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FILED³

JUL 06 2001

Missouri Public
Service Commission

Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
200 Madison Street, Suite 100
P.O. Box 360
Jefferson City, Missouri 65102

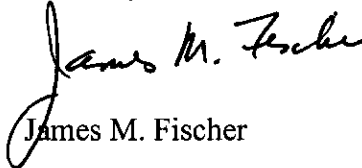
RE: *In the Matter of Laclede Gas Company's Tariff to Revise Natural Gas Rate
Schedules, Case No. GR-99-315*

Dear Mr. Roberts:

Enclosed for filing in the above-referenced matter are the original and eight (8) copies of the Joint Application for Rehearing of Laclede Gas Company and Union Electric Company d/b/a AmerenUE. A copy of the foregoing Joint Application for Rehearing has been hand-delivered or mailed, this date, to each party of record.

Thank you for your attention to this matter.

Sincerely,


James M. Fischer

/jr
Enclosures

cc: Douglas E. Micheel
Dana K. Joyce, General Counsel
Thomas R. Schwarz, Jr., Senior Counsel
Ronald K. Evans
Thomas M. Byrne
John D. Landwehr
Diana M. Vuylsteke
Robert C. Johnson

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

FILED³
JUL 06 2001

Missouri Public
Service Commission

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

JOINT APPLICATION FOR REHEARING

COME NOW Laclede Gas Company ("Laclede" or "Company") and Union Electric Company d/b/a AmerenUE ("AmerenUE") (collectively "the Applicants") and, pursuant to §386.500 RSMo (2000) and 4 CSR 240-2.160 of the Commission's Rules of Practice and Procedure, file their Joint Application for Rehearing in the above-captioned case. In support thereof, the Joint Applicants state as follows:

1. On December 14, 1999, the Commission issued its first Report and Order in Case No. GR-99-315, in which it, among other things, adopted Staff's proposed method for determining the net salvage component of Laclede's depreciation rates. (*First Report and Order*, p. 33). Laclede timely sought rehearing of the Commission's decision regarding the net salvage issue, and upon Commission denial of its request, sought judicial review of the Commission's decision in the Circuit Court of Cole County. On December 1, 2000, the Circuit Court of Cole County issued its Order and Judgment in the review proceeding brought by Laclede in which it remanded the case to the Commission on the grounds that the Commission had failed to provide sufficient findings of fact to support its net salvage decision. In doing so, the Court instructed the Commission to provide "findings of fact sufficient to support a resolution of the net salvage issue."

2. On June 28, 2001, the Commission issued its second Report and Order in Case No. GR-99-315, in which it again adopted Staff's proposed method for determining

the net salvage component of Laclede's depreciation rates. As discussed below, the Commission's second Report and Order does not comply with the remand instructions given by the Circuit Court because, like the Commission's first Report and Order, it does not begin to provide "findings of fact sufficient to support [its] resolution of the net salvage issue." Similarly, like its initial decision adopting the Staff's recommended approach to determining net salvage, the Commission's decision in its second Report and Order is unjust and unreasonable, unsupported by competent and substantial evidence on the whole record, arbitrary and capricious, contrary to Missouri law, and inconsistent with the requirements of the United States and Missouri Constitutions.

A. **The Findings of Fact provided by the Commission in Support of Its Decision are Insufficient in that They Fail to Show how Controlling Issues were Decided and are Inadequate to Permit a Determination that Such Decision is Based on Competent and Substantial Evidence on the Whole Record.**

3. Missouri courts have consistently held that the Commission must support its decisions with findings of fact that are "sufficiently definite and certain under the circumstances of the case to enable the court to review the decision intelligently and ascertain if the facts afford a reasonable basis for the order without resorting to the evidence." *State ex rel. U.S. Water/Lexington v. Missouri Public Service Commission*, 79 S.W.2d 593, 594 (Mo.App. 1990). *See also Office of the Public Counsel v. Missouri Public Service Commission*, 782 S.W.2d 822, 825 (Mo.App. 1990). Conversely, such findings will be deemed inadequate if they are completely conclusory and provide no insight into if and how controlling issues were resolved. *State ex rel. Fischer v. Public Service Commission*, 645 S.W.2d 39, 42 (Mo. App. 1982). Indeed, absent "the requisite specific findings of fact" a court will have "no basis for determining

whether the Commission's decision was supported by substantial and competent evidence"

Noranda Aluminum, Inc. v. Public Service Commission, 2000 WL 620208 (Mo. App.W.D. 2000); §§386.420, 536.090 RSMo. (2000).

It is clear from a review of the Commission's second Report and Order and the evidentiary record in this case, that the "findings" provided by the Commission in support of its decision in that Order do not satisfy these standards. For example, based on the evidentiary record in this case, it is undisputed:

(a) that the fundamental goal of depreciation accounting is to allocate the full cost of an asset, including its net salvage cost, over its economic or service life so that utility customers will be charged for the cost of the asset in proportion to the benefit they receive from its consumption;¹

(b) that to achieve this fundament goal, this Commission, as well as virtually every other regulatory body and authoritative source on the subject, have consistently recognized that depreciation rates must include an estimate of the net salvage costs that will be incurred in connection with such assets once their estimated service life ends (Exh. 23, p. 4); and,

(c) that, for these reasons, this Commission, as well as virtually every other regulatory body and authoritative source on the subject, have consistently endorsed the use of the classical straight-line - average life - amortization method employed by Laclede in this case, as

¹ Indeed, this fundamental goal of proper depreciation accounting was reaffirmed in this case by both Mr. Kottemann and Dr. White on behalf of Laclede (Exh. No. 23, p. 3; Exh. No. 25, p.7; Exh. No. 26, p. 4), as well as Mr. Adam on behalf of the Commission Staff (Tr. 895-896).

opposed to the method proposed by Staff, which provides no allowance for the net salvage costs that will be incurred by the Company in connection with these assets.²

4. Indeed, the Commission decisions addressing this specific issue have been remarkably consistent over the years in their recognition of the need to provide an allowance for net salvage cost in depreciation rates. As one might expect, these decisions include ones issued by the Commission prior to its initial determination in Case No. GR-99-315 to adopt Staff's new approach toward determining net salvage costs. *See e.g. Re: Missouri Public Service*, 30 Mo.P.S.C. (N.S.) 320, 344 (1990) and *Re: St. Louis Water Company*, Case No. WR-95-145, *Report and Order*, pp. 14-15 (1995).³ But they also include at least one decision issued subsequent to that determination – namely, the recent Commission decision in *Re: St. Louis Water Company*, Case No. WR-2000-844, in which the Commission once again reaffirmed the propriety of including an estimate of future net salvage costs in depreciation rates through use of the classical depreciation method proposed by Laclede in this case.

