Commissioners

SHEILA LUMPE
Chair

HAROLD CRUMPTON

CONNIE MURRAY

ROBERT G. SCHEMENAUER

M. DIANNE DRAINER
Vice Chair

Missouri Public Service Commission

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

GORDON L. PERSINGER
Acting Executive Director
Director, Research and Public Affairs

WESS A. HENDERSON
Director, Utility Operations

ROBERT SCHALLENBERG
Director, Utility Services

DONNA M. KOLILIS
Director, Administration

DALE HARDY ROBERTS
Secretary/Chief Regulatory Law Judge

DANA K. JOYCE
General Counsel

October 15, 1999

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

RE: GR-99-315 - In the Matter of Laclede Gas Company's Tariff to Revise Natural Gas Rate Schedules

Dear Mr. Roberts:

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

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

Thank you for your attention to this matter.

Sincerely yours,

Marc Poston

Marc Poston
Senior Counsel
(573) 751-8701
(573) 751-9285 (Fax)

MP/jb
Enclosure
cc: Counsel of Record

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

FILED
OCT 15 1999
Missouri Public
Service Commission

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

INITIAL BRIEF OF THE STAFF OF THE MISSOURI PUBLIC SERVICE COMMISSION

Submitted by:

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

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

42

TABLE OF CONTENTS

Before The Public Service Commission
OF THE STATE OF MISSOURI

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

INITIAL BRIEF

I. PROCEDURAL HISTORY

On January 26, 1999, Laclede Gas Company (Company) submitted to the Commission tariff sheets reflecting increased rates for natural gas service provided to the Company's Missouri customers. The proposed tariff sheets, assigned tariff number 9900536, bear a requested effective date of February 26, 1999 and were designed to produce an annual increase of approximately 6.1 percent ($30.5 million) in the Company's revenues.

The Commission suspended the effect of the tariff sheet rates for 120 days plus six months setting up this case. The following parties thereafter sought and were granted intervention: Missouri Industrial Energy Consumers (Adam's Mark Hotels, Alcoa Foil Products, Anheuser-Busch Companies, Inc., The Boeing Company, Ford Motor Company, General Motors Corporation, Hussmann Refrigeration, MEMC Electronic Materials, Inc., Monsanto Company, Paulo Products Company, Proctor & Gamble Manufacturing Company and Ralston Purina Company), Union Electric Company, d/b/a AmerenUE, MRT Energy Marketing Company, Oil, Chemical & Atomic Workers, Local 5-6, Barnes-Jewish Hospital, Daimler Chrysler Corporation, Emerson Electric Company, and SSM HealthCare. The Commission set the test year for purposes of this case to be the twelve months ending on December 31, 1998, updated for known and measurable changes through March 31, 1999. After a true up audit, updates were made to certain items as of August 1, 1999. In the Proposed List of General Issues filed July 19, 1999, Staff for the Commission (Staff) listed for decision by the Commission, the issues following:

1. Rate Base Issues: Accounting Authority Orders/Trackers, Cash Working Capital;
2. Income Statement Issues: Accounting Authority Orders/Trackers, Depreciation, Weather, Advertising, Appliance Repair/HVAC, Y2K Costs, Capacity Release/Off-System Sales Revenue;
3. Rate of Return Issues: Return on Equity, Capital Structure;
4. Rate Design Issues: Class Cost of Service, Gas (Supply) Cost Removal From Base Rates, Capacity Charge, MEIC Issue on Daily Balancing, Seasonal Air Conditioning/Structure;
5. Tariff Issues: Tariff Language for Off-System Sales, Insulation Financing Program, Service Territory Descriptions.

Prior to the conclusion of the evidentiary hearing in this case, the parties negotiated settlement of a number of the foregoing issues (subject to Commission review and approval) leaving only the following contested issues unresolved:

1. What is the return on common equity Laclede should receive,
2. What level of short-term debt should be included in capital structure,
3. What are the appropriate depreciation rates,
4. What revenue collection lag should be used to determine the cash working capital requirement,
5. How should the revenue from capacity release and off-system sales be included in the cost of service,
6. What is the appropriate tariff language regarding off-system sales revenue,
7. What level of detail describing the Company's service territory should be included in Laclede's tariff,
8. When a safety replacement program accounting authority order (AAO) for the Company should expire if the Company has not sought rate relief relating to that AAO; and
9. Which advertising expenses should be included in cost of service.

II. RATE OF RETURN

The standard used across the nation today to determine what constitutes a fair rate of return was established in the 1923 U.S. Supreme Court case of *Bluefield Water Works and Improvement Company vs. the PSC of West Virginia*, 262 U.S. 679 (1923). That case established the key elements of what constitutes a fair rate of return and found it to be a return that:

1. Is generally being made at the same time in that general part of the country.
2. Is achieved by other companies with corresponding risks and uncertainties.
3. Is sufficient to assure confidence in the financial soundness of the utility.

A. The Staff's 9.0%-10.0% Return on Equity

The testimony before the Commission of Staff witness David Broadwater follows the *Bluefield* standards precisely, while the testimony of Laclede's six rate of return witnesses departs from the Supreme Court's decision. In calculating the recommended cost of equity range between 9.0% and 10.0%, Staff measured its calculation against the key elements of the *Bluefield* decision and Staff's return on equity range easily meets the criteria set forth by the Supreme Court. The model selected by Staff to determine the appropriate range for Laclede was the discounted cash flow (DCF) model. The DCF model is the standard used by regulatory commissions across the country, and more importantly, it is commonly used by this Commission as the standard return on equity determinant. When used properly, the DCF model calculates a return on equity that is inherently capable of attracting capital. As stated in Mr. Broadwater's direct testimony, "the DCF model is a reasonable working model describing an actual investor's expectations and resulting behaviors." (Broadwater Direct, P. 26, L. 4).

B. Staff's DCF Calculation

The DCF formula states that the return on equity is equal to the expected dividend yield plus the expected growth in dividends continuously summed into the future. This addresses one of the key elements of *Bluefield* – a fair rate of return must be sufficient to assure confidence in the financial soundness of the utility. The DCF model calculations performed by the Staff produced a return on equity that will meet an investor's expectations now and into the future. The calculations for the expected dividend yield and the expected growth need to be analyzed separately to assure the Commission that the Staff's proposed 9.0% to 10.0% return on equity was carefully and properly performed to assure confidence in the financial soundness of Laclede.

In calculating the expected dividend yields, the Staff wanted to avoid effects caused by daily volatility in the stock market. Staff used Laclede's monthly average high/low market price of its stock to allow for this fluctuation. Next, the Staff determined Laclede's estimated common dividend declared per share as reported in *The Value Line Investment Survey: Ratings & Reports.* By combining the expected dividend per share with the average market price range, the result is an accurate dividend yield that will be expected by investors. (Broadwater Direct, P. 27, L. 6).

