STATE OF MISSOURI

PUBLIC SERVICE COMMISSION

TRANSCRIPT OF PROCEEDINGS

Hearing

September 24, 2004

Jefferson City, Missouri

Volume 13

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

NANCY DIPPELL, Presiding

SENIOR REGULATORY LAW JUDGE

CONNIE MURRAY,

ROBERT M. CLAYTON III,

JEFF DAVIS,

LINWOOD APPLING,

COMMISSIONERS

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PROCEEDINGS

JUDGE DIPPELL: Let's go ahead and go back on the record. Good morning. We're back on Friday morning in Case No. GR-99-315.

I believe maybe I suggested we might take care of depositions that the parties wanted to offer first. Who wants to begin? Okay, if we don't have this figured out, then we can skip that and come back to it. Let's skip it and come back to it.

Okay, Mr. Lowery, you were in the middle of some recross questions for Miss Schad, and she's returned to the bench.

And I will remind you, Miss Schad, that you are still under oath.

MR. LOWERY: Thank you, Your Honor.

ROSELLA SCHAD, testified as follows:

RECROSS EXAMINATION BY MR. LOWERY:

Q Good morning, Miss Schad.

A Good morning.

Q I think we were talking about, when we ended yesterday evening, I think we were talking about the $1 billion overaccrual the Staff alleged existed in the last Ameren UE rate case, and we were talking about the fact that one-third

of that, about 345 million, was related to net salvage. And I want to talk a little bit more about that.

Staff proposed amortizing that so-called overaccrual over a 40 year period. Do you recall that?

A Yes.

Q So if we take the 345 million related to net salvage, divide by 40, that comes out to 8.625 million; does that sound right? Would you like to verify that?

A Yes.

Q Do you remember what Staff's overall recommended allowance for net salvage expense for Union Electric in that case was?

A It was just under 10 million.

Q So the customers whose rates would be set -- would have been set in that case if Staff's position had been adopted would, on a net basis, contribute about 1.2 million per year toward net salvage?

Actually 1.375 million, I guess. We take 10 million and subtract 8.625 million from that, the 8.625 million being the amount those customers were going to receive back through the

amortization, then net they're contributing about $1.3 million, correct?

A That would be approximately correct, yes.

Q Which means those customers are being subsidized to the tune of $8.625 million, right?

A I don't think that that is true. I think the dollars had already been collected by the company and the company retained those dollars.

Q Those dollars were collected from past customers, were they not?

A They were.

Q And those dollars are being used to lower the rates of customers in the future, were they not?

A That is correct.

Q And it's true, is it not, that you also have recommended in other cases negative amortization similar to that, correct?

A Correct.

Q In the approximately $1.3 million that those customers would actually be contributing to net salvage, if Staff's proposal

had been adopted, that's less than the $2.7 million of net salvage costs that Ameren UE is experiencing in the one account we were looking at yet, account 364.

Do you recall what the current level of net salvage in that account was?

A The current level was just a little over 3 million.

Q So the 1.3 million that they are contributing is about 1.7 million less than the net salvage that we are experiencing in just that one account alone. Correct?

A Correct.

Q Just so the --

A And as -- I would point out, that as the companies' testimonies that pointed out, that that true-up does exist and that is the example of the true-up going into effect.

Q Just so that the record will be just a little bit clearer --

MR. LOWERY: Could I approach the witness, Your Honor?

JUDGE DIPPELL: Yes.

Q (BY MR.LOWERY) Just for the record, this is a depreciation study that we were looking

at yesterday, correct?

A Correct.

Q And it's titled Depreciation Study Calculated Annual Depreciation Accruals Related to Utility Plant at December 31, 2000, prepared by Gannett Fleming, correct?

A Correct.

Q And if we look at the cover letter that's bound within this depreciation study, that's --

MS. O'NEILL: Your Honor, I'll stipulate for the record this is the same depreciation study he dealt with yesterday if it's going to save us some time.