² The undisputed evidence on the record shows that the classical method used by Laclede in this case is supported by the overwhelming weight of authority on such matters. Specifically, Laclede provided evidence showing the wide-spread support among depreciation professionals and the authoritative texts for the Commission's traditional treatment of net salvage. (Exh. No. 23, p.3; Exh. No. 25, pp. 4-6; Exh. No. 26, pp. 4-5). That evidence also establishes that such a method is consistent with generally accepted accounting principles and is recognized and followed almost universally by other regulatory jurisdictions in the United States. (Exh. No. 26, pp. 2, 4-5, 13). In contrast, the evidence shows that Staff was unable to cite any depreciation practitioner, outside of other Staff members, or any depreciation treatise which addressed, much less endorsed, its proposed treatment of net salvage. (Compare Tr. 878-879 to Tr. 919 to 920). In fact, the unchallenged testimony of Dr. White, a depreciation expert, showed that the depreciation method proposed by Mr. Adam, and adopted by the Commission, has no foundation whatsoever in depreciation theory. (Tr. 838; Exh. No. 26, p. 13). And aside from a single state where the recognition of current net salvage costs has been judicially mandated, Staff was unable to cite any decision from another regulatory jurisdiction where its recommended method has been adopted. (Tr. 867-868; 875-876).

³ In *Re: Missouri Public Service*, *supra*, the Commission explicitly recognized that "It is ...customary to recover through the depreciation rates the estimated cost of ultimately removing the asset offset by the projected amount to be realized from its salvage price." (*emphasis supplied*).

5. In view of these considerations, it was incumbent on the Commission to provide some insight in its second Report and Order into how it was ultimately able to determine, based on the evidence presented in this proceeding, that it was reasonable and appropriate to adopt a new method for determining net salvage costs that, like the one proposed by Staff, departs so radically from its own long-standing policies in this area. Specifically, it was incumbent on the Commission to address and make specific findings on:

- whether the primary goal of proper depreciation accounting is, in fact, to allocate the full cost of an asset over the useful life of the asset as claimed by Laclede and AmerenUE and, if not, what the goal or goals of depreciation actually are;
- whether Staff's proposed method does or does not defeat the primary goal of depreciation as claimed by Laclede and AmerenUE by excluding from depreciation rates an allowance for future net salvage cost and, if it does, why it was nevertheless reasonable and appropriate for the Commission to adopt that method;
- whether Staff's proposed method contradicts Generally Accepted Accounting Principles as claimed by Laclede and AmerenUE and, if so, why it was nevertheless reasonable and appropriate for the Commission to adopt that method;
- whether Staff's proposed method is contrary to the depreciation practices and standards followed by virtually every other state and federal utility regulatory body for determining net salvage as claimed by Laclede and AmerenUE and, if so, why it was nevertheless appropriate to adopt that method;

- whether Staff's proposed method is inconsistent with the treatment of net salvage recommended by the authoritative texts on depreciation theory and, if it is, why it was nevertheless reasonable and appropriate for the Commission to adopt that method; and

- whether the end result of Staff's proposed method is to deprive Laclede of millions of dollars in timely and appropriate capital recovery and its customers of an equitable way of being charged for the utility assets used to serve them and, if it is, why it was nevertheless reasonable and appropriate to adopt that method.

6. Nowhere in its second Report and Order does the Commission provide meaningful factual findings in connection with these controlling issues or provide any meaningful insight into whether or how such issues were resolved by the Commission. Instead, the Commission simply repeats the conclusory "findings" that were deemed inadequate by the Circuit Court and then seeks to supplement them with three entirely new statements that do nothing to explain why it was appropriate for the Commission to depart from its traditional policy in this area.

7. The first new statement is the Commission's assertion at page 3 of its second Report and Order that "Laclede's arguments for spreading the costs of the removal of these assets among different generations of customers were not persuasive because of the uncertainty of how much cost will be incurred for removal, when the removal will occur, or if the removal will occur at all." With all due respect, there is not one shred of evidence on the record in this case to suggest that Laclede's estimates of its net salvage costs were inaccurate or inherently unreliable. To the contrary, while Staff witness Adam testified in his direct testimony that net salvage costs had been miscalculated by Laclede, he later acknowledged in a data request response to the

Company, as well as during cross-examination, that no such miscalculation had occurred. (Tr. 884-885). Rather, according to Mr. Adam, the difference between his net salvage calculation and that of the Company's was simply attributable to the fact that they were employing different methods to make that calculation. *Id.*

8. As a result, this new statement offered by the Commission in support of its decision cannot be viewed as anything more than a unjustifiably pejorative way of saying that the Commission is not going to permit an estimate for future net salvage costs to be included in Laclede's depreciation rates because it is, in fact, only an estimate (albeit one that is based on years of historical data showing the relationship or ratio between such costs and the plant to which they apply). In its recent decision in *Re: St. Louis County Water Company, supra*, however, the Commission explicitly found that such generalized criticisms of the use of estimates were not sufficient to warrant rejection of the classical depreciation method and its computation of net salvage costs.⁴ There is simply nothing to distinguish the Commission's willingness to rely on estimated net salvage costs in that case from its unwillingness to do so in this case.

