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October 15, 1999

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

RE: Laclede Gas Company
Case No. GR-99-315

Dear Mr. Roberts:

Enclosed for filing please find the original and fourteen copies of **Initial Brief of the Office of the Public Counsel.** I have on this date mailed or hand-delivered copies to all counsel of record. Please "file" stamp the extra-enclosed copy and return it to this office.

Thank you for your attention to this matter.

Sincerely,

Douglas E. Micheel
Senior Public Counsel

DEM/mm

Enclosures

cc: Counsel of Record

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

INITIAL BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

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I. INTRODUCTION

Laclede Gas Company ("Laclede") filed proposed tariffs with the Missouri Public Service Commission ("Commission") designed to increase rates for its non-gas natural gas local distribution service by approximately $30.5 million on January 26, 1999, thus initiating Case No. GR-99-315. The Commission suspended these proposed tariff sheets on February 9, 1999 and set a procedural schedule for the processing of Laclede's proposed rate increase.

The prehearing conference was convened on July 9, 1999, and continued until July 14, 1999. As a result of the prehearing conference and on-going discussions certain contested issues were settled. The Partial Stipulation and Agreement was filed on September 1, 1999. (Exhibit 118).[1] Subsequent to filing the Partial Stipulation and Agreement the parties filed the First Amended Partial Stipulation and Agreement on September 3, 1999.

The contested case hearings for the remaining contested issues in this matter were held beginning August 30, 1999 and ending September 3, 1999.

II. CONTESTED ISSUES

A. Return on Equity

Public Counsel witness Burdette determined that Laclede Gas Company should be authorized a 9.70% return on common equity (Ex. 44 p. 7, l. 1-2) resulting in a weighted average cost of capital for Laclede of 8.36%. (Ex. 132 p.3, l. 5). In arriving at Public Counsel's recommendation Public Counsel witness Burdette utilized the discounted cash flow ("DCF") method applied to a group of six comparable companies. Witness Burdette also performed a

[1] Citations to the record will be abbreviated Ex. for Exhibit and Tr. for Transcript.

capital asset pricing model ("CAPM") and market to book ratio analysis to support his conclusions. (Ex. 44 p. 7, l. 10-12).

The United States Supreme Court held, in Bluefield Waterworks and Improvement Company v. Public Service Commission of West Virginia, 262 U.S. 679, 67 L.Ed. 1176, 43 S.Ct. 675 (1923) and Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 591, 88L.Ed. 333, 64S.Ct. 281 (1944), that the rate of return for utility must be: 1. comparable to the return on investments in other enterprises having a corresponding risk; and, 2. sufficient to a) assure confidence in the financial integrity of the utility, b) maintain support of the utility's credit; and c) attract capital. Public Counsel believes that its recommendations in this proceeding meet the requirements of the Bluefield and Hope decisions.

The cost of equity, using the DCF method, is represented by the following equation: k=D/P+g, where "k" is a cost of equity capital (required return), "D/P" is the current dividend yield ([D] divided by the stock price [P],) and "g" is the expected sustainable growth rate. (Ex. 44 p. 7, l. 17-21). Witness Burdette's DCF analysis was performed on six comparable local distribution companies with financial risk characteristics similar to those of Laclede. (Ex. 44 p. 13, l. 23-26). Witness Burdette determined the appropriate sustainable growth rate for Laclede to be in the range of 3.0% to 3.5%. (Ex. 44 p. 13, l. 4-6). In calculating the growth rate witness Burdette chose to use the rate at the high end of the range, 3.5%. (Ex. 44 p. 13, l. 5-6). Utilizing these items witness Burdette determined that Laclede should be allowed a return on common equity of 9.70%.

Laclede has requested that this Commission authorize the Company to earn a 12.75% return on common equity. (Ex. 2 p. 3, l. 9). Laclede's return on equity recommendation was proffered by witness McShane. In arriving at her return on equity recommendation witness

McShane used a hodgepodge of methodologies; comparable earnings, risk premium and an adjusted discounted cash flow analysis. (Ex. 2 p. 2, l. 25-28). Laclede's request is simply not consistent with current market conditions and is based upon faulty assumptions.

All three of witness McShane's methodologies suffer from problems that make their use for determining Laclede's return on equity inappropriate. Before discussing each methodology, it is important to note that when witness McShane used the unadjusted discounted cash flow method in arriving at her return on equity recommendation the outcome was a return on equity of 10.5%. (Ex. 2 p. 17, l. 18-19). This discounted cash flow analysis, without the inappropriate adjustments made by witness McShane to ratchet the outcome up to 13.6%, is within 80 basis points of Public Counsel's recommendation and within 50 basis points of Staff's high-end return on equity recommendation.