To calculate the growth rate investors will expect of Laclede, the Staff analyzed Laclede's *actual* dividends per share (DPS), earnings per share (EPS), book value per share (BVPS), and the *projected* growth rates for Laclede. The Staff utilized three outside sources to determine the projected growth rates; I/B/E/S Inc.'s *Institutional Brokers Estimate System,* Standard & Poor's Corporation's *Earnings Guide,* and *Value Line's Investment Survey; Ratings & Reports.* By combining the average of the historical DPS, EPS, and BVPS with the projected growth rates of the three outside sources, the result is a reasonable growth rate that is accurately applied to the DCF calculation. With the dividend yield and the growth rate carefully calculated, the DCF model produced a resulting return on equity that is specific to Laclede.

The next step in the Staff's calculations was to determine the reasonableness of the 9.0% to 10.0% DCF model output. Staff checked the reasonableness of its range using the risk premium analysis. This analysis calculates the return on equity by adding a premium for risk to a current interest rate. Using the Moody's *Bond Rating* and the *Value Line Investment Survey: Ratings & Reports,* Staff found that this analysis produced a return on equity that was 66 basis points from the Staff's range. The similarity in returns indicates that Staff's range was reasonably calculated and produced a reasonable result.

In addition, Staff performed another check on the reasonableness of its recommended return on equity to show that this range will assure confidence in the financial soundness of Laclede. Staff used the Capital Asset Pricing Model (CAPM) to identify the rate of return that investors expect. As outlined in Mr. Broadwater's direct testimony, the CAPM analysis indicates that a 9.08% to 9.65% cost of equity is appropriate for Laclede. (Broadwater Direct, P. 30, L. 20). This range is easily within Staff's proposed range and is further support for the reasonableness of Staff's range.

As required under the *Bluefield* analysis, the Staff performed a cost of equity analysis on other natural gas companies with corresponding risks and uncertainties. A known method of comparing the cost of equity is to apply the same model (in this case, the DCF model) to other natural gas distribution companies. That is exactly what Staff did when it determined that comparable gas distribution companies produce a cost of equity range that overlaps Staff's proposed 9.0% to 10.0%. An additional CAPM check on these companies supported the Staff's range. (Broadwater Direct, p.33, line 18). Staff even checked its numbers by performing an additional analysis of the reasonableness of the comparable company range. By using a market-to-book ratio comparison, Staff's calculations indicate that a return on equity of 9.0%, the low-end of Staff's range, would produce a market-to-book value of 1.0. A 1.0 market-to-book value is a clear indication that investors are satisfied with the potential returns on their investment. (Broadwater Rebuttal, P. 35, L. 6). This establishes that the Staff's 9.0% to 10.0% range is supported by the returns expected by investors in Laclede's comparable companies, and is sufficient to assure confidence in the financial soundness of Laclede.

Mr. Broadwater's testimony offers evidence that the economic environment in which Laclede operates will remain to one of low inflation, low interest rates and low unemployment. (Broadwater Direct, p. 37, line 19). This further assures the Commission that a return on equity within the Staff's range is within the guidelines established by *Bluefield* and will allow Laclede the opportunity to earn the revenue requirement developed in this case.

C. Laclede's 12.75% Return on Equity

Laclede named three tests that it used in its recommendation of a 12.75% return for Laclede. The obvious defect with Laclede's analysis is that the Company apparently believed that these recognized tests were all three producing inaccurate results. Accordingly, Laclede found it necessary to adjust each test's results to reach what it found to be an accurate number. On two of the tests, Laclede raised the return on equity results that the tests produced from 10.75% to 11.25% and from 10.5% to 13.6%. Each adjustment that Laclede used to change the numbers it produced when it ran the tests represents a significant flaw in Laclede's analysis.

Laclede adjusted its DCF analysis output by 310 basis points by use of a market to book adjustment. (McShane Direct, P. 19, L. 18). As Mr. Broadwater pointed out in his rebuttal testimony, this Commission in the past has rejected this very adjustment. (Broadwater Rebuttal, P. 3, L. 9). For more than 20 years the DCF model has been used as the primary tool to determine Laclede's return on common equity without a market to book adjustment. During that time the expectations of Laclede's stockholders were met, but Laclede now finds it necessary to make this adjustment today to support a return of 12.75%. The only reason Laclede makes this adjustment is to move the on equity upward, and Ms. McShane states that a market to book adjustment is necessary to make this upward change. However, this very adjustment is being used incorrectly pursuant to one of the very authorities that Ms McShane cites in her testimony. In her Direct Testimony, Ms. McShane's uses the text *Regulatory Finance: Utilities' Cost of Capital* by Dr. Roger Morin as a finance authority. (McShane Direct, P. 16, L. 7). What Ms. McShane overlooked in Dr. Morin's text is the section in which Dr. Morin addressed the issue of making this market to book adjustment. Dr. Morin states that this adjustment should only be made where the regulatory body has *sanctioned* a difference between the market price and book value. (Tr. 111, L. 11-25). This Commission has not sanctioned a market to book difference. Therefore, according to Ms. McShane's authority, Laclede's adjustment to its DCF analysis is improper.

The Company also believed that its Equity Risk Premium analysis needed an upward adjustment to account for flotation costs. (McShane Direct, P. 14, L. 18). There are two deficiencies in this adjustment – one, flotation costs are already built into the case on a dollar for dollar basis; and two, flotation costs would exist under the DCF test. Laclede chose to adjust for flotation costs in the Equity Risk Premium test alone.

The last test that Laclede performed was the comparable earnings test. Following the *Bluefield* decision, a public utility is allowed a return consistent with the returns achieved by other companies with corresponding risks and uncertainties. Laclede's testimony on the corresponding risks and uncertainties of "comparable" companies, however, tries to convince us that companies such as Hershey Foods, Briggs & Stratton, and PepsiCo are companies that have risks and uncertainties comparable to those of a regulated public utility such as Laclede. (McShane Direct, Schedules 6 and 7). Following the *Bluefield* decision, "a fair return is said to be a return achieved by other companies with corresponding risks and uncertainties."

(Broadwater Rebuttal, P. 5, L. 7). If the Commission looks at the testimony of Laclede's consultant Kathleen McShane, Laclede admits that the industrials it chose in its comparable earnings test have a higher risk than Laclede. (McShane Direct, P. 11, L. 12). Ms. McShane made this statement after an earlier conclusion in her testimony that the chosen companies were "comparable." (McShane Direct, P. 10, L. 26). Furthermore, Laclede is less risky than their sample LDCs, "as indicated by the average beta of the sample of 0.59 verses 0.55 for Laclede." (Broadwater Rebuttal, p. 8, line 6).