9. The Commission's sudden aversion to the use of estimates in determining net salvage costs in its second Report and Order is also inexplicable in light of the fact that such forward looking estimates are essential to the other part of the depreciation process that neither the Commission nor the Staff have challenged in this proceeding, namely, the process by which the service lives for assets are determined and used to spread the recovery of current capital expenditures over many years. As the evidence in

⁴ In *St. Louis County Water*, the Commission specifically noted that "[w]hile Staff criticizes Mr. Stout's estimates of net salvage costs in general, it does not note any specific problem with any specific estimate. Rather, the criticisms are based on the fact that the costs are estimates." *Id.* at pp. 17-18. The exact same thing is true in this case.

this case clearly shows, developing estimates of the future is absolutely required if any of the costs of a capital asset are to be spread over its entire useful life so that all customers who benefit from the use of the asset pay their fair share of the cost. And once again, the Commission has explicitly recognized this reality as evidenced by its analysis in *Re: St. Louis County Water Company*, Case No. WR-95-145 wherein the Commission observed:

Depreciation accounting is a system of accounting which generally aims to distribute costs or other basic values of tangible capital assets less salvage, over the estimated useful life of the unit or group of units in a systematic nature. It is a process of allocation, not of valuation. Depreciation is an attempt to match capital recovery with capital consumption. The emphasis is upon a system and rational allocation of the expense of capital consumption. ... *Any attempt to allocate such costs over a period of time requires an analysis of expected future events such as useful life, salvage value, and cost of removal.*

Report and Order, pp. 14-15.

10. As the above language makes clear, it is necessary for the Commission to estimate the useful service life of every capital asset in order to allocate the original cost of that asset over its life, which, in the case of long-lived assets, can approach a century. Notably, neither the Commission in its Report and Order, nor the Staff in its testimony in this case, have expressed any concerns with this type of forward looking estimation when it was used in this case to delay, over many years, Laclede's recovery of its considerable initial investment in capital assets. But when the same estimating process is applied to spread the cost of future net salvage back over the life of the asset, the Commission's statement would suggest that such a process is suddenly too speculative or uncertain. At a minimum, it was incumbent on the Commission to explain in its second Report and Order how these two conflicting views of estimates can be reconciled. The fact that it

has been unable to do so simply illustrates that the new justification posited by the Commission for its decision is no justification at all.

11. Finally, the Joint Applicants would point out that conclusory assertions to the effect that is suddenly too difficult or problematic to estimate and provide an allowance for inflationary increases in net salvage costs, after many years of having done so, are not the kind of "findings" that are likely to find much purchase before Missouri courts. More than forty years ago, the Missouri Supreme Court rejected similar contentions when they were raised in the context of determining the impact of inflation on the value of a utility's plant. In addressing such arguments, the Court in *State ex rel. Missouri Water Co. v. Public Service Commission*, 303 S.W.2d 704, 719-720 (Mo. 1958), stated as follows:

It is true that determination of "fair value" for ratemaking purposes involves vexing problems of proof. Estimates of reproduction costs or other elements necessary to ascertainment of "fair value" frequently are given from a partisan standpoint and are often unsatisfactory. In this connection, however, it seems that once original cost is ascertained modern bookkeeping methods used in connection with recognized trending percentage tables and price indices can be used to establish both reproduction cost and depreciation with reasonable accuracy. The evidence in this case tends to so show, as do the findings in many of the recent cases involving these questions. But however difficult may the ascertainment of relevant and material factors in the establishment of just and reasonable rates, neither impulse nor expediency can be substituted for the requirement that such rates be 'authorized by law' and 'supported by competent and substantial evidence on the whole record.'

12. Surely, the Commission's obligation to take such factors into consideration has not declined over time. To the contrary, given all of the astounding advances in information management capabilities that have been made over the past four

decades as a result of new computer and software technology, the Court in *Missouri Water* would undoubtedly have a difficult time grasping why a duty that it believed could be performed with adding machines in 1958 cannot be mastered with computers in the year 2001. For all of these reasons, the Commission's "finding" regarding the reliability of Laclede's net salvage estimates is clearly not sufficient to support its decision.

13. The same is true of the other two new statements included in the Commission's second Report and Order. This includes the Commission's observation at page 4 of its second Report and Order that "Laclede's depreciation accrual balance represents an over-recovery of \$26,5755, 903"⁵ and its following statement that "Laclede has historically submitted a rate case to the Commission every few years..." and that this "... process of rate adjustment is sufficient to compensate Laclede if the net salvage should increase in the future."

14. Once again, there is nothing about these two statements that in any way distinguishes Laclede from the situation faced by St. Louis County Water in its most recent rate case. *See Re: St. Louis County Water Company*, Case No. WR-2000-848, Report and Order issued May 3, 2001. As with Laclede in the instant case, Staff also took the position in the St. Louis County Water Company case that the utility had an over-recovery in its accrual balance; a circumstance that the Commission apparently found to be of no consequence given its decision to adopt the classical depreciation method proposed St. Louis County Water Company, rather than the method proposed by Mr. Adam. *See* Report and Order, pp. 6, 19-20. Moreover, it is apparent from the

⁵ The Commission's reference in its Report and Order to an "over-recovery" in Laclede's depreciation accrual balance is particularly puzzling since Mr. Adam himself testified that the balance was probably not a significant amount for a Company the size of Laclede, that he would be "shocked" if a utility's actual

Commission's Report and Order in the St. Louis County Water Company case, that St. Louis County Water has pursued rate relief with even greater regularity than Laclede. *Id.* at pp. 9-11. And yet the Commission nevertheless determined that permitting St. Louis County Water Company to continue using the classical depreciation method, and to include an allowance for future net salvage costs in its depreciation rates, was "in the public interest." Nowhere in its decision permitting such treatment did the Commission even mention St. Louis County Water Company's depreciation accrual balance or its practice of filing regular rate cases as factors that had any bearing on that decision. *See* Report and Order, pp. 17-19.

