Missouri Public Service Commission

POST OFFICE BOX 360
JEFFERSON CITY, MISSOURI 65102
573-751-3234
573-751-1847 (Fax Number)
http://www.ecodev.state.mo.us/psc/

November 1, 1999

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

RE: GR-99-315

Dear Mr. Roberts:

Enclosed for filing in the above-captioned case are an original and fourteen (14) conformed copies of a **REPLY BRIEF OF THE STAFF OF THE MISSOURI PUBLIC SERVICE COMMISSION.**

This filing has been mailed or hand-delivered this date to all counsel of record.

Thank you for your attention to this matter.

Sincerely yours,

Marc Poston

Marc Poston
Assistant General Counsel
(573) 751-8701
(573) 751-9285 (Fax)

MP/jb
Enclosure
cc: Counsel of Record

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

FILED[3]

NOV 0 1 1999

Missouri Public
Service Commission

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

REPLY BRIEF OF THE STAFF OF THE MISSOURI PUBLIC SERVICE COMMISSION

Submitted by:

Dana K. Joyce, #28553
Marc Poston, #45722
Cliff E. Snodgrass, Illinois Bar #3123645
Nathan Williams, #35512
David J. Stueven, #51274

Attorneys for the Staff of the
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102
(573) 751-8701 (Telephone)
(573) 751-9285 (Fax)

87

TABLE OF CONTENTS

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

<u>REPLY BRIEF OF STAFF</u>

The Staff of the Missouri Public Service Commission (Staff) submits this Reply Brief of Staff to respond to the Initial Briefs filed on October 15, 1999. The Staff's case, including its Initial Brief and this Reply Brief, establish an unbiased position on the Laclede Gas Company's (Laclede) request for a rate increase. The Staff's case offers a balance between the demands of Laclede's shareholders and the needs of Laclede's customers. The Staff's position has been carefully developed and presented before this Commission, and the Staff respectfully requests that the Commission issue its Order in accordance with the Staff's case on all issues.

I. INTRODUCTION

The Staff will first respond to the attack on the character of the Staff's case as contained in the Initial Brief of Laclede Gas Company. Accusations regarding the Staff's case are contained in almost every argument used by Laclede. Among the accusations put forth by Laclede, are statements that the Staff purposefully selected methods "to reduce the Company's revenue requirement" (Laclede Brief, P. 10);[1] that the Staff used "unsupported methods to inflate

[1] Initial Brief of Laclede Gas Company (Laclede Brief).

the Company's revenues" (Laclede Brief, P. 15); that the Staff was "irresponsible" (Laclede Brief, P. 15); that the Staff demonstrated "indifference" towards the impact of the Staff's case on Laclede (Laclede Brief, P. 35); and that the Staff showed "utter and complete disregard for their legal obligation" (Laclede Brief, P. 36). These are just a few of the surprising remarks found throughout the Company's Initial Brief. The Staff considered ignoring this attack because such comments regarding the Staff are rare before this Commission. However, the quantity and tenor of this barrage insult the Commission's Staff and question its impartiality to a degree that cannot be ignored. Accordingly, the Staff asks that the Commission take note of this attack and consider it for what it is – a mere attempt by the Company to bolster its arguments through unsupported accusations rather than by objectively addressing the merits of its case.

One item the Company's arguments fail to take into account is the *burden of proof.* While Laclede consumed its entire Initial Brief with allegations that the Staff is anti-Laclede, it fails to make an argument that satisfies the burden of proof that Laclede is required to demonstrate pursuant to § 393.150.2.[2] Laclede has the burden to prove to this Commission that the rate increase and the manner in which it seeks to effectuate that increase is just and reasonable. Laclede has failed to meet that burden on all issues before the Commission. The only issues that warrant a just and reasonable rate increase are those settled by the parties that are included in the Partial Stipulation and Agreement.

II. RETURN ON EQUITY

In its Initial Brief, Laclede is correct when it sets forth the requirements for a fair rate of return as determined by the U.S. Supreme Court in *Bluefield Water Works and Improvement Company v. Public Service Commission of the State of West Virginia,* 262 U.S. 679 (1923).

However, the Company's arguments fail in its interpretation of this decision and its application to an actual rate case.

A. A fair return can change with economic conditions and capital markets.

The first *Bluefield* requirement the Company misapplies is the requirement that "A fair return can change with economic conditions and capital markets." (Laclede Brief, p. 19). Here Laclede argues that it should receive the same returns as S&P 500 companies that have been averaging earned returns on equity of 18% to 20% and above. The departure this argument takes from the *Bluefield* requirement is obvious – the rate of return that Laclede considers "fair" is the rate earned by companies that are not comparable to Laclede. The effect of economic change on the stock prices of competitive S&P 500 companies may be accurate in the graph that appears on page 21 of Laclede's Initial Brief, but the comparison is irrelevant to the decision this Commission must make when it sets Laclede's return on equity.[3] The appropriate comparison would display the stock price of Laclede and contrast that price with the stock price of comparable LDC companies. Why did Laclede's graph fail to depict the stock price for comparable LDCs? The likely answer is because the growth of comparable LDCs is consistent with the growth of Laclede. The Staff presented a good depiction of this growth comparison in the Surrebuttal Testimony of Mr. Broadwater on a chart that compares Laclede with other LDCs. (Broadwater Surrebuttal, Schedule 1).[4] This chart illustrates that Laclede is well within the range of other LDCs – companies that are truly comparable with Laclede.

---

[2] Section 393.150.2 RSMo. (1994) states in part: "At any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the gas corporation, electrical corporation, water corporation or sewer corporation…"

[3] Laclede witness Yeager conceded on the stand that these companies are industrial at not regulated utilities such as Laclede. (Tr. 70, lines 5-8).

[4] In addition, Schedule 15 and Schedule 23 from Mr. Broadwater's Direct Testimony also depict that Laclede's growth is consistent with comparable companies.

