BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Laclede Gas Company Tariff Filing to Recover Bad Debt Expenses Through the PGA and to Modify Cold Weather Rule Provisions.	))))	Case No. GT-2009-0026

INITIAL BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

The Missouri Office of the Public Counsel urges the Commission to reject Laclede Gas Company's attempt to redefine the *cost of gas* to include amounts owed to Laclede for the *sale of gas*. The tariff is unlawful and must be rejected because it would violate the Missouri Supreme Court's prohibitions against single-issue ratemaking and retroactive ratemaking. Laclede's proposal would reduce Laclede's business risks and could increase earnings outside the context of a rate case where all relevant factors can be studied to prevent over-recovery. Laclede claims to have earned a return on equity of *11.68 percent* in the twelve months preceding Laclede's tariff filing, far exceeding the highest authorized return on equity for any electric or a gas company currently operating in Missouri.[1] Approving the proposed tariff filing is neither just nor reasonable.

Additional reasons to reject Laclede's tariff revision include: 1) It would reduce Laclede's incentive to pursue collections, resulting in higher rates for all consumers; 2) The bad debts Laclede wants to include in its Purchased Gas Adjustment (PGA) are not

[1] (Transcript (Tr.) 85-86). The highest authorized return for a Missouri gas company is 10.5 percent, authorized for Missouri Gas Energy in the March 22, 2007 *Report and Order* in Case No. GR-2006-0422. The highest authorized return for a Missouri electric company is 10.76 percent, authorized for AmerenUE in the January 27, 2009 *Report and Order* in Case No. ER-2007-0318.

gas costs under any definition; 3) It would violate the Uniform System of Accounts (USOA) and Generally Accepted Accounting Principles (GAAP); 4) It would violate the Unanimous Stipulation and Agreement from Laclede's last rate case; 5) It would create severe administrative difficulties by requiring the Commission and its Staff to perform an additional and impossible prudency analysis; 6) Laclede's evidence is insufficient to approve the tariff; and 7) Laclede's bad debts are stable and have been for the past three years. Each of these is explained in greater detail below.

I. Background

In 1962 the Commission approved Laclede's first PGA rate mechanism, which was also the first PGA for any Missouri local distribution company (LDC). The Commission authorized the new PGA mechanism to allow rate adjustments outside of a rate case because: 1) It addressed "increasingly frequent changes in the wholesale rate changes"; 2) "the fixing of such wholesale rates is a matter over which the Company and this Commission have virtually no control"; and 3) "The operation of the purchased gas adjustment clause does not affect the return of the company one way or another."[2] Since first approving the PGA, the Commission has repeated its findings that the purpose of the PGA is "to allow the immediate pass-through to retail customers of any difference in wholesale gas rates," and is lawful because the purchased gas costs is not controlled by the Commission or the LDC.[3] Laclede's PGA rate recovers only the costs Laclede incurs

[2] Case No. 12,525, In the matter of the application of Laclede Gas Company to put in effect, as a part of its rate schedules, a purchased gas adjustment clause and a clause relating to readjustment in event of refund, *Report and Order*, November 2, 1962, 10 Mo. P.S.C. (N.S.) 442, 451 (1962).

[3] Case No. GO-85-264, In the matter of the investigation of developments in the transportation of natural gas and their relevance to the regulation of natural gas corporations in Missouri, *Report and Order*, March 20, 1987, 29 Mo. P.S.C. (N.S.) 137 (1987).

to bring gas to its system, defined in Laclede's tariff as "all charges incurred for gas supply, pipeline transmission and gathering and contract storage."[4]

On July 9, 2008, Laclede Gas Company filed the present proposal to amend its tariffs to make an unprecedented change to rates by passing a portion of Laclede's bad debt expense to its customers through periodic adjustments to the customer's PGA rate, rather than in a rate case where bad debt amounts have always been included in rate base.[5] Laclede's proposed tariff seeks to allow Laclede to include a "net write-offs adjustment" calculated by the following formula:

> The net write-offs adjustment shall be derived by subtracting one-twelfth of the gas cost portion of the annual net write-offs recovered through the Company's non-gas rates from the gas cost portion of the Company's actual net write-offs in each month. The gas cost portion of the Company's annual net write-offs recovered through the Company's non-gas rates shall be determined in the Company's most recent general rate case.

Laclede's proposal would authorize periodic rate increases or decreases based upon the single issue of bad debts and without looking at any other factors.

This is Laclede's fourth attempt to include bad debts in the PGA, having been unsuccessful in three prior attempts. In 2001 Laclede and several other LDCs filed a joint application to recover a portion of bad debt expense through the PGA process and to issue an Accounting Authority Order (AAO) to defer a portion of bad debts for future recovery.[6] Laclede later withdrew its tariff proposal, but Missouri Public Service and St.

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[4] P.S.C. MO. No. 5 Consolidated, Ninth Revised Sheet No. 15.

[5] Laclede also requested to change a Cold Weather Rule tariff provision, but this proposal was withdrawn by Laclede. (Tr. 70).

[6] Case Number GO-2002-175, In the Matter of Missouri Public Service and St. Joseph Light and Power, Divisions of UtiliCorp United Inc., for Recognition of Uncollectibles Expense under the Terms of 4 CSR240-13.055(10)1, *Report and Order*, November 14, 2002, 11 Mo. P.S.C. 3d 600.