15. In fact, the only circumstances cited by the Commission in the St. Louis County Water Company case as to when it *might* be appropriate to use a depreciation method other than the classical depreciation method proposed by Laclede in this case was if there was a "situation in which a utility has a type of asset that is at or very near the end of its service life, that is not likely to be replaced, and for which the cost of removal is high and likely to move higher..." *Re: St. Louis County Water Company*, Report and Order, p. 18. From the language used by the Commission in that case, it appears that when it made this statement, the Commission may have been referring to Laclede's gas holders. As the Commission itself seemed to recognize in its second Report and Order in this case, however, the Commission's decision not to permit depreciation expense associated Laclede's gas holders was a completely separate issue in this case and Laclede never sought judicial review of the Commission's separate determination of that issue. More importantly, however, the distinguishing circumstances identified by the

reserve balance ever equaled its theoretical reserve balance and that he had made no proposal attacking Laclede's reserve balance. (Tr. 882-883).

Commission in the St. Louis County Water case for when it might be appropriate to adopt a depreciation method other than the classical one utilized by Laclede provides absolutely no justification for its rejection of the classical method in this case. Simply put, the mass property units affected by the net salvage issue in this case are "not at or very near the end of their service lives." In fact, the evidence showed that these mains, service lines and other facilities are likely to remain in service for decades to come. Nor is there any evidence in the record suggesting that these facilities are "not likely to be replaced" at the end of their service lives or that their removal cost is "high and likely to move higher." In fact, if Laclede does not replace these facilities once they are retired it will presumably have no facilities through which it will be able to provide gas service to its customers in the future.

16. In view of these considerations, it is clear that none of the new "findings" provided by the Commission in its second Report and Order support its decision to abandon the classical depreciation approach proposed by Laclede in favor of the radical new method proposed by Staff in this case. To the contrary, other decisions rendered by the Commission on this issue at virtually the same time it was deciding the net salvage in Laclede's case demonstrate that such findings have no relevance whatsoever to a proper resolution of the net salvage issue. As a result, Laclede and any reviewing court are simply left to speculate over why the Commission chose not to approve the classical depreciation method in this case while almost simultaneously reaffirming its use in another case. As the court observed in *City of Lake Lotawana v. Public Service Commission*, 732 S.W.2d 191, 195 (Mo.App. 1987), "if judicial review is to have any meaning, it is a minimum requirement that the evidence, along with the explanation

therefore by the witnesses and by the Commission itself, make sense to the reviewing court. We may not approve an order on faith in the Commission's expertise." For all of the reasons discussed above, Joint Applicants submit that the Commission's decision fails to satisfy this fundamental test and, in the process, fails to comply with the Circuit Court instruction to provide "findings of fact sufficient to support a resolution of the net salvage issue."

B. The Commission's Decision to Adopt a New Method for Determining the Net Salvage Component of Laclede's Depreciation Rates is Unreasonable Because Such Decision was not Supported by Competent and Substantial Evidence on the Whole Record

17. The fact the Commission has once again been unable to set forth findings of fact sufficient to show that its decision is supported by competent and substantial evidence, makes it increasingly difficult to attribute such failure to an oversight on the part of the Commission. Rather, it can be attributed at this stage, first and foremost, to the fact that no such evidence exists on the record that was produced in Case No. GR-99-315.

18. A decision by the Commission will be deemed unreasonable if it is not supported by competent and substantial evidence on the whole record. *Friendship Vill. v. Public Serv. Com'n*, 907 S.W.2d 339, 344-45 (Mo.App. W.D. 1995). Conversely, a Commission decision is reasonable if it is supported by competent and substantial evidence on the record as a whole and is not against the overwhelming weight of the evidence. *Oak Grove v. Public Service Commission*, 769 S.W.2d. 139, 141 (Mo.App. W.D. 1989), citing *State ex rel. Fee Fee Trunk Sewer, Inc. v. Public Service Commission*, 550 S.W.2d. 945, 946 (Mo. App. 1977).

19. Based on a review of the evidentiary record in Case No. GR-99-315, it is clear that this fundamental prerequisite for a valid Commission decision was not satisfied in this instance. Indeed, it is difficult to conceive of how any Commission determination could have

less evidentiary support, or be contradicted by evidence more overwhelming, than the Commission's decision to adopt Staff witness Adam's proposed method for determining the net salvage component of Laclede's depreciation rates.

1. ***The competent and substantial evidence on the whole record shows that the method adopted by the Commission to determine net salvage costs cannot be reconciled with the fundamental principles and goals of depreciation accounting.***

20. The lack of any competent and substantial evidence to support the Commission's adoption of this method is immediately observable from what the record says about the method itself and its wholesale failure to serve the depreciation goals that Mr. Adam himself espoused. As previously discussed, the overall goal of depreciation accounting is to spread the *full* cost of an asset over its service life, *including its estimated net salvage value*, so that current and future customers will be charged for such costs in proportion to their consumption of the asset over time. At no point in Case No. GR-99-315 did Mr. Adam dispute this fact or suggest that depreciation accounting is designed to advance any other goal. Nevertheless, he proposed and the Commission adopted a method for determining net salvage values that does not recognize the net salvage costs of Laclede's existing depreciable assets, but instead simply relies on the average dollar amount of net salvage costs realized by Laclede in the last ten years for those items of property that have already been retired.

