Exhibit No.:	
Issues:	*Depreciation and Cost of Removal*
Witness:	*Mark L. Oligschlaeger*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Supplemental Rebuttal Testimony*
Case No.:	*GR-99-315*
Date Testimony Prepared:	*September 10, 2004*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SUPPLEMENTAL REBUTTAL TESTIMONY

OF

MARK L. OLIGSCHLAEGER

LACLEDE GAS COMPANY

CASE NO. GR-99-315

Jefferson City, Missouri
September 2004

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

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

AFFIDAVIT OF MARK L. OLIGSCHLAEGER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Mark L. Oligschlaeger, being of lawful age, on his oath states: that he has participated in the preparation of the following supplemental rebuttal testimony in question and answer form, consisting of 13 pages to be presented in the above case; that the answers in the following supplemental rebuttal testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Mark L. Oligschlaeger

Mark L. Oligschlaeger

Subscribed and sworn to before me this 9th day of September 2004.

Notary

TONI M. CHARLTON
NOTARY PUBLIC STATE OF MISSOURI
COUNTY OF COLE
My Commission Expires December 28, 2004

SUPPLEMENTAL REBUTTAL TESTIMONY

OF

MARK L. OLIGSCHLAEGER

LACLEDE GAS COMPANY

CASE NO. GR-99-315

Q. Please state your name and business address.

A. Mark L. Oligschlaeger, P. O. Box 360, Suite 440, Jefferson City, MO 65102.

Q. Please describe your educational background and work experience.

A. I attended Rockhurst College in Kansas City, MO, and received a Bachelor of Science degree in Business Administration, with a major in Accounting, in 1981. I have been employed by the Missouri Public Service Commission (Commission) since September 1981 within the Auditing Department. In November 1981, I passed the Uniform Certified Public Accountant (CPA) examination and, since February 1989, have been licensed in the state of Missouri as a CPA.

Q. Have you previously filed testimony before this Commission?

A. Yes, numerous times. A listing of the cases in which I have previously filed testimony before this Commission is given in Schedule 1, attached to this supplemental rebuttal testimony. A listing of the issues I have addressed in filed testimony in dockets before the Commission since 1990 is provided in Schedule 2 to this testimony.

Q. What knowledge, skills, experience, training and education do you have in the areas of which you are testifying as an expert witness?

A. I have been employed by this Commission as a Regulatory Auditor for over 20 years, and have submitted testimony on ratemaking matters numerous times before the Commission. I have also been responsible for the supervision of other Commission employees in rate cases and other regulatory proceedings many times. I have received training at in-house and outside seminars on technical ratemaking matters since I began my employment at the Commission.

Q. What is the purpose of your supplemental rebuttal testimony?

A. The purpose of this testimony is to address the arguments made by Laclede Gas Company (Laclede) and Union Electric Company d/b/a AmerenUE (AmerenUE) witnesses regarding the ratemaking treatment for net salvage costs and utility cash flow. (Collectively, I will refer to Laclede and AmerenUE as the "Companies.") The Companies allege that adoption by the Commission of the Staff's recommended rate treatment of net salvage costs will harm Missouri utilities' cash flow, and ultimately increase rates charged to consumers for utility service.

The Companies' witnesses make a number of other arguments opposing the Staff's position on rate treatment of net salvage in their direct testimony. These arguments will be addressed in the supplemental rebuttal testimony of Staff witness Rosella L. Schad of the Engineering and Management Services Department.

Q. What Companies witnesses will you be responding to?

A. I will be addressing in particular the assertions of Laclede witnesses Barry C. Cooper and R. Lawrence Sherwin, and AmerenUE witnesses Warner L. Baxter and Steven M. Fetter, as they relate to the cash flow implications of this issue.

Q. What is "net salvage," and what is the fundamental issue being addressed regarding this issue in this proceeding?

A. "Net salvage" is the cost to physically remove and dismantle an asset at the end of its useful life (also known as "cost of removal"), net of any salvage proceeds obtained in connection with disposal of the asset. The fundamental issue in this proceeding is whether utilities should recover estimated net salvage costs from customers over the estimated useful life of the asset (the Company proposal, or what they term as "standard approach"), or recover net salvage costs from customers only when a cash outlay is required, at the end of the useful life of the asset.

Q. What is "cash flow?"

A. "Cash flow" constitutes all of the inflows of cash received by a utility from its customers or its investors. As it relates to utility operations, cash flow can be used to either pay expenses incurred by the utility on a day-to-day basis to provide service to customers, or to invest in assets that are intended for long-term use in the provision of utility service. Of course, cash flow can also be used by utilities for other activities, such as to finance mergers and acquisition transactions, or for investment in non-regulated ventures.