A fatal flaw in Laclede's analysis is its failure to discuss the Supreme Court's holding in *Bluefield* that finds **a public utility "has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures**."[5] Laclede argues that it has a right to realize profits such as the profits earned by the highly profitable and speculative companies that make up the S&P 500. (Laclede Brief, pages 20-21). The testimony before this Commission offers evidence that the companies in the S&P 500 are riskier and more profitable than public utilities. (Tr. 112, lines 16-20; Broadwater Rebuttal, Ex. 61, p. 5, lines 7-14).[6] However, the Brief of Laclede makes it clear that the Company believes it is entitled to reap the benefits of a low risk monopolistic utility *and* earn the same returns as a highly profitable and risky enterprise. This is a misinterpretation of *Bluefield* meant to convince this Commission that the manner in which public utilities have been regulated in Missouri for decades is flawed.

Laclede next compared the difference in the market to book value of these highly profitable and risky S&P 500 companies and the market to book value of other LDCs. (Laclede Brief, p. 21). In this analysis Laclede admits that its market value is consistent with the market values of other LDCs and not that of the S&P 500 companies.[7] Again, comparing Laclede's regulatory controlled market value to the market value of an entirely dissimilar group of unregulated companies does not consider the difference in risk between the two. As a result of the regulatory process, a public utility company's market value and book value will remain similar because the manner in which earnings and cash flow are determined is based upon the book value of the public utility's assets (as shown in the below formula). That is the nature of

---

[5] *Bluefield,* 262 U.S. 679, 692-693 (1923).

[6] Ms. McShane cited this risk differential as her sole reason for adjusting the comparable earnings test.

[7] Laclede states in its Initial Brief that "the market value of Laclede's stock and those of other LDCs have climbed to a level some 1.5 to 1.8 times their book value."

the regulatory process in which monopolistic public utility companies such as Laclede operate. Laclede's argument that the difference in market to book value of Laclede should be consistent with the difference between market to book value for S&P 500 companies should be ignored by this Commission unless the Commission seeks to overhaul the regulatory process as suggested by Laclede's proposal.

The difference between competitive companies and regulated companies is apparent in the manner in which revenues are determined. Competitive company revenues are determined by the price and quantity demanded by the market. The revenue of a regulated company is determined according to the following formula:

Revenue = Operating Expenses + Rate of Return (Rate Base)[8]

Laclede's argument that the Commission should compare these S&P 500 companies with a public utility ignores the difference in how revenues are determined for each. The formula cited above is used to establish the revenues of a regulated company because, as a monopoly, a competitive market does not exist to determine prices and the associated revenues for the Company. Instead, the formula acts as a substitute for competition in order to keep prices reasonable for the consumers while allowing the shareholders an opportunity to earn a fair return. For a public utility such as Laclede, this form of revenue determination is inherent in the nature of regulation. When the economy is weak, utilities fare better than competitive companies due to regulation. When the economy is strong, competitive companies may fare better than utility companies. Now that the economy is strong, Laclede has come before this Commission seeking to get a much larger piece of this economic growth than what should be allowed for a public utility operating as a monopoly.

---

[8] Broadwater Direct, Ex. 59, Schedule 30.

On page 23 of Laclede's Initial Brief, the Company analyzes what it claims to be the effect of the Staff's return on equity. Stating that Laclede's investor's "actually require" a higher return than the Staff's 9%-10% assumes that investors are ignorant of the regulatory process. Laclede's attempt to show that the Staff's recommended return on equity will create a "shortfall" to Laclede's investors is very misleading. The testimony of Staff witness David Broadwater proved that Laclede's investors require the Company to earn a return on equity of 9%-10%. (Broadwater Direct, Ex. 59, p. 28, lines 10-16). These investors are the very same investors that set the level of Laclede's stock based upon all available information. Paramount to the information that investors consider when bidding the stock of a public utility is the regulatory process. Investors understand that the market return is less than the return on equity. Mr. Broadwater's proposed return on equity is what investors in the market expect *today*. To use the mid-point from Laclede's example on page 23 of its Initial Brief, Laclede suggests that a return on equity of 9.5% will produce a market return of 6.3%. Included in an investor's expectation is an understanding that there is a difference between book value (the 9.5%) and market value (the 6.3%). Laclede should not assume that its investors do not have an understanding of this regulatory process. Investors understand that their own actions in bidding the price of their stock up will result in a lower market return. With that knowledge, Laclede's investors *today* require Laclede to earn a 9.0% to 10.0% return on equity and are willing to pay for that return. (Broadwater Direct, Ex. 59, p. 37, lines 1-4). Accordingly, if this is the return on equity that Laclede's investors are requiring, than it would be against the requirements of *Bluefield* and against the needs of Laclede's consumers if the Commission were to set a return on equity outside this range.

If this Commission were to accept the 12.75% return on equity proposed by Laclede during a time when investors are willing to accept a 9.0% to 10.0% return, then it is easy to see how investors would be willing to pay more for Laclede's stock since it would be earning a higher return than what is expected. Mr. Broadwater addressed this situation in his Rebuttal Testimony. Investors would in turn, bid the "stock price above book value to a point where they are receiving" the 9.0% to 10.0% return on their investment. (Broadwater Rebuttal, Ex. 61, p. 3, lines 20-23; p. 4, lines 1-7). The result would be an unsupported increase in the market to book ration and additional argument in the Company's next rate case to further drive up Laclede's allowed return on equity. (Broadwater Rebuttal, Ex. 61, p. 3, lines 20-23; p. 4, lines 1-7). Commissioner Shemenauer's questions to Mr. Broadwater emphasized this point and further revealed that Laclede is intentionally attempting to drive up the price of its stock because the Company ultimately answers to its shareholders. (Tr. 377, lines 14-25; Tr. 378, lines 1-25; Tr. 379, lines 1-6).