21. The undisputed evidence in the record shows that such an approach cannot and will not provide a reasonable estimate of the future net salvage costs that Laclede can be expected to experience with respect to existing plant. For example, since Mr. Adam's methodology only allows Laclede to recover the realized average net salvage cost experienced by the Company over the last ten years on property that has been retired, it effectively eliminates any allowance for the predictable escalations in net salvage costs that are certain to

occur over the useful life of the assets that Laclede is using *today* to provide utility service to its customers. In other words, it makes absolutely no allowance for the fact that the payroll, equipment and other costs incurred to remove the previously mentioned distribution main from service are certain to increase over the 50-year period that the main will be operational. Instead, the method simply assumes that those costs will be the same 50 years from now as they are today. In short, the method proposed by Mr. Adam, and adopted by the Commission in Case No. GR-99-315, does not even attempt to estimate and account for the net salvage costs that Laclede will experience with respect to future retirements of existing plant.

22. As Laclede witness Dr. Ronald E. White testified,⁶ this fundamental deficiency in the method adopted by the Commission is most graphically illustrated by the fact that the method makes *absolutely no allowance* for net salvage costs in connection with assets that have been placed in service but not yet retired. As Dr. White testified:

The practical difference between these two accrual formulas can be observed by considering a plant category in which no plant has been retired from service to date, but it is known with certainty that removal expense will be incurred when the plant is retired at some future date. The formula proposed by Mr. Adam would charge no removal expense to operations until retirements are posted and removal expense has been realized. This treatment will significantly understate the cost of providing utility service to current ratepayers. In contrast, the conventional accrual formula will allocate future removal expense to operations over the

⁶ The contrast between the depreciation experience and credentials of Dr. White and Mr. Adam are striking. Dr. White has been professionally involved in depreciation-related matters for more than thirty years. (Exh. 26, pp. 1-2). During this time, he has obtained a Ph.D in Engineering Valuation from Iowa State University, prepared numerous depreciation studies and analyses, and testified before regulatory bodies in some 27 states and the District of Columbia, as well as before the Federal Energy Regulatory Commission and the Securities Exchange Commission. (Id.). In addition, Dr. White has taught graduate and undergraduate courses in engineering evaluation at Iowa State University and presently serves on the faculty for Depreciation Programs for public utility commissions, companies and consultants, sponsored by Depreciation Programs, Inc., in cooperation with Western Michigan University. (Id.) He is also a member of numerous associations devoted to the study of depreciation-related issues and is a founding member of the Society of Depreciation Professionals. (Id.) In contrast, Mr. Adam testified that in the nine or so different jobs that he held prior to joining the Commission, he had had little or no opportunity to gain experience in depreciation-related matters. (Tr. 853-859) In fact, he only began addressing such issues on a regular basis approximately five years ago when he was first employed by the Commission. (Id.).

accounting periods in which the service capacity of the assets is consumed. Thus, both current and future ratepayers are charged a reasonable share of the cost of the service provided to them.

(Exh. 26, p. 12; *See also* Tr. 862).

23. Notably, Mr. Adam openly admitted that his approach only reflects recently experienced net salvage costs and is not designed to reflect future net salvage costs at all, stating that "the net salvage component of the Depreciation Rate equation should recover the current actual net salvage amounts over the total life of the current plant." (Exh. 92, p. 7). Mr. Adam also conceded that his approach would produce the obviously deficient result described above, unless retirement experience relating to this new category of plant was somehow available from other companies and could be used to calculate a net salvage amount. (Tr. 862-84). He also conceded that even in those circumstances where he "knew with certainty" that a category of plant would have a salvage cost at the end of its service life, his method would nevertheless provide a zero allowance for such costs absent any actual experience of such costs. (Tr. 862). What Mr. Adam did not do, however, was explain how this intentional failure to recognize predictable future net salvage costs in calculating the overall cost of an asset could, in any event, be reconciled with the fundamental goal of depreciation — namely, to do the best job possible in allocating all of the costs of an asset over the entire useful life of the asset.⁷ In fact, no such explanation was possible because the method advocated by Mr. Adam, and adopted by the Commission, fundamentally contradicts this goal.⁸ In view of these evidentiary considerations, it

⁷ Indeed, rather than try and reconcile his method with this overriding goal, Mr. Adam simply suggested that Laclede could correct any inadequacies in the net salvage amounts produced by his method by filing a new rate case each time its actual experienced net salvage cost differs significantly from the amount incorporated into Laclede's depreciation rates. (Exh. 92, p. 8). Needless to say, one cannot justify or cure an obviously unreasonable and invalid regulatory practice by simply imposing a continuing obligation on the victim of that practice to ameliorate its adverse effects through the filing of expensive and time-consuming rate cases year after year.

⁸ As Laclede witness Dr. White pointed out during the evidentiary hearing, Mr. Adam's method effectively modifies "a conventional and widely accepted formula for depreciation rates to produce a net salvage allowance that

is clear that the Commission's decision to adopt such a method is unsupported by the competent and substantial evidence on the whole record.

2. ***The competent and substantial evidence on the whole record shows that the method adopted by the Commission to determine Laclede's net salvage cost is unprecedented and contrary to the overwhelming weight of authority on what constitutes a proper and reasonable method for calculating such costs.***

24. Such a conclusion is further confirmed by the huge gap that the evidentiary record showed to exist between the method adopted by the Commission for determining the net salvage component of Laclede's depreciation rates and the methods accepted as valid by virtually every other recognized authority on the subject. This is not a case where the Commission was confronted with a battle of the experts, with the weight of the opinions and factual assertions equally or even partially divided between the proponents and opponents of a particular issue. Instead, it was a battle between Mr. Adam's opinion of depreciation practices and the opinions held by virtually everyone else who has ever addressed the issue in a utility ratemaking context, or in general practice for that matter.

25. Throughout Case No. GR-99-315, Laclede presented uncontradicted evidence showing that Mr. Adam's approach to calculating net salvage violated Generally Accepted Accounting Principles ("GAAP") in general, and widely-adopted depreciation accounting practices in particular. (Exh. 25, p. 4; Exh. 26, p. 13).⁹ This evidence included the undisputed testimony of Laclede's expert witness Dr. White who, unlike Mr. Adam, has decades of experience in teaching and applying depreciation theory and whose testimony on depreciation

is inconsistent with the goals and objectives of depreciation accounting. Achievement of cost allocation over economic life in proportion to the consumption of service potential requires a recognition of both realized and future net salvage in the depreciation rate formula." (Exh. 26, p. 5).

