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Missouri Public
Service Commission

HAND DELIVERED

Mr. Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
Harry S Truman Building
301 W. High Street, 5th Floor
Jefferson City, MO 65101

RE: Case No. GR-99-315

Dear Mr. Roberts:

Enclosed for filing, please find an original and fourteen (14) copies of the Reply Brief of Laclede Gas Company in the above-referenced case. Please see that this filing is brought to the attention of the appropriate Commission personnel.

Thank you for your consideration in this matter.

Sincerely,

Michael C. Pendergast

Michael C. Pendergast

MCP:jaa

cc: All parties of record

MISSOURI PUBLIC SERVICE COMMISSION

Case No. GR-99-315

REPLY BRIEF OF LACLEDE GAS COMPANY

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November 1999

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REPLY BRIEF OF LACLEDE GAS COMPANY

Pursuant to the briefing schedule established by the Missouri Public Service Commission ("Commission") in this proceeding, Laclede Gas Company ("Laclede" or "Company") hereby submits the following Reply Brief in response to the initial briefs submitted in this case by the Staff of the Commission ("Staff") and the Office of the Public Counsel ("Public Counsel"):

I. ARGUMENT

A. Introduction

Most of the arguments raised by Staff and Public Counsel in their initial briefs have already been anticipated and adequately addressed by the Company in its Initial Brief. Accordingly, Laclede will limit its Reply Brief to those relatively few contentions that have not been previously addressed by the Company or that, in Laclede's view, present an erroneous picture of the law or the record in this case.

Before addressing these specific matters, however, Laclede wishes to briefly respond to one assertion in particular that appears at the end of Staff's Initial Brief. Specifically, Laclede takes strong exception to Staff's statement at page 31 of its Initial Brief that its testimony and evidence "offers an unbiased balance between the needs of Laclede Gas Company and the needs of the ratepaying consumers." Laclede does not take issue with the proposition that Staff should, in fact, seek to strike such a balance whenever it formulates recommendations and testimony in a proceeding before this Commission. And at some point in the past, Laclede believes the Staff may have made an earnest effort to achieve this goal. Certainly, Laclede's ability to reach settlements with the Staff on each of the rate case filings made by the Company over the past twenty years would suggest a prior willingness on the part of both parties to resolve complex issues in a manner that reasonably accommodated the interests of both the Company and its customers.

Unfortunately, Laclede believes it has little choice but to point out the degree to which Staff has failed to meet such a standard in this proceeding. In Laclede's view, Staff has forfeited whatever claim it may have had in this case to being an unbiased advocate of the public interest when it:

- filed a direct case that, for the second year in a row, recommended a rate reduction for a company whose limited growth and rising cost characteristics, as evidenced by Staff's own true-up recommendation, so obviously warrant a significant increase in rates;

- asserted in testimony that Laclede's investors require a return of 9.5% but then only recommended enough revenue requirement to generate a return of 6.3%, all the while dismissing, without a word of comment, the damaging impact of its recommendations on Laclede's ability to preserve a credit rating that it has maintained for over three decades;

- proposed a level of short-term debt that reduces Laclede's revenue requirement by being tens of millions of dollars above the level that was actually carried by the

Company at the end of the true-up period in this case and that, in contrast to the position taken by Staff less than four months ago (not to mention in previous rate cases), completely ignores the annualized effect of both the long-term debt and equity issuances that were placed by the Company for the express purpose of reducing such short-term debt amounts;

- decided to use a statistically unproven and clearly unrepresentative sample, rather than the actual universe of the Company's customer accounts, in order to derive a cash working capital revenue collection lag that arbitrarily reduces the Company's revenue requirement by hundreds of thousands of dollars; and

- proposed a method for calculating depreciation rates that departs radically from virtually every recognized authority on the subject and every accepted principle of depreciation accounting, with the end result of decreasing the Company's revenue requirement by millions of dollars.

Positions and recommendations of this nature are not the handiwork of a Staff that is committed to, or even interested in, striking a reasonable balance between the interests of the Company's shareholders and customers. They are instead the work product of a party that is so relentlessly focused on reducing revenue requirement that it finds itself taking positions that, in virtually every instance, are either identical to, or less favorable to the Company than, those taken on the same issues by Public Counsel -- the actual statutory representative of the consuming public; a Staff that then proceeds to further exacerbate the financial impact of such adjustments on the Company by piling on its own needlessly aggressive adjustments, all of which serve, without exception, to reduce the Company's revenue requirement.

In view of these considerations, the Commission should not and cannot look to Staff for a balanced or unbiased assessment of what outcome in this case will be fair and reasonable to both Laclede and its customers. Instead, as it has so often in the recent past, Staff has left it to the Commission to make nearly all of the difficult decisions required to reach a fair result in this case. Laclede trusts that the Commission will do so and, based on a careful consideration of the record in this case, grant a level of rate relief that truly balances the interests of the Company and its customers in a reasonable and unbiased manner.

B. Return on Equity

In their respective briefs, both Staff and Public Counsel reaffirm the legal standards that have been established by the courts to govern how a regulatory body must go about the task of establishing a fair rate of return. They then proceed to demonstrate how their recommendations fall well short of satisfying those standards.

1. Requirement to take into account changing market conditions.

This is particularly evident in their utter failure to reconcile their return recommendations with the requirement that the Commission take changing market conditions into account when determining a fair return. *Bluefield Water Works and Improvement Company v. Public Service Commission of the State of West Virginia*, 262 U.S. 679, 692-93 (1923). At the beginning of their respective briefs, both Staff and Public Counsel repeat their contention that Laclede's investors require a return of 9.5% and 9.7%, respectively -- recommendations that would not be so unreasonable if only Staff and Public Counsel were actually giving Laclede's investors an opportunity to earn such returns. As the undisputed evidence on the record shows, however, Staff's and

Public Counsel's return recommendations will, based on the current market value of Laclede's stock, only give Laclede's investors an opportunity to earn an actual market return of 6.3%.

In attempting to justify such an absurd result, and its willful refusal to take market conditions into consideration, Staff makes several arguments, none of which withstands scrutiny. It begins by describing its own Laclede-specific discounted cash flow ("DCF") methodology, noting that it included an analysis of Laclede's actual dividends per share, earnings per share, book value per share and the projected growth rates for Laclede. (Staff's Initial Brief, p. 5). What Staff does not do in its brief is repeat the analysis that Staff witness Broadwater provided during cross-examination on this subject. As indicated at pages 407-408 of the transcript, Mr. Broadwater acknowledged that his DCF analysis assumed a projected growth rate for Laclede stock of approximately 4%, or 92 cents per share. Based on the current market value of Laclede's stock, however, Mr. Broadwater conceded that his return recommendation would only give the Company about 8 cents per share to generate this 92 cents per share growth, if Laclede did nothing more than simply maintain its dividend at its current level. (Tr. 407-408). In other words, Staff's recommendation gives the Company the Hobson's choice of either reducing its dividend or somehow trying to generate Staff's projected growth rate with less than one-tenth of the money required to do so. A return recommendation that makes it impossible to both maintain dividends and achieve the growth projected by the party proposing it is bad enough. It is even worse coming from a party, like Staff, that simultaneously suggests in its Initial Brief that utilities warrant a lower return precisely because their investors depend on earning most of their return through less risky dividends. (*See* Staff's Initial Brief, p. 10).