Instead of using comparable companies, Laclede used these more risky industrials to justify an adjustment to account for the differences between Laclede and the companies it used. Had Laclede used comparable companies in its analysis, it would not have needed to adjust the results of its comparable earnings test. Staff, on the other hand, used the tests according to accepted practice and the tests produced a 9%-10% return on equity range that did not need adjusting to account for some inherent inaccuracy in the test itself or an inaccuracy in the manner in which the test was used.

Laclede also inflated its calculated return on equity by measuring *earned returns,* not returns required by investors. As discussed in the Rebuttal testimony of Mr. Broadwater, it is "extremely likely that several of the companies in Ms. McShane's group of 35 low risk industrials earned a return in excess of their required return." (Broadwater Rebuttal, P. 5, L. 15).

It is clear that Laclede would like to reap the benefits of operating as a regulated monopoly that has the option of requesting a rate increase along with the benefits of operating as a competitive company that has the opportunity to earn a return on equity equal to the industrials in the S&P 500. Laclede's method of determining its requested return on equity is a departure from accepted practice. Allowing Laclede a return on equity anywhere outside the Staff's range would also be a departure from the financial theories that are the underlying basis for the return on equity tests used by the parties in this case and those that have been historically accepted by the Commission.

Laclede attempts to justify its position by reasoning that Laclede's stock price has not moved in harmony with the stock prices of the companies on the S&P 500 over the past five years. What this argument fails to mention is that the S&P 500 consists mainly of industrial companies and not monopolies like Laclede, a point that was conceded to by Laclede witness Douglas H. Yeager. (Tr. 70, L. 5). Additionally, the manner in which an investor receives the gain from a regulated utility investment is different than the manner in which the gain is received from an investment in an industrial company such as those in the S&P 500. Investors earn their gains for a utility largely through dividends, while an investor in an S&P Industrial receives their earnings primarily through capital gains. This is a clear indication of the difference in risk between utilities and industrials, and an indication of the problem in trying to make the comparison as Laclede has done in this proceeding. One of the fundamental principles of finance is that a dollar earned today (such as through a utility dividend) is worth more to an investor than a potential dollar earned in the future (such as through an industrial capital gain when a security is sold). (Tr. 413, L. 21). Accordingly, the risk associated with an investment in an S&P industrial company is higher than the risk associated with an investment in a regulated utility.

The Supreme Court in *Bluefield* held that a return should be sufficient to assure confidence in the financial soundness of the utility. A proper application of the DCF model does exactly that. It calculates an investor's required return on equity from the company. Staff asks that the Commission not accept the notion that the method of calculating an appropriate return on equity is as confusing and always in need of adjustment as Laclede would like the Commission to believe. The Staff's proposed return on equity is fair for both the Company's stockholders and the ratepayers. Laclede's request for a 12.75% return on common equity is "merely an attempt by the Company to artificially increase its allowed return." (Broadwater Rebuttal, P. 3, L. 16). The effect of authorizing a 12.75% return on common equity will be to allow Laclede's investors to earn more than what Laclede's investors require, to the detriment of Laclede's ratepayers. (Broadwater Rebuttal, P. 4, L. 1).

III. CAPITAL STRUCTURE

The Staff takes a very reasonable approach respecting Laclede's capital structure and in particular, the contested issue regarding Laclede's short-term debt. The Staff simply averaged the daily short-term debt balance experienced during the last 12 months, less the monthly construction work in progress balance. Laclede is arguing that this level of short-term debt should be adjusted downward to reflect the issuance of debt and equity which occurred in May and June of 1999. A downward adjustment is contrary to the obvious upward trend that has occurred over the past 3-½ years as shown in Mr. Broadwater's testimony. (Broadwater Rebuttal, P. 7, L. 2). In addition, Laclede's projected cash flow analysis indicates that this upward trend will continue into the future. This upward trend is supported by the results of the Staff's true-up which showed a higher average balance of short-term debt for the twelve months ending July 30, 1999, the end of the true-up period, than was experienced during the twelve months ending March 31, 1999, the end of the update period. (Broadwater True-Up, Schedule 3). Whatever effect the debt and equity issuances had on the average balance of short-term through the end of the true-up period, the twelve months ending July 31, 1999, has been included by the Staff in its true-up calculations.

IV. ACCOUNTING AUTHORITY ORDER DURATION

For purposes of this case the parties have agreed, subject to Commission approval, that the costs of the Company's safety replacement program of the Company should be deferred by means of an accounting authority order issued by the Commission, i.e., the parties have agreed these costs are extraordinary. The parties have not agreed on when that order should expire. The parties have resolved, through settlement subject to Commission approval, all other accounting authority orders the Company sought in its original filing.

In the consolidated cases of *In the matter of the application of Missouri Public Service for the issuance of an accounting order relating to its electrical operations*, Case No. EO-91-358, and *In the matter of the application of Missouri Public Service for the issuance of an accounting order relating to its purchase power commitments*, Case No. EO-91-360 (*MPS*), 1 MoPSC 3rd 200, the Commission pointed out that a request for an accounting authority order (AAO) is a request to defer costs to a later period. *Id.* at 202. The Commission stated that an AAO contravenes traditional ratemaking based upon an historical test year because the costs deferred with the AAO arise from a period preceding the test year. *MPS,* 1 MOPSC 3rd *at* 205. The Commission addressed the time limitation on AAOs (deferrals) in *MPS.* There the Commission stated:

> The Commission finds that a time limitation on deferrals is reasonable since deferrals cannot be allowed to continue indefinitely. The Commission finds that a rate case must be filed within a reasonable time after the deferral period for recovery of the deferral to be considered. For purposes of this case the Commission finds that twelve months is a reasonable period. This limitation accomplishes two goals. First, it prevents the continued accumulation of deferred costs so that total disallowance would not affect the financial integrity of the company or the Commission's ability to make the disallowance; and secondly, it ensures the Commission a review of those costs within a reasonable time. If the costs are truly extraordinary, recovery in rates should not be delayed indefinitely. A utility should not be allowed to save deferrals to offset against earnings in some future period.