In the context of this proceeding, the issue involving cash flow and net salvage rate treatment pertains only to the amount of cash flow available to invest in long-term utility assets.

Q. How can a utility obtain cash flow from its investors?

A. Utilities can obtain cash from its investors either by issuing common or preferred equity, or by issuing long-term bonds.

Q. How can a utility obtain cash flow from ratepayers?

A. A utility obtains cash from its customers through rates. While much of the rates a customer pays to a utility are intended to cover the day-to-day expenses of the company, the portion of those rates that cover return on equity, deferred income taxes and depreciation expense in effect provide an available source of cash to the utility for long-term investment.

Q. Why are depreciation, deferred taxes and return on equity sources of cash to a utility?

A. These items provide cash to a utility because there is no contemporaneous required cash outlay by the company associated with these rate elements.

Depreciation expense is a return to shareholders of capital previously invested by the utility in plant assets. Accordingly, amounts collected in rates for depreciation can be used by the utility to re-invest in long-term assets, or for any other purpose the utility chooses.

Deferred income taxes represent amounts collected from ratepayers for taxes that will not have to be paid to federal or state taxing authorities currently. Again, these amounts are available to the utility to invest in long-term assets.

Return on equity is the allowance in rates provided to compensate equity investors for the capital they have provided to the utility. While most utilities pay a portion of the return on equity allowance back to their shareholders in the form of cash dividends, generally some portion of the return on equity rate component is not paid out by the utilities, and is classified as “retained earnings.” Retained earnings are available to the utility to re-invest in its operations, if the company desires.

Q. Is traditional ratemaking, as practiced in this jurisdiction, primarily based upon a utility’s cash flow needs?

A. No. Traditional cost-based regulation is based upon allowing recovery of a utility's costs of providing service to customers. These costs include both normal operating expenses and long-term capital costs. While the rate setting process generally can be expected to provide a utility with cash in rates to pay its short-term cash expenses, the usual practice is for utilities to obtain cash from shareholders to invest in long-term assets, and then recover the cost of those assets from customers over the estimated useful life of the assets through depreciation expense.

Therefore, traditional regulation does not seek to provide rate levels to utilities that approximate their annual cash requirements.

Q. Is it reasonable to expect a utility to acquire some of its cash flow from utility shareholders?

A. Yes. In fact, in my experience, all large utilities invest sizeable amounts of shareholder-supplied funds into their operations over the long-term. A utility's construction budget is normally financed primarily with short-term debt, which is later converted to either long-term debt or financed with equity infusions as the assets are placed in service. A utility's "rate base" is actually the amount of outstanding shareholder net investment in utility assets at a point in time.

Q. Mr. Sherwin, at page 6 of his direct testimony and Mr. Baxter, at page 22 of his direct testimony, imply that there is a problem if there is a shortfall between a utilities collection of depreciation expense in rates and the amount of a utility's annual construction budget. Is this true?

A. No, for several reasons.

First, these witnesses ignore the fact that amounts associated with deferred taxes and return on equity collected in rates are also available to the utility for potential internal investment in construction activities. Therefore, the simplistic comparison of Laclede's and AmerenUE's construction budget amounts to their annual depreciation expense does not present an accurate picture of the cash flows obtained from customer sources available to fund these companies' construction projects.

Second, these claims seem to be based upon the assumption that utilities should not have to use external sources of funding to finance construction activities. This is false. While ratepayer-provided capital can be used to reduce the total amount of external financing needed for construction, it is an expectation that external financing be used as necessary as well to invest in long-lived assets. If this were not so, then Missouri utilities would not have the substantial amount of shareholder investment reflected in their rate bases that they currently have.

Q. Have there been recent legislative developments that have increased the cash flow available to Missouri utilities?

A. Yes. In 2003, the Missouri Legislature passed, and the Governor signed into law, legislation that authorized single-issue rate changes for gas and water utilities for certain types of plant additions through Infrastructure System Replacement Surcharges (ISRS). Implementation of ISRS rate increases will have the effect of increasing utility cash flow above the level normally achieved through traditional cost of service regulation in this jurisdiction.

Laclede has recently been granted an ISRS increase by the Commission. This enhancement to Laclede's cash flow was not mentioned in Mr. Sherwin's testimony in this proceeding.