Next, Staff argues that its return recommendation is reasonable because it would produce, at the low end, a market-to-book ratio of 1.0 as opposed to the 1.55 to 1.77 market-to-book ratios that Laclede's stock has actually traded at over the past five years. (Exh. 59, p. 20).[1] Incredibly, Staff seems to be suggesting that the Commission should conclude that its return recommendation is reasonable because it will permit the Company's investors to earn something close to Staff's recommended return, as long as the value of their stock first declines by one-third or more. It is, to say the least, difficult to understand how anyone could conclude that a regulatory body has met its obligation to set a fair return by finding, on the one hand, that investors require a return of 9% to 10%, and then approving, on the other hand, a recommendation that is designed to give them a negative return of 33% or more on the value of their stock before they even have an opportunity to earn that return.

Finally, Staff suggests that market conditions should not be taken into account in setting Laclede's return because the Commission has previously rejected market-to-book adjustments. (Staff's Initial Brief, p. 8). In fact, Mr. Broadwater noted in his rebuttal testimony that such an adjustment had been rejected at a time when market-to-book ratios

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[1] At page 3 of its Initial Brief, Public Counsel makes the ludicrous assertion that Laclede witness McShane's 12.75% return on equity ("ROE") recommendation would drive up the Company's market-to-book ratio. Public Counsel apparently based this assertion on a statement that appeared at page 3 of Staff witness Broadwater's rebuttal testimony in which he stated that such a recommendation could have that effect, *assuming that a utility's stock was trading at a market-to-book ratio of 1.0.* (Exh. 61, p. 3). Apparently, Public Counsel failed to read Mr. Broadwater's subsequent admission during cross-examination that since Laclede's stock was not currently trading at a market- to-book ratio of 1.0 and had not done so for at least five years, his theory regarding the impact of Laclede's ROE recommendation was based on an incorrect assumption. (Tr. 328). Notably, Staff did not repeat this discredited theory in its Initial Brief, as Public Counsel should not have.

were less than 1.0, implying that it was therefore inappropriate to adopt such adjustments now that they are higher than 1.0. (Exh. 61, p. 3). Mr. Broadwater conceded during cross-examination, however, that market values for utility stocks in the past have never fallen below book value to the degree they have risen above book value in more recent times. (Tr. 346-348). Indeed, he could not recall any utility in this state or elsewhere that had market to book ratio as much below 1.0 (i.e. 0.4) as Laclede's is currently trading above 1.0 (1.6). (*Id.*).

In view of these considerations, it is clear that neither Staff nor Public Counsel has offered any tenable justification for their failure to take changing market conditions into account, as they and the Commission must do when determining a fair return. The Commission should accordingly adopt Laclede's proposed ROE which, as Staff notes at page 7 of its Initial Brief, is based, in part, on a market-to-book adjustment that does nothing more than compensate for the 300 plus basis point gap between the 9.5% to 9.7% ROEs that Staff and Public Counsel assert Laclede's investors require, and the 6.3% market return their recommendations would actually produce.

2. **Requirement to take into account returns earned by other business undertakings with comparable risks.**

Staff's and Public Counsel's arguments are equally meritless on the issue of which ROE recommendation in this case actually satisfies the requirement to consider the returns being earned by other business undertakings with similar risks. *Bluefield, supra*, at 693. In an effort to downplay the fact that their ROE recommendations are based on a Laclede-specific DCF analysis that does not consider the returns being earned by *any* company other than Laclede, both Staff and Public Counsel attempt to convey the impression that they have somehow corrected for this obvious deficiency by also performing alternative analyses of comparable companies. (Staff's Initial Brief, pp. 6-7; Public Counsel's Initial Brief, p. 1). Indeed, Public Counsel goes so far as to claim at page 1 of its Initial Brief that in "arriving at Public Counsel's recommendation Public Counsel witness Burdette utilized the DCF method applied to a group of six comparable companies" -- a statement that erroneously implies that Mr. Burdette did not even use a company-specific DCF analysis as his primary tool for developing his ROE recommendation. A review of Mr. Burdette's direct testimony, however, shows that his return recommendation is not only based on, but identical to, the results of his Laclede-specific analysis. (Exh. 44, pp. 7-18).

For its part, Staff is somewhat more direct in acknowledging that its ROE recommendation is, in fact, based on a Laclede-specific analysis. (Staff's Initial Brief, p. 5). Unfortunately, Staff then ruins this moment of candor by going on to imply that its ROE recommendation was also influenced by Mr. Broadwater's alternative analyses of comparable companies. (Staff's Initial Brief, pp. 6-7). As demonstrated at pages 30-31 of Laclede's Initial Brief, however, it is abundantly clear that Mr. Broadwater paid only the barest lip service to these alternative analyses as evidenced by: (a) his failure to vary his Laclede-specific ROE recommendation by even a single basis point to reflect the higher ROE ranges produced by these alternative analyses (Exh. 59, pp. 32-35); and (b) his complete inability to explain the circumstances under which he would take such higher ranges into account. (Exh. 116, p. 16).

Nevertheless, it is not too late for the Commission to take Staff and Public Counsel at their word and do what they have not done. Specifically, it is not too late for the Commission to give force and effect to the only ROE analyses performed by Staff and Public Counsel that satisfy the comparable company standard. The Commission can do so by recognizing that Staff's and Public Counsel's alternative analyses resulted in ROE ranges that, at the upper end, indicated returns of 11.45% to 11.51%, respectively. (Exh. 44, pp. 18-19; Exh. 59, pp. 32-35; Exh. 60, Schedules 24 through 28; Exh. 116, pp. 92-95). Given all of the other considerations discussed herein and in Laclede's Initial Brief, these returns should be considered the *minimum* starting point for any range of possible returns considered by the Commission in this proceeding. After all, they are almost identical to the 11.51% average return granted to LDCs in 1998 (Exh. 8, p. 5) and only slightly below the 11.65% return that Mr. Broadwater acknowledged during his deposition was the minimum return required to satisfy the interest coverage criteria that is consistent with Laclede maintaining its current credit rating. (Exh. 116, p. 42; Exh. 8, p. 5). If Staff's and Public Counsel's ROE recommendations are to be viewed as meeting any of the standards they assert must be followed to determine a fair return, then it is this portion of their analyses -- and only this portion -- that should be relied upon by the Commission.