MPS, 1 MoPSC *at* 206. It is Staff's position that "[a]n AAO should be viewed as a mechanism to partially mitigate regulatory lag between rate cases, not as a substitute for or a means to avoid a rate case. (Exhibit 83, P. 3, L. 14-16). Although stated in response to company raised grounds for finding extraordinary circumstances to create an AAO, the following analysis used by the Commission in *MPS* is also relevant to determining the reasonable duration of an AAO:

> Avoidance of rate case expense is a beneficial goal since it reduces the cost of doing business, but delaying rate cases just to avoid rate case expense should not be used as an excuse to defer costs that are attributable to normal operations of a company. The benefit gained will not necessarily outweigh the increased rates caused by the deferral.
>
> Lessening the effect of regulatory lag by deferring costs is beneficial to a company but not particularly beneficial to ratepayers. Companies do not propose to defer profits to subsequent rate cases to lessen the effects of regulatory lag, but insist it is a benefit to defer costs. Regulatory lag is a part of the regulatory process and can be a benefit as well as a detriment. Lessening regulatory lag by deferring costs is not a reasonable goal unless the costs are associated with an extraordinary event.
>
> Maintaining the financial integrity of a utility is also a reasonable goal. The deferral of costs to maintain current financial integrity, though, is of questionable benefit. If a utility's financial integrity is threatened by high costs so that its ability to provide service is threatened, then it should seek interim rate relief. If maintaining financial integrity means sustaining a specific return on equity, this is not the purpose of regulation. It is not reasonable to defer costs to insulate shareholders from risks. If costs are such that a utility considers its return on equity unreasonably low, the proper approach is to file a rate case so that a new revenue requirement can be developed which allows the company the opportunity to earn its authorized rate of return. Deferral of costs just to support the current financial picture distorts the balancing process used by the Commission to establish just and reasonable rates. Rates are set to recover ongoing operating expenses plus a reasonable return on investment. Only when an extraordinary event occurs should this balance be adjusted and costs deferred for consideration in a later period.

Because AAOs defer costs to a later period, for all the grounds stated above, the duration of an AAO should be minimized to avoid excessively aggregating the costs deferred into the future period, to minimize the perturbation to traditional ratemaking theory and practice, and to facilitate auditing. (Exhibit 83, P. 3, L. 10-14).

The Company has proposed a three-year deadline for requesting an extension of the AAO with monitoring by Commission Staff during that three-year period. (Exhibit 8, P. 7, L 3-13).

However, the Company's proposal could increase the deadline for filing for a rate increase to recover safety deferrals to four years. (Exhibit 83, P. 4, L. 16-18). The Company has made no record stating reasons explaining why this proposal is more reasonable than the past Commission practice of two years duration, which the Staff has recommended. (Exhibit 81, P. 10, L. 12-14). Imposing a deadline of two years is a simple straightforward means of providing certainty, clarity and minimal oversight by the Commission while giving the Company a generous period of time in which to accrue deferrals and to determine if it will seek rate relief for the safety replacement program costs it defers. As the Company admits, the requirement that it file a rate case within two years following the date an AAO issues to qualify for recovery of the deferral, has been a requirement of past AAOs. (Exhibit 8, P. 7, L. 4-5). Additionally, the Company will have the ability to seek another AAO, an extension or other relief without filing a rate case. (Exhibit 83, P. 3, L. 17-20).

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

V. CASH WORKING CAPITAL – COLLECTION LAG

It is Staff's position that the collection lag component of cash working capital be 25.4 days. The collection lag is the period of time between the day the bill is placed in the mail by the company and the day the company receives payment from the ratepayer for services rendered. (Tr. p. 655). Staff utilized a sample of customer billing records from Case No.GR-98-374. (Tr. p. 659). The collection lag for the current case was computed by weighting the number of days that amounts billed for services were outstanding for each individual customer in the sample. Based on this calculation, Staff determined that the proper collection lag was 25.4 days.

Laclede's position is that the collection lag should be 34.8 days. A lag of 34.8 days is nearly twice as long as the collection lag produced when it is assumed that all customers pay their bills within the delinquent period. (Griggs Rebuttal, Ex. 85, p. 2)

Laclede criticized Staff for not including uncollectable accounts in the collection lag. However, it is Staff's position that uncollectable accounts should not be included in the collection lag. "Including customers whose accounts are uncollectable in the sample would, in effect, allow a return on bad debts, a non-cash item, in cash working capital. [Laclede] is compensated for the effect of bad debts through an allowance for this item as an expense." (Griggs Surrebuttal, Ex. 86, p. 5, Lines 15-18). Further, in response to allegations by Laclede that Staff's sample did not properly weight certain classes of customers, Staff recalculated the sample based on Laclede's information and determined that the difference created was less than a day. (Griggs Surrebuttal, Ex. 86, p. 5 and 6). Laclede also questioned the statistical validity of Staff's sample, however, Laclede produced no statistical analysis that Staff's sample was not statistically valid. (Griggs Surrebuttal, Ex. 86, p. 2)

Staff also contends that its position is far more reasonable than Laclede's. The collection lag proposed by Staff is similar to the collection lags calculated in Laclede's previous rate cases, GR-94-220 and GR-96-193 (Griggs Surrebuttal, Ex. 86, p. 2). Staff's proposed collection lag is also closer to the average number of days before a bill becomes delinquent, 19.4 days. (Griggs Direct, Ex. 84, p. 7, Griggs Surrebuttal, Ex. 86, p.2). It should also be noted that no other utility company, electric or gas, has sponsored a collection lag greater than 21 days. (Tr. p. 700).

The collection lag sponsored by Staff is consistent with the collection lag in Laclede's previous rate cases, is more closely related to when Laclede's customers' bills become delinquent, and is more consistent with what other utility companies experience. Laclede produced no statistical evidence that Staff's sample was not appropriate, and did not produce any evidence that Staff's weighting of the sample produced significant errors.

VI. ADVERTISING EXPENSES

The parties have no agreement as to which test year advertising expenses should be included in the Company's cost of service for ratemaking purposes. The Company originally took the position that **all** advertising expenses should be included in cost of service so long as they do not in the aggregate exceed a preset percentage, presumably Commission determined, of the total gross revenues of the Company. (Exhibit 20, P. 7, L. 11; Exhibit 21 P. 3, L. 12 to 4, L. 2). The clear implication from the Company's prefiled testimony was that **all** advertising expenses should be included.

During cross-examination by the Office of the Public Counsel, the Company suggested a preset percentage of 0.5%. (Tr. 719, L. 10-22; Tr. 734, L. 20-24; Tr. 738, L. 16 to Tr. 740, L. 13). The Company further stated that under its proposal only above-the-line advertising costs, not political in nature, would be includable in cost of service. (Tr. 720, L. 11-21; Tr. 730, L. 9-13; Tr. 743, L. 14 to Tr. 744, L. 5). The Company further refined the proposal to include institutional advertising in the allowable advertising, subject only to the preset percentage of revenues limitation. (Tr. 730, L. 14-22). During examination by Commissioner Schemenauer the Company was unable to state how items such as box seats for the Rams or legislative lobbying efforts would be treated under the Company's proposal. (Tr. 746, L. 15 to Tr. 748, L. 8).