Q. How does rate treatment of net salvage costs affect utility cash flow?

A. If utilities recover net salvage costs on a projected basis, as the Companies propose in this proceeding, then rate recovery will be achieved, on average, years before the utilities are required to expend cash for removal/dismantlement activities for the related assets. Obviously, this treatment of net salvage provides utilities with cash flow that can be invested in utility assets or other long-term ventures.

Q. Should the Commission's primary interest in setting depreciation rates, or in determining an approach to rate treatment of net salvage, be allowing a certain level of cash flow to the utility?

A. No. The primary purpose of rate collection of depreciation expense is not to provide a utility with cash flow; it is to return shareholder-invested capital to the utility shareholders over the approximate life of the assets financed with the funds. Likewise, the purpose of rate recovery of net salvage is not to provide a utility with cash flow; it is to allow the utility to recover its costs associated with net salvage. The fact that rate recovery of depreciation expense and net salvage costs can provide cash flow to utilities is a side benefit, but that benefit has not been and should not be the primary driver of the Commission's policies in this area.

Q. The Company witnesses claim that the Staff's position on rate recovery of net salvage costs will reduce the utilities' cash flow. Is this accurate?

A. Certainly, utilities will receive more cash flow from customers under what they term the "standard approach" of rate recovery of net salvage than they would under the Staff's proposal in this proceeding. However, it is important to make the distinction that the Staff's recommended position on this issue will in no way create a cash flow detriment to the utilities. The Staff method is intended to make the companies whole for their actual cash net salvage costs. The Companies' proposal, however, would have the ratepayers supply the companies with additional cash flow that will be used for activities that have nothing to do with net salvage activities.

Q. What are the implications of the utilities desire to obtain additional cash flow through pre-collections of net salvage in rates?

A. If a company collects funds from customers in rates associated with net salvage, and then takes those funds and invests them in plant or other investment vehicles, then those funds will presumably not be available to pay actual net salvage costs at the time those cash outlays are made. In turn, this means that the utilities will have to obtain shareholder funds to finance its net salvage outlays, notwithstanding that customers would have already "paid" in rates for such costs under the Companies' proposed "standard approach."

Q. Are you stating that utilities do not segregate the funds they have pre-collected in rates associated with net salvage from other funds, so that such funds can be preserved for use towards net salvage activities?

A. That is exactly right. In fact, utilities typically cannot even determine the exact amount of net salvage they have collected from customers in rates at any point in time.

Please refer to the supplemental rebuttal testimony of Staff witness Schad for further elaboration on this point.

Q. If utilities are allowed to pre-collect net salvage funds in rates, is there any guarantee that such funds will ultimately be used to the benefit of Missouri utility customers?

A. No. Missouri utilities have frequently used cash flow to engage in merger and acquisition activities, pay dividends to parent companies, and start up or invest in non-regulated ventures. Both Laclede and AmerenUE have been involved in utility acquisitions and/or non-regulated investments in recent years. Under the Companies' proposed standard approach, there are absolutely no safeguards that require that the additional cash flow obtained by the utilities from customers under this rate treatment be invested for the direct benefit of Missouri utility customers.

Q. Does the "standard approach" for collecting net salvage costs in rates provide the utilities with strong incentives for efficient operations?

A. No, because the utilities are allowed to pre-collect the costs in rates before they are expended. The Staff's approach is superior to the "standard approach" in encouraging greater efficiency in net salvage activities, because the utilities can receive a financial benefit if they are able to beat historical experience in their cost of removal expenditures.

Q. In general terms, the Companies' witnesses claim that pre-collection of net salvage costs in rates will result in lower overall customer rates in the long term. Is this valid?

A. Keep in mind that the Companies are essentially claiming that utility ratepayers are financially better off paying amounts to utilities upfront for net salvage costs, rather than retaining the use of their own funds until a cash outlay is required for these expenses. All such claims depend upon a subjective judgment of whether utilities or customers have a higher cost of capital. If the utilities' cost of capital is lower on average than its customers, it is not cheaper from the consumer perspective for ratepayers to provide monies for net salvage upfront. It is counter-intuitive, to say the least, to claim that multi-million dollar utilities cannot obtain capital more cheaply than the average utility ratepayer.

Q. At page 12 of his direct testimony, UE witness Fetter states that credit rating agencies consider cash flow criteria to be the most important factor in their evaluation of utilities, and that such agencies do not look favorably upon the Staff's method of treating net salvage for rate purposes. Please comment.

