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*Witness:* STEPHEN M. RACKERS  
*Sponsoring Party:* MoPSC Staff  
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*Case No.:* GR-99-315

**MISSOURI PUBLIC SERVICE COMMISSION**

**UTILITY SERVICES DIVISION**

**SURREBUTTAL TESTIMONY**

**OF**

**STEPHEN M. RACKERS**

**LACLEDE GAS COMPANY**

**CASE NO. GR-99-315**

*Jefferson City, Missouri*  
*August, 1999*

**FILED<sup>2</sup>**  
AUG 19 1999  
Missouri Public  
Service Commission

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1 AAO. The Safety AAO allows for the inclusion of the cost of surveys on customer  
2 owned buried fuel lines, not Company owned copper service lines.

3 Q. Does Laclede recognize that the surveys of copper service lines are not  
4 properly included in the Safety AAO?

5 A. Yes. Laclede recognized this fact and, as a result, did not include the cost  
6 of the surveys, specifically discussed by Mr. Fallert, in the Safety AAO deferrals to this  
7 point.

8 Q. Should the Company have raised this new issue in its direct filing?

9 A. Yes. On page 6 of his rebuttal testimony Mr. Fallert states that these  
10 surveys were completed during the period March through June of 1999. However, even  
11 though Laclede filed its testimony in the same month it was incurring these expenses, it  
12 did not raise this new proposal in its direct filing. Although the Company did not identify  
13 the value of this item in its testimony, Laclede should have raised this new issue in its  
14 direct case since the Company considers the amount significant enough to seek recovery  
15 for it now.

16 Q. What is the Staff's response to this new issue raised by the Company?

17 A. The Safety AAO contains specific language allowing the survey of buried  
18 fuel lines. The survey and replacement of copper service lines is currently being  
19 addressed as part of Case No. GO-99-155. The Commission's Gas Safety Staff will be  
20 issuing a report and recommendation in that case on August 31, 1999. Any rate and/or  
21 deferral treatment of copper service line survey costs should not be determined until after  
22 the outcome of that case is known.

23 Q. Do the copper service line surveys performed in 1999 represent an  
24 ongoing level of cost, as Mr. Fallert implies on page 6, lines 20 through 21?

1           A.     No. Mr. Fallert states that Laclede surveyed all of its copper service lines  
2 in 1999, using a "bar hole" method. However, the Company has informed the  
3 Commission's Gas Safety Staff that it intends to use a less expensive modification of this  
4 survey method in 2000.

5           Q.     Do you agree with Mr. Fallert's statements on page 7, and Laclede's  
6 proposal in Schedule 3 of his testimony, regarding the period of time the authority  
7 granted by the Safety AAO should be in effect?

8           A.     No. As Mr. Fallert states, the requirement that the Company must file a  
9 rate case within two years following the effective date of the rates to qualify for recovery  
10 of the deferral, has been a provision of this AAO in the past. This provision is necessary  
11 to insure the continued need for the AAO. If after two years, the deferral is not  
12 significant enough to cause the Company to file a rate case, the authority is no longer  
13 necessary. This also prevents the accrual from continuing indefinitely during a period of  
14 potential excess earnings. An AAO should be viewed as a mechanism to partially  
15 mitigate regulatory lag between rate cases, not as a substitute for or a means to avoid a  
16 rate case.

17          Q.     Could the Company request an extension of the AAO and a waiver of the  
18 requirement to file a rate case within two years at anytime?

19          A.     Yes. This is an option that is available to the Company as an alternative to  
20 filing a rate case within two years.

21          Q.     Mr. Fallert states that the procedure he discusses in Schedule 3 establishes  
22 a three-year deadline upon which the Commission could decide on the continuation of the  
23 AAO. Is he correct?

1           A.     No. The proposal attached to Mr. Fallert's testimony contains only two  
2 events that have defined time periods. The first is the Company's request for an  
3 extension of the AAO without filing a rate case. Under the Company's proposal this  
4 filing would occur within 30 months following the effective date of the rates established  
5 in this case. The second is the Company's request for a general rate increase six months  
6 after the Commission has ruled on its request for an extension of the AAO. In between  
7 these two timeframes is an undefined period when parties will have an opportunity to  
8 respond to the Company's request and the Commission will issue an order resolving the  
9 question of whether the Company may continue to defer costs under the AAO without  
10 filing a rate case. Such a scheme does not in any way establish a three-year deadline. No  
11 deadlines exist for parties to respond or for the Commission to issue an order.