Laclede argues that under the *Bluefield* finding that "a fair return can change with economic conditions and capital markets," that the Company is properly taking into consideration the changes in the economic conditions and capital markets. (Laclede Brief, p. 24). The Commission should note that Laclede purposely chose only *one* change when it did its analysis. Laclede's argument assumes that the change in stock prices of the S&P 500 companies is the only change in economic conditions that the Commission should determine. Not only is that an irrelevant economic condition when considering the return of a public utility, but it fails to take into account any other changes in the economic conditions and capital markets. Where is Laclede's discussion regarding the changes in interest rates, inflation, and unemployment? It does not exist. The Staff, on the other hand, by use of its discount cash flow (DCF) analysis, incorporated stock prices into the model that account for an investor's perception of the economic environment and capital markets as a whole. The Staff's analysis offers a more detailed and thorough application of the current economic conditions and capital markets than the analysis offered by Laclede's witnesses.

To support its inflated return on equity, Laclede included a graph on page 25 of its Initial Brief. This graph is an apple to oranges comparison that should be disregarded. For one, the graph compares the return on market value earned by the competitive S&P 500 companies to that of a regulated public utility. This was discussed above and will be addressed again later in this Reply Brief. Second, the graph is comparing what *has been earned in the past* to what Laclede's investors *are currently requiring.* Third, the graph shows the risk free rate as the 30-year treasury bond rate in comparison to market value. This is improper because regulated utilities are not regulated to market value; they are regulated to book value. (Broadwater Direct, Ex. 59, p. 36, lines 6-8). Furthermore, by using a 30-year treasury bond instead of the 3-month treasury bill, there is more risk and the Commission is not looking at a true "risk free rate." This gives an incorrect appearance to Laclede's comparison between the Staff's return and other investments.

Laclede claims that its "explicit market-to-book adjustment" accounts for market changes that need to be included in the calculation. (Laclede Brief, p. 25). Laclede's argument has historically been rejected by this Commission for the very reason it should be rejected in this proceeding. (Broadwater Rebuttal, Ex. 61, p. 3, lines 9-14). The reason is that the adjustment would lead to Laclede earning a return different from what investors are requiring them to earn.

The Staff asks that the Commission not allow Laclede to be treated as a competitive S&P 500 company as Laclede is proposing. Contrary to the arguments made by Laclede, the Supreme Court was clear when it determined that a public utility "has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures." Laclede should be treated as it has always been treated – as a regulated monopoly offering public utility services to consumers that lack competitive choice.

B. A fair return is one that is generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties.

Once again Laclede is correct when it cites to the above requirement as found in *Bluefield,* and once again Laclede misapplies this requirement to support its case. Laclede argues in its Initial Brief that the Staff ignored *Bluefield's* requirement that "a fair return is one that is generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties." (Laclede Brief, p. 26). Laclede's only basis for that argument is that the Staff's DCF model calculation did not incorporate a company comparison in the model itself. The Supreme Court in *Bluefield* did **not** hold that a specific method must be used to determine a fair return or that a specific method could not be used, rather the Court focused its holding on the return itself. So long as the return is fair under *Bluefield,* the manner in which that fair return was derived is irrelevant. To assure the Commission that the Staff's DCF derived return on equity complied with this requirement of *Bluefield,* Mr. Broadwater performed a comparable company analysis. (Broadwater Direct, Ex. 59, p. 31-35). Not only did Mr. Broadwater subject the comparable natural gas distribution companies to the DCF analysis, but he also checked the fairness of the Staff's return on equity by performing two additional analyses on the comparable companies. As expected, the comparable company results overlapped the 9.0% to 10.0% range and confirmed that the Staff's range for Laclede is consistent with comparable companies as required under *Bluefield.* (Broadwater Direct, Ex. 59, p. 33, lines 20-23; p. 34, lines 1-20).

Just as the Company incorporated a misleading graph into the first part of its *Bluefield* test, it incorporated a misleading graph into this second part of *Bluefield.* The graph on page 27 of the Company's Initial Brief captioned "Authorized Returns" gives a false appearance regarding the Staff's case. First, Union Electric (UE) does not have an authorized return as suggested by Laclede – rather UE utilizes a sharing grid. (Tr. 416, lines 13-21). The graphic gives the false assumption that this Commission authorized a 16.0% return for UE. Second, the data for "Average LDC" companies is misleading because it reflects returns that were authorized in 1998 using data from 1997. That data, and those authorized returns, are over two years old due to the regulatory lag between the time the return was calculated and recommended and the time the authorized returns became effective.[9] Accordingly, Laclede's assumption that these returns were received "at the same time" as required by the Supreme Court is inaccurate since the Average LDC return was set more than two years prior. Third, the Missouri Gas Energy (MGE) authorized return is deceptive because the capital structure of MGE contains a significantly higher debt ratio and therefore has higher financial risk. This, in part, explains the higher return on equity for MGE. As a result of this capital structure difference, a comparison of these two companies' return on equity is meaningless.

The company specific DCF analysis as performed by the Staff is the most accurate way to determine what investors are requiring of Laclede. The Company, however, claims in its Initial Brief that the Staff's "company-specific DCF analysis is legally invalid when standing alone." (Laclede Brief, p. 29). Again, it is the result of the analysis that is subject to the requirements of *Bluefield,* not the analysis itself. In addition, the Staff's DCF analysis does **not** "stand alone." It is accompanied by a thorough comparable company analysis. (Broadwater Direct, Ex. 59, p. 31, lines 12-28; p. 32, lines 1-10). The company specific DCF analysis is the most widely used and most accurate model for determining the return required by investors.

---

[9] For example, the DCF analysis of the Staff in the present case was performed using 1999 data, yet the return on equity that this Commission will include in its Order will not go into effect until the year 2000.