Joseph Light and Power, Divisions of UtiliCorp United, Inc., ("Aquila") continued to pursue a $1 million bad debt AAO, asserting:

> …that it was experiencing or would experience extraordinary high levels of uncollectibles expense that significantly exceed operating expense levels included in Aquila's revenue requirement, as a consequence of the 2000-2001 heating season and the accommodations it made to its customers under the Cold Weather Rule.

(11 Mo. P.S.C. 3d 600). In a 5-0 Commission vote, the Commission rejected Aquila's AAO request and concluded that Aquila's uncollectible expense was the "normal ongoing cost of doing business", was routinely considered during a general rate case, and under the USOA are "to be placed in Account 904." (*Id.*). The Commission concluded that any link between bad debts and high gas costs, and between bad debts and cold weather, was not proven. (*Id.*)

In 2005 Laclede requested a $39 million rate increase and again attempted to include bad debt expenses in the PGA rate, but Laclede dropped its bad debt proposal in settlement. The Commission authorized the following measures agreed upon by the parties to assist Laclede in managing its bad debts:

- Allowed Laclede to use credit scoring as a means of determining when to require a deposit;
- Expanded the hours Laclede may disconnect a customer from 8:00 a.m. to 4:00 p.m., to the new disconnection hours of 7:00 a.m. to 7:00 p.m.;
- Increased the number of days a notice of discontinuance is effective from 11 days to 30 days; and
- Increased the allowed deposit amount from double the highest bill to four times the average bill.[7]

[7] Case Number GR-2005-0284, In the Matter of Laclede Gas Company's Tariff to Revise Natural Gas Rate Schedules, *Order Approving Stipulation and Agreement and Order Approving Tariffs*, September 30, 2005, 14 Mo. P.S.C. 3d 59.

In 2006 Laclede came back to the Commission with its most recent request for a rate increase, this time seeking a $44.9 million increase in revenues. Laclede again sought to include a portion of its bad debt expense as a gas cost to be recorded and recovered through the PGA. Once again the parties entered into an agreement that did not include bad debt expenses in the PGA and that specifically stipulated that Laclede was "no longer seeking approval of the tariff sheets and rate schedules that it filed on December 1, 2006," which included the attempt to recover bad debts in the PGA. The agreement approved by the Commission authorized Laclede to receive a revenue increase of $38.6 million (85 percent of Laclede's initial request). The agreement also included provisions to assist Laclede in lowering its uncollectible expense. Laclede was allowed to continue using credit scoring on an experimental basis as a means of determining when to assess deposits. Laclede was also allowed to amortize and recover an additional $5,033,655 for increased bad debt expenses Laclede claims it incurred as a result of complying with the Commission's Emergency Cold Weather Amendment (ECWR) in Case Number GX-2006-0434, which amounts to an annual recovery in base rates of $1,006,731 for five years.[8]

In addition to the $5,033,655 ECWR compliance costs that Laclede currently recovers for 2006 bad debts, the Commission recently granted Laclede an AAO to defer an additional $2,494,311 for bad debt expenses incurred by Laclede in 2007 as a result of its compliance with the Commission's September 30, 2006 *permanent* amendment to the

[8] Case Number GR-2007-0208, In the Matter of Laclede Gas Company's Tariff to Revise Natural Gas Rate Schedules, *Order Approving Unanimous Stipulation and Agreement and Authorizing Tariff Filing,* July 19, 2007.

Cold Weather Rule (CWR).[9] These two significant deferrals and recoveries approved by the Commission to assist Laclede in managing any increases in bad debts caused by the CWR were not subtracted from the bad debt numbers quoted in Laclede's testimony. (Tr. 46-47). According to Laclede's evidence, Laclede had $10,547,022 bad debts write-offs in 2005. (Ex.3, p.5). In 2006, Laclede claims bad debts of $10,734,707, which is an $186,685 increase in bad debts from 2005. (*Id.*) This is a surprisingly small increase in bad debts from 2005 to 2006 given the $5,033,655 Laclede attributes to increases in bad debts caused by the ECWR in 2006, which Laclede is currently recovering in rates. Laclede also claims it had $11,353,394 bad debts in 2007, $2,494,311 of which Laclede attributes to the permanent CWR amendment. (*Id.*). The Commission authorized Laclede to defer the $2,494,311 through an Accounting Authority Order for possible recovery in Laclede's next rate case.[10]

II. Argument

The parties narrowed the issues to three general questions that essentially ask the Commission to determine: 1) Can the Commission lawfully include uncollectible expenses in the PGA?; 2) Can the Commission lawfully make the requested change to rate design and rates outside of a general rate case?; and 3) Is it otherwise reasonable to allow Laclede to require consumers to pay Laclede's bad debt expenses through the PGA? A "no" answer to any one issue necessitates a Commission order rejecting the tariff, and would moot the need to consider the other two issues.

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[9] Case Number GU-2007-0138, In the Matter of the Application of Laclede Gas Company for an Accounting Authority Order Authorizing the Company to Defer for Future Recovery the Costs of Complying with the Permanent Amendment to the Commission's Cold Weather Rule, *Report and Order*, April 17, 2008.
[10] *Id.*

<u>Issue 1: Can the Commission lawfully permit Laclede to recover the gas portion of its uncollectible revenues (bad-debt expense) through the PGA/ACA process?</u>

The Commission does not have the lawful authority to permit Laclede to recover the gas cost portion of its bad-debt expenses through the PGA. Laclede's proposal: 1) would violate the prohibition against single-issue ratemaking; 2) would violate the prohibition against retroactive-ratemaking; 3) would violate the Unanimous Stipulation and Agreement approved in Laclede's last rate case; and 4) is based on an argument that is not supported by the evidence.

