVE ALREADY BEEN COMPENSATED FOR THIS PARTICULAR BUSINESS RISK?

A. Yes. It is a well accepted principle of regulation that common stockholders contribute what is known as "risk capital" to the utility company for which they receive a compensatory rate of return. Among the uncertainties that common stockholders accept in return for this added compensation is the danger, for whatever reason, of earnings shortfall.

Company response to OPC Data Request No. 1019 identified that the acquisition dates for the two sites were the early 1900's for Carondelet Coke and 1947 for Shrewsbury. Each year subsequent to the acquisitions stockholders have received the benefit of a risk premium while the MGP was in operation. The stockholders have been rewarded with an additional return, above a risk free investment such as U.S. government securities, on their investment for unplanned, unforeseeable and unexpected events. Now, after receiving the benefit of the additional risk return for nearly thirty-five years for Carondelet Coke and fifty-two years for Shrewsbury, the Company proposes that it is ratepayers, not

stockholders, who should bear the financial responsibility for the MGP site remediation costs.

Public Counsel believes that ratepayers have already satisfied the requirements imposed upon them by past Commission orders. They provided the revenues to meet the Company's Commission approved earnings level for each of the years that the MGP plant was in service. It is the Company's stockholders that should bear total responsibility for the remediation costs because the stockholders have already been remunerated for assuming the risk of an event such as MGP site remediation occurring.

Q. WOULD INTERGENERATIONAL INEQUITY OCCUR SHOULD THE DEFERRED COSTS BE ALLOWED IN THE COST OF SERVICE?

A. Yes, that is a distinct probability. The Company is demanding that current and future generations of ratepayers bear a cost that does not relate to the provision of safe and reliable gas service that they receive now or in the future. It is my opinion that the MGP site remediation expenses Company is demanding relates to out of period service. Such costs are not related to the provision of utility service to current customers. Also the quality, quantity, and reliability of gas service is not likely to improve no matter how much MGP remediation Laclede conducts. Clearly, imposition of these costs on current and future ratepayers would be unjust and should be denied.

A denial of recovery from present and future ratepayers is appropriate because past generations of ratepayers, those that received the service from the manufactures gas plants in question, provided Laclede shareholders a return "on" their investments in the MGPs. Those same shareholders were also provided a return "of" the MGP investment through depreciation rates during the time such plant were in service. This depreciation should have been sufficient for plant wear and tear, obsolescence, and complete and prudent decommissioning of each MGP, less salvage value. Therefore, Laclede is attempting to charge ratepayers for costs its has already recovered.

Q. WERE RATEPAYERS AT FAULT FOR THE ENVIRONMENTAL CONTAMINATION?

A. No. Ratepayers had no input as to the manner in which MGP sites were operated or dismantled nor were they at fault for the contamination of the MGP sites.

Q. ARE CURRENT RATEPAYERS RECEIVING MANUFACTURED GAS SERVICE FROM THE MGP?

A. No. As I stated earlier, the Carondelet Coke plant site is not owned by the Company as it was sold on May 27, 1950. The Shrewsbury plant site ceased MGP operations in or about 1961. Consequently, the MGPs likely served an unknown and unrelated group of customers from those being served today by Laclede.

Q. WHY IS IT SIGNIFICANT TO ESTABLISH THAT THE RATEPAYERS ARE NOT AT FAULT FOR THE ENVIRONMENTAL CONTAMINATION?

A. It is significant to establish the ratepayers lack of fault in order to highlight the impropriety of Laclede's proposal. The Company's proposal is a classic example of a public utility taking advantage of the captive position of its customers. Essentially, it's the Company's desire to shift the risk and financial burden of the MGP sites remediation from its shareholders to its customers. Customers did not cause the contamination. In fact, it is unlikely that they played any part in the management and operation of the plant that is now being remediated. Any contamination that occurred was done under the auspices of managers of the Company. To absolve them of this responsibility, for whatever reason, is not appropriate. The Company's shareholders have been reimbursed for the risk of events such as these through Commission approved rates of return. Accordingly, the Company's shareholders should be held responsible for the resulting liabilities and costs.

