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The Honorable Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102-0360

Re: Case No. GR-99-315

Dear Judge Roberts:

Enclosed for filing please find the original and eight copies of Laclede Gas Company's Proposed Findings of Fact.

Would you please see that this filing is brought to the attention of the appropriate Commission personnel.

Thank you.

Sincerely,

NEWMAN, COMLEY & RUTH P.C.

By: Mark W. Comley
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MWC:ab
Enclosure
cc: Hon. Nancy Dippell, Senior Regulatory Law Judge
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BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

PROPOSED FINDINGS OF FACT

COMES NOW Laclede Gas Company ("Laclede" or "Company") and, pursuant to the Commission's May 14, 2001 Order Directing Filing in the above-captioned case, submits its proposed findings of fact. This matter arose initially by virtue of the Commission's December 14, 1999 Report and Order in Case No. GR-99-315, in which the Commission, among other things, adopted Staff's proposed method for determining the net salvage component of Laclede's depreciation rates. (*Report and Order*, p. 33). In that same Report and Order, the Commission also adopted the Staff's position on a separate depreciation issue relating to the Company's natural gas holders. (*Id.*). Although the Company sought rehearing and ultimately judicial review of the Commission's decision regarding the net salvage issue, it did not seek rehearing or judicial review of the Commission's decision regarding the depreciation issue relating to gas holders. The Company has, however, referenced the Commission's depreciation decision on the gas holders issue in this case to show how these proposed findings of fact, together with the separate disposition of the gas holders issue, can be harmonized with the reasoning set forth in the Commission's recent decision on a net salvage issue in ***Re: St. Louis County Water Company***, Case No. WR-2000-844, Report and Order, dated May 3, 2001.

As a result of the review proceeding, the Circuit Court of Cole County remanded the Commission's decision on the net salvage issue with instructions that the Commission provide findings of fact "sufficient to support a resolution of the net salvage issue." To

119

that end, and in compliance with the Commission's Order Directing Filing, Laclede submits the following proposed findings of fact. Please note that for the Commission's convenience, citations to the record have been provided for each of the proposed findings of fact.

DEPRECIATION/ NET SALVAGE

In determining depreciation rates, the parties did not agree as to the method for calculating net salvage value. Laclede Witness Richard Kottemann testified that the Company and the Commission have traditionally used the straight-line - average life - amortization system to calculate Laclede's depreciation rates. (Exh. No. 23, p. 4). Under this traditional method, the depreciation rate for a particular asset or group of assets equals (100% minus the net salvage percentage) divided by the average service life of the asset (in years). (*Id.*). In this formula, net salvage equals the gross salvage value of the asset minus the cost of removing the asset from service. (*Id.*). The net salvage percentage is determined by dividing the net salvage experienced for a period of time by the original cost of the property retired during that same period of time. (Exh. No. 23, pp. 4-5). Mr. Kottemann's testimony demonstrated that many natural gas assets will have a negative net salvage value and corresponding negative net salvage value percentage, since the cost of removing the asset from service frequently exceeds its gross salvage value. (Exh. No. 23, p. 9; Schedule 1).

Also submitting testimony on Laclede's behalf, was Dr. Ronald White, a valuation engineer and depreciation expert who has testified about depreciation matters in numerous jurisdictions and served on the faculty for depreciation programs conducted for various public utility commissions, companies and consultants. (Exh. No. 26, pp. 1-2).

Both Mr. Kottemann and Dr. White testified that the method utilized by Laclede was consistent with the fundamental goal of depreciation accounting -- namely, to allocate the full cost of an asset, including its net salvage cost, over its economic or service life so that utility customers will be charged for the cost of the asset in proportion to the benefit they receive from its consumption. (Exh. No. 23, p. 3; Exh. No. 25, p.7; Exh. No. 26, p. 4). They also testified that this goal, and the classical depreciation method utilized by Laclede in this case to achieve it, was supported by the overwhelming weight of authority on how to establish proper depreciation rates. Specifically, they testified that such a method was in line with the definition of depreciation accounting utilized by the National Association of Utility Regulatory Commissioners ("NARUC") (Exh. No. 23, p.3); supported by Generally Accepted Accounting Principles ("GAAP") (Exh. No. 26, pp. 4-5); consistent with the authoritative texts on proper depreciation accounting, including the text compiled and edited by the Depreciation Subcommittee of NARUC (Exh. No. 25, pp. 4-6), and almost universally accepted by other state and federal regulatory bodies in the United States. (*See* Exh. No. 26, pp. 2 and 13).