1. Single-Issue Ratemaking - *Utility Consumers Council of Missouri, Inc. v. P.S.C*

To better understand how Missouri Courts would treat Laclede's request, it is helpful to consider the proposal in light of the specific findings in the relevant Supreme Court and Court of Appeals decisions regarding single issue ratemaking and the PGA. The Commission's ratemaking authority under § 393.270 requires that the Commission "consider all facts…with due regard, among other things to a reasonable average return upon capital actually expended" when establishing a rate. The Missouri Supreme Court interpreted this language to be a legislative prohibition against single-issue ratemaking. <u>*Utility Consumers Council of Missouri, Inc. v. P.S.C.*</u>, 585 S.W.2d 41 (Mo. 1979) ("*UCCM*"); <u>*Missouri Water Co. v. Public Service Commission*</u>, 308 S.W.2d 704 (Mo. 1957). "Missouri's prohibition against single-issue ratemaking bars the Commission from allowing a public utility to change an existing rate without consideration of all relevant factors such as operating expenses, revenues, and rates of return. § 392.240.1; <u>*State ex rel. Mo. Water Co.*</u>, 308 S.W.2d at 718-19." <u>*Sprint Spectrum L.P.d/b/a Sprint PCS v. P.S.C.*</u>, 112 S.W.3d 20 (Mo. App. 2003).

In *UCCM* the Supreme Court reviewed a Commission decision authorizing a fuel adjustment clause (FAC) that allowed dollar for dollar recovery of fuel costs above or below the base fuel cost. The facts in *UCCM* are very similar to Laclede's current proposal to allow dollar for dollar recovery of bad debt costs above or below a base bad debt cost. The Supreme Court cited to the § 393.270 RSMo requirement that the Commission consider "all relevant factors" and concluded that the Commission's order authorizing the FAC permitted "one factor to be considered to the exclusion of all other factors in determining whether or not a rate is to be increased." The Supreme Court reversed the Commission's order because it did not consider whether other costs had decreased and thus offset any increase in fuel costs.

a. Single-Issue Ratemaking - *Hotel Continental v. Burton*

In <u>*Hotel Continental v. Burton*</u>, 334 S.W.2d 75 (Mo. 1960), the Supreme Court reviewed a Commission decision approving a tax adjustment clause (TAC) that passed local taxes to utility customers outside the context of a rate case. The Court approved the TAC in part because the taxes were "not affected by economy of operation in other respects or by greater volume of sales or by variations in the amounts of any other expense items", and because the TAC could be levied "without regard to changes in other costs and without disturbing the statutory scheme that changes in rates of return not occur without consideration of all costs factors and without public awareness and understanding of rates proposed to be charged." The Court concluded that an increase in taxes could not affect the utility's revenue because the "approved rate of return of necessity remains the same". (*Id.*).

Under the *Hotel Continental* analysis, Missouri Courts would uphold a Commission decision rejecting Laclede's proposed tariff. First, bad debt expenses are different from local taxes because bad debts are "affected by economy of operation in other respects or by greater volume of sales or by variations in the amounts of any other expense item." Laclede's witness Mr. Cline testified that Laclede's approach to bad debts and its collections practices could impact Laclede's level of bad debts. (Tr. 42, 53). Testimony from Staff witness Ms. Fred shows that Laclede could greatly improve its collection practices. (Tr. 158). Improvements in Laclede's collection practices or directing more expenses towards collections efforts could lower Laclede's bad debts, making this proposal distinctly different from the TAC in *Hotel Continental*.

Second, Laclede's proposal could not be implemented "without disturbing the statutory scheme that changes in rates of return not occur without consideration of all relevant factors." The evidence showed that Laclede is currently earning a high 11.68 percent ROE. (Tr. 85-86). Laclede's witness Mr. Cline admitted during cross-examination that reducing the variability of Laclede's bad debt recovery would also reduce Laclede's earnings risks, thus making Laclede a less risky investment. (Tr. 64). Recent Commission decisions have followed the understanding that reducing a company's business risks necessitates a reduction in the company's return on equity.[11] Laclede's witness Mr. Buck acknowledged this risk reduction and the impact on ROE

[11] In Case Number GR-2006-0422, In the Matter of Missouri Gas Energy's Tariffs Increasing Rates for Gas Service Provided to Customers in the Company's Missouri Service Area, *Report and Order*, March 22, 2007, the Commission reduced Missouri Gas Energy's ROE by 32.5 basis points due to a rate design that removes weather as a business risk.

when he testified that variations in write-offs can equal a change in ROE of "approximately 40 basis points." (Ex.3, p.9). A rate change that does not factor the necessary changes to ROE and all other relevant factors when making the requested rate change would be a violation of § 393.270 RSMo.