A. The primary concern of credit rating agencies is that debt repayment by utilities be as certain and secure as possible. As such, any rate measure that tends to increase cash flow is a good thing from the rating agency perspective, and any rate measure that tends to decrease cash flow is a detriment. It must be recognized that credit rating agencies do not have as a primary concern the setting of just and reasonable rates for utility customers. That concern requires a balancing of interests, which includes but is definitely not limited to the financial health indicators emphasized by credit rating agencies. Setting rates based primarily upon the preferences of credit rating agencies is unlikely to achieve a balancing of customer and investor interests.

Q. Mr. Cooper and Mr. Fetter also allege that utilities' debt costs will be higher if their credit ratings are downgraded on account of the Commission's net salvage policies. Do you agree?

A. It is my understanding that a general relationship exists between a utility's credit ratings, and its debt costs (i.e., the lower the credit rating, the higher the cost of debt). However, nowhere in the Companies' direct testimony was any evidence presented that the Commission's policy on net salvage in itself would be likely to cause a credit rating downgrade. In addition, there is a cost to the customer of utilities maintaining high credit ratings; generally, higher rates. The Companies presented no evidence in its direct testimony that the proposed treatment of net salvage costs, when also taking into account the cost of debt, will result in rates being set at an optimal level over time from a customer perspective.

Q. Is the Staff concerned about utility credit ratings?

A. Yes. In particular, the Staff is concerned that utilities in this jurisdiction maintain an "investment" grade rating. It is our belief that threats to such ratings for Missouri utilities have come about in recent years not because of Commission actions, but because of voluntary initiatives by utilities to expand into non-regulated activities.

Q. Are utilities always opposed to actions that have the potential to lower their credit ratings?

A. No. Many Missouri utilities over the years have undertaken merger and acquisition activities. It is not uncommon for credit rating agencies to consider credit downgrades to utilities involved in such activities, particularly for those companies seeking to acquire other utilities.

Q. UE witness Fetter also claims at pages 12-13 of his direct testimony that credit rating agencies view the Staff's net salvage position as more risky than the "standard approach," because there is a greater chance that cost of removal amounts will ultimately not be completely recovered due to regulatory lag or fear of "rate shock." Do you agree?

A. No. The clear implication to Mr. Fetter's statements is that the Commission might choose not to allow recovery of prudently incurred actual cash expenditures for net salvage activities in future rates. There is absolutely no evidence to support any contention that there is a real "risk" of such behavior by this Commission in the future.

Q. Does the Staff believe that cash flow considerations should play any role in the Commission's determinations on the net salvage issue?

A. Not under normal circumstances. If a utility can demonstrate in a rate proceeding that it is facing a serious cash flow problem, the Staff recommends that the Commission take those circumstances into account in determining whether the Staff's recommended approach, or an alternative approach such as the "standard approach," be utilized regarding net salvage for rate purposes. The Staff believes that this flexibility is consistent with the Commission's decision on the net salvage issue in the St. Louis County Water Company rate proceeding, Case No. WR-2000-844.

Q. If the Commission determines that a return to the "standard approach" of treating net salvage costs for ratemaking is justified in this proceeding, does the Staff have any alternative recommendations to offer?

A. Yes. In that event, the Staff would recommend that the Commission require the utilities to separately track and account for net salvage amounts received in rates from other components of depreciation expense. Further, the Commission should require that the utility implement measures to safeguard customer funds obtained through rate collections of net salvage so that the funds are available for payment of net salvage expenditures as needed. These measures should include a requirement that amounts collected in rates related to net salvage be segregated from other corporate funds, so that such amounts can eventually be used to cover actual cash net salvage outlays.

Q. Does this conclude your supplemental rebuttal testimony?

A. Yes, it does.

MARK L. OLIGSCHLAEGER

COMPANY	**CASE NO.**
Kansas City Power and Light Company	ER-82-66
Kansas City Power and Light Company	HR-82-67
Southwestern Bell Telephone Company	TR-82-199
Missouri Public Service Company	ER-83-40
Kansas City Power and Light Company	ER-83-49
Southwestern Bell Telephone Company	TR-83-253
Kansas City Power and Light Company	EO-84-4
Kansas City Power and Light Company	ER-85-128 & EO-85-185
KPL Gas Service Company	GR-86-76
Kansas City Power and Light Company	HO-86-139
Southwestern Bell Telephone Company	TC-89-14
Western Resources	GR-90-40 & GR-91-149
Missouri-American Water Company	WR-91-211
UtiliCorp United Inc. / Missouri Public Service	EO-91-358 & EO-91-360
Generic: Expanded Calling Scopes	TO-92-306
Generic: Energy Policy Act of 1992	EO-93-218
Western Resources, Inc./Southern Union Company	GM-94-40
St. Louis County Water Company	WR-95-145
Union Electric Company	EM-96-149
St. Louis County Water Company	WR-96-263
Missouri Gas Energy	GR-96-285
The Empire District Electric Company	ER-97-82
UtiliCorp United, Inc./Missouri Public Service	ER-97-394
Western Resources, Inc./Kansas City Power & Light Company	EM-97-515
United Water Missouri, Inc.	WA-98-187
Missouri-American Water Company	WM-2000-222