MR. LOWERY: Your Honor, that's not my purpose in making the record clear. Since Miss Schad had indicated she had some different data, I felt like we need to make the record clear about which one we're talking about.

JUDGE DIPPELL: Go ahead, Mr. Lowery.

Q (BY MR.LOWERY) The cover letter that's bound within the depreciation study signed by Bill Stout and John Weidmayer [phonetic] is dated February 11, 2002, correct?

A That is correct.

Q And we were, in particular, focusing on page III-181. Correct?

A Correct.

Q Do you recall our discussion yesterday about the roughly 750 to $800,000 expense level that would have been allowed in the hypothetical 1966 rate case had Staff applied its method to the net salvage costs experienced, say, between 1961 and 1965? Do you recall that discussion?

A I believe so.

Q And we contrasted that with the roughly 3 million level of current net salvage costs that we're seeing in that account?

A You did.

Q Let's take a look at 1965, since we were talking about that example. Look at that one year. What's the net salvage percentage for 1965 in this account?

A Negative 78 percent.

Q I'm going to hand you a document, ask you if this appears to be a printout from Gannett Fleming software.

A Yes, it does.

Q And that relates to account 364. Correct?

A Yes.

Q And that's the same account we're talking about. Correct?

A Correct.

Q What's the plant balance in 1965, according to the Gannett Fleming document that we're looking at related to account 364?

A The plant balance?

Q Yes.

A Sixty-seven million.

Q You're familiar with these kinds of printouts. Correct?

A Yes.

Q Because you use the same software in doing your depreciation studies. Correct?

A Yes.

Q If we divide the 78 percent net salvage percentage by the 34 year average service life, that's going to give us about 2.2 percent. Is that fair?

A Okay.

Q Would you like to verify that?

A You want to ask me that for sure

again?

JUDGE DIPPELL: Miss Schad, could you speak up just a little bit?

THE WITNESS: Okay.

Q (BY MR.LOWERY) If we divide the negative 78 percent net salvage by the 34 year average service life in this account, that would give us a rate of 2.2 percent, roughly?

A Yes.

Q Is that correct? And if we multiply 2.2 percent by the $67.9 million plant balance in 1965, that would give us an accrual of about 1.5 million. And feel free to verify that if you're not sure whether my math is correct. Is my math correct or do you need to verify that?

A You're saying 67 --

Q Point 9 million times that 2.2 percent accrual.

A Point 9 million?

Q Why don't we just go through the math together.

MS. O'NEILL: Your Honor, I'm going to object again to these long examples from several decades ago for a company that's not before us on a rate case as becoming outside the

bounds of relevance.

JUDGE DIPPELL: Okay, I'm going to overrule the objection. We've been going through these long examples throughout the entire hearing with every witness, so we're going to let Mr. Lowery clear this one up and then he's going to move on to something else.

Q (BY MR.LOWERY) If we divide the 78 percent, you verify that I'm doing this correctly, by the 34 year average service life, that's 2.29 percent. Correct?

A Okay.

Q Is that correct?

A Yes.

Q And if we multiply that by the 67.9 million, and I'll just use 67.9, that would be -- $1.55 million would be the annual accrual using that net salvage percent, correct?

A That is correct. And in the next -- for the next year, is there 1.5 million being incurred by the company in the year 1966?

Q And that $1.55 million, that's a very conservative predictor of the $3 million of actual expense that we are seeing in the current period, is it not?

A I cannot tell you that because I don't have the -- I don't have the data to verify that this is representative for data from that year.

Q In your example, Exhibit 148, you used one year, correct, to illustrate your point?

A That's correct.

Q Let's assume just for a moment that the 278 percent number that you calculated had been correct. Isn't it true that that would have been the highest net salvage percent you could have chosen out of the 40 years of data that you had for that account?

A I can tell you that I looked at about three or four of them and they were all over 200 percent.