The United States Supreme Court, in *Bluefield Water Works and Improvement Company v. Public Service Commission of West Virginia*, 262 U.S. 679, 67 L.Ed. 1176, 43 S.Ct. 675 (1923), and in *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 88 L.Ed. 333, 64 S.Ct. 281 (1944), mandated that the rate of return for a utility must be comparable to the return on investments in other enterprises having a corresponding risk. Unless the elimination in business risk is accounted for through an offsetting reduction in the Company's return on equity, customers will unjustly pay through rates the higher return associated with a riskier investment in violation of the *Hope* and *Bluefield* standards. The *Hope* and *Bluefield* standards were advanced by Missouri courts in *State ex rel. Missouri Gas Energy, et al. v. P.S.C.*, 186 S.W.3d 376 (Mo.App. 2005).

The Commission should also take note of arguments made by Laclede in a recent case that contradict Laclede's arguments and proposal in this case. In the Commission's 2006 Emergency Cold Weather Rule (ECWR) amendment, Case Number GR-2006-0434, Laclede argued in comments to the Commission that the ECWR was unlawful because it did not consider all relevant factors:

> …by requiring the reconnection or preventing the disconnection of customers that would otherwise not be on the system, the proposed amendment requires the Missouri Utilities to incur greater bad debts than otherwise would exist and thereby incur new expenses. As a result, the proposed amendment creates an "unconstitutional taking of revenues without due process as revenue reduction imposed by the Commission

> without considering all relevant factors," as the Commission has not found, nor does it have any basis to find, that the Missouri utilities' rates are unreasonable or unjust. (Tr. 132-133).

Laclede now wants to place its customers on the same position that Laclede argued was unconstitutional when applied to Laclede. The tariff revision would cause ratepayers to incur an increase in rates, which would be an unconstitutional taking without due process because all relevant factors would not be considered. Laclede has not provided the Commission with any basis for a finding that the current rates paid by consumers are unreasonable or unjust.

b. Single-Issue Ratemaking and the PGA – *Missouri Gas Users Association v P.S.C.*

The *UCCM* and *Hotel Continental* decisions provide an analysis of the Commission's statutory authority to change rates outside of the context of a rate case. Other relevant Commission and Court decisions address these same issues when considering single-issue ratemaking as it relates to a PGA clause. In 1987 the Commission distinguished the *UCCM* decision rejecting a fuel adjustment clause from the use of a PGA mechanism that also adjusts rates outside of a rate case. In Case Number GO-85-284, <u>*In the Matter of the Investigation of Developments in the Transportation of Natural Gas and their Relevance to the Regulation of Natural Gas Corporations in Missouri*</u>, the Commission stated in its March 10, 1987 Report and Order:

> The Commission first addressed the PGA clause in *In Re Laclede Gas Company*, 10 Mo. P.S.C. (N.S.) 442 (1962). The primary reason for allowing the PGA mechanism was to allow the immediate pass-through to retail customers of any difference in wholesale natural gas rates. This simplified method of regulation alleviated the need for an LDC to constantly file rate cases reflecting the difference in wholesale rates. The Commission noted in the *Laclede* case that neither the

> Commission nor the company has any control over federally regulated wholesale rates of natural gas and that the "increases or decrease in wholesale gas cost are simply offset by corresponding increases or decreases in retail rates."
>
> …
>
> In the *UCCM* case an automatic fuel adjustment clause was not allowed by the court, primarily because the Commission was not considering all relevant factors in determining that the overall charge was reasonable. The Commission finds the PGA mechanism distinguishable from the fuel adjustment clause in the *UCCM* case primarily because the purchased gas cost is not controlled by this Commission for the LDC. It is federally regulated and then passed on to the retail customers by the state commission.[12]

Here the Commission finds that the LDC's lack of control over gas costs is the primary reason why the PGA clause does not violate the prohibition against single-issue ratemaking. This follows the findings in the *UCCM* decision, and clearly distinguishes including gas costs in the PGA, which Laclede has little control over, from Laclede's bad debt levels, over which Laclede has significant control. (Tr. 42; Ex.8, p.5).

This distinction was furthered by the Missouri Court of Appeals in *Midwest Gas Users Association, et al. v. P.S.C.*, 976 S.W.2d 470 (Mo.App. 1998) (*MGUA*), where the Missouri Court of Appeals considered whether the Missouri statutes permitted the Commission to utilize a PGA/ACA clause in setting rates for Missouri Gas Energy. The Court upheld the PGA/ACA clause despite Public Counsel's claims of single-issue ratemaking because: 1) The PGA is first considered in a general rate case; 2) Gas fuel costs are different and unique in nature from other expenses; and 3) The Commission may disallow imprudent gas purchasing decisions. The Court of Appeals concluded that under "these circumstances" the PGA mechanism does not violate the principle of single-issue ratemaking. (*Id.*).

[12] 29 Mo. P.S.C. (N.S.) 137.

Laclede's proposal does not satisfy any one of the reasons the Court in *MGUA* determined the PGA clause does not violate the single-issue ratemaking prohibition. First, the Commission did not consider including bad debts in the PGA when it approved the Agreement, nor did the Commission consider the changes this could have on other revenue requirement items such as return on equity. Moreover, Laclede's bad debt expense was not considered by the Commission in the general rate case. The parties proposed a black-box settlement, which Laclede admits did not include an agreement on the level of bad debts to be included in Laclede's revenue requirement. (Tr. 118). The PGA clause is considered in a general rate case whereas the mechanism proposed by Laclede was not.