⁹ Although the Commission is not obligated by law to adopt GAAP in all cases, the Commission has shown a consistent preference for following accounting practices consistent with GAAP in the absence of a compelling reason to depart from it. *See, for example, Re: Missouri Cities Water Company*, 2 Mo.P.S.C. 3d. 60, 90 (1993).

has been adopted in numerous jurisdictions. Given the breadth of his experience, Dr. White's comments regarding the lack of precedent or authority for Mr. Adam's proposed method of depreciation accounting was particularly telling. As Dr. White testified:

The treatment of net salvage advocated by Staff reduces to a recommendation to the Commission to abandon accrual accounting for net salvage and to institute a policy of allowing no more than the annual average of the net salvage realized over a recent band of years as the currently recoverable revenue requirement for salvage and cost of removal. This, in my experience, is without precedence both in theory and in practice. The proposal violates generally accepted accounting principles and would shift the expense recognition and recovery of net salvage to accounting periods beyond which the service capacity of the related assets had been consumed. I firmly believe, however, that responsible regulation would not knowingly abandon a universally accepted accounting practice and sanction a new depreciation formula designed with no other objective than to shift current costs to future accounting periods.

(Exh. 26, p. 13).

26. In addition to Dr. White, Laclede's in-house witness on depreciation issues, Mr. Kottemann, also testified that all of the texts with which he is familiar universally support the treatment of net salvage costs that Laclede was proposing in Case No. GR-99-315. In particular, Mr. Kottemann cited the NARUC publication entitled Public Utility Depreciation Practice, and Depreciation Systems authored by Wolf and Fitch as examples of authoritative texts that support Laclede's approach to net salvage. Numerous other depreciation authorities cited by Laclede also unanimously agreed upon the "classical"¹⁰ method utilized by Laclede for calculating net salvage. Mr. Adam, on the other hand, was unable to cite a *single* authority that supports his unconventional approach to calculating net salvage costs.¹¹

¹⁰ Mr. Adam himself referred to Laclede's method as the "classical" method.

¹¹ During cross-examination, Mr. Adam cited only a single sentence in the Wolf and Fitch text: "Salvage is sometimes viewed as though it remains constant as a property agent as opposed to the more realistic view that

27. In view of this undisputed record, Joint Applicant would submit that there is no tenable basis upon which a court could conclude that the Commission's net salvage decision is supported by competent and substantial evidence on the whole record. To the contrary, whether viewed in isolation or evaluated within the larger context of what other regulatory agencies and depreciation authorities have said and done, it is clear that the method adopted by the Commission is fundamentally at odds with what the evidentiary record indicates is properly and reasonably required to determine net salvage costs. In sharp contrast, there is absolutely no evidence in the record to suggest that there were any theoretical or factual deficiencies in the method that was advocated by Laclede for determining the net salvage component of its depreciation rates. The Commission should accordingly grant rehearing and modify its decision by adopting the method used by Laclede in this case -- a method that is, in fact, supported by competent and substantial evidence on the whole record.

C. **The Commission's Decision to Adopt a New Method for Determining the Net Salvage Component of Laclede's Depreciation Rates is Arbitrary and Capricious.**

28. Given the absence of any evidentiary foundation for the Commission's decision to adopt a new method for determining the net salvage component of Laclede's depreciation rates, the Joint Applicants would submit that such decision is also arbitrary and capricious within the meaning of §536.140 RSMo. (2000). Such a conclusion is particularly compelling in light of how casually the Commission has discarded its own long-standing policies on this depreciation issue.

29. As previously discussed, the Missouri Commission, like the overwhelming majority of regulatory bodies in other states, has consistently used the methodology employed

salvage varies with age." (Tr. 866). But this sentence does not appear to have anything to do with Mr. Adam's calculation of net salvage.

and advocated by the Joint Applicants in Case No. GR-99-315 for calculating net salvage values. As this Commission has pointed out: "It is ... customary to recover through the depreciation rates the estimated cost of ultimately removing the asset offset by the projected amount to be realized from its salvage price." *Re: Missouri Public Service*, 30 Mo.P.S.C. (N.S.) 320, 344 (1990) (*emphasis supplied*). This is clearly a forward-looking standard that does not artificially limit a utility's recovery to net salvage costs that have been experienced in the recent past, as the method adopted by the Commission in this proceeding does. Instead, such a standard supports the use of the classical method for calculating net salvage, as Laclede proposed in Case No. GR-99-315. In view of the Commission's prior acknowledgement that it is "customary" to estimate the cost of ultimately removing an asset from service when determining net salvage values, as proposed by Laclede in this case, any significant departure from such a practice should have only been countenanced by the Commission after long and careful consideration. The record indicates, however, that the process employed to develop and adopt this method in Case No. GR-99-315 was anything but deliberate or considered.

30. Consider the casual process that was followed by Staff witness Adam in deciding to adopt his new position on this issue. According to Mr. Adam's testimony, in the course of preparing his work papers in an earlier rate case, he suddenly realized that the net salvage rate incorporated into Laclede's depreciation rates under the conventional methodology produced an annual recovery of net salvage costs that exceeded the recent net salvage costs being experienced for some accounts. Apparently, based on this single observation alone, Mr. Adam simply scratched out the salvage values he had calculated using the conventional methodology and substituted lower net salvage values calculated in accordance with his new ten-year average of realized salvage values. (Tr. 889-892; Exh. 124).

31. Given the substantial impact that such a revision promised to have on Laclede and other Missouri utilities, one would expect that Mr. Adam would have at least taken steps to thoroughly discuss his proposal with other Staff members before moving forward with it. According to his testimony, however, Mr. Adam did not even discuss his proposal with upper level Staff personnel prior to filing testimony advocating the new method. (Tr. 893). Indeed, at the evidentiary hearing in Case No. GR-99-315, Mr. Adam testified that he could only hope that senior Staff members were aware of his proposal by the time he testified. (Tr. 893).