Q Well, looking at page III-181 of the Gannett Fleming depreciation study, if 278 percent had been correct instead of 120 percent, that's higher than any of the net salvage percentages shown for any of the other 39 years in this account, is it not?

A That is correct. Year 2000 was over 2 percent and the year 1998 was over 2 percent. The year 1995 was over 2 percent. This was starting to show up.

Q But using the 40 years of data that you agreed yesterday was used to calculate the net salvage percent, the net salvage percent for this account, and I should have shown it to you before I walked away, is 134 percent, correct?

A For those 40 years?

Q Yes.

A On that page, yes.

Q Not 278 percent.

A No, it's still higher, though, than the currently ordered rate.

Q But the example you used illustrated a rate that's twice what it actually is in that account, isn't that true?

A Well, assuming that that data is correct, and I would assume that it is. The fact that we have different data in our salvage data files concerns me, but even with that situation, that is correct.

MR. LOWERY: Your Honor, at this time I'd like to request to reserve a late filed exhibit number so that we can obtain from the secretary certified copies of just the pages that I identified with Miss Schad this morning in this depreciation study and put them into the record since Miss Schad has indicated she has different data so that we can clear for the record what the actual Ameren UE data in that case is in EC-2002-1. I'd like that -- to have that admitted to the record once I'm able to get it to the secretary and submitted.

JUDGE DIPPELL: So you want to admit the pages from the study that you have there which is part of the case; is that --

MR. LOWERY: Yes, which is part of EC-2002-1 so that the record in this case will be clear as to what the actual numbers are.

JUDGE DIPPELL: Okay. I'll mark your request --

MR. SCHWARZ: If I might respond? I don't believe that -- and, as a matter of fact, I propose to offer page III-181 if Mr. Lowery doesn't, but I will respectfully suggest to the Commission that simply because -- the only thing that getting an official copy from the Commission's records will establish is that this is what Mr. Stout proposed in the hearing. And it will not resolve any discrepancy between Staff's data files and Gannett Fleming's data files.

JUDGE DIPPELL: And I think that you can point that out in your brief, Mr. Schwarz.

MR. SCHWARZ: Yes. I'm just pointing out that the representation that introducing --

JUDGE DIPPELL: I understand. We're going to mark -- mark that as Exhibit No. 149, and it won't actually have to be a late filed exhibit as such if everyone is prepared to state any objections they have to it now, given that we've been discussing it all afternoon.

MS. O'NEILL: You know, Judge, as many times as we've discussed it, I don't think I've ever actually seen it, so that would be helpful for me to know whether or not I'm going to object.

MR. LOWERY: And just for the record, you made those copies from what source, Mr. Schwarz?

MR. SCHWARZ: I made it from a copy of Mr. Stout's depreciation study that was used in the Staff's complaint case EC-2002-1.

MR. LOWERY: So we're in agreement, then, that that is from the actual depreciation study submitted and made a part of the record in

EC-2002-1?

MR. SCHWARZ: Yes.

MR. LOWERY: That's fine, Your Honor. We don't need to make it a late filed exhibit, we can just admit it to the record at this time.

MS. O'NEILL: Your Honor, I'm going to continue to object on the grounds of relevance. I realize what the result is going to be of that, but I am still failing to see the relevance of Ameren UE from a case filed after this case.

JUDGE DIPPELL: I'm going to overrule the objection. We've been through it. It's relevant as an example. Not relevant obviously as to the specifics of -- for Laclede, but it's relevant as an example. So I'm going to -- are there any other objections to Exhibit 149? Then I will receive it into evidence.

But, Mr. Lowery, I will let you get copies for --

MR. SCHWARZ: I've got copies.

JUDGE DIPPELL: Okay. And that is all the pages that you were intending to submit, Mr. Lowery?

MR. LOWERY: Since Mr. Schwarz has

stipulated that that is from the actual record in EC-2002-1, then we really don't need any additional pages.