Second, bad debt expenses are not a different and unique expense. Gas costs are a natural resource that Laclede must purchase from the suppliers available on the pipelines connected to Laclede's distribution system. LDCs do not have control over the prices offered by suppliers. Bad debts, on the other hand, are a typical business expense over which Laclede exercises significant control. Laclede's witness Mr. Cline acknowledged that bad debts are impacted by Laclede's collection efforts. (Tr. 53). For example, Laclede chooses when to write off an account and currently writes off accounts that go unpaid after 126 days. (Tr. 74). If Laclede is authorized to flow increases in bad debt write-offs directly to consumers, nothing would prevent Laclede from simply writing off accounts at an earlier opportunity knowing that recovery through the PGA would be almost certain since a prudency audit would be ineffective. (Ex.8, pp.11-12). This and other collection practices that impact Laclede's level of bad debt, and which Laclede has exclusive control, clearly distinguishes this proposal from the *MGUA* case.

Finally, the Commission will have no way of ensuring that only prudent bad debt write-off decisions were made because a prudency standard for bad debts would be virtually impossible to prove and enforce. Staff witness Mr. Tom Solt testified:

> There is no way for the Staff to determine the amount of bad debt write-offs related to margin versus those related to gas. It is merely an estimate, and an estimate is not technically capable of measurement or audit to the degree that presently exists relative to the gas costs currently in the PGA/ACA clause. (Ex.8, p.6).

Laclede's witness Mr. Buck concurred with Mr. Solt's testimony and acknowledged that it would be impossible to accurately audit Laclede's PGA if it included bad debt costs. (Tr. 135).

The bottom line of the single-issue ratemaking argument is that under all standards applied by the Courts, be it *UCCM, Hotel Continental, or MGUA,* Laclede's proposal would constitute single-issue ratemaking.

2. Laclede Seeks Prohibited Retroactive Ratemaking

In *UCCM,* the Supreme Court concluded that the Commission may not "redetermine rates already established and paid without depriving the utility (or the consumer if the rates were originally too low) of his property without due process." Laclede argues that its bad debt expense is included in the revenue requirement included in rates charged since August 1, 2007. (Ex.1, p.4). If true, Laclede's bad debt adjustment could increase what a customer already pays for bad debts through base rates, violating the customer's right to due process under the *UCCM* analysis. The Supreme Court in *UCCM* also stated:

> The utilities take the risk that rates filed by them will be inadequate, or excessive, each time they seek rate approval. To permit them to collect additional amounts simply because they had additional past expenses not covered by either clause is retroactive rate making, i.e. the setting

> of rates which permit a utility to recover past losses or which require it to refund past excess profits collected under a rate that did not perfectly match expenses plus rate-of-return with the rate actually established. *Board of Public Utility Commissioners v. New York Telephone Co., 271 U.S. at 31; Lightfoot v. Springfield, 236 S.W.2d at 353.* Past expenses are used as a basis for determining what rate is reasonable to be charged in the future in order to avoid further excess profits or future losses, but under the prospective language of the statutes §§ 393.270(3) and 393.140(5) they cannot be used to set future rates to recover for past losses due to imperfect matching of rates with expenses.

Laclede's proposed tariff would specifically allow Laclede to increase future PGA rates for the sole purpose of recovering for past losses due to an imperfect matching of rates with bad debt expenses.

The Missouri Court of Appeals for the Western District in *Midwest Gas Users Assoc., et al. v. P.S.C.*, 976 S.W.2d 470 (Mo.App. 1998) addressed arguments that the PGA clause constituted retroactive ratemaking. The Court concluded that the PGA for gas costs is not retroactive ratemaking because adjustments "are applied only to future customers on future bills" and "companies are not allowed to adjust the amount charged to past customers either up or down." Laclede's proposal involves both past customers and past bills because past losses or excesses would be netted against Laclede's claim to an $8,100,000 base amount.

When a customer pays his gas bills for January through March, Laclede claims a portion of that bill includes revenue for bad debt expense. If Laclede determines afterwards that it wrote off more bad debts during January through March than what it claims are now in rates, Laclede's proposal would allow Laclede to raise future rates to recover the difference. Under Laclede's proposal, Laclede would look at past expenses (bad debts for January through March) to set future rates to recover for these past losses due to an imperfect matching of rates with expenses. This was specifically determined to be unlawful by the Supreme Court in *UCCM* when the Supreme Court concluded that "under the prospective language of the statutes §§ 393.270(3) and 393.140(5)," past expenses "cannot be used to set future rates to recover for past losses due to imperfect matching of rates with expenses." Accordingly, Laclede's proposal would retroactively adjust rates in violation of §§ 393.270(3) and 393.140(5), as determined by the Supreme Court in *UCCM*.

3. Laclede's Tariff Proposal Violates the Terms of a Commission-Approved Unanimous Stipulation and Agreement

Laclede's disregard for and violation of the Unanimous Stipulation and Agreement (Agreement) from Laclede's last rate case, Case Number GR-2007-0208, is twofold. First, Laclede agreed to withdraw its bad debt tariff proposal in the rate case in exchange for a $38.6 million rate increase and other tariff changes requested by Laclede. Public Counsel expected Laclede to honor the Agreement and not seek to circumvent the Agreement's terms by filing the same proposal that it agreed to withdraw. The Agreement specifically states on page five that "Laclede is no longer seeking approval of the tariff sheets and rate schedules that it filed in this case on December 1, 2006." The Agreement also states that "none of the signatories shall be prejudiced or bound in any manner by the terms of this Stipulation and Agreement in this or any other Commission, judicial review or other proceeding, except as otherwise expressly specified herein." The "terms" of the Agreement expressly specify that Laclede is no longer seeking approval of the tariff sheets, and since Laclede is seeking approval of the same tariff proposal from its rate case, Laclede is bound by the terms of the Agreement and its tariff filing should be rejected.