Witness McShane's discounted cash flow analysis resulted in a return on equity for Laclede of 13.6%. (Ex. 2 p. 3, l. 7). However, witness McShane was <u>only</u> able to arrive at such a high return on equity recommendation by utilitizing comparable companies that are more risky than Laclede and that do not receive the majority of their revenues from the sale of natural gas. (Ex. 45 p. 6, l. 23-27; p. 7, l. 1-4). Witness McShane also made a market to book adjustment that increased the output of the DCF model by 310 basis points. (Ex. 61 p. 3, l. 17-18). This type of market to book adjustment has been rejected by this Commission as inappropriate. (Ex. 61 p. 3, l. 9-14). If the Commission accepts Laclede's unwarranted adjustment, the effect will be that investors who are currently requiring between 9 and 10 percent return on common equity will be receiving a 12.75% return on common equity, this will drive up the Company's market to book ratio, thus leading to an increased return on equity when Laclede files its next case. (Ex. 61 p. 4, l. 1-6). This would occur even though the investors required return is only 9 to 10 percent. The

Commission should reject this adjustment and reject witness McShane's perverted discounted cash flow analysis.

Witness McShane also utilized the comparable earnings test. According to witness McShane, based upon this test Laclede should be authorized a return on common equity of 13.00% to 13.25%. (Ex. 2 p. 3, l. 3). Witness McShane used 35 companies she asserted were similar in overall risk to Laclede. (Ex. 2 p. 10, l. 26-27). Unfortunately a review of the 35 companies shows that the companies picked by witness McShane are more risky than Laclede. For example, six of the companies are rated BBB+ by Standards and Poor's and four are rated only BBB. (Ex. 45 p. 7, l. 15-16). These ratings are well below Laclede's AA- rating. Also, the 35 companies have an average beta of 0.83, significantly greater (more risky) than Laclede's beta of 0.50. (Ex. 45 p. 7, l. 18-19). Finally, witness McShane's comparable earnings analysis is based upon measuring earned return and not returns investors require. (Ex. 61 p. 5, l. 15-16). This fact brings into question the results of her comparable earnings analysis. An investor's required return to invest is something different than the actual returns achieved. For the purposes of setting an authorized return on equity for Laclede, the focus should be on the returns investors require to invest not the actual returns achieved by higher risk industrial companies. Simply put, the measure used by witness McShane (actual earned returns) is not correct and should be disregarded by this Commission. (Ex. 61 p. 6, l. 2-3).

The final test utilized by witness McShane is the equity risk premium test. Based upon this test, witness McShane claims Laclede should be granted an 11.25% return on equity. (Ex. 2 p. 3, l. 5). Witness McShane applied her equity risk premium analysis to 17 companies. (Ex. 61 p. 4, l. 10). However, the companies are more risky than Laclede and derive a significant amount of their revenues from other business undertakings than the sale of natural gas. (Ex. 45 p.

6, l. 23-27; p. 7, l. 4). The sample chosen by witness McShane had an average beta of 0.59 as compared to Laclede's beta of 0.50. (Ex. 61 p. 4, l. 12-14). However, witness McShane failed to apply a downward adjustment to lower the output of her equity premium analysis. (Ex. 61 p. 4, l. 16-17). The questionable comparable companies and the failure to make a downward adjustment to her outcome, due to Laclede's less risky status, make witness McShane's equity risk premium analysis unreliable and inappropriate for use in determining what return on equity Laclede should be authorized.

Finally, witness McShane's 12.75% return on equity recommendation does not pass the test of common sense. In response to Chair Lumpe, witness McShane was unable to cite to any regulated LDC that has an authorized 12.75% return on equity. (Tr. p. 123, l. 6-11). The best witness McShane could do was a Wisconsin company authorized a 12.25% return on common equity. (Tr. p. 123, l. 10-11). However, the utility was Wisconsin Electric and they do not have any natural gas operations. (Tr. p. 146, l. 10-20). The fact of the matter is no LDC's have been authorized a return on equity of 12.75% in the past year. The Commission should reject Laclede's unreasonably high 12.75% return on equity request and accept Public Counsel's more reasonable 9.70% return on equity.