Q. IF THE COMMISSION DISALLOWS THE COMPANY'S REQUEST FOR RECOVERY OF THE REMEDIATION EXPENDITURES WOULD THAT DECISION MATERIALLY IMPACT THE COMPANY'S FINANCIAL POSITION?

A. It's the Public Counsel's opinion that Laclede's financial position would not be materially impacted if the Commission disallows the remediation expenditures from its cost of

service. The deferred balance the Company is requesting recovery of represents approximately 1.1% ($459,221 divided by $41,881,000) of the 1998 total utility operating income per books as shown on Schedule 1, page 1 of 1, of the Company's direct testimony filing for the instant case. Public Counsel does not believe that Commission disallowance of such a relatively small percentage of costs would have a material impact on the Company's operations. This view is further bolstered by our opinion that we believe ratepayers should not be held responsible for reimbursement of any of the costs and that it is quite possible that the Company will receive future reimbursement of some of the expenditures from its insurers and/or other PRPs.

Q. IS IT THE PUBLIC COUNSEL'S RECOMMENDATION THAT THE DEFERRED COSTS BE EXCLUDED IN THE DETERMINATION OF THE COMPANY'S COST OF SERVICE?

A. Yes, it is. The Public Counsel's recommendation is that the Commission exclude all MGP remediation costs from the instant case cost of service. This results in the reduction of $91,844 from the Company proposed expense level and $459,221 from the Company proposed rate base. (Source: Company's response to Public Counsel Data Request No. 1040)

Q. IS THERE AN ALTERNATE PROPOSAL THAT WOULD ALLOW BOTH STOCKHOLDERS AND RATEPAYERS TO SHARE RESPONSIBILITY FOR THE REMEDIATION COSTS?

A. Yes. While the Public Counsel does not waiver from the recommendation made earlier, in the alternative, if the Commission decides that current and future ratepayers should be held partially responsible for the remediation costs, the Company could be allowed to amortize an annualized level of prudently incurred remediation costs over a reasonable time period, but it should not receive rate base recognition for any unamortized expenditures. Use of this sharing method would allow the Company's stockholders and customers to share the financial responsibility for the remediation efforts.

Q. HAS THE MPSC ADDRESSED THE UTILIZATION OF COST SHARING MECHANISMS?

A. Yes. Regarding the issue of cancellation costs incurred for Rush Island Units 3 and 4, the MPSC Report and Order for Union Electric Company, Case No. ER-77-154, stated on page 24:

> Staff's proposal permits only the recovery of the sunk costs but permits no return on them. Any period of amortization for an extraordinary expense is arbitrary in nature, but the Commission will accept Staff's proposal.

ACCOUNTING AUTHORITY ORDERS CONTINUANCE

Q. WHAT IS THE ISSUE?

A. Company has proposed that the SRP, MGP and Y2K accounting authority orders continue to be utilized subsequent to the end of the instant case. (see James A. Fallert Direct Testimony page 22, lines 11- 23)

Q. DOES THE PUBLIC COUNSEL OPPOSE THE CONTINUANCE OF THE MGP, Y2K AND SRP ACCOUNTING AUTHORITY ORDERS?

A. Yes. The Public Counsel believes that the time has come for the discontinuance of these accounting authority orders. Our position is based on the fact that many of the reasons that originally prompted their implementation either never existed or no longer exist.

Q. PLEASE EXPLAIN WHY THE PUBLIC COUNSEL BELIEVES THAT THE MANUFACTURED GAS PLANT ACCOUNTING AUTHORITY ORDER IS NO LONGER REQUIRED?

A. Public Counsel's position on this issue is based on several factors. The primary reason being that the level of costs that the Company feared would materialize has not occurred. Public Counsel stipulated to the creation of this accounting authority order in prior Laclede rate cases out of concern for Company claims that it was about to incur

significant expenditures related to the remediation of the former manufactured gas plant sites. Those fears have not materialized.