What the Commission should not rely on are the criticisms leveled by Public Counsel at Laclede's efforts to do what it did not; namely take into account the returns being earned by companies with comparable risks. For its part, Public Counsel claims, erroneously, that Laclede witness McShane conducted a DCF analysis that utilized "comparable companies that are more risky than Laclede and that do not receive a majority of their revenues from the sale of natural gas." (Public Counsel's Initial Brief, p. 3). In fact, Ms. McShane's DCF analysis was based on a sample of 13 <u>LDCs</u>. (Exh. 2, p. 15). Public Counsel has apparently confused Ms. McShane's DCF analysis, which produced a 10.5% return prior to her recommended market-to-book adjustment of 310 basis points, with Ms. McShane's comparable earnings analysis, which was based on a sample of 35 comparable industrials and produced a range of returns of 16.1% to 16.6%. (*See* Exh. 2, pp. 9-11).

Setting aside Public Counsel's confusion, there is nothing on the record to suggest that Ms. McShane's comparable earnings analysis was in any way flawed. In addition to selecting industrials with risk characteristics similar to LDCs (Exh. 2, Appendix B, pp. 1-3), Ms. McShane also made an explicit adjustment to her comparable earnings analysis to fully reflect the differences in the industrial companies' betas and the LDCs' betas. The theory and mechanics of this adjustment, which resulted in a final comparable earnings range of 12.9% to 13.25%, was fully explained by Ms. McShane in her direct testimony. (Exh. 2, pp. 9-11, Appendix B). Notably, neither Public Counsel nor Staff was able to point out any flaw in this adjustment in their testimony or explain in their briefs why it does not result in a fully comparable set of required returns.[2]

In a belated effort to finally consider the return requirements of companies other than Laclede, Public Counsel also argues that Ms. McShane's 12.75% ROE recommendation does not pass the "common sense" test because it exceeds the returns recently authorized for other LDCs. (Public Counsel's Initial Brief, pp. 5-7). Suffice it to say that appeals to common sense are hard to listen to, let alone take seriously, when they come from a party that has recommended an ROE for Laclede (9.70%) which is:

[2] To the contrary, rather than take issue with the mechanics of Ms. McShane's adjustment, Public Counsel criticizes Ms. McShane's risk premium analysis on the grounds that it failed to include a similar downward adjustment to reflect the relatively minor difference between Laclede's beta and the betas of the companies used in that analysis. (*See* Public Counsel's Initial Brief, p. 5). Needless to say, one cannot logically assert that an adjustment must be made to account for risk differences whenever there is a difference in betas and then dispute the efficacy of such an adjustment when it has actually been employed for that purpose.

(a) more than 180 basis points below the average ROEs authorized for LDCs in 1998 (11.51%); and (b) nearly 300 basis points below the minimum ROE (12.61%) that Laclede's primary electric competitor is permitted to earn (with Public Counsel's concurrence) before it even has to begin sharing with its customers.[3] (Exh. 8, p. 5). Clearly, if common sense is the test, then the Company's ROE recommendation passes and Public Counsel's fails.

Finally, Laclede has to take exception to Public Counsel's absurd contention at page 6 of its Initial Brief that the Commission should dismiss Laclede's return recommendations in favor of its own because the Company has been able to successfully issue common stock and debt in the recent past. There is simply no reason to believe that when investors purchased these instruments they did do so on the assumption that the Commission would adopt return recommendations, such as those proposed by Staff and Public Counsel, that are so low they would jeopardize the credit rating the Company has maintained for more than three decades and so inadequate they would afford Laclede's equity investors a market return (6.3%) that is just barely above the rate for risk-free treasury bonds (6.1% as of March 1999). (Exh. 8, p. 6; Exh. 8, Schedule 2). To the contrary, it is far more reasonable to assume that these investors, to the extent they gave the matter any consideration, concluded that the Commission would comply with the legal standards governing how a fair return must be determined and in the process reject the recommendations proposed by Staff and Public Counsel.

[3] Staff may point out, as it did at the hearing, that Laclede slightly exceeded this minimum 12.61% ROE in Fiscal 1996 and 1997. As indicated by the graph at page 6of Exhibit 1, however, the winter of 1996/97 was one of the few years out of the last fifteen when the weather was actually colder, rather than warmer, than normal -- a factor that would have to be corrected prior to making any claim about how Laclede's earnings compared to the weather normalized ROE granted UE.

In view of these considerations, it is clear that the Company has provided the only ROE recommendation and analyses in this case that conforms with the legal requirement to consider the returns being earned by other business undertakings with comparable risks. It should accordingly be adopted by the Commission.

3. <u>Requirement to consider impact of recommendations on the utility's financial integrity.</u>

Little response is required to Staff's and Public Counsel's arguments regarding the impact of their recommendations on Laclede's financial integrity, since they have ignored this fundamental requirement in their briefs to the same degree they did when developing their recommendations. In fact, neither party addresses the subject at all except for a single, conclusory sentence in Staff's Initial Brief to the effect that use of the DCF formula somehow satisfies the *Bluefield* requirement that a return must be sufficient to assure confidence in the financial soundness of the utility. (Staff's Initial Brief, p. 5). This assertion is completely refuted, however, by the actual evidence in this case, which, as discussed at pages 33-36 of Laclede's Initial Brief, showed that Staff's and Public Counsel's ROE recommendations would seriously jeopardize the Company's ability to maintain the AA- or better credit rating that it has held for more than three decades. Staff's failure to address this issue in any substantive way is particularly troubling given Mr. Broadwater's admission in his deposition that his return recommendation would result in interest coverages consistent with a downgrade in Laclede's credit rating of two levels (i.e., to BBB). (Exh. 116, pp. 38-39). His subsequent admission that other ratings criteria would be diminished even further, i.e., to a level that was actually *below* investment grade (i.e., BB) (Tr. 404-406), simply underscores the irresponsible nature of Staff's and Public Counsel's approach to this entire issue.

For all of these reasons, as well as those set forth in Laclede's Initial Brief, the Commission should not hesitate to adopt the Company's ROE recommendation in this case. By any objective measure, it is the only one that complies with all of the legal standards that all of the parties to this case have acknowledged must govern the determination of a fair return.

C. Capital Structure

Both Staff and Public Counsel provide very little in their Initial Briefs in the way of substantive support for the level of short-term debt that they propose be included in the Company's capital structure. What is most noteworthy is their failure to explain why it is appropriate for the Commission to assume that Laclede will carry an average short-term debt level of approximately $79 million when their own evidence shows that Company's actual level of short-term debt for the two most recent months of the true-up period used in this case was averaging around $35 million.[4]

As noted in Laclede's Initial Brief, this current level of short-term debt is entirely consistent with the record evidence in this case, which unambiguously showed that the $24 million equity and $25 million bond issuances placed by the Company in May and June of this year were to be used to repay short-term debt. (See Laclede's Initial Brief, pp. 36-37). Nowhere in their initial briefs do Staff or Public Counsel dispute the fact that these issuances were to be used for that purpose, let alone provide a compelling reason as to why it is appropriate to ignore their effect on the Company's short-term debt balances now that they have, in fact, been used for that purpose. Their only arguments are that a

[4] Schedule 3 of Staff witness Broadwater's true-up testimony shows that in June and July of this year the Company had average short term debt balances of $27,310,000 and $43,129,000, respectively. (See Exh. 128, Schedule 3). Adding the balances from the two months together and dividing by 2 produces an average short-term debt balance of approximately $35 million.

higher level of short-term debt is more consistent with: (a) the Company's historical levels of short-term debt; and (b) the Company's projected "cash flow" analysis. (Staff's Initial Brief, p. 11; Public Counsel's Initial Brief, p. 8).