Staff Witness Adam agreed that for many accounts, the cost of removal far exceeds the gross salvage value and that therefore "net salvage is negative and represents dollars that the company should collect from the customer in addition to the recovery of the original plant's cost." (Exh. No. 92, p. 8). He also agreed that a recognized goal of depreciation accounting is to spread the cost of an asset, including its net salvage cost, over the useful service life of the asset. (Tr. 895-896). Mr. Adam argued, however, that the "[n]et salvage should recover the current actual net salvage amounts, not an average over the life of the current plant" and, therefore, proposed a depreciation calculation that

would charge "Laclede's customers annually for a net salvage amount, equal to, or nearly equal to, the amount Laclede is spending annually for net salvage." (Exh. No. 94, p. 3). Specifically, Staff's approach would limit any allowance for net salvage costs to the amount currently being incurred by the Company to remove its retired plant from service, rather than the net salvage costs that the Company is incurring and, based on historical net salvage percentages, can be expected to incur in connection with the plant being used to provide service today.

In support of its position to limit net salvage costs to what the Company is currently expending to remove assets from service, Staff noted that Laclede is currently recovering more in depreciation for net salvage than it is spending, and argued that final salvage costs are unmeasurable and unknown except in specific cases. (Exh. No. 92, p. 7). Staff also suggested that its method would address an "intergenerational problem." (Exh. No. 93, p. 2; Tr. 896). Finally, Staff argued that its method was appropriate since the filing of frequent rate cases would permit the level of net salvage costs reflected in rates to be adjusted in the event such adjustments were necessary. (Exh. No. 92, p. 7).

In response, both Mr. Kottemann and Dr. White testified that the approach recommended by Staff was inconsistent with GAAP, the methods prescribed by the authoritative texts on depreciation accounting, and the widely-accepted methods that have been implemented by virtually all other regulatory bodies in the United States. (Exh. No. 23, p. 10; Exh. No. 25, p. 4-6; Exh. No. 26, pp. 2, 13). They also testified that by not recognizing the net salvage costs that historical data has shown are, in fact, certain to be incurred in connection with assets being used to provide service today, the method proposed by Staff would defeat the fundamental goal of depreciation accounting. (Exh.

No. 26, p. 5). Specifically, it would preclude any ability to allocate the full cost of such assets, including their net salvage costs, over the period during which such assets are actually being used to provide service. In fact, for new categories of plant or equipment, Dr. White testified that Staff's approach would provide no allowance at all for net salvage costs until such time as the plant is actually retired. (Exh. No. 26, p. 12; *See also* Tr. 862). As a result, it is Laclede's position that Staff's proposed method would diminish rather than promote intergenerational equity by ensuring that customers only pay for the net salvage costs associated with plant that is no longer used to serve them, while preventing them from paying for the full cost of plant that is being used to serve them. (Exh. 25, pp. 6-7).

Finally, in response to Mr. Adam's contentions that net salvage costs are not known and measurable, Laclede's witnesses testified that the same kind of depreciation techniques used to estimate net salvage costs are also used to estimate the service lives of the assets to which those costs apply. (Tr. 841). These service lives are, in turn, used to defer for decades into the future the Company's recovery of the capital expenditures that it is currently spending to place assets in service.

Based on the competent and substantial evidence on the whole record, the Commission finds as follows:

It is undisputed on this record that the straight-line - average life - amortization method used by Laclede to determine the net salvage component of its depreciation rates has traditionally been used by both Commission and the Company to establish the Company's depreciation rates. (Exh. No. 23, p. 4). It is also undisputed on the record that the propriety of using such method for this purpose is supported by the

overwhelming weight of authority on such matters. Laclede provided evidence showing the wide-spread support among depreciation professionals and the authoritative texts for the Commission's traditional treatment of net salvage. (Exh. No. 23, p.3; Exh. No. 25, pp. 4-6; Exh. No. 26, pp. 4-5). Laclede also established, and no party disputed, that such a method is consistent with generally accepted accounting principles and is recognized and followed almost universally by other regulatory jurisdictions in the United States. (Exh. No. 26, pp. 2, 4-5, 13). In contrast, Staff was unable to cite any depreciation practitioner, outside of other Staff members, or any depreciation treatise which addressed, much less endorsed, its proposed treatment of net salvage. (*Compare* Tr. 878-879 to Tr. 919 to 920). In fact, the unchallenged testimony of Dr. White, a depreciation expert, showed that the recommendation of Mr. Adam had no foundation whatsoever in depreciation theory. (Tr. 838; Exh. No. 26, p. 13). And aside from a single state where the recognition of current net salvage costs has been judicially mandated, Staff was unable to cite any decision from another regulatory jurisdiction where its recommended method has been adopted. (Tr. 867-868; 875-876).