Accordingly, if the two company-specific checks performed by the Staff and the three comparable company checks performed by Staff are consistent, as was the case here, the Staff knows that the DCF model produced a return on equity that is truly reflective of the return required by investors for Laclede. If the DCF model's output is not supported by the "checks," then a deviation by the Staff may be appropriate. Since the checks produced results that are similar to the Staff's DCF output, any deviation away from the 9.0% to 10.0% range would be inappropriate.

The Commission should also note that while Laclede and every LDC may wish to be "above average" in terms of their authorized returns, half of all the LDCs are less than average. In any average there is going to be a high end, a low end, and those that fall in between. While Laclede believes it deserves to be in the high end, financial measurements do not support that ranking. Laclede's risk, as reflected in the Company's Beta, is lower on average than the risk associated with the average company. (Broadwater Rebuttal, Ex. 61, p. 4, lines 11-16). Laclede's beta of .55 is below the .63 average beta of comparable companies, thus justifying a return that is below the average earned by comparable companies.

C. A fair return is one that is reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

Laclede's strategy to convince this Commission that the return proposed by the Staff is insufficient, is to accuse the Staff of being "indifferent" as to whether the return supported by the Staff would lead to a loss to Laclede's credit rating. (Laclede Brief, p. 35). The Commission should not be mislead into falsely believing that its Staff is not weighing the best interests of Laclede's shareholders with the needs of Laclede's customers. In addition, the Staff asks that the Commission not be mislead into believing that its duty is to regulate gas companies to a specific credit rating. The Commission's duty under *Bluefield* is to ensure that the Company is able to raise capital. Accordingly, Laclede has the burden of proof to convince this Commission that the Staff's proposed return on equity is incapable of raising capital. Laclede's evidence failed to meet that burden of proof. In the unlikely event that Laclede's credit rating were to drop to "BBB", there is no proof before the Commission that a "BBB" is not an investment grade credit rating. In fact, Staff witness Mr. Broadwater testified that a "BBB" credit rating is *investment grade.* (Tr. 387, lines 16-18). Regardless of the Company's arguments, it failed to prove that its credit rating would drop at all, much less drop to a "BBB." Laclede's claims that its credit rating will drop is hard to believe, especially in light of the fact that the Staff and Laclede settled many issues in the Partial Stipulation and Agreement that would increase the Company's rates if approved by this Commission.[10]

In the final paragraph of Laclede's return on equity argument it states that Mr. Broadwater "conceded" that the Company's 12.75% return is the only return on equity recommendation that is "consistent with the Company maintaining its current credit rating." (Laclede Brief, p. 36). Laclede's statement chose to ignore the *revised* Standard and Poor's targets that were presented during the hearing. Mr. Broadwater, in response to questions from Commissioner Murray, testified that based upon Standard and Poor's revisions, the Staff's 9% to 10% return on equity *will allow* Laclede to maintain its current credit rating. (Tr. 379, lines 19-25; Tr. 380, lines 1-25; Tr. 381, lines 1-5). Regardless, a company's credit rating is not dependent upon return on equity alone. Laclede's credit rating depends on a number of

[10] The Company also failed to adequately explain why the Commission should aim for its arbitrary AA- credit rating and not something higher – further proof that the Company has not met its burden of proof.

additional factors that are beyond the control of this Commission. (Tr. 380, lines 18-23). As evidenced by the Company's issuance of $25 million of debt in June 1999 and $24 million equity in May 1999, Laclede is able to raise the money necessary for the proper discharge of its public duties. (Buck Direct, Ex. 11, p. 9-10). Pursuant to Standard and Poor's and pursuant to the thoroughly analyzed and objectively presented return on equity proposed by the Staff, a 9% to 10% return will allow Laclede to attract capital as required under *Bluefield* and it will allow the Company a return that will not be harmful to Laclede's ratepayers.

III. CAPITAL STRUCTURE

Despite Laclede's claims to the contrary, the Staff and the Office of the Public Counsel are not trying to "punish" the Company by their positions regarding short-term debt. (Laclede Brief, p. 37). The Staff's position as presented by Mr. Broadwater is an analysis of the short-term debt amounts, provided to the Staff by the Company, using the method chosen by Laclede. In the Rebuttal Testimony of Mr. Broadwater, Schedule 3-1 depicts the projected cash flows for Laclede during 1999, 2000 and 2001. (Broadwater Rebuttal, Ex. 61, Schedule 3-1). Those projections, in millions of dollars, are as follows:

	1999	2000	2001
Issuance of Short-Term Debt	8	14	11
Redemption of Short-Term Debt	-21	0	0

Laclede is correct in its statements that the average monthly balance of short-term debt will decline in 1999. However, as shown above, the issuance of short-term debt in 2000 and 2001 will increase Laclede's short-term debt. The Staff's evidence indicated that at the end of December 1998, the Company's level of short-term debt was $136,157,000. (Broadwater

Schedules, Ex. 60, Schedule 12). If the estimates shown above are used to project forward as shown below, the levels of short-term debt will be increasing during the period the rates from this case are in effect:

	1998	1999	2000	2001
		$136,157,000	$123,157,000	$137,157,000
		+ 8,000,000	+ 14,000,000	+ 11,000,000
		- 21,000,000		
End of Year:	**$136,157,000**	**$123,157,000**	**$137,157,000**	**$148,157,000**

This increase in short-term debt is consistent with the increases Laclede has experienced in the recent past. The Staff's evidence demonstrated that Laclede's average short-term debt balance reflects an increasing trend as follows:

	October 1995 to March 1999	April 1997 to March 1999	April 1997 to March 1999
Average Daily Short-Term Debt Balance:	**$57,755,000**	**$65,544,000**	**$79,231,000**

As the Commission can see from both the Company's projections into the next few years and the Company's historical data of its average daily short-term debt balances, the Staff's inclusion of an average balance of $79 million of short-term debt in this case is supported by the weight of the evidence using figures that are not in dispute.