Laclede's second disregard for and violation of the Agreement follows Laclede's reliance on a level of bad debts that Laclede claims was in evidence in the rate case. The parties specifically agreed that no signatory "shall be deemed to have approved or acquiesced in any ratemaking or procedural principle, including, without limitation, any method of cost determination or cost allocation." Now Laclede wants the Commission to find that the agreed upon revenue requirement includes a specific cost allocation for bad debts. Laclede's attempt to force a cost allocation on Public Counsel and Staff after agreeing to no cost allocation is a violation of the Agreement and should be rejected.

To allow Laclede to violate the rate case Agreement and the treatment of bad debts in the rate case would be a disservice to the process and would discourage parties from settling rate cases. Violating the Agreement prejudices the Staff and Public Counsel because each party made stipulations to reach settlement with Laclede in exchange for Laclede's $38.6 million rate increase, one stipulation being the withdrawal of the proposal to recover bad debts in the PGA. The Commission approved the Agreement, and a tariff that ignores those terms, if approved, would violate the *Missouri Constitution*, Art. I, Section 13, which states "that no ex post facto law, nor law impairing the obligation of contracts, or retrospective in its operation, or making any irrevocable grant of special privileges or immunities, can be enacted."

4. Laclede's Evidence is Insufficient

Ratemaking orders of the Commission must be based on competent and substantial evidence on the record. *Union Electric Co. v. P.S.C.*, 136 S.W.3d 146, 151 (Mo. App. 2004). The Commission cannot lawfully approve Laclede's proposed tariff because the record in evidence is insufficient to support Laclede's request. Laclede wants the Commission to establish $8,100,000 as Laclede's annual amount of bad debts included in current base rates. However, the Commission did not determine a level of bad debts in Laclede's last general rate case, and Laclede has provided no data supporting Laclede's calculated estimate. Case Number GR-2007-0208 settled as the result of a black box settlement wherein the parties did not agree on a level of bad debts. Laclede witness Mr. Cline attempts to sweep this major flaw aside by alleging that the Commission should *now* determine a specific level of bad debts a year and a half later. Mr. Cline states:

> The last bad debt write-offs that were available to the parties for review in that case, and that can be considered to be representative of the bad debts included in the Company's base rates, were based on the twelve months ended March 31, 2007 and amounted to approximately $10.8 million. Due to the time that generally elapses between billing and write-offs, the foregoing write-offs were associated with revenues for the twelve months ended May 31, 2006. Since approximately 75% of those revenues were gas cost related, $8.1 million represents the Company's recovery of the gas cost portion of bad debts that is included in base rates. (Ex.1, p.4).

The Agreement resolving Case Number GR-2007-0208 does not include a level of bad debt expenses. Neither Public Counsel nor Staff concur with Laclede that $10.8 million represents a level of bad debts from the rate case, and Public Counsel is aware of no evidence submitted by Laclede in this case to corroborate that amount. Laclede's proposed tariff is an unlawful attempt at retroactively establishing a level of bad debts using numbers that were not agreed on by the parties, and even if accurate for 2006, will be three years out of date by the time Laclede makes its next PGA adjustment. (Tr. 47-49). This lack of evidence is insufficient and does not provide support for Laclede's proposal.

<u>ISSUE 2: Can the Commission permit Laclede to recover the gas portion of its uncollectible revenues (bad-debt expense) through the PGA/ACA process by modifying its PGA/ACA tariff outside of a general rate case?</u>

There is no question that bad debts have always been included in base rates, and no party has claimed that the statutes allow base rate changes outside of a rate case to ensure Laclede's recovery of its subjective bad debt write-offs. But that is essentially what Laclede is requesting. Laclede is isolating an amount it claims is in rates and raising rates to recover a portion of that amount, outside of a rate case, and based on Laclede's subjective write-off decisions. Laclede seeks periodic rate increases for an expense that has always been included in rate base and always determined in rate cases. The appropriate and lawful manner to address this issue is during a rate case as Laclede recognized in its two prior rate case filings where it made the same proposal before the Commission today.

Much of the single-issue ratemaking argument raised under Issue 1 regarding the lawfulness of including bad debts in the PGA also apply to the question of whether rate design changes to the PGA can be made outside of the context of a rate case. The Commission's ratemaking authority under § 393.270 requires that the Commission "consider all facts…with due regard, among other things to a reasonable average return upon capital actually expended" when establishing a rate. *<u>Utility Consumers Council of Missouri, Inc. v. P.S.C.</u>*, 585 S.W.2d 41 (Mo. 1979). Laclede's proposal may only be considered in a general rate case that looks at all relevant factors. To do otherwise could lead to rates that are not just and reasonable.

ISSUE 3: Should the Commission permit Laclede to recover the gas portion of its uncollectible revenues (bad-debt expense) through the PGA/ACA process?