12           Q.     What other problems exist regarding the Company's proposal?

13           A.     The Company's proposal does not discuss the method of response by the  
14 parties. If opposition existed to the Company's request the Commission may set a  
15 procedural schedule requiring testimony, hearings and briefs. Such a procedure would  
16 increase the time period encompassed by the Company's proposal. The Company's  
17 proposal could increase the deadline for filing a rate case that has been historically  
18 required after issuance of an AAO from two years to four years.

19           Q.     Do the differences between the Laclede and Missouri Gas Energy  
20 Company (MGE) safety programs, as cited by Mr. Fallert on page 8, lines 1 through 13,  
21 provide any basis for departure from Commission precedent on rate base inclusion of  
22 unamortized deferred balances?

23           A.     No. The Commission's rationale as stated in the Order in Case  
24 No. GR-98-140 does not mention the Allowance for Funds Used During

1 Construction (AFUDC) rate or the ability of MGE to schedule its replacements. In  
2 addition, the reduction to the AFUDC carrying cost of 1% for Laclede was not  
3 established to address regulatory lag. The Company agreed to this reduction as  
4 consideration for the Staff agreeing not to propose offsets to the AAO deferrals for future  
5 cost savings resulting from the replacement of old plant. This difference is not related to  
6 the Commission's decision to exclude the unamortized deferral balance from rate base.  
7 Further, Laclede has not identified any problems or the lack of flexibility in the  
8 scheduling of its Safety Replacement Program.

9 **MANUFACTURED GAS PLANTS (MGP)**

10 Q. Do Mr. Fallert's statements on page 12, lines 5 and 6 indicate that the  
11 costs incurred for MGP should not receive the special treatment afforded by an AAO?

12 A. Yes. A requirement for the granting of an AAO by the Commission has  
13 historically been linked to defining the item as "extraordinary". The definition used by  
14 the Commission for extraordinary is that the item is both unusual in nature and infrequent  
15 in occurrence. Mr. Fallert states that the MGP remediation costs have been incurred and  
16 are expected to be incurred in each year for the foreseeable future. These conditions are  
17 not indicative of the existence of an extraordinary item. MGP costs are being considered  
18 as ongoing costs by the Staff in this case. The Staff has included a normalized level of  
19 MGP cost based on a five-year average of the actual payments. This treatment is  
20 consistent with the way similar ongoing costs have been considered for ratemaking  
21 treatment before this Commission. Laclede is requesting additional consideration for this  
22 ongoing expense even though MGP costs fail to meet the extraordinary criteria necessary  
23 to justify such treatment.

1 Q. On page 15, lines 12 through 17 and in his Schedule 4 Mr. Fallert  
2 discusses a proposal for a future MGP AAO. Why is this proposal inappropriate?

3 A. Laclede's proposal seeks to establish a mechanism for receiving an AAO  
4 that would be unopposed if the associated dollar amount met a predetermined threshold.  
5 This proposal seeks to limit the ability of parties to challenge the appropriateness of the  
6 Company's request for a future AAO. Such a limitation on the rights of other parties  
7 should not be accepted, because it inappropriately fails to consider the relevant facts and  
8 conditions that exist when these costs are being considered for AAO treatment.

9 Q. Does the \$1,000,000 threshold included in the Company's proposal  
10 highlight the immateriality of the amounts currently deferred through the MGP AAO?

11 A. Yes. The amount of the deferral balance estimated to exist at the true-up  
12 cut-off date in this case, August 1, 1999, is less than half of the threshold suggested by  
13 Laclede's proposal for requesting a future MGP AAO. In addition, it has taken over  
14 three years for the balance to reach this level. This relationship highlights the immaterial  
15 nature of the MGP AAO deferred balance as previously discussed in my rebuttal  
16 testimony.

17 Q. Is it appropriate to suggest the current recovery of the unpaid amounts of  
18 MGP cost through an amortization?

19 A. No. The suggestion by the Company that it be allowed to recover  
20 estimated payments is a new issue, not previously addressed in the Company's direct  
21 testimony. The Company is asking the ratepayers to provide up front cash payments,  
22 through rates, for amounts Laclede has accrued on its books. These accrual amounts have  
23 never previously been included in the AAO for MGP costs. In addition, the Company



1 has never informed the Staff that it intended to use the MGP AAO as a mechanism to  
2 record accruals on its books.

3 Q. Will the elimination of the AAO eliminate the mechanism for recovery of  
4 future payments of MGP cost, as Mr. Fallert states on page 16, lines 1 through 6 of his  
5 testimony?