IV. ACCOUNTING AUTHORITY ORDER DURATION

As Laclede has stated in its brief at pages 54-55 and elsewhere, the primary goal of its proposal for the duration of the safety replacement program AAO is to avoid "forcing" the Company to file a rate case again after two years. Delay is not a proper purpose for an AAO. Staff's position remains that stated at page 12 of its initial brief: "It is Staff's position that '[a]n AAO should be viewed as a mechanism to partially mitigate regulatory lag between rate cases, not as a substitute for or a means to avoid a rate case.'"

Laclede's proposal could lead to a situation where the Company is both overearning and deferring costs. This could potentially allow costs to be deferred from a period of excess earnings to a period of underearnings. (Rackers' Surrebuttal, Exhibit 83, p.3, lines 13–14). In such a situation, these deferred costs, which if considered at the time they were incurred probably would not have impacted rates, would be considered at a time where they would have the effect of increasing rates. As Laclede states in its initial brief at page 9, in Laclede's last rate case the Staff's filing indicated a rate reduction, i.e., that the Company was overearning. In that case Laclede had filed for a rate increase but settled stipulating to no rate increase. This very recent event of excess earnings by the Company demonstrates the real potential for this Company to be in an excess earnings situation. It also highlights the need for frequent rate case review when a company is allowed to defer costs. This recent event also serves to refute Laclede's assertion at page 55 of its initial brief that "Laclede's ratepayers would unquestionably benefit from any successful effort by the Company to defer seeking rate relief . . . ." In the last case, while Laclede was seeking rate relief, the Staff uncovered excess earnings.

Although the Company states at page 56 of its initial brief that it fails to see how the Commission or anyone else is disadvantaged by its proposal, the response to this is simple. The Company's proposal increases the potential for shifting costs from a period of overearnings to a period of underearnings by leaving undefined the time when Laclede must seek the recovery of the costs deferred under the AAO. In addition, the format of the proceeding envisioned by Laclede is vague. (Rackers' Surrebuttal, Exhibit 83, p. 4, lines1-18). Laclede's proposal, while advantageous to the Company, places everyone else at a disadvantage by creating vague timeframes and an indeterminate procedure. Staff feels these arguments and those propounded in its initial brief adequately address the need for a provision requiring the Company to file a rate case within no more than two years to qualify for recovery of costs deferred under an AAO.

For all the reasons set forth in its initial brief, Staff recommends the Commission set an expiration date for the safety replacement program accounting authority order so that it expires no later than two years after the date the Commission issues its Order in this case.

V. CASH WORKING CAPITAL – COLLECTION LAG

Laclede has failed to meet its burden of proof that its proposed calculation of the revenue lag is reasonable and accurate. "[T]he burden of proof to show that the increased rate is just and reasonable shall be upon the gas corporation[.]"[11] Therefore, Laclede has to show that its proposed rates, and the components of its proposed rates, are just and reasonable. A showing by Laclede that attempts to point out perceived flaws in Staff's position does not, in and of itself, prove that Laclede's proposed rates are just and reasonable, even if those characterizations of Staff's proposal were accurate, which they are not.

Laclede, in its initial brief, is extremely critical of Staff's calculation of the collection lag in this case. Laclede criticizes Staff's sample size, the exclusion of customers with less than 12 months of billing data, and the demographics of Staff's sample. Staff addressed those issues of sample size and demographics, as well as the inclusion of uncollectable accounts by Laclede, in its initial brief and sees no need to reiterate those entire arguments in the reply brief. Suffice to say that Laclede has offered no statistical analysis that Staff's sample is not statistically sound and that discrepancies in demographics (if any, as Laclede has not provided any statistical analysis on any impact that may have occurred) had any significant impact on the collection lag.

---

[11] § 393.150.2 RSMo (1994)

(Staff's Initial Brief, pp. 14-16). It is important to remember that Laclede's method calculates a relationship between billed revenues and the accounts receivable balance. This method does not examine the payment habits of any individual customers. (Buck Direct, p. 6, lines 12-17). However, the Staff's sampling method examines the actual payment habits of individual customers. (Griggs' Direct, p. 7, lines 5-8).

Laclede contends that customers with less than 12 months of billing data should be included in the collection lag study. However, inclusion of customers with less than 12 months of billing data would be improper in a collection lag calculation. Customers with less than 12 months of billing data may not be "representative of the ongoing payment average for Laclede's customer." (Tr. 675, lines 11 and 12). In addition, Laclede has supplied no evidence to support the notion that the customers who did not have 12 months of billing data pay slower than the customers included in the Staff's sample, or that by not including these customers the revenue collection lag computed by the Staff is shorter. As Company witness Glenn Buck testified, a customer who is cut off could have their service restored in one day. (Tr. 648, lines 10 and 11). In fact, the sample used by the Staff includes such customers. (Tr. 674, lines 5 – 17)

Laclede contends that these customers are primarily renters and submitted Exhibit 120 to show that renters had poorer payment histories. However, once again, Laclede furnished no evidence that supports this contention. Laclede's Exhibit 120 only shows accounts that were uncollectable (Tr. 695). And, as Staff has repeatedly pointed out, "[i]ncluding customers whose accounts are uncollectable in the sample would, in effect, allow a return on bad debts, a non-cash item, in cash working capital. [Laclede] is compensated for the effect of bad debts through an allowance for this item as an expense." (Griggs Surrebuttal, Ex. 86, p. 5, Lines 15-18).

Laclede has offered no evidence on the payment habits of renters as requested by Staff. When Staff requested this information, Laclede just provided information on accounts from renters that were uncollectable accounts. (Tr. 695). This does not show that renters are more likely to be late on their payments; at best, it may show that renters are more likely to not pay at all. Steps have been taken, which should be realized during the time the rates from this case will be in effect to influence the payment habits of renters. As a part of the Stipulation and Agreement in the last Laclede rate case, the deposit criteria included in the tariff was changed. This change should affect rental customers. Since these new tariff rules have only been in place since October of 1998, their effect on customer payment habits is only now beginning to be realized by the Company. The full effect of the new deposit criteria will be realized during the period rates from this case are in effect.