As to the first point, one can always argue for ignoring the present by simply claiming that the focus should be on the past. To Laclede's knowledge, however, the Commission has never subscribed to the view that historical data can or should be used to the exclusion of new and more relevant information, such as the effects of the equity and bond issuances on the Company's capital structure. Moreover, even if it were appropriate to use historical data in this instance, which it is not, Staff and Public Counsel have completely failed to justify their use of a 12-month average for purposes of calculating a short-term debt level. As Staff's own witness acknowledged, use of a longer historical period of 42 months to determine the Company's short-term debt level would have resulted in an average short-term debt level of approximately $58 million instead of the approximate $79 million amount derived through Staff's and Public Counsel's use of a 12-month average. (See. Exh. 62, p. 7). The much lower average produced by using a longer historical period is due, of course, to the fact that the Company has carried much lower levels of short-term debt in the recent past than those reflected in the 12-month average used by Staff and Public Counsel. Indeed, as Staff witness Broadwater testified during the true-up hearing in this case, the Staff was recommending a $30 million short-term debt level for the Company as recently as the Company's 1996 rate case (Tr. 1092-1093) -- an amount that is far more consistent with both the Company's position in this case, and its actual level of short-term debt at the end of the true-up period, than it is with Staff's and Public Counsel's recommended level of short-term debt.

In short, Staff and Public Counsel would not only have the Commission look to the past rather than the most recent information in the record to establish a level of short-term debt in this case, but also have it look only at that limited historical period that -- surprise! -- produces the highest possible level of short-term debt and therefore the lowest possible revenue requirement. The Commission should not hesitate to reject such obvious efforts to manipulate historical data in order to achieve a particular (and plainly unreasonable) result.

As to Staff's and Public Counsel's reference to the Company's projected "cash flow" analysis, it is clear from the record that such an analysis was only developed in order to estimate the Company's overall cash needs, not to determine what type of financing alternatives would be used to meet those needs. (Exh. 13, p. 7). Notably, neither Staff nor Public Counsel sought to cross-examine or otherwise challenge Laclede witness Buck's statement in this regard. In view of Mr. Buck's undisputed explanation of the purpose of the cash flow analysis, it is clear that Staff's and Public Counsel's reference to that analysis is misplaced and has no relevance to the issue under consideration.

Finally, Laclede notes that neither Staff nor Public Counsel has even mentioned, let alone dealt with, the fact that their recommended level of short-term debt would produce an overall capital structure amount that is tens of millions of dollars in excess of the overall rate base that Staff has proposed to recognize for ratemaking purposes. (*See* Laclede's Initial Brief, pp. 38-39). Their complete failure to address this glaring discrepancy between the overall capital structure amounts that they propose to include in rates and the total rate base amounts that they are willing to acknowledge will be financed by that capital structure is telling indeed. Even if the other considerations discussed above were set aside, this factor alone would warrant rejection of Staff's and Public Counsel's position on this issue.

D. Cash Working Capital/ Revenue Collection Lag

The cash working capital issue in this proceeding is whether the Commission should use Laclede's accounts receivable turnover analysis of all of its accounts, or Staff's analysis of a small, selective and wholly unrepresentative sample of accounts, to determine the appropriate revenue collection lag for Laclede. Perhaps the most striking aspect of Staff's position on this issue is Staff's inability to point out any deficiencies in the methodology Laclede used in calculating the revenue collection lag. In brief cross-examination of Mr. Buck, Laclede's witness sponsoring testimony on this issue, Staff asked no questions at all about his accounts receivable turnover analysis. (Tr. 646-651). And in its Initial Brief, Staff did not even attempt to argue that the Company's turnover analysis was improperly calculated, or included any inappropriate elements, aside from the treatment of uncollectibles, which is addressed below. Staff's inability to provide any substantial criticism of Laclede's accounts receivable turnover analysis is understandable, since it is a methodology the Commission has approved in the past and, unlike Staff's methodology, includes every Laclede account. But it also is a clear indication that Laclede's analysis is a better means of determining the appropriate revenue collection lag than Staff's flawed sample.

The arguments regarding the revenue collection lag that are contained in Staff's Initial Brief fall into three categories. First, Staff argues that it has no obligation to show that the sample it has chosen is statistically valid, but that it is up to Laclede to prove that it is statistically invalid. (Staff's Initial Brief, pp. 15-16). This argument shows a fundamental misconception on the part of Staff regarding its obligation to support its own case. Just as Laclede is obligated to provide competent evidence in support of its own position (which it has, in the form of the undisputed accounts receivable turnover analysis), Staff is responsible for supporting its own recommendation with competent evidence.

Moreover, even though it is not Laclede's obligation to do so, Laclede actually has provided a significant amount of evidence in this case that clearly demonstrates Staff's sample is invalid and unrepresentative. For example, Laclede has pointed out that the small size of the sample (.0004 of Laclede's customer base) indicates that it is unlikely to be a useful reflection of the customer base as a whole. (Exh. 12, p. 4). Laclede has also provided evidence that the Staff's sample is not reflective of the demographics of Laclede's customer base, in some cases by several orders of magnitude. (Exh. 12, pp. 4-5). In addition, Laclede has explained why Staff's exclusion of customers with less than twelve months of billing information eliminates from the sample over 20% of Laclede's customers, many of whom have worse-than-average payment histories. (Exh. 12, pp. 6-7). Finally, Laclede has pointed out that the data contained in the Staff's sample is significantly out of date, since it reflects calendar year 1997 information. (Tr. 660-661). Faced with this evidence of the obvious and significant deficiencies of its sample, it is simply inexcusable that the Staff has made no effort to determine whether the sample has any validity from a statistical standpoint.[5]

Second, Staff argues that Laclede's revenue lag must be rejected because it is significantly longer than the due date for the payment of bills. (Staff's Initial Brief, p. 15). However, Staff witness Griggs admitted that Staff's own recommended revenue lag is also longer than the due date for the payment of bills. (Tr. 658). Although it may seem counter-intuitive that customers as a whole pay their bills after the due date, the evidence in this case clearly shows that Laclede's customers do. This is no doubt due in part to the impact of Cold Weather Rule customers, who are permitted by the Cold Weather Rule to carry significant balances on their accounts for months. It is also due to the fact that, under the Commission rules, Laclede is not permitted to disconnect other customers immediately when they are late in paying their bills. But whatever the reason for the customers' late payments, Laclede is entitled to recognition of customers' <u>actual payment patterns</u> in the calculation of the revenue collection lag regardless of the date that the payments are due.