The Company disclosed it arrived at a 0.5% advertising limit by dividing all the Company's advertising cost by its total utility revenues to arrive at a current percentage of 0.2%, then adjusting upward. (Exhibit 20, P. 10, L. 4-6; Tr. 750, L. 13 to Tr. 751, L. 8; Tr. 742, L. 14 to Tr. 744, L. 10; Tr. 738, L. 16 to Tr. 740, L. 13). The Company asserts that its proposal is realistic, reliable, predictable and easy-to-apply since it focuses not on categorizing individual advertisements, but on overall levels of advertising expenditures. (Exhibit 20, P. 8, L. 3 to 10, L. 4). Other than a higher limitation the Company's proposal is essentially the "New York Rule" as the Commission applied it in the past. From the preceding paragraph it follows that under the Company's proposal advertising content review will be required to determine whether costs associated with a particular advertisement should be included in cost of service.

As pointed out by Vice-Chair Drainer during the evidentiary hearing in this case, the adoption of a preset limit on advertising costs which may be expended without review which is over double all advertising costs the Company expended in the test year is inconsistent with including in rate base only items which the Commission has determined to be used and useful. Tr. 740, L. 14 to Tr. 743, L. 5. Adopting the Company's proposal could open the door to charges the Commission had abdicated its obligation to assure that only items that are used and useful are included in rate base. Further, the higher the preset limit, the greater the likelihood of such a charge.

Prior to 1986 this Commission followed a procedure nearly the same as that proposed by the Company—the Commission's implementation of the "New York Rule" where all political and promotional advertising was excluded and the remaining advertising was allowed up to a limit of 0.1% of the utility's revenues. *See In the matter of Kansas City Power & Light Company of Kansas City, Missouri, for authority to file tariffs increasing rates for electric service provided to customers in the Missouri service area of the Company, and the determination of in-service criteria for Kansas City Power & Light Company's Wolf Creek Generating Station and Wolf Creek rate base and related issues*, Case No. EO-85-185, and *In the matter of Kansas City Power & Light Company, a Missouri corporation, for determination of certain rates of depreciation*, Case No. EO-85-224, 28 MoPSC (N.S.) 228, 269. The

Commission abandoned its implementation of the "New York Rule" in part because one goal in adopting the rule--eliminating advertisement-by-advertisement review--had not been accomplished. *Id. at* 270. In lieu of the "New York Rule," the Commission began categorizing each advertisement into one of five categories—General, Safety, Promotional, Institutional and Political—based on the primary message of the advertisement. Based on the category into which the advertisement fell its associated cost was included or excluded from the cost of service for ratemaking purposes. *Id. at* 269-276. The five categories are defined as follows:

(1) general—informational advertising that is useful in the provision of adequate service;

(2) safety—advertising which conveys the ways to safely use the regulated commodity or service and to avoid accidents;

(3) promotional—advertising used to encourage or promote the use of the regulated commodity or service;

(4) institutional—advertising used to improve the company's public image; and

(5) political advertising.

See 29 MoPSC (N.S.) *at* 322. Once categorized, the reasonable cost of general and safety advertisements are includable in cost of service, the cost of institutional and political advertisements are not includable in cost of service and the cost of promotional advertisements are includable only to the extent they are cost justified, i.e., the shown benefit outweighs the cost thereof. *See* 28 MoPSC (N.S.) *at* 270-71.

The Commission has continued to use these five categories for advertising applying them in at least the following cases: *The Staff of the Missouri Public Service Commission, Complainant, vs. Union Electric Company, Respondent*, Cases Nos. EC-87-114 and EC-87-115 29 MoPSC (N.S.) 313, 322; and *In the matter of Missouri Public Service for authority to file* *tariffs increasing rates for electric service provided to customers in the Missouri service area of the company; In the matter of the application of Missouri Public Service for issuance of an accounting order relating to its electrical operations; In the matter of the application of UtiliCorp United Inc. d/b/a Missouri Public Service for authority to implement revised depreciation rates for its electric properties; and In the matter of the application of UtiliCorp United Inc. d/b/a Missouri Public Service for authority to initiate a late payment charge on delinquent customer bills for electric service*, Cases Nos. ER-90-101, EO-90-114, ER-88-167 and ER-90-268, 30 MoPSC (N.S.) 320, 327.

The Staff applied this Commission approved categorization of advertisements procedure to determining which of the Company's advertising costs should be included in the cost of service for ratemaking purposes. (Exhibit 87, P. 3, L. 6 to P. 4, L. 19). The Office of the Public Counsel also applied the five categories procedure in determining which advertising costs should be included in cost of service. (Exhibit 50, P. 2, L. 7 to P. 3, L. 19). With the exception of the advertisement shown as Schedule No. 2-13 which Staff reclassified as a general advertisement (Tr. 824, L. 3-12), Schedule 2-1 of Exhibit 87 sets forth Staff's categorization of the Company's advertisements. With the exception of three advertisements which Staff categorized as below-the-line (Schedules Nos. 2-33, 2-35 and 2-36) and which the Office of the Public Counsel categorized as promotional, the Office of the Public Counsel also by the time of hearing had placed each of the Company's advertisements in the same category as had the Staff. Schedule KKB-6 of Exhibit 51. Because the Office of the Public Counsel did not include any promotional advertising in cost of service (Exhibit No. 50, P. 5, L. 1-10), the difference in categorization of these items by the Staff and the Office of the Public Counsel had no impact on which advertisement costs were included in cost of service for ratemaking purposes.

All parties agree that under the five categories procedure, the Company had no political advertising. (Schedule 2-1 of Exhibit 87; Schedule KKB-6 of Exhibit 51; Tr. P.720, L. 25 to P. 721, L. 1; Exhibit 20, P. 10, L. 19). The parties also are in agreement as to which advertisements should not be included in cost of service because they are directed to unrelated unregulated activities of the Company (classified as below-the-line). (Schedule 2-1 of Exhibit 87; Schedule KKB-6 of Exhibit 51; Tr. P.720, L. 25 to P. 721, L. 1). The Company does not dispute the categorization by the Staff or the Office of the Public Counsel of advertisements as general or safety. The Company does dispute the omission of advertisements classified as institutional from cost of service as well as those classified as promotional arguing it has shown justification for inclusion of those advertisements in cost of service by establishing benefit to consumers and, for advertisements classified as promotional, by establishing benefits to consumers exceed costs. (Exhibit 20, P. 11, L. 14-21; Exhibit 21, P. 4, L. 8-11; Tr. 745, L. 6-10.)