6 A. No. The Staff's inclusion of a normalized expense amount for MGP in the  
7 cost of service provides a mechanism for the recovery of future payments. In addition,  
8 future recovery of costs through insurance claims and reimbursement from other liable  
9 parties is another potential mechanism for the recovery of future payments of MGP costs.

10 YEAR 2000

11 Q. Would it be appropriate to capitalize the amounts incurred to modify  
12 existing software systems to make them Year 2000 compliant prior to March 1, 1998, as  
13 Mr. Fallert suggests on page 17, lines 5 through 9 of his rebuttal testimony?

14 A. No. The amounts incurred prior to March 1, 1998 were expensed on the  
15 Company's books. These amounts were not eliminated from the cost of service through  
16 any income statement adjustments in Case No. GR-98-374. The update period for that  
17 case ran through February 1998. Therefore, these amounts are already included in the  
18 cost of service and are being recovered in current rates.

19 Q. Are Mr. Fallert's statements regarding materiality of the Year 2000 AAO  
20 deferrals on page 19 lines 6 through 11 of his rebuttal testimony misleading?

21 A. Yes. The \$16 million discussed by Mr. Fallert is the total amount spent by  
22 Laclede for both modifying its existing software systems to make them Year 2000  
23 compliant and upgrading, enhancing and replacing its other computer systems to meet the  
24 business requirements of the Company. If the associated asset is in service by the

1 July 31, 1999 true-up date, the Staff is proposing to include in the cost of service any  
2 amount not previously included in rates. However, the amount specifically in question  
3 with regard to materiality is the associated AAO balance. The total AAO balance is  
4 estimated to be only \$368,000 by the true-up date. On an after tax basis, the AAO  
5 balance is only approximately \$266,000. As discussed in my rebuttal testimony, the Staff  
6 believes these amounts are immaterial and that no recovery of the AAO deferrals should  
7 be provided.

8 OPEBS (FAS 106)

9 Q. On page 20, lines 6 through 10 of his rebuttal testimony, Mr. Fallert states  
10 that no specific provision appears in the Stipulation and Agreement approved in Case No.  
11 GR-98-374, which allows the recovery of amounts deferred in the OPEBs AAO to be  
12 challenged. Does this absence of language guarantee recovery of these amounts?

13 A. No. The granting of an AAO has never automatically guaranteed recovery  
14 of deferred amounts in future rates. The Commission's granting of an AAO merely  
15 allows the booking of deferrals. Recovery of these deferrals is determined in a future  
16 proceeding and may be opposed on any grounds. This has been the standard practice of  
17 the Commission. The mere absence of language specifically allowing parties to oppose  
18 recovery does not change this standard Commission practice.

19 Q. The Company distinguishes the OPEBs and the Supplemental Pensions  
20 (SERP) AAOs from the Safety, MGP and Year 2000 AAOs by referring to them as  
21 "trackers". Have the OPEBs and SERP AAOs previously been referred to in the same  
22 manner as the Safety and MGP AAOs by the Commission and parties to rate  
23 proceedings?

1           A.     Yes. In the Stipulation and Agreement approved by the Commission in  
2 Case No. GR-98-374, the following reference to the MGP, Safety, OPEBs and SERP  
3 AAOs appears:

4                     The balances resulting from the four accounting authority  
5 orders granted in the Case No. GR-96-193 (as such balances  
6 existed on June 1, 1998) shall be rolled forward, and Laclede shall  
7 be permitted to seek rate recovery of these amounts in its next rate  
8 case proceeding.  
9

10                 Also, the Commission's Order in Case No. GR-96-193 refers to the SERP  
11 and OPEBs deferrals as AAOs and as continuations of the AAOs approved in the  
12 Company's previous case, No. GR-94-220.

13           Q.     Does the Staff agree that the OPEBs AAO balance should be recovered  
14 through a five-year amortization including rate base inclusion of the unamortized  
15 balance?

16           A.     No. As discussed in my rebuttal testimony, the Staff believes this amount  
17 is immaterial and that no recovery should be provided.

18     **SUPPLEMENTAL PENSIONS (SERP)**

19           Q.     On page 22, lines 14 through 22 and page 23, lines 1 and 2 of his rebuttal  
20 testimony, Mr. Fallert discusses the reason the SERP AAO was established. Is his  
21 explanation accurate?

22           A.     Mr. Fallert's explanation for the establishment of the SERP AAO is  
23 inconsistent with the Staff's understanding and is also illogical on its own terms.