The Commission has explicitly recognized this in previous cases in which revenue collection lags have been at issue. For example, in the Southwestern Bell Telephone Company case in which the revenue collection lag issue was last litigated, the Commission rejected the Staff's position that Southwestern Bell's revenue collection lag should be limited to 21 days -- the period of time permitted for payment under

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[5] Staff has argued that the collection lag it has calculated in this case must be reasonable because it is "similar to the collection lags calculated [by Staff] in Laclede's previous rate cases." (Staff's Initial Brief, p. 15). But these previous collection lags were calculated using samples with similar flaws. All that Staff's consistency demonstrates is that Staff has used consistently flawed samples in estimating Laclede's revenue collection lag.

Southwestern Bell's tariff. Instead, the Commission decided that the *actual* revenue collection lag of 28.46 days, based on an accounts receivable turnover analysis, should be used. *Re: Southwestern Bell Telephone Company*, 2 Mo.P.S.C. 3d 479, 502-505 (1993). Likewise, Laclede's revenue collection lag should not be rejected simply because it is longer than the due date for paying bills contained in Laclede's tariff.

Finally, Staff argues that Laclede's revenue collection lag should be rejected because it includes uncollectible accounts. (Staff's Initial Brief, p. 15). The Staff mistakenly asserts that accounts that become uncollectible should be completely eliminated from the revenue lag calculation because they are addressed as uncollectible expenses. However, this argument completely ignores the fact that most uncollectible accounts are slow-pay accounts in the months before the customer's service is finally terminated and his account becomes uncollectible. Consequently, complete elimination of all uncollectible accounts from the calculation has the effect of significantly understating the Company's actual revenue collection lag.

Laclede witness Buck has adjusted his revenue collection lag calculation to effectively eliminate uncollectible balances from the date the customer is cut off, until the date the account is ultimately written off as uncollectible. (Exh. 13, pp. 4-5). This adjustment prevents Laclede from collecting the cost of uncollectible accounts twice, but it also recognizes the detrimental impact these accounts have on the Company's revenue collection lag while the customers still have active accounts. This is clearly superior to Staff's simplistic and patently incorrect tactic of completely ignoring uncollectible accounts in calculating the revenue collection lag.

In summary, Staff has provided absolutely no justification for the Commission to reject Laclede's accounts receivable turnover analysis of all of its accounts in developing the appropriate revenue collection lag. Staff's alternative revenue collection lag is based on out-of-date account information, collected from a miniscule sample of accounts that is clearly not representative of Laclede's customer base as a whole. In collecting the sample, the Staff has intentionally excluded a large portion of Laclede's customer base, many of whom have very poor payment habits. Staff has openly admitted that it has no idea whether its sample has any statistical validity at all. (Tr. 661). Under these circumstances, it is clear that the Commission should adopt Laclede's revenue collection lag in this case.

E. Advertising

The issue with regard to advertising is how the Commission should address the fact that the current standard for determining the recoverability of advertising expenses as it is being applied by Staff and Public Counsel simply does not work.[6] The Commission can address this failure of the current standard by either modifying the existing standard or by providing much-needed guidance to Staff and Public Counsel that will enable them to apply the existing standard in a more practical and reasonable manner.

Staff and Public Counsel appear unwilling to even consider changing to a more workable standard for evaluating advertising costs, such as that proposed by Laclede. (Staff's Initial Brief, pp. 16-17; Public Counsel's Initial Brief, pp. 9-14). Under

[6] Laclede notes that Public Counsel's Initial Brief states that its proposed disallowance of advertising is $475,082 (Public Counsel's Initial Brief, p. 9), while Staff has proposed a disallowance of $448,000. (Exh. 131). This would suggest that if Laclede prevails, an additional amount of at least $448,000 should be added to the revenue requirement established in the partial settlement in this proceeding. In fact, Laclede has already reduced its advertising expense to reflect approximately $211,000 in advertising associated with HVAC service. Consequently, should Laclede prevail on this issue, Laclede's revenue requirement should only be increased by no more than $237,000.

Laclede's proposal, a company would be allowed to recover a reasonable amount of advertising expense based on the amount expended during the test year, or a five or ten year average of actual advertising expenditures. (Laclede's Initial Brief, pp. 51-52). Instead of thoughtfully considering this proposal, or a variation thereof, that might lead to a more equitable treatment of normal, reasonable and prudently incurred advertising expenses, Staff and Public Counsel have chosen to exaggerate and, in some cases, mischaracterize the possible effects of such a modified system. (Staff's Initial Brief, pp. 16-17; Public Counsel's Initial Brief, pp. 9-11). For example, in a blatant misrepresentation of the Company's position, Staff claims that the Company is seeking to recover all of its advertising costs and that the Company was unable to state how box seats for St. Louis Rams football games or legislative lobbying efforts would be treated under Laclede's proposal. (Staff's Initial Brief, p. 16). In fact, at the hearing, Mr. Hargraves clearly stated that Rams tickets would not be recoverable as advertising and that legislative lobbying would be considered political advertising, and thus be excluded from recovery under Laclede's proposal. (Tr. 746-748). As Staff well knows, Laclede has not incurred above-the-line expenses for lobbying efforts, nor has the Company pursued reimbursement for Rams box seats from ratepayers.

Public Counsel argues that Laclede's proposed system should be rejected out of hand, because it is a "radical and unprecedented method of preapproving a certain level of advertising expense." (Public Counsel's Initial Brief, p. 9). It would be neither radical nor unprecedented for the Commission to include in rates an amount for advertising equal to the amount actually expended by the utility for advertising during the test year (excluding political advertisements), provided such amount was reasonable in the judgment of the Commission, or, in the alternative, an amount equal to the average of the amounts that the company expended on advertising (excluding political advertisements) during the previous five or ten years. In this manner, the Commission would be treating advertising expenses in the same way that it treats other normal, recurring operating expenses incurred by regulated public utilities, such as payroll, plant maintenance and employee health care costs. In today's competitive environment, advertising is just another of the normal and reasonable expenses routinely incurred by a utility in its daily operations for which it should be allowed to obtain a reasonable recovery in rates.

With regard to the issue of whether Laclede has met the existing standard for recovery of all, or at least a portion, of its promotional advertising expenses, Staff and Public Counsel have once again in their respective briefs evidenced their confusion regarding the existing standard. Staff is inconsistent in faulting Laclede for failing to provide a statistical correlation between Laclede's advertising and Laclede's customers' choice to use natural gas, while simultaneously declaring, <u>without any explanation or supporting analysis</u>, that even if Laclede's advertising is effective (thus exhibiting the statistical correlation that Staff incorrectly claims is lacking), Laclede has not met the existing standard for recovery of promotional advertising costs. (Staff's Initial Brief, p. 21). Public Counsel, meanwhile, claims that the customers in the Marketeam Survey that stated that their decision to choose gas was influenced by Laclede's advertising should be ignored simply because there were other factors, in addition to advertising, that <u>may</u> have influenced their decisions. (Public Counsel's Initial Brief, p. 15).[7] Public

[7] Public Counsel misstates the results of the Marketeam Survey when it says that only 4 people cited Laclede's ads as a factor in their choice of natural gas. When one considers the number of customers that cited information from Laclede's advertising that they found important in their decision, such as pricing

Counsel is thereby requiring Laclede to prove that advertising is the sole factor that caused most customers to choose natural gas in order for Laclede to meet the standard. Clearly, Staff and Public Counsel have both misunderstood and misapplied the Commission's current standard and failed to give the proper weight to the evidence submitted by Laclede in this case, which evidence shows that the Commission's current standard has been met, i.e. the benefits received by Laclede's ratepayers from the Company's promotional advertising exceed the cost of such promotional advertising.