The Staff disagrees. In support of its position that the benefits of promotional advertising exceeded costs thereof, the Company states that it helps in increasing the customer base and provides information not readily available elsewhere. (Exhibit No. 21, P. 5, L. 4-9). The Company then sets forth a number of hypotheticals based on unsupported assumptions purporting to demonstrate economic impacts of these factors. (Schedule 2 attached to Exhibit No. 21; Tr. 724, L. 9 to Tr. 728, L.15). The Company relies upon a 1990 survey as support for its position that ratepayers benefit from the Company's advertising. (Exhibit 21, P. 6, L. 6 to P. 7, L 5; Schedule 3 attached to Exhibit 21.) In addition to the staleness of the survey, there is no indication of the validity of the results thereof in terms of absence of bias in the questions used or those conducting the survey. Further, the sample population of those who had chosen to keep or install gas service brings into question the survey results. (Exhibit 21, P. 6, L. 14-19).

Importantly, no statistical correlation between the Company's advertising and customer choice of using gas service was presented in the survey results disclosed to the Commission. All these factors call into the question the utility of the survey for purposes of establishing benefit to ratepayers through the Company's advertisements. It appears to Staff the survey is directed more to justifying an advertising budget than to establishing a benefit to ratepayers. The Company's argument that advertising is responsible for increased revenues to the Company from service work demonstrates that the benefits to ratepayers from the Company's advertising outweighs its costs is misdirected. (Exhibit 21, P. 7, L. 18 to P. 8, L. 15). While the assertions may support that advertising can be effective and that the Company has derived an economic benefit, they do not demonstrate the benefit exceeds costs. Although the Company may have made some attempt to demonstrate the benefits of its promotional advertising exceeds the cost associated with them, it is the Staff's position that the Company still has not satisfied the requirements established by this Commission in 1986.

For all the foregoing grounds, the Staff recommends the Commission reject the Company's proposal of allowing advertising costs up to a preset percentage of its revenues without review and accept the Staff's proper categorization of the advertisements and allow in expense the costs associated with them under the criteria the Commission established in *Kansas City Power & Light Company*, Case No. EO-85-185.

VII. DEPRECIATION

A. Calculation of Net Salvage

The depreciation rates sponsored by Staff's witness Paul Adam "will, with reasonable accuracy, charge Laclede's customers annually for a net salvage amount, equal to, or nearly equal to, the amount Laclede is spending annually for net salvage." (Adam Surrebuttal, Ex. 94, p. 4, lines 19-21). Laclede's proposed calculation of net salvage will result in the customers paying, through rates, approximately $2.3 million (Tr. p. 861, line 9) more for depreciation annually than the customers would pay under Staff's depreciation rates.

Both Staff and Laclede use a formula known as the whole life formula to calculate depreciation rates. For purposes of looking at this case, the whole life formula can be separated into two pieces: the recovery of capital cost and the recovery of net salvage. Recovery of capital cost is the recovery of a one time capital expense over the used and useful life of the plant. (Tr. P. 844-845). Recovery of net salvage is the recovery of an annual expense, primarily the annual cost of removal experienced by the company for plant retired and removed from service. Whole life depreciation rates are calculated by subtracting net salvage from the capital cost and dividing by the average service life for each account. The parties have agreed upon an appropriate calculation for the capital cost recovery component of the formula. The dispute concerns only the method of calculating the net salvage portion of the formula.

Net salvage consists of the gross salvage value of the property after removal, less the cost of removal. When the depreciation formulas were developed in the 1920's and 1930's, the gross salvage value was slightly greater than the cost of removal. This produced a small positive number and therefore, reduced the depreciation rate slightly. However, in the last decade or so, the cost of removal has increased to the point where it is often substantially in excess of the gross salvage value, which results in the net salvage being a negative number. When the cost of removal is in substantial excess of the gross salvage value, it greatly increases the depreciation rate. Negative net salvage is an annual expense that, in many accounts, exceeds the capital recovery component calculated by the whole life formula. (Adam Direct, Ex. 92, P. 8). It should be noted that cost of removal has become large in recent years while gross salvage approaches zero for many accounts. Therefore, depreciation engineers frequently refer to negative net salvage as cost of removal.

Mr. Adam, in preparing for GR-98-374, reviewed various Laclede depreciation accounts. In reviewing the smaller accounts, Mr. Adam noticed that the amount generated by Laclede's proposed rates "[were] going to be significantly greater than what the current net salvage was..." (Tr. p. 891, L. 21-23). For a smaller account, Mr. Adam, using Laclede's rates, determined that the Company would collect $23,900 a year from customers for negative net salvage when the Company only averaged approximately $11,000 a year for negative net salvage over the previous five years. (Tr. P. 927). When Mr. Adam looked at a larger account, such as services, the difference, between what the Company would collect from customers and what the Company was expending annually, increased. Using depreciation rates proposed by Laclede, the Company would recover $986,000 annually for negative net salvage for the services account. However, Mr. Adam noted that "there was only one year when [Laclede] spent over $500,000 [during the past 15 years], so it - - indicated to me ... that ... using the five-year average on the percentage would result in an accrual that was [about] $500,000 more annually than was being spent for total negative net salvage." (Tr. P. 928, L. 17-22).

As previously stated, Staff contends that the cost of removal is an annual expense for the company, unlike the portion of the formula that recovers the one time capital expense over the used and useful life of the property. Mr. Adam formulated a net salvage rate for each account that would reflect the amount spent on negative net salvage annually not an estimate calculated from ratios as Laclede is proposing. (Adam Surrebuttal, Ex. 94, P. 4). If Laclede's depreciation rates are used, the Company will recover, through customer rates, $2.3 million more a year than they are currently expending for cost of removal (negative net salvage).

Laclede and its consultant advocate rates that recover more than the Company currently expends for cost of removal (negative net salvage). Laclede suggests, that at some unspecified year in the future, the company will have cost of removal expenses that exceed the amount of the then net salvage accrual, thus compensating for the $2.3 million over recovery in each year currently. It is unreasonable to expect that Laclede will, at some future date, find that their actual cost of removal (negative net salvage) is greater than what the customers are paying through rates, but remind the Commission that no depreciation rate increase is necessary because Laclede has collected the dollars needed from their customers in preceding years.

Staff's proposed negative net salvage rates allow Laclede to collect from its current customers an amount that approximates what Laclede currently expends for cost of removal. Laclede's proposed negative net salvage rates require customers to pay $2.3 million more a year than what Laclede currently needs to remove retired plant from service.