Q (BY MR.LOWERY) Miss Schad, I want to just try to clear up a couple of other things related to what's now been admitted to the record as Exhibit 149 which -- do you have a copy of that?

A Yes.

Q The net salvage amount in the last column, that is the -- those are the current net salvage amounts being expended by the company for the years shown. Correct?

A Correct.

Q And that's the numerator in the net salvage percentage calculation when calculated according to the standard approach. Right?

A Correct.

Q And the first column after the year called regular retirements, that is the original cost of the plant retired in that account in the particular years shown. Correct?

A Correct.

Q And that's the denominator, right?

A Correct.

Q And the column labeled Cost of Removal Amount, those are -- those are total retirements, whether the pipe or the pole in this case, the pole or fixture was actually removed or whether it may have been abandoned in place, those are total retirements, whether they be abandoned or removed; is that correct?

A That is correct.

Q Says cost of removal, but it may be removal, may be other costs associated with retirement, correct?

A That is correct.

Q I think in response to some questions Commissioner Murray asked you, you mentioned that if replacement programs end, net salvage costs can drop off significantly. Do you remember that discussion?

A Yes.

Q So after the drop-off, the total net salvage costs would -- could be much less than they were. Correct?

A They could be. Other factors could come in and it could be more.

Q In that case where the costs go down after the drop-off, Staff's cash basis approach

would decrease what needs to be collected. Correct? You reflect that reduction in costs by decreasing the expense allowance that you're allowing. Correct?

A If the company comes in for a rate case.

Q Well, assume the company did come in for a rate case. You would decrease that. Correct?

A That is correct.

Q Could it also be the total net salvage increases as replacement programs ramp up?

A Yes, that is the trend we try and look at.

Q Doesn't that -- dynamic replacement programs ramp down, expense levels go down, expense levels go up, doesn't that contribute to rate volatility?

A I would suspect there are other factors also doing the same thing. In the netting of all of it, I can't tell you what the rate volatility could be.

Q That factor at least contributes to rate volatility, does it not?

A I would say yes.

Q Isn't it true that the standard approach removes that volatility? At least relating to net salvage?

A Does it remove volatility. That's an interesting question because if you're excessively high, that's a volatile situation.

Q Was that a yes or a no?

A I would say it still -- I believe in the way you used it, no.

Q But under the standard approach, we don't adjust expense allowance levels right after ramp down or ramp up or expense levels change in the short term, do we?

A Correct. That's the detriment to the customer.

MR. LOWERY: May I approach, Your Honor?

JUDGE DIPPELL: Yes.

Q (BY MR.LOWERY) I think yesterday you read the first paragraph on page 18 into the record. Do you remember that?

A Yes.

Q And we agreed that the fourth sentence, I believe, that I have highlighted is an expression of the standard approach to calculating

the net salvage percent, correct?

A It is one.

Q It's the -- it is a description of the standard approach as we have used that terminology in this case, is it not?

A It is.

Q Would you read this next paragraph, the second paragraph on that page into the record, please?

A This treatment of net salvage is in harmony with generally accepted accounting principles and tends to remove from the income statement any fluctuations caused by erratic, although necessary, abandonment and removal operations. It also has the advantage that current consumers pay or receive a fair share of costs associated with a property devoted to their service even though the costs may be estimated.

Q And when the NARUC publication refers to this treatment, it's referring to the standard approach described in the immediately preceding paragraph, is it not?

A It is.

Q Is it a fair summary of what that paragraph, particularly the first sentence of that

paragraph, that the NARUC publication is indicating that the standard approach -- this treatment to net salvage removes fluctuations?

A That's what the statement was.

Q That's a fair characterization of the statement, correct?

A Yes.

Q If we remove those fluctuations, aren't we reducing rate volatility?

A Okay, yes.