In support of its proposed 12.75% return on equity recommendation, Laclede presented witness Olson of Sanders, Morris and Mundy. Witness Olson recommended that the Commission utilize an indexing proposal when setting Laclede's return on equity.[2] (Tr. p. 180, l. 7-9). Witness Olson opined that such an inflated return on equity was necessary to ensure that investors were willing to invest in Laclede's stock and to prevent Laclede from becoming a take-

[2] Witness Olson admitted that no Commission has set return on equity based on his index proposal, but "hope springs eternal." (Tr. p. 180, l. 12-14). The Commission should reject witness Olson's novel and unproven index proposal.

over target. (Tr. p. 165, l. 4-24). Neither of these "reasons" supports the Commission authorizing Laclede a 12.75% return on equity.

The record evidence in this proceeding demonstrates that Laclede has been and is able to attract investors. Laclede recently issued $25 million of common stock and $25 million of debt. As admitted by witness Olson, Laclede was able to attract investors to both its equity and debt offerings. (Tr. p. 176, l. 4-16; p. 177, l. 19-25). The undisputed facts of this case show that investors are not dumping Laclede's stock because Laclede is not authorized a return on equity of 12.75% or above as witness Olson postulates. In fact, there are investors ready, willing and investing in Laclede's stock presently.

Witness Olson's other rationale for supporting a 12.75% return on equity for Laclede is witness Olson's belief that absent such an inflated authorized return on equity level, Laclede could become a "take-over" target. This Commission should not set Laclede's return on equity to prevent the Company from becoming a "take-over" target. Such a justification for setting a return on equity is wholly inappropriate.

In fact, witness Olson's testimony demonstrates that Laclede's requested 12.75% return on equity request is well above the realm of a reasonable authorized return on equity for a local distribution company such as Laclede. Witness Olson candidly admitted that he was not aware of any LDCs that had authorized returns on equity of 12.75% and that the last time he was aware of authorized returns on equity of 12.75% was in the early 1980's and late 1970's. (Tr. p. 168, l. 5-18).[3]

[3] Witness Olson also admitted that when setting returns on equity for LDCs, most state utility regulatory bodies currently utilize the discounted cash flow method, the method used by Public Counsel witness Burdette. (Tr. p. 173, l. 21-25; p. 174, l. 1-3).

Simply put, witness Olson's own testimony demonstrates that Laclede's requested return on equity of 12.75% is too high and not consistent with current market conditions. Witness Olson's testimony also supports the use of the discounted cash flow method for determining the appropriate return on equity that this Commission should authorize Laclede to earn.

The Commission should reject Laclede's inflated return on common equity request. Public Counsel believes the appropriate authorized return on common equity for Laclede should be 9.70%. Using this return on common equity produces an overall rate of return of 8.36%.

B. Capital Structure

Public Counsel recommends that the Commission adopt the following capital structure for Laclede for this proceeding:

	Amount	Percent
Common Equity	$291,738,842	50.70%
Preferred Stock	$ 1,958,250	0.34%
Long Term Debt	$202,335,995	35.16%
Short Term Debt	$ 79,429,639	13.80%
Total	$575,462,726	100.00%

(Ex. 132, Schedule MB-2(T)). The dispute between Laclede and the Staff and Public Counsel with respect to the capital structure is the appropriate amount of short term debt ("STD") to include for purposes of setting rates. Public Counsel and Staff have recommended a level of approximately $79 million. (Ex. 45 p.9, l. 14; Ex. 61 p. 7, l. 6). Laclede has proposed a level of STD of approximately $29 million. (Ex. 13 p. 9, l. 2-8).

Public Counsel believes that Laclede's proposed level of STD is too low and is simply not representative of the Company's historical or pro forma levels of STD. (Ex. 45 p. 9, l. 24-

26). To arrive at its proposed level of STD, Laclede reduced the STD balance by $25 million to reflect a recent issuance of common equity and $25 million to reflect a recent issuance of long term debt. (Ex. 45 p. 9, l. 20-22). However, there is no reason to believe that Laclede's level of STD will remain at this reduced level. (Ex. 46, p. 2, l. 7-8). In fact, Laclede's own financial documents indicate that the level of STD will increase in the future. (Ex. 46 p. 2, l. 8-10). The coincidental timing of this rate case and Laclede's recent equity and long-term debt issuances (and the current reduced level of STD) is not a justification for using an unrepresentative level of STD in the Company's ratemaking capital structure. (Ex. 46 p. 2, l. 11-14). Thus, the Commission should determine that $79 million of STD is appropriate for Laclede's ratemaking capital structure as recommended by Public Counsel and Staff.