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COMPANY	CASE NO.
UtiliCorp United Inc. / St. Joseph Light & Power Company	EM-2000-292
UtiliCorp United Inc. / The Empire District Electric Company	EM-2000-369
Green Hills Telephone Corporation	TT-2001-115
IAMO Telephone Company	TT-2001-116
Ozark Telephone Company	TT-2001-117
Peace Valley Telephone Company, Inc.	TT-2001-118
Holway Telephone Company	TT-2001-119
KLM Telephone Company	TT-2001-120
Missouri Gas Energy	GR-2001-292
The Empire District Electric Company	ER-2001-299
Oregon Farmers Mutual Telephone Company	TT-2001-328
Ozark Telephone Company	TC-2001-402
Gateway Pipeline Company, Inc.	GM-2001-585
Missouri Public Service	ER-2001-672
Union Electric, d/b/a AmerenUE	EC-2002-1
Laclede Gas Company	GA-2002-429
Aquila, Inc., d/b/a Aquila Networks-MPS-Electric and Aquila Networks-L&P-Electric and Steam	ER-2004-0034 & HR-2004-0024 (Consolidated)
Missouri Gas Energy	GR-2004-0209

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Company Name	Case Number	Issues
Western Resources	GR-90-40 and GR-91-149	Take-Or-Pay Costs
Missouri-American Water	WR-91-211	True-up; Known and Measurable
Missouri Public Service	EO-91-358 and EO-91-360	AAO
Generic Telephone	TO-92-306	Revenue Neutrality; Accounting Classification
Generic Electric	EO-93-218	Preapproval
Western Resources & Southern Union Company	GM-94-40	Regulatory Asset Transfer
St. Louis County Water	WR-95-145	Policy
Union Electric Company	EM-96-149	Merger Savings; Transmission Policy
St. Louis County Water	WR-96-263	Future Plant
Missouri Gas Energy	GR-96-285	Riders; Savings Sharing
Empire District Electric	ER-97-82	Policy
Missouri Public Service	ER-97-394	Stranded/Transition Costs; Regulatory Asset Amortization; Performance Based Regulation
Western Resources & Kansas City Power & Light	EM-97-515	Regulatory Plan; Ratemaking Recommendations; Stranded Costs
United Water Missouri	WA-98-187	FAS 106 Deferrals
Missouri-American Water	WM-2000-222	Conditions
UtiliCorp United & St. Joseph Light & Power	EM-2000-292	Staff Overall Recommendations
Utilicorp United & Empire District Electric	EM-2000-369	Overall Recommendations
Green Hills Telephone	TT-2001-115	Policy
IAMO Telephone Company	TT-2001-116	Policy

Company Name	Case Number	Issues
Ozark Telephone Company	TT-2001-117	Policy
Peace Valley Telephone	TT-2001-118	Policy
Holway Telephone Company	TT-2001-119	Policy
KLM Telephone Company	TT-2002-120	Policy
Missouri Gas Energy	GR-2001-292	SLRP Deferrals; Y2K Deferrals; Deferred Taxes; SLRP and Y2K CSE/GSIP
Empire District Electric	ER-2001-299	Prudence/State Line Construction/Capital Costs
Ozark Telephone Company	TC-2001-402	Interim Rate Refund
Gateway Pipeline Company	GM-2001-585	Financial Statements
Missouri Public Service	ER-2001-672	Purchased Power Agreement; Merger Savings/Acquisition Adjustment
Union Electric Company	EC-2002-1	Merger Savings; Criticisms of Staff's Case; Injuries and Damages; Uncollectibles
Laclede Gas Company	GA-2002-429	AAO Request
Aquila, Inc., d/b/a Aquila Networks-MPS-Electric and Aquila Networks-L&P-Electric and Steam	ER-2004-0034 and HR-2004-0024 (Consolidated)	Aries Purchased Power Agreement; Merger Savings
Missouri Gas Energy	GR-2004-0209	Revenue Requirement Differences; Corporate Cost Allocation Study; Policy; Load Attrition; Capital Structure