Q I believe you indicated to Commissioner Murray yesterday that with respect to the negative amortization that you've recommended in the past, that I think the two of you were talking about 20 to 25 years being a reasonable period to amortize back those overaccruals. Correct?

A Yes.

Q And the reason you chose 20 to 25 years is because you indicated that you thought the overaccrual that you alleged existed had been built up over that period. Over a 20 to 25 year period. Is that correct?

A It's possible, yes.

Q So your proposal based on those

assumptions is that amounts contributed to net salvage by customers over the past 20 to 25 years will be paid to customers over the next 20 to 25 years. Correct?

A That is the effect.

Q I think you also indicated that amortizations of over or underaccruals do not happen very frequently in Missouri. Do you remember that?

A Of the depreciation reserve?

Q Yes. Overaccruals that you believe exist in net salvage costs don't happen very often in Missouri. Was that your testimony?

A I only know of a few.

Q Don't you calculate the difference between the actual and the theoretical reserve in every depreciation study you do?

A Sometimes the data is not available to --

Q If you had the data, wouldn't that be a standard part of the depreciation study?

A Yes.

Q And if the difference between that actual and the theoretical was small, then no amortization would be needed. Correct?

A Correct.

Q And wouldn't that mean that the estimates are good and have changed little over time, and as a result of those good estimates, we haven't seen very many amortizations, have we?

A Again, you have to have the data to support it. If the data isn't there, then work can't be done, and that perhaps is the reason that we haven't seen them.

Q We really didn't see any proposals to do a negative amortization until Staff started following its approach, did we?

A I'm not aware of them earlier.

MR. LOWERY: That's all the questions I have. Thank you.

JUDGE DIPPELL: Thank you, Mr. Lowery. Is there further cross examination based on questions from the bench from Laclede?

Commissioner Murray, you have a question?

COMMISSIONER MURRAY: I'm sorry, I just have one question, I want to clear something up to make sure I understand.

BY COMMISSIONER MURRAY:

Q On your exhibit 147, what does the

denominator number represent?

A The denominator is the dollars of plant retired.

Q Dollars of plant retired. Explain that more. That could mean a number of things.

A If during that period you retired a given amount of plant, that plant has, on the books and records, dollars associated with it.

Q It's original cost dollars?

A Yes, it is.

Q And do those original cost dollars include the net salvage allowance?

A No.

Q This is just the dollars -- dollar amount of the original cost of the plant that was retired in that particular period of time. Is that right?

A That is correct.

COMMISSIONER MURRAY: Okay. Thank you.

JUDGE DIPPELL: Thank you. Would Public Counsel have any additional questions based on the Commissioner's question?

MS. O'NEILL: No, Your Honor.

JUDGE DIPPELL: Did Ameren want to

ask anything further based on the Commissioner's question?

MR. LOWERY: No, Your Honor.

JUDGE DIPPELL: Okay. Does Laclede have any further recross?

MR. ZUCKER: No, Your Honor.

JUDGE DIPPELL: Okay. Is there any redirect from Staff?

MR. SCHWARZ: Yes, there is.

JUDGE DIPPELL: Thank you.

REDIRECT EXAMINATION BY MR. SCHWARZ:

Q Good morning.

A Good morning.

Q There were questions to you yesterday about cash flow and the impacts of depreciation on cash flow. Do you recall those?

A Yes.

Q Would you agree that both you and Mr. Stout concur that cash flow is not a consideration in calculating depreciation rates?

A I would.

Q I think you had some questions yesterday about experts and authoritative sources. Do you recall those questions?

A Yes.

Q I'm going to read you a definition and tell you that this -- in Missouri, in any civil action, if a scientific, technical or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness is qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise. That's the law in Missouri.

MR. LOWERY: Objection, calls for a legal conclusion on the part of a lay witness, I think at least when it comes to this subject.

MR. SCHWARZ: No, it doesn't. I didn't ask the witness if she agreed with that, I'm instructing her that it's the statute in the state.