24           Q.     Why does the Staff believe the SERP AAO was established?

25           A.     The Staff agreed to the establishment of the SERP AAO to address  
26 Laclede's concern regarding the fluctuating nature of this item. This characteristic was  
27 discussed in my direct testimony and is the reason the Staff is using a five-year average

1 of SERP payments to determine an ongoing level to include in the cost of service. The  
2 alleged need for this AAO to address Financial Accounting Standard (FAS) Nos. 87 and  
3 88 was never brought to the attention of the Staff or the Commission by Laclede to my  
4 knowledge. The Explanatory Memorandum supporting the Stipulation And Agreement  
5 in both Case Nos. GR-96-193 and GR-98-374 contains no language linking the SERP  
6 AAO to FAS 87 and 88. The on the record presentations in Case Nos. GR-94-220, the  
7 case in which this item first appeared, GR-96-193 and GR-98-374 contain no statements  
8 regarding the establishment of the SERP AAO as a result of FAS 87 and 88.

9 Q. Why do you characterize Mr. Fallert's explanation as illogical?

10 A. As Mr. Fallert says on page 22, lines 18 through 20 of his rebuttal  
11 testimony, the longstanding practice for Laclede has been to allow recovery of the cost of  
12 SERP on a payments basis. This practice was specifically identified in the Accounting  
13 Schedules in Case No. GR-92-165, two years before the SERP AAO was first  
14 established. FAS 87 and 88 were required for financial accounting purposes in  
15 approximately 1987. These facts show that a difference between the way SERP was  
16 recovered and the way the Company booked this item for financial accounting purposes  
17 existed for several years prior to the establishment of the SERP AAO.

18 Q. In Mr. Fallert's rebuttal testimony on page 23, lines 19 through 22 he  
19 states that eliminating the SERP AAO would require the recognition of \$2.1 million of  
20 accrued SERP costs in rates. Would this be appropriate?

21 A. No. Requiring the recovery of accruals, which have never been  
22 considered in the regulatory scheme either through inclusion in the cost of service or  
23 deferral, as a condition of ending an AAO is inappropriate. As previously discussed, the  
24 establishment of the SERP AAO was never based of the booking of accruals according to

1 FAS 87 and 88. SERP has always been recovered based on payments and the amounts  
2 included in the SERP AAO have always been based on payments. Including these  
3 accruals in the cost of service is a new issue, not previously appearing in the Company's  
4 testimony.

5 Q. On page 23, lines 5 and 6 of his rebuttal testimony, Mr. Fallert states that  
6 excluding the recovery of the amounts deferred for SERP is contrary to the  
7 Commission's order. Do you agree?

8 A. No. As previously discussed, the mere absence of language specifically  
9 allowing parties to oppose recovery does not change the standard Commission practice of  
10 determining the amount of recovery, if any, of the costs deferred according to an AAO in  
11 a subsequent case. The Staff opposes specific recovery of the amounts deferred  
12 according to the SERP AAO.

13 The Company has taken the position with regard to the OPEBs and SERP  
14 AAOs that it should receive guaranteed recovery in rates of the amounts deferred. The  
15 granting of an AAO has never automatically guaranteed recovery of deferred amounts in  
16 future rates. Rates are established to provide the utility an opportunity to recovery its  
17 expenses and earn a fair rate of return. Allowing guaranteed recovery of past over or  
18 under recovery of OPEB and SERP expenses, as Laclede proposes, is retroactive  
19 ratemaking.

20 Q. What is the Staff's response to Mr. Fallert's statements regarding the  
21 inclusion in rate base of the accumulated deferred AAO balances?

22 A. The Staff is only recommending recovery of the amounts deferred  
23 according to the Safety Replacement Program. This program is very similar to the  
24 Service Line Replacement Program for MGE. Therefore, the Staff believes the

Commission precedent of not including the Service Line Replacement AAO deferred balance in rate base, as established in the MGE Case No. GR-98-140, is appropriate with regard to Laclede's AAO for the Safety Replacement Program. The life of the assets associated with Laclede's program are in excess of the ten-year amortization period prescribed in the MGE case and proposed by the Staff in this case. As a result of the Staff's proposal, Laclede will be treated consistent with other utilities in the State.