32. As previously discussed, the Commission also seems to have given very limited consideration to the overwhelming weight of the evidence that demonstrated the unreasonableness and inappropriateness of the method proposed by Staff. For example, the Commission has made absolutely no effort to address the undisputed expert testimony presented by Laclede which showed the method proposed by Mr. Adam to be contrary to the goals of depreciation, inconsistent with GAAP and contrary to the overwhelming weight of authority on how the net salvage component of a depreciation rate is to be determined. As Missouri courts have recognized, “[a]n administrative agency may not arbitrarily ignore relevant evidence not shown to be disbelieved. Only if it makes a specific finding that undisputed or unimpeached evidence is incredible and is unworthy of belief may it disregard such evidence.” *Knapp v. Local Govern. Emp. Retire. Sys.*, 738 S.W.2d 903, 913 (Mo.App. 1987). By failing to address in any fashion the competent, substantial and wholly relevant evidence presented by Laclede in Case No. GR-99-315, it is clear that the Commission engaged in this very kind of arbitrary decision-making. Under such circumstances, the Commission’s decision to adopt a new

method for determining the net salvage component of Laclede's depreciation rates has all the hallmarks of an arbitrary and capricious exercise of its statutory powers.

- D. The Commission's Decision is Unlawful Because it: (1) Violates the Statutory Prohibition Against Discriminatory Ratemaking Treatment; (2) Violates the Commission's Duty to Consider All Relevant Factors When Setting Rates; (3) Permits a Public Use of Laclede's Property without Just Compensation in Violation of the Missouri and United States Constitutions; and (4) Deprives Laclede of the Equal Protection of the Laws in Violation of Missouri and United States Constitutions.**

33. Not surprisingly, a method that deviates so radically from long-standing and universally-accepted principles of depreciation accounting is also contrary to the legal requirements governing the Commission's ratemaking powers. As discussed below, the method adopted by the Commission is unlawful in at least four critical respects:

1. *The method adopted by the Commission violates the statutory prohibitions against discriminatory ratemaking treatment and the granting of unreasonable preferences and advantages to certain customers.*

34. The first, and perhaps most obvious, legal deficiency relates to the fact that the method adopted by the Commission to determine net salvage value will inevitably produce results that are in direct violation of §393.130. Subsection 2 of that statutory provision expressly prohibits gas and electric utilities from demanding or collecting from customers less compensation for utility service than the utility demands and collects for like services from similarly situated customers. Similarly, subsection 3 of that same statutory provision prohibits gas and electric utilities from granting any form of undue or unreasonable preference or advantage to customers receiving utility service. Subsection 3 also prohibits gas and electric utilities from subjecting customers to any form of undue or unreasonable prejudice or disadvantage. The method adopted by the Commission, if sustained, would violate all of these prohibitions.

35. As previously discussed, under the method adopted by the Commission, no allowance is made in calculating the net salvage component for predictable increases or decreases that are certain to occur in the cost of removing assets that are currently being used to provide service. Moreover, for new items or classes of property that have not yet experienced retirements, no allowance whatsoever is made for net salvage value. Since the net salvage value will usually be negative (i.e., costs of removal will exceed proceeds from sales of asset), such an approach guarantees that current customers will receive an undue preference or advantage and that future customers will be subject to an undue and unreasonable prejudice or disadvantage.

36. Take, for example, a distribution main that has an original cost of \$1 million and a service life of 50 years. Under the method adopted by the Commission, the current customer will continue to benefit from a spreading of the \$1 million cost of the main over its entire estimated service life by only being charged for 1/50th of its original cost in the first and subsequent years that the main is in service. At the same time, however, the current customer will pay nothing to reflect the fact that while the main is in service its cost of removal upon retirement is escalating. Even though this is an integral and undeniable component of the asset's cost, the current customer gets a free ride under the method adopted by the Commission, while future customers are left to pay a disproportionate share of the cost of the asset's removal. The unreasonableness of the advantage accorded current customers and the prejudice visited on future customers under such an approach is both obvious and substantial, as the former pay rates that are unreasonably low while the latter pay rates that are unreasonably high.

37. The courts have recognized that whether a particular practice unlawfully discriminates against customers will usually be a question of fact. *State ex rel. Marco Sales v. Public Service Commission*, 685 S.W.2d 216, 221 (Mo.App. 1984). In this case, all of the facts

show that such discrimination will occur and there is nothing in the Commission's decision or the evidentiary record that would suggest anything to the contrary. Consequently, the method adopted by the Commission violates the explicit requirements of §393.130 RSMo. (1994).

2. *The method adopted by the Commission's violates its duty to consider all relevant factors when establishing rates.*

38. The adoption of a method that spreads out the cost of an asset over its entire useful life when calculating a depreciation rate, and then simply ignores how the cost of removing that asset will escalate over the same period of time when calculating the same rate, also directly violates the Commission's duty to consider all relevant factors when setting rates. *State ex rel. Missouri Water Company v. Public Service Commission*, 308 S.W.2d 704, 718-719 (Mo. 1957); *State ex. rel. Missouri Public Service Company v. Frass*, 627 S.W.2d 882, 886 (Mo. App. 1981); §393.270 RSMo. (2000).

39. In effect, the method adopted by the Commission recognizes and reflects some of the economic consequences associated with the fact that an asset is being used over an extended period of time while blatantly ignoring others. Specifically, the method pushes recovery of a significant portion of the original cost of the asset into later years in recognition of the fact that the asset is expected to provide service over many years. The method does nothing, however, to recognize that this very same factor (i.e., that the asset will be in service for many years) will ultimately increase the overall cost of the asset as its cost of removal escalates over time. The end result is a regulatory practice that will always understate the current cost of service by selectively recognizing only those factors in the depreciation formula that tend to reduce current depreciation rates and turning a blind eye to those factors that would tend to increase them. This is a direct and completely unjustified violation of the Commission's duty to consider all relevant factors when setting rates.