MR. LOWERY: Then it's irrelevant.

JUDGE DIPPELL: I don't even think a question's been asked yet, Mr. Lowery, so I'm going to let Mr. Schwarz continue.

Q (BY MR. SCHWARZ) Given that that's the definition of an expert, Mr. Lowery went through a list of people yesterday. Mr. Winfrey, Mr. Ron White, Mr. Bob White, Mr. Stout. Under that definition, would those people qualify as

experts?

A Yes, I would agree.

Q But you seem to make a distinction between expert and authoritative. Could you explain that for me, please?

A Well, authoritative would be in regard to that there is a body that can sanction for violation of principles. If something is an authoritative body, they have certain powers to operate under.

Q Let me ask you this. Is it possible for experts on a particular subject to agree on some points and disagree on other points?

A Yes.

Q And with respect to authoritative statements, am I understanding you correctly to say that there are some points if -- if an expert doesn't agree or doesn't apply those points, they can somehow be sanctioned or disciplined?

A Yes.

Q When you cite something to the Commission from a text or a article, something of that nature, are you asserting to the Commission that that is a reliable source for the particular point on which it is cited?

A Yes.

Q You were given an example yesterday, I think, of a fleet of trucks with a ten year life expectancy and 10 percent historical net salvage. Do you recall those questions?

A Yes.

Q And I think you indicated that given those circumstances, that you would -- that Staff would, in fact, accrue net salvage. Is that correct?

A Yes.

Q And is the reason for that that Staff believes that that estimate of net salvage is accurate?

A Yes, that would be the context of that.

Q You were asked questions about mains that might be removed in the late '90s would have been placed, on average, 70 years earlier. Do you recall those questions?

A Yes.

Q In that -- and is the Staff attempting to accrue the future net salvage of all plant in service at the present time?

A Can you ask that again?

Q Is Staff attempting, in its evolutionary manner, to accrue all future net salvage of a particular plant account?

A No.

Q What is Staff attempting to do?

A Staff is attempting to provide the level of cost of removal in rates for which the Company is incurring them.

Q So is -- is it safe to say that Staff is attempting to provide recovery for plant that will actually retire in the next three to five, six years?

A That is what Staff is attempting to do, yes.

Q And given that, that the two estimates are not estimates of the same thing, is it surprising that the estimates are different?

A No.

Q I think that you were asked if Mr. Adam, in his testimony, indicated that he would prefer an estimate of cost to remove property in the near future, and I believe that your response said that it was not in the text of his testimony. Do you recall that?

A Yes.

Q If he didn't, would we be here today?

A No.

Q I think Mr. Zucker asked you a series of questions about a property that retired in 20 years instead of the -- of replacement instead of the 30 year average service life. Do you recall those questions?

A Yes.

Q And isn't it part of the very concept of average service life that some property will have a shorter life and some property will have a longer life?

A Most definitely.

Q I think he also asked you if the $50 million that Laclede makes in capital improvements was known and measurable, and I think that you agreed to that. Do you recall that?

A Yes.

Q Is that true only of historical investments that Laclede has made? Strike that. Let me rephrase it.

Is it known and measurable that Laclede will invest $50 million in capital in plant in the year 2006?

A No.

Q Is it known and measurable that they will do so in 2010?

A No.

Q So it's only with respect to what Laclede has done recently that you can say that $50 million will be known and measurable?

A Correct.

Q I think that you noted that in Chapter 40 of the Commission's rules in which it adopted the USOA that the Commission specifically noted that the USOA would not be for amounts recorded thereunder, would not be binding in rate making proceedings. Is that --

A That's correct.

Q So under the USOA, could Laclede properly book its $50 million as an expense rather than a capital item?

A Um --

Q Laclede is not free to record capital expenditures as an expense under the USOA, is it?

A No.

Q However, in the rate making process, Laclede would be permitted to ask the Commission to expense that $50 million per year, could it not?