C. Advertising

This issue deals with the regulatory treatment of Laclede's advertising expense. Public Counsel and the Staff have proposed utilizing the traditional Commission treatment of advertising expense as established in the seminal Commission case Re: Kansas City Power and Light Company, 28 Mo. P.S.C. (N.S.) 228 (1986) ("KCPL"). In KCPL the Commission adopted an approach which classifies advertisements into five separate categories for rate treatment. The five categories adopted by the Commission for the purposes of this approach are:

> 1. General – informational advertising that is useful in the provision of adequate service.
>
> 2. Safety – advertising which conveys the ways to use the utility's service safely and to avoid accidents.
>
> 3. Promotional – advertising used to encourage the use of a particular commodity that the utility is selling.
>
> 4. Institutional – advertising used to improve the utility's public image.

5. Political – advertising associated with political issues.

The Commission adopted these categories for advertisements because it believed that a utility's revenue requirements should: 1) always include general and safety ads, provided such costs are reasonable, 2) never include the cost of institutional or political ads, and 3) include promotional ads only to the extent that the utility provided cost justification for the ads. KCPL, pages 269-271. The Commission has also stated that it is the burden of the utility to prove that the ratepayer benefited from promotional activities such as promotional advertising. Re: Missouri Public Service et al., 30 Mo. P.S.C. (N.S.) 320, 328 (1990).

Public Counsel witness Bolin utilized the KCPL standards and reviewed all of the advertisements included by Laclede in the test year cost of service and proposed disallowing $475,082 of expense related to Laclede's advertisements during the test year. (Ex. 51 Schedule kkb-7). In reviewing the advertisements for Laclede Public Counsel witness Bolin allowed into rates, consistent with the KCPL standard, all advertisements classified as general and safety. (Ex. 50 p. 4, l. 10-18).

On the other hand, Laclede witness Hargraves recommends that the Commission abandon, or at least reform the KCPL standard applied by this Commission for a number of years. (Ex. 20 p. 7, l. 11-14). In the place of the current method, Laclede witness Hargraves recommends the radical and unprecedented method of preapproving a certain level of advertising expense and allowing Laclede recovery of any advertising costs so long as the costs are below a predetermined cap on expenditures. (Tr. p. 719, l. 18-25, p. 720, l. 1-10). The cap Laclede is recommending is one-half of one percent of utility revenues. (Tr. p. 719, l. 10-22). Under Laclede's proposal the Company would be preapproved to spend one-half of one percent of utility revenue on advertising. Public Counsel believes the Commission should reject this proposal. This proposal is both inconsistent with sound public policy and contrary to this Commissions statutory authority.

Laclede's position is based at least in part on the Company's belief that it is the cost of the advertisements that is important and not the content of the advertisements. (Ex. 20 p. 4, l. 23-24; Tr. p. 741, l. 20-23). Public Counsel disagrees. Both the content and the cost of advertisements are important when determining whether or not Laclede should be allowed to recover advertising expenses from captive ratepayers. This Commission has a duty to determine what cost items should be included within Laclede's rate schedules. Section § 393.140 (5) and § 393.270 (4) authorize the Commission to examine the methods, practices, regulation and property employed by public utilities. These statutory sections authorize the examination of advertising cost. State ex rel. Laclede Gas Co. v. P.S.C., 600 S.W.2d 220, 228 (Mo. App. 1980). Laclede's proposal, if accepted by the Commission, would allow Laclede to incur advertising expense for ads that are not beneficial to ratepayers nor necessary to provide safe and adequate service to Laclede's captive customers. For example according to witness Hargraves, Laclede's proposal would allow the Company to spend its entire advertising budget promoting gas usage over electric usage (Tr. p. 721, l. 3-6) or the Company could spend its entire advertising budget on ads designed to enhance its public image and promote goodwill. Neither of these pursuits are appropriate or necessary for captive customers to pay for. And yet under Laclede's cap proposal the Commission would have already preapproved a level of expenditures for which Laclede could spend on any type of advertisements.[4] This fact was demonstrated by witness Hargraves response to questions from Vice Chair Drainer:

Q. But by blessing a cap - -

A. Uh-huh.

[4] Witness Hargraves stated Laclede's proposal would exclude political advertising. (Tr. p. 720, l. 19-21).