In view of these considerations, the Commission finds that before it departs in a contested case from its traditional approach to determining net salvage there must be clear and compelling evidence present in the record showing that its traditional policy is no longer appropriate and why the proposed alternative to that traditional approach is superior. The Commission finds that the Staff has failed to provide such evidence in this case.

During cross-examination, Mr. Adam agreed that a proper goal of depreciation is to allocate the full cost of an asset, including its net salvage cost, over the useful life of

the asset. (Tr. 895-896). He did not, however, provide any evidence to demonstrate that this goal is not achieved by the classical approach traditionally used by the Commission and employed by Laclede in this case. In criticizing the classical approach to determining net salvage, Mr. Adam did state that the traditional method has produced a level of net salvage costs greater than what the Company has recently incurred to remove plant from service. (Exh. No. 92, p. 7). This is hardly an unexpected result, however, given the unrebutted evidence which showed a consistent and significant upward trend over time in both the installation cost of the plant used by Laclede to provide utility service, as well as in the cost of removing such plant from service. (Exh. 23, pp. 21-26; Exh. 25, p. 9; Tr. 841). In light of this evidence, the Commission finds that it would be highly unusual if the net salvage costs produced by a method that is specifically designed to accrue for such increasing costs were *not* higher than the net salvage costs currently being realized in connection with plant that has already been retired. In fact, as a matter of pure mathematics, just maintaining the net salvage percentage at its historical rate would result in a higher level of net salvage costs than that currently being realized by the Company, since it applies to an asset base which has grown and continues to grow over time.

The Commission is also not convinced that the net salvage costs calculated under the traditional method are unknown and unmeasurable because they are derived through the use of estimating techniques that reflect the continuing impact of factors such as inflation which have driven up installation and removal costs for decades. Mr. Adam presented absolutely no evidence which would show that such inflationary pressures will not continue into the future. In contrast, both of the depreciation witnesses for Laclede

clearly demonstrated that continuing recognition of such a factor was well grounded in the historical data. (Tr. 841; Exh. 23, pp. 18-23; Exh. 25, p. 9, Schedule 1). Moreover, both the rate of return witness for the Company as well as the rate of return witness for the Staff also presented evidence showing that some level of inflation can be expected to continue for the foreseeable future. (*See* Tr. 841; Exh. No. 2, pp. 4, 7, 10-11, 19-21, D6, Schedule 8; Exh. No. 59, pp. 9-17, Schedules 4 and 7). In view of this evidence, the Commission finds it would be unreasonable to adopt a method which completely ignores a factor that all of the witnesses addressing this matter have testified will occur.

The Commission is also concerned regarding the lack of any other substantive evidence showing that net salvage costs, as determined under the traditional method, have been calculated erroneously. Although Mr. Adam testified in his direct testimony that net salvage costs had been miscalculated, he later acknowledged in a data request response to the Company as well as during cross-examination that no such miscalculation had occurred. (Tr. 884-885). Rather, according to Mr. Adam, the difference between his net salvage calculation and that of the Company's was simply attributable to the fact that they were employing different methods to make that calculation. (*Id.*). The Commission also notes that the evidence on the record showed that the use of informed estimating techniques is just as critical to determining the service lives of a utility's assets which, under both the methods proposed in this case, are used to spread and defer the utility's recovery of current capital expenditures over many years, and even decades, into the future. (Tr. 841; Exh. 23, pp. 8-10). In fact, Mr. Adam testified in his direct testimony that the fact that the Company was accruing more net salvage costs than it is currently realizing could just as easily be attributable to the estimated length of service lives used

to calculate the depreciation rates as it was to the determination of net salvage costs in the depreciation rates. (Exh. No. 92, pp. 8-9). He did not explain, however, why it was nevertheless appropriate to rely on such service life estimates for purposes of deferring cost recovery 50, 70 or even 100 years into the future, but not for purposes of estimating net salvage costs over the same period of time.

The Commission is also not persuaded that the method proposed by Staff will resolve an intergenerational problem but instead finds that it is likely to create one. Although Mr. Adam initially testified that his method would address an intergenerational problem, he later conceded on cross-examination that he wished he hadn't made that claim. (Tr. 896). In fact, Mr. Adam acknowledged on cross-examination that to address any intergenerational problem, customers benefiting from the use of an asset should pay for its costs of removal during the service life of the asset, not after it is retired from service. (*Id.*). Since it is clear from the evidence in this case that the classical method does just that, while Staff's method does not (Exh. No. 25, pp. 6-8), the Commission finds that intergeneration equity will be promoted by the continued use of the traditional method used by Laclede in this case.