3. ***The method adopted by the Commission permits a public use of the Company's property without just compensation in violation of the Missouri and United States Constitutions.***

40. The method adopted by the Commission to determine the net salvage component of Laclede's depreciation rate also permits a public use of the Company's property without just compensation in violation of Article 1, Section 26 of the Missouri Constitution and the Fifth and Fourteenth Amendments of the United States Constitution. The method does so by permitting customers to benefit from the use of the Company's property without paying their fair allotment of a significant component of its cost – namely the net salvage costs that will be incurred to remove the asset when it is ultimately retired. As previously noted, these costs can be substantial.

41. Indeed, the distribution main example shows just how significant this deprivation of the Company's constitutional rights would be under the method adopted by the Commission. In effect, such a method would permit the Company's customers to benefit from the use of the distribution main over its entire 50-year service life. Only upon conclusion of that service life would the Company finally be compensated by someone for the net salvage cost of the distribution main, as such cost has escalated over the years. In the meantime, however, Laclede's cash flow and potentially its earnings are diminished as it receives revenues from its customers that are simply inadequate to cover the true cost of the asset.¹²

¹² From an earnings perspective, Mr. Adam acknowledged during redirect examination that if the utility attempted to defer seeking rate relief in circumstances where its net salvage costs were understated because of his method, it would risk an erosion in earnings. (Tr. 931-932). On the other hand, if the Company's net salvage costs were overstated, Mr. Adam testified that, under the traditional method, deferring the filing of a rate case would *not* enhance the Company's earnings since any overstatement would be captured, for later adjustment, in the depreciation accrual balance. (Tr. 932). As a result, it is clear that by adopting Mr. Adams' proposed method, the Commission has created a ratemaking mechanism where the Company's ability to recover its net salvage costs will be dependent not on the actual level of those costs, but on completely unrelated changes in other revenues and expenses and how they affect the Company's overall earnings. Under such circumstances, the Company is virtually guaranteed to under recover its net salvage costs until such time as they, together with all of the other costs incurred by the Company, are sufficiently

43. There is simply no justification under the above-cited constitutional provisions for permitting customers of Laclede, or any other utility for that matter, to benefit from the use of utility assets decade after decade at non-compensatory rates. A utility customer who graduates from high school at the same time a distribution main is placed in service should not be allowed to wait until he retires before paying, for the first time, an amount that reflects the full cost of the asset. Such a method, as adopted by the Commission, is plainly unlawful.

4. *The unequal and disparate treatment afforded Laclede under the Commission's net salvage decision deprives Laclede of the equal protection of the laws in violation of the Equal Protection Clause of the Missouri and United States Constitutions*

44. The equal protection clause of the Fourteenth Amendment binds the state when it acts through its administrative offices. *Tunstill v. Eagle Sheet Metal Works*, 870 S.W. 264, 272 (Mo. App. 1994). In particular, the reasonableness of rates charged by a public utility must be determined by the Commission with regard given to the due process and equal protection clauses of both the federal and state constitutions, and the statutes of the state of Missouri. *Missouri Water Company v. Public Service Commission*, 308 S.W. 2d. 704, 713-714 (Mo. 1957). Hence, for purposes of the equal protection, Commission action is state action.

45. The equal protection clauses do not prohibit a state from classifying persons, such as utilities, for the purposes of legislation. *State Ex. Rel. Jackson County v. Public Service Commission*, 532 S.W.2d 20, 32 (Mo. 1975). In fact, under the legislative framework that governs this proceeding, Section 393.110 to 393.285 RSMo 2000, the Missouri General Assembly has done so by establishing a host of uniform

under recovered to warrant a general increase in rates and the Company can, in fact, obtain such an increase.

regulatory requirements and standards for sewer, electric, water and gas utilities. While the establishment of such classifications is reasonable for equal protection purposes, however, it is also clear that "... the law [must] operate equally upon all in the same class. *State ex rel. Collins v. Donelson* 557 S.W. 2d 707, 711 (Mo.App. 1977).

46. The Commission has violated this fundamental constitutional requirement with its decision on the net salvage issue in this case. As discussed at length in Section A of this Application for Rehearing, the Commission has taken an entirely different approach to the net salvage issue in this case than it did less than two months ago in the case involving St. Louis County Water Company. *Re: St. Louis County Water Company*, Case No. WR-2000-844, Report and Order issued May 3, 2001. In the latter case, it reaffirmed the propriety of using the classical depreciation method proposed by Laclede in this case and, in the process, permitted an allowance for future net salvage costs to be included in St. Louis County Water Company's depreciation rates. Report and Order, pp. 17-18. In this case, it has done just the opposite, with the end result of depriving Laclede of millions of dollars in depreciation-related revenues that it would have received had it been accorded similar treatment. Moreover, as demonstrated in Section A of this Application for Rehearing, the Commission has completely failed to offer any valid or rational basis that would justify the uneven – indeed the diametrically opposite – treatment that it has afforded Laclede and St. Louis County Water Company. Under such circumstances, it is clear that the Commission's decision violates the equal protection guarantees of both the United States and Missouri Constitutions.

WHEREFORE, for the foregoing reasons, Laclede Gas Company and Union Electric Company d/b/a/ AmerenUE respectfully request that the Commission rehear its

Report and Order issued on June 28, 2001, and, thereafter, issue a new Report and Order consistent with this pleading.

Respectfully submitted,

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CERTIFICATE OF SERVICE

Michael C. Pendergast, Assistant Vice President and Associate General Counsel for Laclede Gas Company, hereby certifies that the foregoing Joint Application for Rehearing has been duly served upon the following parties of record by placing a copy thereof in the United States, First Class mail, postage prepaid, or by hand delivery, on this 6th day of July 2001:

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