Laclede has not provided sufficient evidence to show that its calculation of the collection lag produces accurate results. Laclede's calculation includes accounts that should not be included in a collection lag, either because those accounts receive treatment elsewhere (as in the uncollectable accounts) or that the accounts are not representative of Laclede's on going customer base.

Laclede's collection lag of 34.8 days is over 13 days longer than any other collection lag sponsored by any other electric or gas utility company in the state. (Tr. 700). The weighted average of days before a Laclede customer's bill becomes delinquent is 19.4 days. (Griggs Direct, Ex. 84, p. 7). Laclede's collection lag would require that Laclede's average customer pays his or her bill **15.4 days after** the bill is delinquent. This does not appear to be reasonable and may be the result of including uncollectable accounts in the collection lag study.

Laclede has not provided any concrete evidence that Staff's sample and calculation of the collection lag suffer from any significant errors. When Staff adjusted its calculation based on alleged demographic errors by Laclede, it made only minor differences in the revenue lag. Laclede submitted no statistical analysis that shows that Staff's sample is not statistically significant. Regardless of Laclede's allegations, the Company has not satisfied its burden of proof that its collection lag study is just and reasonable and should be utilized in formulating the Company's rates.

VI. ADVERTISING EXPENSES

In response to Laclede's briefing of the advertising expenses issues, Staff points out that Staff witness Boczkiewicz refutes the Company's statement on page 47 of its initial brief, that the current standard requires force-fitting advertisements into one of five categories, by pointing out that "Most of the ads can be easily placed into one of the five categories mandated by the Commission." This ability comes from the fact that the Staff has consistently applied the Commission's standard in every rate and complaint case since the standard was adopted in 1985. (Boczkiewicz Surrebuttal, Exhibit 88, p. 2, lines 2-6).

At lines 8-9 of page 52 of its initial brief Laclede states that under the Company's proposal expenditures for Political advertisements would be excluded from cost of service for ratemaking purposes. During cross-examination Company witness Hargraves stated that only above-the-line advertising costs, not political in nature, would be included in the cost of service according to the Company's proposal. (Tr. 720, lines 11-21). These exclusions mandate content review of all advertisements. Each advertisement would therefore have to be reviewed to determine that it was not political or related to non-utility below-the-line operations. The foregoing undermines one of the advantages Laclede claims of its proposal. Laclede's proposal contains only these two content limitations, and would allow Laclede to recover all of its other advertising costs or any other cost it elects in its sole discretion to categorize as advertising, e.g., providing football tickets to St. Louis Rams' or St. Louis Cardinal's games. Essentially, Laclede seeks unfettered discretion as to what costs it denominates as advertising costs to pass on to its natural gas customers. Mr. Hargraves also testified that Schedule 2-15, categorized by Staff as institutional advertising, would be included in the cost of service under the Company's proposal. (Tr. 751, lines 9-21). Therefore, under Laclede's proposal, the Company would be allowed to include in the cost of service an advertising campaign that consisted exclusively of institutional advertising, as long as it did not exceed the spending cap. The exclusion of institutional advertising in a rate case is an item generally conceded by the utility. Laclede's proposal is fraught with potential for abuse by the company and should be rejected out of hand. As to promotional advertising, Laclede confuses the standard with what evidence is required to establish the standard has been met. The standard is that a company must establish that each advertisement is cost justified.

The suggestion that customers receive valuable information from advertising stated on page 50 of Laclede's initial brief, is unsupported by proof that the cost associated with such advertising is cost justified. Valuable information can be obtained from many sources other than advertising, such as contractors and consumer reports. (Boczkiewicz Surrebuttal, Exhibit 88, p. 4, lines 7-9). The problem with Laclede's argument and evidence is that the relationships it asserts between purported benefits and costs of promotional advertising are too vague and unquantified. Laclede has not adduced evidence establishing a sufficient link between the benefits it claims accrue from each promotional advertisement and the advertisement itself. Therefore, as a result, Laclede cannot establish that the advertisement is cost-justified. Although the Company's references a Marketeam Association survey as proof that a causal relationship exits between customer benefits and promotional advertising at page 50 of its initial brief, an examination of the actual results discounts this notion. The survey polled a mere 103 customers. Only 4 of these customers even mentioned advertising as having some influence. Nine other sources of information were mentioned more frequently than advertising. Since those surveyed were allowed to list more than one source, none of the customers may have considered advertising to be the most important source of information. None of the questions asked customers if they would have chosen a heat pump over natural gas without exposure to advertising. (Boczkiewicz Surrebuttal, Exhibit 88, p. 5, lines 8-17).

On page 49 of its initial brief, Laclede incorrectly states that the Commission did not establish in *Kansas City Power & Light* or any other case a revenues generated test for promotional advertising. In Case No. EC-87-114 the Commission accepted the concept that promotional advertising should be justified by the revenues generated. In that case the Commission stated that Union Electric Company was unable to show a causal relationship between its heat pump advertising, heat pump sales and increased revenue. (Case No. EC-87-114 at 14). The Company's use of its appliance service work program advertising as support for its argument is inapposite. Although customers may not know that the Company provides appliance service work, Laclede does not need to advertise that it provides natural gas in the St. Louis area, since it enjoys a monopoly with this service. (Boczkiewicz Surrebuttal, Exhibit 88, p. 3, lines19-21). For all the grounds stated here and in its initial brief filed in this matter, the Staff recommends the Commission reject the Company's proposal regarding advertising expenditures and accept the Staff's proper categorization of the advertisements and allow in expense the costs associated with them under the criteria the Commission established in *Kansas City Power & Light Company*, Case No. EO-85-185.