> Q. - - then you're saying that there really would not have to be review up to that cap, that - - that it would take away from having to review the ads. And how - - how can we do that and still keep our responsibility and obligation to make sure that the spendings at the Company are prudent?
>
> A. Well, what I'm suggesting is that the Commission as an economic regulatory body focus on the cost, and not the content of the ad, and determine that X is a reasonable amount, given the competitive situations, given that advertising is an important information vehicle, that X amount is a certain - - is an appropriate amount for the ratepayer to pay. And you would do that by basing it on revenues.
>
> When we come - - you're not building it in rates. I mean, we get what we've got here. Next time we come in for a case, then we would - - that cap would be applicable, and we would either be above or below it. If we go above it, we don't get it. If we go below, we get only what we spend.
>
> Q. Yeah, but you're saying I've already blessed it.
>
> A. I believe you've already said that you would have - - would have said this amount is reasonable.

(Tr. p. 741, l. 22-25; p. 742, l. 1-12).

The Commission should not accept Laclede's proposal to predetermine a level of advertising expense to be built into rates on a going forward basis regardless of the content of the advertisement. Allowing such a proposal would set a dangerous precedent of this Commission preapproving a certain level of expenditures as reasonable and necessary.

Laclede also attempts to justify its proposal to allow preapproval of a certain level of advertising expense in rates based upon the Company's assertion that promotional ads are necessary to ensure customers receive information about natural gas and electricity so customers can make "informed choices" with respect to their prospective energy supplier. (Ex. 20 p. 4, l.

24-26; p. 5, l. 1; p. 6, l. 1-15). This "reason" does not justify allowing Laclede to recover the cost of promotional or institutional advertising.

Laclede's "reason" is based upon a faulty premise that the only place consumers can get information to make "informed choices" is from Laclede. Consumers can get information about electric, gas, propane or other alternative energy sources from various outlets. For example, an Energy Guide label is required to be displayed on new appliances such as stoves, A/C units, furnaces, and water heaters. (Ex. p. 51, l. 2-3). A fact that Laclede witness Hargraves admits. (Tr. p. 715, l. 7-25; p. 716, l. 1-7). Moreover, consumers are generally aware of the price advantages that natural gas currently enjoys over electricity in the St. Louis market place. (Ex. 52 p. 5, l. 11-14). The fact of the matter remains that ads promoting natural gas use over electricity or other fuels is not necessary for Laclede to provide safe and reasonable gas service to its customers. (Ex. 51 p. 5, l. 18-20).

Laclede also attempts to justify its proposal to predetermine a level of advertising expense to be built into rates on a going forward basis by asserting that the Commission has not applied the KCPL standards to Southwestern Bell and AmerenUE. (Ex. 20 p. 4, l. 2-5). Close scrutiny of Case No. TC-89-14 (SWB) and ER-95-411 (UE) shows that each case is distinguishable from the facts and circumstances that Laclede is facing.

With respect to the Commission's decision in Case No. TC-89-14 it is clear on the face of the Commission's Report and Order that the Commission was specifically addressing promotional advertising for the competitive telecommunications industry. (Ex 51 p. 2, l. 4-5). The Commission in its Report and Order distinguished the telecommunications industry from other regulated utilities when it stated:

> "In spite of the fact that this Commission has, in the last two litigated Southwestern Bell Telephone Company cases,

> acknowledged that competition is a factor to be considered in advertising expense, the Staff and PC propose to apply the standard previously adopted for electric companies. There are significant differences. An electric company sells only one product. Telephone companies, however, sell a multitude of services and products and are subject to increasingly competitive pressures since divestiture." (Emphasis added).

(Ex. 51 p. 2, l. 5-12)

Witness Hargraves admits that the Commission's decision only applies to the competitive telecommunications industry. (Ex. 22 p. 3, l. 4). However, witness Hargraves asserts that the natural gas industry faces the same competitive pressure as the telephone industry. (Ex. 22 p. 3, l. 5-22). Public Counsel believes there is marked difference between the competition that exists (or possibly could exist) as a result of deregulation of the telephone industry compared to the competition that exists in the natural gas industry. There is no gas-on-gas competition within Laclede's service territory. (Tr. p. 721, l. 12-20). Natural gas does compete with electricity for customers, but this type of competition is not new. Laclede has been competing with UE for customers for decades. (Tr. p. 721, l. 7-11).[5] The Commission historically has determined that it is inappropriate for ratepayers to fund advertising to encourage gas and electric companies to compete. This Commission in January of 1997 reaffirmed this position in Case No. GR-96-285, Missouri Gas Energy when it stated:

> "The Commission finds that the $5,035.57 amount should not be allowed in rates because these expenses are incurred to encourage use of gas over electricity or to promote MGE's corporate image. The Commission has to consider the energy market in making these decisions. The Commission will not encourage gas and electric companies to compete by passing those costs on to ratepayers. Since these companies are still subject to rate base/rate of return regulation in Missouri, it does not make sense to pass these types of expenses through to ratepayers. Shareholders, not

[5] Laclede currently has 85% of the space heating market and 98% of new homes built use natural gas for space heating. (Ex. 121)

ratepayers, must bear the expense of advertisements designed to increase sales of energy resources." (Emphasis added).

(Ex. 51 p. 2, l. 18-26; p. 3, l. 1-2)

In this proceeding Laclede requests the Commission allow Laclede to use ratepayer funds to encourage natural gas usage over electricity or other fuels. The Commission should deny Laclede's request.

Laclede's pointing to the settlement in ER-95-411 for AmerenUE that produced an alternative regulatory plan does not support this Commission preapproving a level of advertising expense to be built into rates on a going forward basis. First, UE is now operating under an alternative regulatory plan and at the present time is not subject to traditional rate base/rate of return regulation. Second, the UE case was a settled case. (Ex. 51 p. 3, l. 17-23). The UE case is totally inapposite to Laclede's situation because UE is operating under an alternative regulatory plan.

This Commission has for utility companies regulated under traditional rate base/rate of return regulation held that shareholders, not ratepayers, must bear the expense of advertisements designed to increase sales of energy resources. Laclede has failed to carry its burden to prove the Commission should abandon this regulatory principle. Moreover, abandoning this principle, and allowing preapproval of Laclede's advertising expense would be contrary to the Commission's statutory authority and would be bad public policy.

Recognizing that the Commission may not adopt its proposed alternative, Laclede has attempted to prove that its promotional advertising expense benefits outweigh the costs consistent with the standards set-out in the KCPL decision. To that end, Laclede provided what is purported to be a cost/benefit study. Laclede also presented its guesstimates of market share loss if it did not conduct promotional ads. Neither of these items demonstrates that the benefits of the promotional ads outweigh the costs.

The Marketeam Survey presented by Laclede does not establish that the benefits of Laclede's promotional advertisements outweigh the costs. This survey (See results attached to EX. 52 Schedule KKB 8.1 – 8.10) only polled 103 customers of Laclede. Only 4 out of 103 customers interviewed cited advertising as a source that led them to choose natural gas.[6] (Ex. 51 p. 5, l. 11-12). According to Laclede's own survey less than 4% of customers in the survey were influenced by Laclede's advertising, this represents a very small part of the market compared with other methods of influence such as past experience with gas (34%) and friends/other homeowners (20%). (Ex. 52 p. 6, l. 4-7). The Marketeam survey fails to provide a crucial link between Laclede's promotional advertising and the choice of natural gas. (Tr. p. 795, l. 9-23).

Laclede's self-serving calculations of benefits found on Schedule 2 to witness Hargraves rebuttal testimony Exhibit 21 should also be rejected. The Company's loss of revenue is based upon the assumptions that the Company will lose one-half of its estimated customer growth and one percent of the Company's current heating customers if Laclede discontinues it s promotional advertising. (Ex. 52 p. 4, l. 9-11). However, these estimates are wholly based upon Laclede witness Hargraves unsupported assumptions. Witness Hargraves admitted during cross-examination he conducted no study or underlying analysis to verify his assumptions. (Tr. p. 725, l. 3-25; p. 726, l. 1-16). The Commission should reject Laclede's guesstimate of the impacts of advertising.

The Commission should reaffirm the KCPL standard used by Public Counsel witness Bolin and disallow $475,082 of expense related to Laclede's advertisements during the test year.

[6] Advertisement was not the sole reason for any person to use natural gas according to the survey. For only 4 people Laclede's ads were a factor in their choice of natural gas.