If the Commission determines that recovery of the balances deferred according to the Company's AAOs for MGP, Year 2000, OPEBs and SERP should be allowed, the Staff believes the precedent from the MGE case would also be appropriate with regard to rate base treatment. In its Order in that case the Commission stated that "AAOs are not intended to eliminate regulatory lag but are intended to mitigate the cost incurred by the Company because of regulatory lag." Allowing the Company to defer costs that would normally be expensed serves to mitigate regulatory lag by providing a return "of" amounts that may not be recovered if incurred outside of a rate case. However, including these costs in rate base provides a return "on" amounts that are generally regarded as ongoing expenses or period costs that do not provide future benefits.

Q. Has the Commission ruled against rate base inclusion with regard to AAOs granted to other Companies?

A. Yes. In the St. Louis County Water Company Case No. WR-95-145 the Commission ruled that the AAO balance related to the cost of the 1993 flood should not be included in rate base.

**INCLUSION OF DEFERRED TAXES ON SAFETY DEFERRALS IN RATE BASE**

Q. In his rebuttal testimony on page 25, lines 14 through 19 Mr. Fallert states that it is inappropriate for the Staff to include the accumulated deferred tax balances associated with the Safety and Year 2000 AAOs as an offset to rate base while not including the balances deferred as an increase to rate base. What is your response?

A. The deferred taxes associated with the Year 2000 AAO were mistakenly included in the accumulated deferred tax balance the Staff is proposing as an offset to the rate base. The Staff will correct this item when it files updated Accounting Schedules. However, with regard to the deferred taxes associated with the Safety AAO, the Staff recommends that this amount should be offset against rate base.

Q. Please describe the Staff's recommendation to the Commission on this issue.

A. Mr. Fallert's statements imply that Safety deferred taxes are generated by the Safety deferrals being included in rate base, which is not the case. The Safety deferred taxes are created as a result of the timing difference between when Laclede takes an income tax deduction for Safety deferred costs and when the Safety amortization expense is recognized in the cost of service. Since the existence of the Safety deferred taxes is not related to the inclusion of the deferred balance in rate base (but are created solely because of the timing difference in book and tax recognition), the Safety deferred taxes should be recognized in rate base, regardless of whether the unamortized balance is included in rate base or not.

Q. Will Laclede recover the Safety deferrals in rates if they are not included in rate base?

1           A.     Yes. Laclede will recover in rates the costs associated with the deferrals  
2 over the amortization period authorized by the Commission. The amortization "of" the  
3 Safety deferrals is an expense that will be recovered in the cost of service. The exclusion  
4 from rate base only affects the return "on" the deferrals, not the return of the deferrals.

5           Q.     Please briefly describe deferred income taxes and why they are treated as  
6 an offset to rate base.

7           A.     Deferred taxes are simply the result of timing differences between when a  
8 company deducts a certain expense on its tax return and when it deducts the expense on  
9 its financial records (books). Laclede's deferred tax reserve represents, in effect, a  
10 prepayment of income tax by the ratepayers. As an example, because the Company is  
11 allowed to deduct depreciation expense on an accelerated basis for income tax purposes,  
12 depreciation expense deducted on its income tax return is greater than the depreciation  
13 expense used for ratemaking purposes. This results in what is referred to as a book/tax  
14 timing difference and a deferral of future income taxes is created. The net credit balance  
15 in the deferred tax reserve represents a source of cost free funds to Laclede. Therefore,  
16 the rate base is reduced by the deferred taxes to avoid having ratepayers pay a return on  
17 funds that are cost free to the Company. Deferred taxes result when a cost is expensed in  
18 the income statement in a period different from when it is recognized as a tax deduction  
19 on the tax return. Deferred taxes are not related to whether or not an asset is recognized in  
20 rate base.

21                 The deferred taxes related to depreciation are the most significant  
22 component in the Company's deferred tax reserve. Although these deferred taxes are  
23 associated with Laclede's plant in service, they are not included in rate base because the  
24 plant in service assets are included in rate base. These deferred taxes are included in rate



1 base because of the cash flow benefits related to the book/tax timing difference  
2 associated with the amount of depreciation expense recognized in the income statement  
3 and in the income tax return. Thus, the event that gives rise to deferred taxes is the timing  
4 difference between when the item is deducted in the calculation of income tax and when  
5 it is deducted for the calculation of financial income.

6 Q. Should the determination of whether or not deferred taxes are included in  
7 rate base be contingent on whether the related asset is in rate base?

8 A. No. As described above, inclusion of deferred taxes as a rate base offset is  
9 appropriate due to the provision of cost free capital by the ratepayer and is not contingent  
10 on the specific inclusion of the related asset in rate base.

11 Q. Does this conclude your surrebuttal testimony?

12 A. Yes, it does.