VII. DEPRECIATION

A. Calculation of Net Salvage

Laclede alleges that the net salvage rates proposed by Staff are "arbitrary" (Laclede Brief, p. 58), "illogical" (Id. p. 59), "inadequate" (Id. p. 59), and "punitive" (Id. p. 62). First, Staff's proposed rates are not arbitrary. Staff developed these rates to more accurately reflect the annual net salvage (i.e. cost of removal) experienced by Laclede. (Adam Surrebuttal, Ex. 94, p.4). The rates were carefully calculated, based on the net salvage as experienced by Laclede. Staff has not changed these costs or adjusted them in any manner.

As stated above, Laclede also describes Staff's proposed rates as illogical and inadequate. While Laclede disagrees with the formulation of the net salvage rates by Staff, the rates are not only extremely logical but also adequate to "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. " (Adam Surrebuttal, Ex. 94, p. 4, lines 19-21). Staff's initial brief clearly points out the rationale for allowing Laclede to recover only what it expends annually in net salvage and Staff will not reiterate that rationale here.

Staff contends that its proposed depreciation rates are not punitive. While Staff's proposed depreciation rates reduce the revenue requirement by $2.3 million dollars, describing Staff's position as punitive is not accurate. Staff's objective in any rate case is to propose depreciation rates that are adequate to allow Laclede to fully recover the cost of property used in its operations. While Laclede may disagree with Staff's position, the Company's suggestion that Staff is being punitive is not supported by any evidence.

Laclede also appears to try and characterize Mr. Adam as making rogue decisions without the knowledge of his line management. Laclede's characterization that Staff's position was not discussed with upper level Staff personnel prior to filing testimony (Id. p. 65) is inaccurate. Mr. Adam stated that he did not "recall" discussing this issue with Mr. Schallenberg (the Director of the Utility Services Division) prior to writing the testimony for this case. (Tr. 893, line 9). However, Mr. Adam went on to state:

> The meetings that we had with the company where we discussed the depreciation rates. . .Bob Schallenberg became aware of ..the difference between the way we were looking at net salvage versus the Company and some other cases. (Tr. 893, lines 13 - 19)

It should also be noted that the line of questioning that elicited the above response was dealing with Mr. Adam's work papers from Laclede's last rate case, GR-98-374.

It is simply not the case that Mr. Schallenberg, Mr. Rackers (the case coordinator) or any other Staff member responsible for Staff's overall position on this matter was not aware of, or disagreed with, this position. Mr. Schallenberg participated in the Stipulation and Agreement in Case No. GR-98-374 where Mr. Adam used the same calculations in formulating the depreciation rates. Mr. Schallenberg knew of Mr. Adam's methodology and has supported it for over a year.

Laclede also criticizes Staff, suggesting Staff's depreciation rates assume that net salvage will remain the same. (Laclede Brief, p. 58). Laclede's depreciation rates, however, assume that Laclede's actual net salvage will be more negative, at some point in the future, than what the customers are paying through rates. Laclede's depreciation rates also assume that Laclede will then remind the Commission, in a future rate case, that no depreciation rate increase is necessary because Laclede has collected the dollars needed from their customers in preceding years. The best alternative is to continue with a periodic rate case proceedings (as has been the case over the last 20 years) and adjust depreciation rates in those proceedings, than to rely on Laclede's representations in those rate cases that the Company's depreciation rates assume will be made.

Laclede also appears to criticize the qualifications of Mr. Adam, in that he does not have the decades of theoretical experience of Dr. White. (Id. p. 62;Tr. 853-859). Mr. Adam has over five years of real world experience applying deprecation rates to utility companies within the state of Missouri, a degree in chemical engineering, a Masters degree in Business Administration, and years of experience in economic evaluation. (Adam Direct, Ex. 92, pp. 1-2). On the other hand, not even Laclede employs all of the theory espoused by Dr. White in the Company's depreciation rates. (Tr. 848).

B. Gas Holders

Laclede appears to base its argument that the cost of final removal of the Gas Holders should be included in depreciation rates strictly on the Company's criticisms of Staff. However, in only criticizing Staff, Laclede fails to satisfy its statutory obligation to show that the Company's rates are just and reasonable. Laclede's argument also fails to address the issues that Staff has raised in this case. As Laclede has made repeated requests, over a number of years and in various rate cases, that the cost of final removal be included in depreciation rates, it is Staff's position that the company actually make a commitment to remove the Gas Holders before those costs be recovered through rates. Staff is not opposed to Laclede recovering the costs that it will incur in the final removal of the Gas Holders, but Staff is opposed to having the ratepayers fund the final removal of plant that the Company has shown no intent or action toward actually removing.

VIII. OFF-SYSTEM SALES AND CAPACITY RELEASE

Staff stands by its original position that if off-system sales revenue is considered in Laclede's revenue requirement, Laclede's off-system sales profits/net revenue be based on a three-year average of the off-system sales profits, which Laclede experienced in its three most recent actual cost adjustment ("ACA") periods. This gives the Commission a broader view of Laclede's performance over a period of time, not just in a single year.

While Laclede has shown a net decrease in revenues over the last few years, it should be noted that the $900,000 that the Company shows for 1998-1999 is an estimate (Laclede Brief, p.

72) and has not been audited by Staff. Staff does not believe that, given the volatile and changing nature of the off-system sales market, three or four years of data is indicative of a downward trend in off-system sales profits. Staff's position is that the three-year average would give a better representation of the revenues that Laclede would generate in off-system sales transactions and should be used in this case.

IX. SERVICE TERRITORY DESCRIPTION IN TARIFFS

Staff concedes that the five points suggested by Staff in its testimony as support for its proposed descriptions were lifted from testimony in another case, and that the first three points were inappropriate for this case. The remaining two Staff points are entirely adequate to support that Laclede provide in its tariff a meaningful description of its service territory.