B. Gas Holders

Staff's proposed depreciation rate of zero percent recognizes that Laclede has over recovered their capital investment in the four Gas Holders, that there is no expected interim net salvage and that the current customers should not pay for final removal of the Gas Holders until Laclede takes a non-reversible action toward the removal of any of the four Gas Holders. (Adam Surrebuttal, Ex. 94, p. 2). Laclede has requested that the cost of final removal for the Gas Holders be depreciated over the next ten years, but makes no commitment what so ever that it will incur those costs in the next ten years. The issue before the Commission is whether the final removal costs for the Gas Holders should only be recovered once Laclede has taken non-reversible action toward the removal of any of the four Gas Holders or if the final removal costs should be recovered in depreciation rates over the next ten years, with no guarantee that the Gas Holders will be removed in ten years or at any other time in the foreseeable future.

Based on the data obtained from Laclede, not only have the capital costs of the Gas Holders been fully recovered (Tr. Adam Rebuttal, Ex. 93, p.4), Laclede has collected $65,000 more than the original capital costs plus any interim retirements. (Tr. p. 912). In the past 30 years, Laclede has "spent something like $59,000", cumulative, or less than $2,000 per year on average, for interim retirements for Gas Holders. (Tr. p. 917, L. 15-16). Therefore, Laclede's over recovery would be adequate to cover, on average, interim retirements in this account for the next 30 years.

Nor is this Laclede's first request that the cost of final removal of the Gas Holders be depreciated "over the next ten years." The same plea was made in 1996 and 1998 as well. However, the only movement that Laclede has made toward the removal of the Gas Holders in the last three years has been to obtain an estimate on the cost of removal for the Gas Holders, and that took place in April 1998. (Tr. p. 832). Further, Laclede has not even determined if the Gas Holders are no longer needed for its operations. (Tr. p. 832). Staff has seen no commitment by the Company to actually retire the Gas Holders. (Adam Rebuttal, Ex. 93, pp. 3 and 4).

Laclede has requested that the Commission depreciate the cost of removal, as determined by the estimate obtained in 1998, over the next ten years. Laclede witness Mr. Kotteman admitted that the removal of the Gas Holders must be approved by at least the executive vice-president level, if not by the president of the Company. (Tr. p. 833). Mr. Kotteman also stated that there has been no decision by Laclede's executives when the Gas Holders will be removed. (Tr. p. 834).

Staff also has concerns that the longer Laclede waits to remove the Gas Holders, the more expensive it will become. Several years ago when Laclede last removed a Gas Holder, the net cost for removal was $1.00; now the estimate to remove the four Gas Holders is approximately $1,000,000 each. (Adam Direct, Ex. 92, p. 12) These costs may continue to grow or could decrease. (Tr. p. 914). If they were to decrease prior to removal, then Laclede's proposal would over recover these costs from the Company's current customers without a method for reimbursement.

Staff's position on the Gas Holders is not that Laclede cannot ever recover some portion of the cost of final removal. On the contrary, Staff supports the granting of an amortization to the company to recover reasonable costs, once Laclede makes a binding commitment to remove any of the Gas Holders. However, as the capital costs of the Gas Holders have been fully depreciated, and there is no firm commitment by Laclede to remove those Gas Holders, Staff opposes including the final removal costs of the Gas Holders in depreciation rates at this time.

VIII. OFF-SYSTEM SALES AND CAPACITY RELEASE

The Staff requests that the Commission approve the Staff's proposed off-system sales purchase gas adjustment ("PGA") tariff language (Imhoff Direct, Ex. 97, R. 4, L. 4-34) regardless of whether or not the Commission allows Laclede to operate under a gas supply incentive program ("GSIP") now or in the future. If the Commission does not approve the off-system PGA tariff language, Staff's alternate proposal is to impute, in the rate case revenue requirement, off-system sales revenues.

The Staff's proposed tariff language would ensure that ratepayers would receive 100% of all off-system sale revenue and would "specifically define how off-system sales revenues are to be treated and accounted for." (Imhoff Direct, Ex. 97, P. 3, L. 20-21). Under the current underlying tariffs, if there is no GSIP the Company retains all of the profits generated by off system sales transactions. Laclede uses firm transportation contacts and firm gas supply contracts to enter into off-system sales transactions. However, Laclede's captive ratepayers, through the actual cost adjustment ("ACA")/PGA process, fund the transportation reservation and gas supply demand charges for those contracts. (Wallis Direct, Ex. 95NP, P. 4). Laclede opposes any change to the tariff that would appropriately credit the ratepayers for these charges.

If the Commission does not approve the off-system sales PGA tariff language, Staff's alternate proposal is to impute, in the rate case revenue requirement, off-system sales revenues.

This amount is approximately $2.5 million. 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. (Wallis Direct, Ex. 95NP, P. 4).

If the proposed tariff language is not approved and the profits from off-system sales transactions are not included in Laclede's revenue requirement, then, absent a GSIP, Laclede will retain 100% of the profits from off-system sales transactions, even though the transactions are funded by the ratepayers through the transportation reservation and gas supply demand charges which the customers pay through the PGA/ACA process. (Wallis Direct, Ex. 95NP, P. 5).

Staff has not addressed capacity release credits in this proceeding because, unlike off system sales profits, Staff maintains that, absent a GSIP, capacity release credits are addressed in Laclede's underlying PGA tariff language which specifies that 100% of all capacity release credits will flow back to the rate payers thru the PGA/ACA process. (Wallis Surrebuttal, Ex. 96, P. 2).

IX. SERVICE TERRITORY DESCRIPTION IN TARIFFS

The Staff proposes that Laclede's tariff should provide an accurate and understandable description of the service area for the general public. Utilities often serve rapidly developing unincorporated areas. Laclede's current tariff has no meaningful description of where it provides service. The tariff does not even explicitly describe the communities and areas in St. Charles County and Jefferson County. Laclede merely says it provides service in those areas where it provides service. (Gray Dir., Ex. 69, P. 21, L. 11-12; Gray Surr., Ex. 71, Sched. 1 and 2).

Listing the county, township, range and section numbers in the tariff provides a convenient source of information for developers, contractors, potential homeowners, government officials and others to determine if a particular utility, in this case Laclede Gas Company, provides service in an area of interest. Staff's approach is not unreasonable, evidenced by the fact that four utilities already provide such descriptions, and a fifth has agreed to do so. (Gray Surr., Ex. 71, P. 6, L. 16 to P. 7, L. 10).

The Staff does not suggest that the tariff descriptions contain metes and bounds legal descriptions, nor that the general reference in the tariff will supercede the service territory description in a Commission-approved certificate of convenience and necessity. The Staff has specifically endorsed a description by exception, e.g., "all of unincorporated St. Charles County except . . . ". Customers are entitled in the tariff to a simple general service area description easily understood by builders, contractors, developers and surveyors, and using a method which has been long used in the United States. *See*, *1 Mo. Real Estate* §3.24 (Mo. Bar 3d. ed. 1986,1988); §60.480 RSMo 1994.