D. Accounting Authority Order Sunset

This issue deals with the appropriate "sunset" provision to be utilized for Laclede's one remaining accounting authority order ("AAO") related to its Safety Replacement Program ("SRP"). Instead of the traditional two year "sunset" provision contained in Laclede's past SRP AAO, Laclede has proposed a procedure of surveillance and monitoring of the SRP deferrals and a three-year deadline by which the Commission could decide whether to continue SRP deferrals beyond the three year period, without the necessity of Laclede filing for a general increase in rates. (Ex. 8 p. 7, l. 8-12). A general outline of Laclede's proposal is attached as Schedule 3 to witness Fallert's rebuttal testimony Exhibit 8. Public Counsel opposes Laclede's request and believes extending the time frame that the Company is allowed to book the SRP deferrals before the Commission implements its oversight function is not in the best interests of either the Company or ratepayers. (Ex. 49 p. 5, l. 19-20; p. 6, l. 1).

In order to understand why this Commission should reject Laclede's proposal it is important to understand the purpose and function of an accounting authority order. The request by utilities regulated by the Commission to defer costs from one accounting period to another accounting period has been characterized as a request for an accounting authority order.[7] This characterization occurs because what is authorized by the Commission is the booking of certain costs to Account No. 186 or 182.3 under the Uniform System of Accounts ("USOA") rather than the booking of the costs in a traditional account for the type of cost incurred by the utility. In the Matter of Missouri Public Service, 1 MPSC 3d 200, 202 (1991).

Generally, the deferral of costs from one accounting period to another period for the development of a revenue requirement violates the traditional method for setting utility rates. Id.

[7] An accounting period is normally one twelve month period.

at 205. Rates are usually established upon a historical test year which focus on four factors: (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a return maybe earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses. Id. citing State ex rel. Union Electric Company v. Public Service Commission, 765 S.W.2d 618, 622 (Mo. App. 1988).

In the seminal decision regarding accounting authority orders, In the Matter of Missouri Public Service, 1 MPSC 3d 200 (1991) the Commission discussed the necessity of time limitations for allowing deferrals of costs stating:

> 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 extraordinary, recovery in rates should not be delayed indefinitely. a utility should not be allowed to save deferrals to offset against excess earnings in some future period.

Id. at 206 (Emphasis added). Under Laclede's proposal it is possible for the Company to extend cost deferrals to between four and five years. (Ex. 49 p. 6, l. 1-3). Moreover, the terms of Laclede's proposal present numerous workability problems and create a new and distinct type of proceeding before the Commission. Simply put, Laclede's proposal should be rejected by the Commission.

First, Laclede's proposal would allow the Company to defer the SRP expenses for too long a time period. Under Laclede's proposal it would be allowed to have an AAO in place for 30 months prior to filing its request for extension of the AAO with the Commission. (Tr. p. 600,

l. 4-12). After the Company files its request for an extension there is no time limit upon when the Commission would have to rule upon the request. (Tr. p. 602, l. 19-22). After filing the extension request, per Laclede's proposal other parties could file responses to Laclede's request. However, Laclede's proposal is devoid of any specific procedures. (Tr. p. 601, l. 22-25). Public Counsel believes that, the administrative burdens placed on the Commission and the Staff and Public Counsel to track and manage Laclede's plan would be cumbersome and provide for a new unworkable proceeding.

Moreover, Laclede's proposed procedure leaves numerous questions unanswered and further complicates the regulatory process. For example, how would the Commission determine if the Company would be required to file a rate case? Would the Staff and/or Public Counsel be required to simply review, and trust in, the Company's unadjusted financials or conduct a full-blown earnings investigation at the end of the first three years? How would the Commission determine the actual source of the underearnings experienced by the Company, if underearnings exist? The Company's proposal fails to state if the Commission will be required to look at all rates to determine reasonableness, not the cost deferred. Laclede's proposal contains no provision for a hearing. Laclede's proposal complicates a currently easily workable system. If the Company does not file a ratecase case within two years the deferrals cannot be recovered in rates.

Laclede's proposal also unnecessarily extends the time period of the deferrals making the deferral balances unnecessarily large. If ratemaking treatment of the costs is not ultimately allowed by the Commission, the Company would be required to perform a "write-off" of the entire deferred amount at the time of the Commission's decision. (Ex. 49 p. 9, l. 1-2). If the Company had been deferring costs for several years, this immediate write-off could be large and it would have more severe consequences on publicly reported earnings than if the Company had merely charged the deferred costs to expense when incurred. (Ex. 49 p. 9, l. 2-5). The possibility of a larger write-off will almost certainly cause the Company to argue that rate recovery of the deferred costs is required for that reason alone. (Ex. 49 p. 9, l. 5-7). (Witness Fallert uses this very argument for manufactured gas plant deferrals on page 16 lines 1-6 of his rebuttal testimony Exhibit 8).