Unlawfulness aside, the proposed tariff should also be rejected because it runs contrary to the *primary* purpose of the Commission, which is to protect consumers of investor-owned utilities. *Capital City Water Co. v. P.S.C.*, 850 S.W.2d 903, 911 (Mo. App. 1993). Laclede's proposal would run contrary to the Commission's purpose and is unreasonable because: 1) Laclede's reduced incentive to pursue collections harms consumers; 2) Bad debts are not gas costs under the USOA and GAAP; 3) After-the-fact prudency reviews of Laclede's bad debt write-offs are impossible and could not prevent rate manipulation by Laclede; and 4) Laclede is earning an 11.68% ROE and its bad debt levels have been stable for the past three years.

1. Laclede's Reduced Incentive to Collect Harms Consumers

Laclede currently has a significant incentive to be persistent in its pursuit of collecting bad debts. The more aggressive Laclede is at collecting, the more successful Laclede will be in collecting, thus reducing bad debt expense and increasing revenue. Staff witness Mr. Solt testified that Laclede's tariff proposal "eliminates most of the incentive for Laclede to pursue collections." (Ex. 8, p.2). Public Counsel's witness Mr. Trippensee testified that Laclede's proposal "reduces incentives to implement appropriate collection processes…thus placing additional risk on other customers' rates" due to the increase in bad debt costs. (Ex.10, p.4).

Past Commission decisions have recognized the concern that "preapproval or a periodic review process of utility's decisions" may reduce the utility's incentive "to closely scrutinize its costs."[13] In 2007 the Commission considered a request for a fuel adjustment clause and explained the concerns of reducing a company's incentives to reduce costs:

> If, however, a fuel adjustment clause is in place, the utility has less financial incentive to minimize its fuel costs because those costs will be automatically recovered from ratepayers. Efforts can be made to design a fuel adjustment clause in a manner that maintains some incentive**;** for example, the Missouri statute authorizing a fuel adjustment clause requires the utility to file a new rate case every four years and requires the Commission to review the prudence of the company's purchasing decisions every 18 months. But regulatory reviews are only a partial substitute for the direct incentives that can result from a utility's quest for profit.[14]

The Commission recognizes that a prudency review is not a complete substitute for a utility's direct incentives for profit. The aggressiveness of Laclede's repeated attempts to implement this tariff proposal proves that Laclede's incentive and determination to increase profits is strong. A prudency review would provide no substitute for that incentive, but would instead harm consumers by reducing Laclede's incentive to aggressively pursue collections and minimize its bad debts.

2. Tariff Violates the USOA and GAAP

Laclede's proposal is opposed by three licensed Certified Public Accountants (CPA), the only CPAs testifying in the case. Mr. Solt and Mr. Trippensee testified that Laclede's proposal violates accepted accounting systems and principles. Their primary

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[13] Case No. EO-92-250, In the Matter of the Application of Kansas City Power & Light Company for Review of its Phase I Compliance Plan and Other Activities Under the Clean Air Act, *Order Establishing Jurisdiction and Clean Air Act Workshops*, August 26, 1992.

[14] Case No. ER-2007-0002, In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area, *Report and Order*, May 22, 2007.

assertion is that bad debts are not a gas costs under the Uniform System of Accounts (USOA) and including bad debts in a gas cost account would violate the USOA.

The USOA was established by the Federal Energy Regulatory Commission (FERC) and adopted by the Commission, requiring Laclede to conform and maintain its books and records with the USOA. 4 C.S.R. 240-40.040. Mr. Solt testified that no portion of bad debt write-offs is recognized as a gas costs on Laclede's books and records. (Ex.8, p.6). Mr. Solt testified that under the USOA, uncollectible accounts and purchased gas costs are booked to different accounts, and Laclede's proposed treatment runs contrary to the requirements of the USOA. (Ex.8, pp.6-7).

Public Counsel's witness Mr. Trippensee also testified that the FERC, through its adoption of the USOA, does not classify bad debt expenses as a gas costs. (Ex.10, p.4). A review of all gas cost accounts under the USOA, Accounts 800 through 813, reveals that they do not contain *any* reference to revenues or bad debts. (Ex.10, p.5). Furthermore, Mr. Trippensee testified that he is "aware of no GAAP [Generally Accepted Accounting Principles] that would require" Laclede to increase its expense related to payments to "third party vendors…to reflect a company's inability to collect revenue from its own customers." (*Id.*). The Commission should reject the tariff proposal as a violation of the USOA, and consequently, a violation of 4 C.S.R. 240-40.040.

3. Prudency Reviews of Bad Debt Write-Offs are Impossible and Could Not Prevent Rate Manipulation

The possibility for rate manipulation by Laclede would be substantial if this tariff is approved. Staff's witness Mr. Solt testified that Laclede's proposal would be harmful to consumers because it could result in over-recovery of bad debts. Mr. Solt testified:

> Approval of this tariff could result in over-recovery of bad debt expenses, since the amount Laclede proposes may, in fact, be more than actual bad debts. It may also be possible for the Company to write-off bad debts sooner or later to manipulate the outcome, possibly resulting in over-recovery. (Ex.8, pp.11-12).

Staff witness Mr. Sommerer testified that Laclede's "convoluted proposal" grants Laclede "great discretion" over the amounts that would be included in rates:

> The Company's approach in its tariff proposal is to go behind a settled rate case stipulation, attempt to measure some level of expense it believes was included in the settled rates, further subdivide the expense into a "gas cost portion" and a nongas portion, and then track that estimate against an "actual" "gas cost portion" of net write-off amount, which itself is an estimate. This adjustment is then netted against billed revenues. More estimating takes place when some sort of subjective guess occurs as the Company tries to determine the relationship between a calculated gas cost percentage of total revenues during some time period and apply that percentage to an actual level of write-off for "the period to which such write-offs apply". It should be no surprise that this convoluted proposal seems difficult to follow. It allows the Company great discretion in the determination of what the final numbers will be. (Ex.9. p.5).