Mr. Difani describes (Tr. pp. 980-1) an exacting process to effect <u>changes in service territories</u> which produces the detail needed to resolve conflicts in overlapping or competing service territories in certificates of convenience and necessity. Staff is not suggesting such detail in the tariffs, nor is Staff suggesting that tariff descriptions are the equivalent of service territory descriptions in certificates of convenience and necessity. Neither Mr. Difani (Tr. 986-9) from AmerenUE, nor Mr. Cline (Tr. 964-6) from Laclede, were aware of the possible existence of readily available resources inside or outside of their companies to provide the information needed for the tariff descriptions. Finally, AmerenUE has had to alter its electric tariffs only fifty times in ten years (Difani Surr., Ex. 103, P. 3, L. 23) in a service territory which encompasses 40% of the entire state of Missouri (Tr. 79), including the fastest growing suburban/rural areas of the state.

The evidence strongly supports the Staff recommendation that Laclede provide a meaningful, understandable, but simple description of its service territory in its tariff. The Commission should so order.

X. TRUE-UP

A. Customer Annualization

Customer annualization is the first of two remaining true-up issues. As stated in the True-Up Testimony of Arlene S. Westerfield and as admitted by Laclede witness James A. Fallert, the Staff and Laclede agreed to the manner in which true-up would be handled for customer annualization. (Westerfield True-Up Testimony, P.1, L 17; Fallert True-Up Testimony, P. 3, L. 11). As agreed, both parties would true-up their revenue annualizations through July 31, 1999 using the originally filed methodologies. As admitted by Mr. Fallert, any differences between Laclede and Staff's annualized, trued-up amounts were to be split. (Fallert True-Up, P. 7, L. 15). Accordingly, the Staff took the true-up data *given to it by Laclede,* and performed its calculations in the same manner it calculated its customer growth revenue adjustments, as updated through March 31, 1999, for its case in chief. The Company was well aware of how the Staff was going to perform its true-up calculation having seen the method in the update of the current case through March 31, 1999 and in the previous case through June 30, 1998. The Staff's true-up process and update process are the same for annualizing revenues for customer growth. (Tr. 1109, L. 4). An estimate was the only method the Staff could use to determine its original true-up amount until all the customer numbers were available to perform the complex calculations required to develop the final trued-up customer growth adjustments. (Westerfield True-Up, P. 3, L. 8). Since the result of the *actual* true-up amount is not what Laclede expected, the Company now wishes to ignore its agreement with the Staff and argue against the methodology that the Staff has used to annualize customer levels in this cases and in the last two Laclede cases. Had Staff's number been what Laclede had expected or hoped for, this matter would have been settled pursuant to the agreed split. Laclede had no dispute with the same methodology in past rate cases and in the settled portion of this case. It was not until

Laclede realized that it was not going to receive the number it wanted, that the Company decided to criticize Staff's methodology. This confirms that Laclede's real problem is with the true-up amounts that were realized through July 31, 1999.

Regarding the True-Up Testimony of Mr. Fallert, the Commission should disregard the number of customers that Mr. Fallert suggests the Staff's adjustment would add. The Staff's true-up amount is for the period between March 31, 1999 and July 31, 1999. Laclede attempts to mischaracterize the Staff's adjustment by suggesting that if 2,645 customers were added during this period, that it implies an annual increase of 7,935 customers. (Fallert True-Up, P. 3, L. 19; P. 5, L. 21). This simple calculation fails to consider that there is a fluctuation of customers coming to and dropping off the system, with large amounts of customers dropping off during the summer months. Under cross-examination, Mr. Fallert conceded that point and admitted that the Company experiences "seasonal patterns" which indicates that Laclede's misleading 7,935 annual customer increase was an attempt by the Company to inflate the number thereby discrediting the Staff's tried and proven methodology. (Tr. 1075, L. 14).

This very assumption that Laclede is using in its attempt to rebut the Staff's methodology is the same assumption that is central in the flawed reasoning of Laclede's methodology. Laclede's methodology assumes that the level of customer change occurring during March 31, 1999 to July 1, 1999 is consistent with the annual level of fluctuation. However, as discussed above, Mr. Fallert admits that customers do not drop off the system evenly throughout the year. Knowing this seasonal difference, Laclede is attempting to lead the Commission away from the actual fluctuation that was realized during the true-up period.

B. Short-Term Debt

The second and last outstanding true-up issue involves the level of the Company's short-term debt as trued-up through July 31, 1999. Just as the Staff was consistent in using the same methodology for customer annualization, the Staff stayed with the same methodology for short-term debt that it agreed to in the Partial Stipulation And Agreement in this case. (Tr. 1096, L. 3). Despite the claims made by Laclede, the only change that occurred is the change between Staff's *estimated* true-up amount that was previously prepared and the *actual* true-up amount that is now at issue. By the nature of what an estimate represents, as testified to by Mr. Broadwater, it is common for an estimated true-up to be different from the amount that is known and measurable following the true-up period. (Tr. 1102, L. 8). The Company finds the Staff's estimate more favorable than the actual true-up because it produced a higher rate of return. Now that the actual levels for all the capital structure components are known, regardless of what the Staff calculated as an estimate, the Commission should only focus on the trued-up amounts. "Since the treatment of short-term debt was an issue heard by the Commission, their decision regarding this item should determine the level of short-term debt included in the capital structure as revised for true-up." (Broadwater True-Up, P. 3, L. 22).

IX. CONCLUSION

As the Commission deliberates the difficult issues of this rate proceeding, the Staff hopes its position on the outstanding issues as presented in the record before the Commission is clear. The Staff's testimony and supporting evidence offers an unbiased balance between the needs of Laclede Gas Company and the needs of the ratepaying consumers. *The Company has the burden of proving* to this Commission that the rate increases it requests in this tariff filing are just and reasonable, and are supported by the evidence presented before the Commission. Any increase in the rates of Laclede or any other utility should be granted only if the strong weight of evidence supports such an increase. The Staff respectfully requests that the Commission accept Staff's case in its entirety and reject any attempt by the Company to extract earnings from ratepayers which are not supported by the evidence presented in this proceeding.

Respectfully submitted,

DANA K. JOYCE
General Counsel

Marc Poston
Senior Counsel
Missouri Bar No. 45722

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

Certificate of Service

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record as shown on the attached service list this 15th of October 1999.

SERVICE LIST FOR
CASE NO: GR-99-315
October 15, 1999

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

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

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

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

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

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

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