The flaws in Staff's proposed method were also illustrated by the record evidence which showed that for an entirely new category of plant that had no depreciation experience, Mr. Adam's method would make no allowance at all for net salvage costs until decades later, when plant from that category is finally retired. (Exh. No. 26, p. 12). Mr. Adam conceded during cross-examination that his method would produce such a result, unless retirement experience relating to this new category of plant was somehow available from other companies and could be used to calculate a net salvage amount. (Tr.

862-864). He also conceded that even in those circumstances where he "knew with certainty" that a category of plant would have a salvage cost at the end of its service life, his method would nevertheless provide a zero allowance for such costs absent any actual experience of such costs. (Tr. 862).

The Commission is also not convinced by Staff's claim that its method is appropriate because the utility is always free to file a new rate case, if and when the net salvage costs actually experienced diverge significantly from those underlying its depreciation rates. If the utility has to wait until the net salvage costs are actually incurred, the opportunity for achieving an equitable distribution of costs among customers who benefited from the use of the assets over their service life will have long since passed. In fact, Mr. Adam acknowledged during redirect examination that if the utility attempted to defer seeking rate relief in circumstances where its net salvage costs were understated because of his method, it would risk an erosion in earnings. (Tr. 931-932). On the other hand, if the Company's net salvage costs were overstated, Mr. Adam testified that, under the traditional method, deferring the filing of a rate case would *not* enhance the Company's earnings since any overstatement would be captured, for later adjustment, in the depreciation accrual balance. (Tr. 932). Considering the potential harm of under-recovery that would be created by Mr. Adam's proposed method, compared to the absence of any potential harm of over-recovery under the traditional method, the Commission finds that the Company's opportunity to file frequent rate cases does not cure the flaws in Staff's proposed method.

Finally, the Commission is concerned about making such a significant change in its policies based on the casual process Staff took in developing and explaining its

proposed method. The Commission notes that the workpapers supporting Staff's proposed method were never included with Mr. Adam's pre-filed testimony, but were only offered into the record upon conclusion of Mr. Adam's cross-examination. (Tr. 929). It is also clear from the discussion of those workpapers, that Mr. Adam adopted his method by simply scratching out the salvage values he had calculated using the conventional methodology and substituting instead lower net salvage values, based on apparently nothing more than his realization that his original set of values yielded higher dollars in net salvage to the Company than those actually being incurred by the Company in recent periods. (Tr. 889-892; Exh. No. 124). Moreover, the only specific concerns expressed by Staff regarding the net salvage values determined by the Company for particular accounts were voiced by Staff only upon redirect examination, after the Company's opportunity for cross-examination had passed. (Tr. 924-929). Each of these factors make it difficult for the Commission to find that Staff has supported and explained its proposed method with the degree of thoroughness necessary to justify such a significant departure from the Commission's traditional policy in this area.

The Commission wishes to emphasize, however, that where Staff does provide evidence that an alternative approach to calculating depreciation rates is appropriate, it will not hesitate to adopt such alternative methods. For example, as the Commission indicated in ***Re: St. Louis County Water Company***, Case No. WR-2000-844, in a situation in which a utility has a type of asset that is at or very near the end of its service life, that is not likely to be replaced, and for which the cost of removal is high and likely to move higher, the Commission will consider alternative approaches. And the Commission has done so in this case with its separate decision adopting Staff's position

that Laclede should not be permitted to recover removal costs for its natural gas holders until it has made an irrevocable commitment to dismantle those holders. These considerations are not applicable, however, to the mass property units involved in the net salvage issue, and the Commission therefore finds that the classical method used by Laclede for determining net salvage in this case should be retained.

WHEREFORE, for the foregoing reasons, Laclede Gas Company respectfully requests that the Commission issue an order resolving the net salvage issue in a manner consistent with the proposed findings of fact set forth herein and directing the Company to file a tariff implementing such resolution on a prospective basis.

Respectfully submitted,

Michael C. Pendergast by B.A.C.

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that the foregoing Proposed Findings of Fact have been duly served upon the General Counsel of the Staff of the Public Service Commission, Office of the Public Counsel and all parties of record to this proceeding by placing a copy thereof in the United States mail, postage prepaid, or by hand delivery, on this 4th day of June, 2001.