An analysis of the actual expenditures incurred by the Company since 1994 indicates that it has incurred approximately $858,837 of remediation costs. That total approximates $172,000 on an annual basis (five-year average). This annualized amount if shared equally between shareholders and ratepayers would only be $86,000 on an annual basis. Public Counsel does not believe that the expenditures incurred represent a material amount, and it is certainly not worthy of the accounting variance provided by an AAO.

Interestingly, during the same time period (1994 to current) Laclede has actually recovered approximately $506,849 of its total MGP expenditures in rates leaving approximately $351,988 not yet recovered. Public Counsel's position all along has been that the ratepayer should not be responsible for any of these costs and certainly not all of the costs. Allowing the Company to recover all of its MGP remediation expenditures is completely inequitable especially since we are uncertain as to the level of future cost reimbursement the Company will receive from its insurers and other PRPs.

Q. HASN'T THE COMPANY PRESENTED TESTIMONY THAT IT IS ABOUT TO INCUR ADDITIONAL COSTS FOR REMEDIATION OF THE TWO MANUFACTURED GAS PLANT SITES?

A. Yes, that is correct; however, it's my understanding that the costs have not yet been finalized and that they are not significant enough to require a special accounting variance such as an accounting authority order. This is especially true if the Commission agrees that the costs to be incurred should not be reimbursed by ratepayers at all.

Q. PLEASE EXPLAIN WHY THE PUBLIC COUNSEL BELIEVES THAT THE YEAR 2000 COMPLIANCE ACCOUNTING AUTHORITY ORDER IS NO LONGER REQUIRED?

A. Public Counsel's position on this issue is based on the fact that the Company has misused the current accounting authority order to characterize its extensive replacement and enhancement of numerous computer hardware and software operating systems as Year 2000 compliance costs. The Year 2000 compliance issue is not all that complicated, it is basically an issue of expanding date fields in computer operating systems from two spaces to four spaces. Information reviewed by the Public Counsel shows that little, and maybe not any, of the costs the Company actually incurred to resolve the date field expansion issue were charged to the work orders which the Company utilized to calculate its proposed deferrals pursuant to this AAO.

Q. DOES THE PUBLIC COUNSEL EXPECT THE COMPANY TO INCUR SIGNIFICANT FUTURE COSTS TO BECOME YEAR 2000 COMPLIANT?

A. No. The Company has approximately five more months until the Year 2000, or thereabouts, to become Year 2000 compliant. Based on the information and contracts that I have audited, I do not expect the Company to incur significant or material future costs to become Year 2000 compliant.

Q. IF NO SIGNIFICANT FUTURE COSTS ARE FORTHCOMING ISN'T IT REASONABLE TO ASSUME THAT THE NECESSITY FOR A CONTINUANCE OF THE ACCOUNTING AUTHORITY ORDER IS NONEXISTENT?

A. Yes, that is correct. If the Company is not expected to be financially or otherwise harmed by the regulatory lag associated with the project costs, it would be unreasonable to continue the specialized accounting associated with the accounting authority order.

Q. PLEASE EXPLAIN WHY THE PUBLIC COUNSEL BELIEVES THAT THE SAFETY REPLACEMENT PROGRAM ACCOUNTING AUTHORITY ORDER IS NO LONGER REQUIRED?

A. Public Counsel's position on this issue is based on the belief that the Company's management is solely responsible for planning and implementing the safety replacement program. As such, it is management's responsibility to correlate its investment program

with requested changes in rates when it becomes apparent that its ordered rate of return is not being achieved. The Company should not be protected, to the detriment of ratepayers, from the effects of regulatory lag. When was the last time this Commission had a Missouri utility come in and voluntarily ask for a rate decrease because it was overearning? To my knowledge, never. Regulatory lag is a two-edged sword it can equally harm or help both the shareholder and the ratepayer. It makes little sense to shield only the Company from its harmful effects.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.