There is nothing just and reasonable about a rate that can be easily manipulated by the company to increase revenues, and that cannot be properly reviewed.

Mr. Solt testified that Laclede's proposal would calculate costs "based on an assumption that a certain percentage is 'related' to gas costs, thus making these costs less subject to verification compared to all of the other gas costs currently reflected in the PGA/ACA process." (Ex.8, p.6). Costs based on assumptions cannot be accurately quantified for a prudency audit. (*Id.*). Mr. Sommerer testified that this would further complicate an ACA process that "is already cumbersome." (Ex.9, p.6). Under Laclede's proposal, the ACA process would move "far beyond the already difficult task of reviewing gas procurement decisions" and "into an entirely unrelated aspect of the Company's operations, 'credit and collections'." (Ex.9, p.7).

It is clear from Mr. Sommerer's testimony that the administrative difficulties created by Laclede's proposal would impede the ability of Staff and Public Counsel to review Laclede's pass-through of bad debt expenses, and would essentially give Laclede the ability to manipulate its rates while simultaneously making it more difficult for the Staff and Public Counsel, and ultimately the Commission, to review Laclede's write-offs, assumptions, recoveries, and estimations. This is not just or reasonable.

4. Laclede's Evidence Shows Minimal Variation in Bad Debt Expense

Staff witness Mr. Solt testified that Laclede's bad debts over the last three years "have been relatively stable." (Ex.8, p.8). Laclede's witness Mr. Glenn Buck testified that Laclede's bad debt write-offs for 2005, 2006 and 2007 were $10.3 million, $10.7 million, and $11.3 million respectively. (Ex.3, p.5). Assuming for argument's sake that Laclede's current rates include $10.8 million for bad debts as Laclede claims (which Public Counsel disputes), the average variation from this amount over the last three years is only $74,707 per year.[15] This is an insignificant sum to a company with the resources to pay a consultant $40,000 for a single round of prefiled testimony. (Tr. 101). If $10.8 million had been recovered in revenue for bad debts over the past 3 years, Laclede would have recovered revenue for bad debts over that 3 year period that was only $224,122 below the amounts actually written-off.[16] Laclede's claim that the current rates are insufficient is not supported by the evidence.

[15] The difference between the cumulative three year bad debts claimed by Laclede for 2005-2007 ($10,547,022 + $10,734,707 + $11,353,394 = $32,634,123) and the level of bad debts that Laclede claims are now recovered in rates times three years ($10.8 million x 3 = $32,400,000) equals $224,122. The 3-year average variation from the amount Laclede now claims is in base rates is $74,707 for 2005-2007. (Ex.3, p.5).

[16] *See* calculation in footnote 12.

Laclede's bad debt write-off for 2006 was calculated by Laclede without including offsets for the additional bad debt revenues that Laclede is now receiving since its new rates went into effect on August 1, 2007. (Tr. 46-47). Laclede is now recovering an additional $5,033,655 to offset bad debt expenses caused by the ECWR in 2006, with the implication being that Laclede's bad debt expenses increased by this amount as a result of compliance with the ECWR, and that Laclede's bad debts for 2006 would be $5,033,655 less had the Commission not adopted the ECWR. Subtracting the $5,033,655 ECWR recovery from the $10,734,707 Laclede claims were its 2006 bad debt write-off total, suggests that Laclede experienced only $5,701.052 in bad debt expenses not related to the ECWR. (Ex.3, p.5). The relevance of this evidence is unclear – it may show that the Commission's previous orders granting Laclede additional bad debt management tools, coupled with all pre-existing bad debt management tools, are proving to be extremely effective in allowing Laclede to recover and manage its level of bad debts, or it may show that Laclede is grossly over-recovering for bad debts.

III. Conclusion

The Supreme Court in *UCCM* understood the importance of maintaining the ratemaking balance created by the Missouri Legislature. The Court held:

> [W]e will not travel further down the "slippery slope" and risk a dismantling of the carefully balanced fixed rate system established by the legislature. While in itself the clause looks innocuous, and while the cost of fuel may look high, to permit such a clause would lead to the erosion of the statutorily-mandated fixed rate system. If the legislature wishes to approve automatic adjustment clauses, it can of course do so by amendment of the statutes, and set up appropriate statutory checks, safeguards, and mechanisms for public participation…
>
> If the electric companies are faced with an "emergency" situation because of rising fuel costs, they can take advantage of the method set

> up by the legislature to deal with such situations and file for an interim rate increase on the basis of an abbreviated hearing…

Approving this tariff runs the risk of eroding a system that has proven successful and protected consumers since the beginning of utility regulation in Missouri. Laclede has identified no statutory authority that would allow the Commission to approve the proposed tariff and allow the rate increases requested by Laclede. If Laclede is having legitimate problems recovering its costs, the Supreme Court explained that LDCs have statutory remedies that do not run afoul of the ratemaking system. One such remedy is to file a rate case.

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, emailed or hand-delivered to the following this 13th day of February 2009:

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