A Yes.

Q Has Laclede ever done so?

A Not that I'm aware of.

Q Mr. Zucker asked you, in looking at overaccruals, how far back you would go. Do you recall that question?

A Yes.

Q At any point in time in a plant account, there will be items of plant from many vintages, will there not?

A Yes.

Q Some of those vintages might be as much as 40, 50, 60 or more years old. Is that correct?

A Yes.

Q And in examining the accrual and the reserve for that account, you would have to examine the entire period in which plant is remaining. Is that accurate or --

A Yes. You would have to go to that depth.

Q If you only went back five years in looking at overaccruals, what would happen to the safeguards that the traditional method or standard method is supposed to be providing for, say, years that were ten or 15 or 20 years ago?

A It wouldn't exist.

Q I think you were asked a question if there was anything in the record to indicate that net salvage and not average service life is the problem. Do you recall that?

A Yes.

Q Is the estimator of average service life considered reasonably accurate by both Laclede and Staff in this case?

A Yes. I mean, in this case, because we don't have some other situations going on.

Q Mm-hmm. And we are discussing negative net salvage, are we not?

A Yes.

Q You were asked about possibilities of rate shock under the Staff's method. Do you recall those questions?

A Yes.

Q From your review of records generally, would it be fair to say that the cost of removal recovered in rates would increase gradually over time as the actual cost of removal increases under Staff's method?

A Yes.

Q So that you would not anticipate, given relatively regular rate cases, that there would be a sudden and dramatic change?

A No.

Q Let me ask you this. Would you expect that -- well, strike that. Calls for speculation. Well, no, it doesn't.

I think that Union Electric has asserted that the cost of removal has gone up over time. Would you --

A Yes.

Q So it's safe to assume that between 1987, say, and 2002, that Union Electric's cost of removal went up; is that correct?

A Yes.

Q Did customers suffer from rate shock in 2002 when the rates changed?

A No.

Q Rates actually went down in 2002, did they not?

A They did.

Q Even though the cost of removal had gone up. Is that correct?

A That is correct.
Q Do you have a copy of Exhibit 149 in front of you?
A I do.
Q And because you used it in your example, and although the numbers may still be in dispute, I am going to ask you to consider the year 1996.
A Okay.
Q The exhibit indicates that $2,502,125 was retired in the poles and fixtures account in that year. Do you agree with that? That that's what it says?
A That is what it says.
Q Would you expect, given what you know about poles and fixtures, that there -- that figure may reflect retirements from more than one vintage of plant?
A From many vintages of plant.
Q As many as 30 or 40, perhaps?
A Yes.
Q And that means that the plant that was retired, then, some of it was placed in 1956 and some was placed in '66, and -- perhaps. I mean, we don't know that plant from any vintage

retires in any particular year, do we?

A No.

Q So how would you establish that -- okay. And the $3,006,896 that is the net cost to remove that plant, those costs would be associated with many vintages of plant, would they not?

A They would.

Q And how would you go about checking whether the standard formula, if you will, accurately predicted that $3,006,896?

A You would have to have very detailed records going back for each year, and then cumulative until the present time.

Q So you would need the estimates for each of the vintages for each of the years that particular vintage that retired had been exposed for retirement purpose?

A I would need that estimate for each year, for each -- up -- from the beginning of the time until year 1996.

Q And, to your knowledge, has anyone established the accuracy of any of these net salvage estimates for Union Electric?

A No.

Q Has anyone established them for

Laclede Gas Company?

A No.

Q Has anyone established them generally for any utility property that you're aware of?

A No.

Q If such a proof existed, would experts like Mr. Wolf, Mr. Fitch, Mr. White, Mr. White, and Mr. Stout and Mr. Ferguson have published such a study?

A I believe so.

Q Would you expect such a study to be disseminated by organizations such as the Society of Depreciation Professionals?

A Most definitely.