Based on all of the evidence in the record, and for the reasons stated above, the Commission should adopt Laclede's position on the issue of advertising, and reject Staff's and Public Counsel's adjustments.

F. Sunset Provision for AAO

In opposing Laclede's recommendation that the Commission be given additional discretion to determine when, and under what circumstances, Laclede's Gas Safety Accounting Authority Order ("AAO") should be terminated, both Staff and Public Counsel raise a number of arguments that simply ignore the record in this case. Even more telling than what they assert, however, is what they fail to address. Perhaps most significantly, neither Staff nor Public Counsel explain how ratepayers could possibly be disadvantaged by permitting the Company to defer over a longer period of time a portion of its gas safety costs. Specifically, they do not explain how ratepayers are harmed when such costs are subject to extremely low carrying costs of 5% or less, particularly when Staff's alternative to deferral is simply to force the Company into a rate case that, once concluded, would immediately permit the Company to begin collecting from its

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information, the number of customers is significantly higher than that stated by Public Counsel. (*See*, Exh. 22, pp. 5-6).

customers a significantly higher overall return on *all* of the rate base additions it has made since its last rate case. By anyone's measure, such a deferral would represent a superb result for utility customers, and Staff and Public Counsel should be seeking to encourage it rather than hinder the Company's effort in this regard.

Instead of looking at the actual economics, however, Staff and Public Counsel simply cite a Commission's order from a prior proceeding in which an electric utility was granted an AAO on the condition that it file a rate case within a specific period of time or lose the benefit of the AAO. *See Re: Missouri Public Service*, 1 Mo.P.S.C. 3d 200 (1991). (Staff's Initial Brief, pp. 12-13; Public Counsel's Initial Brief, p. 17). The principles quoted by Staff and Public Counsel from the Commission's Order in the Missouri Public Service case are clear and straight forward. They in no way warrant, however, rejection of the Company's proposal.

First, there is nothing in Laclede's proposal that requests that the Company be permitted to defer costs indefinitely or without limitation – the results that the Commission sought to avoid in *Missouri Public Service, supra*. To the contrary, the Company's proposal contemplates specific deadlines by which it would have to submit a request with the Commission addressing whether the AAO should be continued beyond three years.

Second, there is nothing in *Missouri Public Service* that mandates a particular length of time during which an AAO may remain in effect without the necessity of a general rate case filing. Indeed, the fact that the duration proposed by Staff and Public Counsel already varies from the one that was adopted for purposes of the *Missouri Public*

Service case is a perfect illustration of the flexibility with which those principles can be applied in a given case to justify a different duration.

Laclede would submit that, based on the record in this case, its three year proposal is completely justified under these principles, particularly in light of the clear evidence which demonstrated the advantages that would accrue to customers in the event such a proposal enabled the Company to defer seeking rate relief for a longer period. In light of this fact, and the inability of the proponents of a two year duration to explain why their proposal period is somehow superior (See Tr. 615-617), Laclede believes that there are sound reasons for the Commission to adopt the Company's proposal in this case.

G. Depreciation

1. Net Salvage.

As explained in Laclede's Initial Brief, the net salvage issue in this proceeding arises because of Staff witness Paul Adam's recommendation that the Commission order a dramatic departure from conventional depreciation methodology. The conventional whole life depreciation formula permits a utility to recover the future cost of net salvage of current plant through depreciation rates over the life of the plant. However, under Mr. Adam's approach, Laclede's depreciation rates would include only *current* net salvage costs, a result that would reduce Laclede's depreciation rates by approximately $2.3 million in this case.

The undisputed evidence presented by Laclede in this proceeding demonstrates that there is absolutely no theoretical foundation for Mr. Adam's approach. The conventional treatment of net salvage (requested by Laclede) adheres to accrual accounting principles, whereas Mr. Adam's proposal clearly does not. Staff appears to be oblivious to this fundamental distinction. In its Initial Brief, the Staff incorrectly (and for the first time) characterizes the recovery of net salvage as "the recovery of an annual expense..." presumably similar to wages, pipeline maintenance costs or other annual costs that the Company incurs. (Staff's Initial Brief, p. 22). However, the unchallenged evidence presented by Laclede in this proceeding clearly demonstrates that net salvage is a *future* cost of the assets now in service which must be accrued through depreciation rates over the life of those assets.[8] Mr. Adam's methodology fails to recognize this critical distinction. Consequently, his methodology violates Generally Accepted Accounting Principles, it has not been accepted in any depreciation treatise, and it has never been adopted by this Commission, or the overwhelming majority of other agencies that set depreciation rates for public utilities at the federal and state levels.[9] Mr. Adam apparently developed his proposal in the middle of his audit in Laclede's last rate case, without consulting senior Staff members, solely for the purpose of reducing Laclede's depreciation rates. (Tr. 891-893).

[8] As Dr. White testified:

> The economic principle underlying this accounting treatment is that in addition to return *of*, return *on*, and income taxes, a revenue requirement for removal expense (or a reduction in the revenue requirement attributable to gross salvage) is created when an asset is placed in service. It is appropriate, therefore, to include a net salvage rate component in current depreciation rates to more nearly achieve the goals and objectives of depreciation accounting. (Exh. 26, p. 5).

[9] Mr. Adam did testify that he had heard, through second-hand information, that the states of Arkansas and Pennsylvania may have adopted treatments of net salvage similar to his proposed treatment. (Tr. 867). Laclede's research indicates that the Arkansas Commission has excluded net salvage costs from depreciation rates for telephone utilities only, and apparently only in settled cases. *See Re: Southwestern Bell Telephone Company,* Arkansas Public Service Commission Docket No. 85-295-U, Stipulation, p. 6. The Pennsylvania Commission's treatment of net salvage is based on the specific requirements of a 1962 Pennsylvania Superior Court decision. *See Penn Sheraton Hotel v. Pennsylvania Public Utility Commission,* 198 Pa.Super. 618, 184 A.2d 324 (1962). These cases clearly do not provide any kind of precedent for this Commission to adopt Mr. Adam's proposed treatment of Laclede's net salvage costs.

Under these circumstances, the Commission should clearly reject Mr. Adam's irresponsible proposal. Mr. Adam has provided absolutely no evidence[10] that would justify this significant change to the Commission's reliance on conventional whole life depreciation principles for establishing Laclede's depreciation rates. As is demonstrated by the decision of Union Electric Company ("UE") to file a brief in support of Laclede on this issue, the Commission's adoption of Mr. Adam's proposal would have a detrimental impact on the depreciation rates of all Missouri utilities, not just Laclede's. Consequently, the Commission should approve the depreciation rates proposed by Laclede in this proceeding.