The Commission should decline Laclede's invitation to allow Laclede to defer costs for longer than two years before being required to file a general rate case. The two-year time limitation proposed by Public Counsel for the AAO sunset provision provides for a reasonable time for Laclede to seek recovery of the amounts deferred. This time period is a proper balance between Company and ratepayer interests.

E. Off-System Sales Revenue

In GT-99-303 In the Matter of the Laclede Gas Company's Tariff Sheets to Extend and Revise the Company's Gas Supply Incentive Plan the Commission accepted Public Counsel's recommendation that off-system sales revenues should be addressed in a general rate case proceeding. (Report and Order at p. 15). However, in GT-99-303 the Commission did not make a finding as to the appropriate amount of revenue to impute in this proceeding. (Report and Order at p. 16). Public Counsel recommends that test year revenues in this proceeding be increased by $2.4 million to reflect a reasonable amount of off-system sales revenue for inclusion in the Company's base rates. (Ex. 53 p. 10, l. 21-23; p. 11, l.1).

In determining the appropriate amount of revenue to include in Laclede's revenues for off-system sales, Public Counsel has analyzed Laclede's historical off-system sales revenue levels for a three-year period. During the 1996-1997 ACA period Laclede received over $3.5

million in net revenue from off-system sales. (Ex 125, citing Shaw Direct p. 35, l. 20-21). During the 1996-1997 and 1997-1998 ACA periods Laclede achieved approximately 2.3 and $1.6 million in net off-system sales. (Ex. 125, citing Shaw Rebuttal p. 48, l. 11-13). Public Counsel's proposal to impute $2.4 million of revenue, based upon Laclede's historical off-system sales revenues, is an amount net off-system sales.

Laclede accuses Public Counsel of failing to take into account the alleged "downward trend" in off-system sales revenues. However, Public Counsel has recognized any alleged trend by recommending a baseline that is below Laclede's three-year average of net off-system sales. (Ex. 125 citing; Tr. p. 779, l. 13-16). Public Counsel believes the Commission should develop a baseline based upon historical market data, not the unsubstantiated claims made by Laclede of "changed market conditions." In rebuttal testimony witness Jaskowiak claims that the off-system sales market has "changed dramatically" since the implementation of its experimental GSIP. (Ex. 125 citing Jaskowiak Rebuttal 6 p. 18, l. 13-17). At no time in this proceeding has Laclede provided any written documentation or empirical data to support various allegations of changing market conditions. (Ex. 125 citing Shaw Rebuttal p. 33, l. 21-23; p. 44, l. 3-7). In his rebuttal testimony witness Jaskowiak attached Schedule 8 that allegedly supports Laclede's claim regarding the reductions in off-system sales value. (Ex. 125). However, it is not surprising that Laclede's average off-system sales margins correlate with the price of natural gas. (Ex. 125 citing Shaw Rebuttal p. 44, l. 14-15). Schedule 8 of witness Jaskowiak's rebuttal testimony ignores the fact that the winter spot market cost of gas has decreased each year from 1997 through 1999. (Ex. 125 citing Jaskowiak Rebuttal p. 44, l. 15-17). Public Counsel's use of hard market data should not be ignored. Historical facts with respect to Laclede's off-system sales firmly support Public Counsel's proposal to set a baseline at $2.4 million.

F. Depreciation

Public Counsel takes no position on this issue.

G. Miscellaneous Tariff Issues

Public Counsel takes no position on this issue.

H. Customer Growth Revenues (True-up).

Public Counsel supports the Staff position on this issue.

III. CONCLUSION

For the above reasons, Public Counsel requests that Laclede be authorized a 9.70% return on common equity based upon a capital structure that includes $79 million in short-term debt. That the Commission disallow $475,085 in advertising expense from the cost of service and reaffirm the use of the KCPL standards for determining whether or not certain advertising expenses are appropriate for recovery from ratepayers. That the Commission set a two-year "sunset" period for Laclede's SRP accounting authority order and reject Laclede's proposal to extend the sunset period. Finally, Public Counsel requests the Commission determine that the appropriate amount of revenues to impute to represent Laclede's level of off-systems sales is $2.4 million.

Respectfully submitted,
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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing has been mailed or hand-delivered to the following on this 15th day of October, 1999:

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