Laclede (Laclede Brief, p. 75) asserts that a list of the areas it serves by township, range, and section provides absolutely no useful information to its customers. Ameren/UE asserts Ameren Brief, p. 3) that the proposed information would be comprehensible only to real estate professionals. Consider, however, who are the ultimate consumers of "real estate" professionals. These include developers, contractors, and home buyers. (Tr. p. 1003). Perhaps Laclede and Ameren/UE have not considered these users need for information.

Mr. Gray also cited the example where such descriptions might be useful to <u>other</u> utilities in planning their operations. (Tr. p.1000; 1029). He repeatedly stated, in contradistinction to the straw arguments advanced by Laclede and Ameren/UE, that the purpose of the listing of areas served was to provide general notice to the public, not to resolve area disputes between utilities (Tr. p. 998, line 7-9; 1013; 1021; 1024 . The earlier the public, and utilities themselves, can identify such conflicts the sooner they can be resolved. Staff's recommendation will promote such early identification.

Finally, as Staff noted in its initial brief, the detail described by Mr. Difani (TR. pp. 981-982) is appropriate for territory descriptions in certification proceedings, but the same level of detail is not required here. Moreover, Staff has indicated that where a general description provides meaningful information to the public (e.g., "All of St. Louis County") Tr. p. 1014-1016) such a general description is adequate.

The Staff has proposed a reasonable means of providing useful information to the public. Laclede and Ameren/UE have attacked hypothetical cases not suggested by Staff. The Commission should require Laclede to provide meaningful descriptions of its service territory in its tariff.

X. CUSTOMER ANNUALIZATION

On this issue, the Company is asking the Staff to roll forward its ten-year average because it produces a result more to Laclede's liking, not because it was the agreed upon methodology. The Staff's methodology is simple. When the Staff determined the level of customer growth, as updated through March 31, 1999, in its Direct case, it used a methodology which employed calendar year ending average customers. Ten years of calendar year averages were studied to determine Laclede's growth. However, if the Staff had used the methodology in its customer annualization in its Direct case, that Laclede would *now* like the Staff to use, it would have used ten year averages ending in March. This result would have produced a *decrease* in the Company's revenue requirement. It is interesting to note that the Company did not complain when the Staff used calendar year averages in its Direct case, but makes that argument now. Why is Laclede now changing their position and arguing that the Staff should use ten year averages that end in July? Because Laclede has determined that by changing the methodology by rolling forward the ten-year average it would *now* lead to a revenue requirement increase. It would be inapprpriate for the Staff to change its methodology at this late stage, especially when the basis behind Laclede's argument is the *outcome* and not the methodology. Had the Company's arguments been against the methodology, it should have and could have made those arguments against the Staff's direct case.

The Staff's methodology is clearly stated in the Direct Testimony of Arlene Westerfield: "the annualized level was determined by first multiplying the March 31, 1999 level of customers by the ten year average percentage of March 31 customers to the **calendar year average customers**." (Westerfield Direct, p. 11, line 11). The Staff followed this agreed upon methodology in calculating the true-up revenues by multiplying the July 31, 1999 level of customers by the ten-year average percentage of July 31 customers to the **calendar year average customers**.

The Company argues in its Initial Brief that it could not have anticipated the Staff's true-up method. However, this is the same method used by the Staff in its Direct case for both filing and update and the same methodology that the Staff utilized in the last three Laclede rate cases. This is the same methodology used by the Staff to update its customer annualization in Case No. GR-98-374. As Ms. Westerfield responded under cross-examination during the true-up hearing, for the annualization of customer growth, the same procedure used in the update is followed for true-up. Despite Laclede's claims to the contrary, the Company knew full well the process that the Staff would follow in the true-up based on its knowledge of how the Staff had performed its filing and update calculations in the past. The true-up process as traditionally followed by this Commission is one of truing-up specific amounts such as plant balances, employee counts and customer counts, not changing methodologies that are consistently applied and agreed to by the parties. Laclede chose not to challenge the Staff's methodology when such a challenge would have been proper, and the Company is now attempting to criticize Staff's methodology because the results are not what Laclede hoped for or expected.

IX. CONCLUSION

In conclusion, the Staff strongly believes that the case it presented to the Commission is the only position that takes into account the demands of Laclede's shareholders and the important needs of Laclede's ratepayers. The Company has the burden of proof on all issues and the evidentiary record before the Commission does not support Laclede's case. The Staff respectfully requests that the Commission adopt its recommendations on all issues.

Respectfully submitted,

DANA K. JOYCE
General Counsel

Marc Poston
Senior Counsel
Missouri Bar No. 45722

Attorneys for the Staff of the
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102
(573) 751-8701 (Telephone)
(573) 751-9285 (Fax)

Certificate of Service

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record as shown on the attached service list this 1st of November 1999.

SERVICE LIST FOR
CASE NO: GR-99-315
October 29, 1999

Office of the Public Counsel
P.O. Box 7800
Jefferson City, MO 65102

Michael C. Pendergast
Laclede Gas Company
720 Olive Street
St. Louis, MO 63101

Ronald K. Evans/Susan B. Knowles
Union Electric Company d/b/a AmerenUE
1901 Chouteau Avenue
P.O. Box 66149 (MC 1310)
St. Louis, MO 63166-6149

Diana M. Schmidt
Bryan Cave LLP
211 N. Broadway
St. Louis, MO 63102-2750

John D. Landwehr
Cook, Vetter, Doerhoff & Landwehr
231 Madison
Jefferson City, MO 65102

Richard Perkins
Diekemper, Hammond, Shinners, Turcotte
7730 Carondelet, Suite 200
St. Louis, MO 63105

Robert C. Johnson
720 Olive Street, 24th Floor
St. Louis, MO 63101