2. **Natural Gas Holders.**

With regard to Laclede's gas holders, Mr. Adam has again taken an unusual and punitive position. As explained in detail in Laclede's Initial Brief, for the last several of Laclede's rate cases, Mr. Adam has made demand after demand for ever more information about the cost of removing the gas holders, offering repeated assurances that, if adequate cost information were provided, Laclede's depreciation rates would be adjusted to account for these costs. In an effort to satisfy Mr. Adam, Laclede has conducted its own studies of the holders, retained an engineering firm to conduct a separate study of the cost of dismantling the holders, and even arranged for a contractor specifically recommended by Mr. Adam to examine the holders and calculate the estimated cost of holder sludge remediation. (See Laclede's Initial Brief, pp. 66-68).

[10] In its Initial Brief, the Staff offers a number of generalizations which are completely unsupported by any evidence in the record and, in any event, have little relevance to the question at issue. For example, Staff argues that the cost of removal of capital assets has increased substantially since the 1920's and 1930's when gross salvage was slightly higher than the cost of removal. (Staff's Initial Brief, p. 22). There is no evidence in the record to support this assertion and, even if it were true for some accounts, this would in no way suggest that the traditional treatment of net salvage should now be abandoned.

Now, when Laclede has finally provided an estimated cost of removal that not even Mr. Adam can contest, Mr. Adam argues that no removal cost can be recovered in depreciation rates until the Chief Executive Officer of Laclede makes an irrevocable commitment to retire the holders by a date certain. (Tr. 901). This is clearly an unwarranted requirement that is apparently unique in the annals of utility regulation.

As Staff points out in its Initial Brief, Laclede is estimating that the remaining service life for its holders will be ten years. (Staff's Initial Brief, pp. 24-25). However, estimates of service lives are routinely performed in calculating depreciation rates for *all* of Laclede's capital assets, as well as all of the capital assets of the other utilities regulated by the Commission. Mr. Adam has not argued that there is anything wrong with Laclede's estimate of the average remaining life for the holders -- he has simply argued that absent an irrevocable commitment from Laclede's CEO to retire the holders by a date certain, the depreciation on the holders should be stopped, and Laclede should not be permitted to recover any cost of removal. This recommendation is contrary to standard depreciation treatment and it contradicts Mr. Adam's own past position on this issue. Therefore, the Commission should reject Mr. Adam's proposal and permit Laclede to depreciate its gas holders at the level recommended by Laclede witness Kottemann.

H. Off-System Sales

With regard to this issue, the only question is whether the Commission should take into account the persistent decline in off-system sales that Laclede has experienced in the last three to four years in determining a level of off-system sales revenues to be imputed for purposes of setting Laclede's future rates. Laclede has provided undisputed evidence of consistently declining off-system sales revenues, volumes and margins explained in detail in its Initial Brief. (Laclede's Initial Brief, pp. 70-74).[11] Laclede has provided testimony explaining the reasons for this trend, consisting primarily of significant changes in the capacity of specifically identified pipelines serving the Chicago market. Laclede has also cited several cases articulating the consistent position of the Commission that trends should be taken into consideration when establishing rates in general, and when imputing revenues in a rate case in particular. (Laclede's Initial Brief, pp. 74-75). Based on these considerations, Laclede has argued for an imputation of the most recent year's off-system sales revenues -- $900,000.[12]

Staff, for its part, has elected to completely ignore this trend, and recommends the use of the average of off-system sales revenues experienced in the ACA periods ending in 1996, 1997 and 1998 -- $2.5 million. This amount exceeds the off-system sales revenues Laclede has earned in each of the last three years (including the ACA period ending in 1999), and greatly exceeds the amount of such revenues it has earned in the last two years. In support of its position, the Staff offers the following one-sentence explanation in its Initial Brief:

> Staff's proposed off-system sales net revenue amount is based on a three-year average of the off-system sales profits, which Laclede experienced in its three most recent ACA periods. (Staff's Initial Brief, p. 27).

[11] The parties have agreed to incorporate portions of the record from Case No. GT-99-303, which contains evidence regarding Laclede's off-system sales into the record in this proceeding. (Tr. 1041, Exh. 125).

[12] $900,000 is the amount of Laclede's off-system sales for the most recent ACA period (ending September 30, 1999) as shown in Exhibit No. 42 from Case No. GT-99-303, which was jointly prepared by Laclede and Public Counsel. Although this figure was partially estimated at the time of the hearing in Case No. GT-99-303 (in July, 1999), more than nine months of the ACA period, and all of the winter months, had passed by that time.

Obviously this terse statement of position does not begin to address the evidence Laclede has submitted about the declining trends in off-system sales revenues, volumes and margins. Consequently, Staff's argument on this issue, such as it is, should be rejected.

For its part, Public Counsel has devoted almost 2 pages of its Initial Brief to this issue. However, Public Counsel's own witnesses have already admitted that there is a clear declining trend in off-system sales revenues and that trends should be considered in determining the amount of off-system sales revenues for Laclede. (*See* Laclede's Initial Brief, pp. 71-72). Consequently, Public Counsel has no choice but to recognize the trend in providing its recommendation. Incredibly, however, Public Counsel only reduces the average amount of off-system sales revenues for the last three ACA periods by a paltry $100,000 (or 4%) in recognition of the trend. This produces an imputed level of revenues -- $2.4 million -- which, like Staff's, is substantially in excess of the level of revenues Laclede has experienced in the last two years, and substantially in excess of the level of revenues that Laclede has any reasonable likelihood of experiencing in the future.

Given the undisputed evidence of the significant and persistent decline in off-system sales revenues, volumes and margins, the only reasonable amount of off-system sales revenues for the Commission to impute is that from the most recent year, as set forth in Public Counsel-sponsored Exhibit No. 42 from Case No. GT-99-303 -- namely $900,000. Any greater amount does not provide adequate recognition of the declining trend and establishes an imputed amount of revenues Laclede cannot reasonably hope to achieve.

I. Service Territory Descriptions

With regard to service territory descriptions, the issue in this case is whether the Commission should adopt the Staff's recommendation that Laclede be required to list in its tariff all of the townships, ranges and sections encompassed by its service area. The Staff's Initial Brief characterizes this recommendation as an effort to provide "a meaningful, understandable, but simple…" description of Laclede's service territory in its tariff. (Staff's Initial Brief, p. 28.) Unfortunately for Staff, the evidence in this case shows that a litany of legal descriptions contained in Laclede's tariff would be anything but meaningful, understandable and simple.

Staff's claim that these legal descriptions would be meaningful and understandable is contradicted by the Staff's own witness, Mr. Gray, who admitted that even after months of working on this issue, he did not know the township, range and section in which his own house is located. (Tr. 994). Similarly, Mr. Difani, UE's witness on this issue, testified that even he does not fully understand the township, range and section descriptions contained in UE's tariff, in spite of the fact that he helped write the tariff. (Tr. 981). Furthermore, Laclede's witness, Mr. Cline, testified that he did not understand the meaning of the terms the Staff is proposing for inclusion in Laclede's tariff, until he read Mr. Gray's testimony. (Tr. 959). If these three expert witnesses have difficulty understanding and utilizing the information Staff proposes to include in Laclede's tariff, it seems inconceivable that this information will be "meaningful and useful" to the general public.

Staff argues in its Initial Brief that there are various groups of people with expertise sufficient to permit them to make use of this arcane information. Specifically, Staff suggests that people like surveyors and contractors may be able to make use of this information.[13] But there is no evidence at all that even a single surveyor or developer has ever sought this kind of information from a tariff. No developers or surveyors testified in this proceeding about their need for such information. The Staff supplied no examples of surveyors or developers who have sought such information. In addition, Mr. Difani's testimony that similar service territory descriptions in UE's tariff have been "absolutely useless" suggests that no developers or surveyors have used them. (Tr. 981). Finally, both Mr. Gray and Mr. Cline testified that they were not aware of any of Laclede's customers having ever expressed any concern or confusion over the service territory descriptions currently contained in Laclede's tariff. (Tr. 954; 1025-1026).

Based on the record in this case, it is clear that the Commission should decline the Staff's invitation to introduce a confusing, costly and completely unnecessary addition to Laclede's tariff. The Staff has provided absolutely no justification to support this proposed requirement.

J. Customer Annualization

Staff makes two arguments at pages 29-30 of its Initial Brief in an effort to convince the Commission to adopt a Staff customer annualization adjustment that: (a) erroneously implies a level of customer growth that is significantly higher (by several thousand customers) than the level actually experienced by Laclede for the year ending July, 1999; and (b) inexplicably assumes that such growth will be greatest in those areas of the Company's service territory where it has traditionally been lowest, and lowest in

[13] This is apparently a back-up rationale for the Staff's proposal. As both Laclede and UE pointed out in their Initial Briefs, during cross-examination, Staff witness Gray essentially disavowed each of the five rationales he offered in prefiled testimony to support Staff's position on this issue. (Laclede's Initial Brief pp. 76-78; UE's Initial Brief, p. 5).

those areas where it has traditionally been highest. (*See* Laclede's Initial Brief, pp.80-81). Both of Staff's arguments mischaracterize the record.

First, Staff suggests that, notwithstanding the absurd results produced by its adjustment, the Company should have been aware of how Staff was going to calculate its customer annualization adjustment for true-up purposes and should, therefore, have no grounds for complaint. (Staff's Initial Brief, p. 29). What Staff fails to explain, however, is exactly how Laclede could have fathomed beforehand Staff's approach to truing-up its customer annualization methodology when the Company has not even had a true-up proceeding conducted in one of its rate cases since that methodology was first adopted -- a fact that was acknowledged by Staff's own witness, Ms. Westerfield. (Tr. 1108).[14] Nor does Staff explain why the Company should have assumed that Staff would apply its methodology in the way it ultimately did during true-up given the fact that Staff used an entirely different method (with entirely different results) at the time it filed its direct case to estimate what customer annualization level should be included in its true-up allowance. (Exh. 128, p. 6; Exh. 130, pp. 2-3).

Indeed, Staff tries to skirt these obvious flaws in its position by suggesting that the approach it used for truing-up its customer annualization levels is the same as that used when Staff updates a test year. (Staff's Initial Brief, p. 29). Since Staff did not bother to make this claim until redirect examination of its main witness on this issue (*See* Tr. 1109), the Company was hardly in a position to address this contention on the record.

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[14] It would have also been impossible for Laclede to glean such information from cases involving other utilities, because Staff apparently does not use the same customer annualization methodology for companies other than Laclede. (Tr. 1106). In fact, Staff witness Westerfield was unable to say whether the customer annualization method used by Staff in this case had ever been trued-up in any proceeding. (Tr. 1106-1107).

Suffice it to say, that the very purpose of a true-up proceeding is to move forward the period of time over which cost and revenue changes will be recognized to a point well past the update period for a test year, as evidenced by the four month gap between the March 31, 1999 update and August 1, 1999 true-up periods in this case. Under such circumstances, the mere fact that Staff may not have updated all of the components of its customer annualization methodology for a period that ended only a few months after the conclusion of the 1998 test year in this case says nothing about whether it would true-up, or should have trued-up, such components for a true-up period that concluded some *seven* months after the end of the test year.

To the contrary, Laclede had every right to expect that the Staff would indeed true-up *all* of the components of it methodology, including the ten-year average part of its adjustment, since such an approach would have been more consistent with the purposes of a true-up proceeding; would have produced results that are much more reflective of reality; and would have resulted in a customer annualization level much closer to Staff's initial true-up estimate. The mere fact that Staff unilaterally chose to true-up only part of its customer annualization methodology out of an alleged allegiance to a true-up method that had never been used or disclosed before does not mean that either the Commission or the Company should be required to accept the faulty results of Staff's adjustment.

Staff's second argument is equally meritless. At page 30 of its Initial Brief, Staff asserts that it is not appropriate to suggest that Staff's adjustment implies an annual increase of 7,935 customers based on the fact that Staff's adjustment added 2,645 customers for the four-month period between March 31, 1999 and August 1, 1999. According to Staff, multiplying 2,645 by three to derive an annual number does not take into account the fact that there are "seasonal patterns" in customers coming onto and dropping off of the Company's system -- patterns that Staff states were acknowledged by Laclede witness Fallert. An actual review of Mr. Fallert's testimony and cross-examination, however, shows how misleading Staff's argument is. As Mr. Fallert explained, the fact that customers tend to drop off the system in the spring and summer and come back on in the fall and winter is precisely why a customer annualization must be done -- to separate out the effects of these temporary fluctuations in customer numbers and recognize only permanent customer additions. (Tr. 1079).[15] With regard to the latter, Mr. Fallert indicated that permanent customers are added to the Company's system on a relatively even basis throughout the year -- a fact that he confirmed by a review of the amounts spent by the Company on installing new services. (Tr. 1075). Notably, Staff never offered any evidence to challenge Mr. Fallert's conclusion that there is no significant difference in permanent customer additions from one time of the year to the next. (*Id.*).

In short, Staff has offered nothing but red herrings in support of a customer annualization adjustment that is plainly and wildly inconsistent with Laclede's actual customer growth experience. The Company's position on this issue should accordingly be adopted.

[15] By way of illustration, because of these seasonal effects, the number of customers on Laclede's system actually declined by approximately 9,000 customers between March 31, 1999 and August 1, 1999. (Tr. 1082). Only by performing a customer annualization could Staff and the Company actually assume that customers had been added during this period.

II.
CONCLUSION

For all of the foregoing reasons, as well as those set forth in its Initial Brief, Laclede Gas Company respectfully requests that the Commission resolve the issues in this case in the manner proposed by the Company.

Respectfully submitted,

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CERTIFICATE OF SERVICE

Michael C. Pendergast, Associate General Counsel for Laclede Gas Company, hereby certifies that the foregoing Reply Brief has been duly served upon 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 1st day of November, 1999.

Michael C. Pendergast