Q I'm not sure if I'm going to need to draw lines or not. With respect to 1996, I believe that you and Mr. Lowery, using the Company's figure, the two million five, established what the accrual would have been for that year, did you not? Can you check -- I didn't write the number down. Do you have that? 13, 15 million? Something like that?

A Do you have a copy of that exhibit?

Q Well, I have a copy of the exhibit,

but not with the Company's numbers. I will show you this sheet which Mr. Oligschlaeger provided, and it suggests that the -- under the Company's -- using the Company's number, that the accrual would have been $16 million. Does that refresh your recollection?

A Yes.

Q So that even under the Company's assumption or figures, that the accrual would exceed the actual net salvage for that year by $13 million. Is that correct?

A Yes. It says the amount of $13 million.

Q Is it your understanding of the testimony in this case that there is, as far as the accruals are concerned, that there is an upward trend in those accruals based on plant growth, inflation, and -- there's one other factor that I -- generally, that there's an upward trend in those?

A Yes.

Q Would you agree there's also an upward trend in actual cost of removal?

A Yes.

Q Does the existence of an upward

trend in the accrual establish that those accruals are accurate estimators of the actual cost of removal?

A No.

Q If there -- if there were such a study, would you expect that Mr. Stout, Mr. White, Mr. White, Mr. Robely, and Mr. Fitch and Mr. Wolff would have published such a study?

A I would have expected that, yes.

Q And no such study --

A It doesn't exist.

Q And is that -- well. Is that consistent with Mr. Stout's testimony yesterday or the day before, whenever it -- with Mr. Stout's testimony that such a study by vintage cannot be done? Is his statement consistent with the fact that there are no published studies?

A Yes.

Q Were you present for Mr. Stout's testimony?

A I was only present in the room for just a few minutes. But I was --

Q Let me -- that's fine. Let me suggest to you that -- do you have a copy of WMS-4-1?

A Yes.

Q Okay.

A Okay.

Q There's a column headed Estimated Net Salvage Costs. Do you see that?

A Yes, I do.

Q And there's also a column headed Net Salvage Accrual. You see that?

A Yes, I do.

Q In order -- and -- and those -- at -- at the end of the exhibit on the next page, those pretty much both come back to zero. You see that?

A Amazingly so, yes.

Q Well, is it correct that in order for those to -- to come to zero, that is, the net salvage accrual over time eventually equalling the net salvage costs, that those net salvage costs must be accurate?

MR. PENDERGAST: Your Honor, I'm going to start -- I need to object here now. I don't hear Mr. Schwarz prefacing his questions by did so and so ask you this and I need to elaborate on that. Now he's starting to go through testimony and asking her to basically, I don't know, provide surrebuttal testimony or something, and I don't believe that's appropriate on redirect.

MR. LOWERY: Your Honor, I would add that it's beyond the scope of cross examination. I don't believe she was asked any questions about WMS-1 during any of the cross examination.

MR. SCHWARZ: She may not have been, but Commissioner Clayton asked her yesterday if Staff wouldn't have a chance to update and verify the standard approach in a rate case, and this goes -- this is demonstrating the response to Commissioner Clayton's question.

JUDGE DIPPELL: Okay, I'll allow it. Objections overruled.

Q (BY MR. SCHWARZ) So in order for the numbers to come out even at the end, the estimated net salvage has to be accurate. Is that correct?

A That is correct.

Q Do you have Exhibit 149 in front of you?

A I do.

Q The last column contains a net salvage amount. Do you see that?

A Yes.
Q I'd ask you to add up the last five numbers in that account and then divide by five.
A Beginning with the year 2000 and going back?
Q Yes.
A Or 1999?
Q That's fine.
A I'll start with 1999 and go back five years. Okay.
Q And what's the average?
A The average is 3,232,366 from 1999, 1998, 1997, 1996, and 1995.
Q Could you repeat the number again for me? I'm sorry.
A 3,232,366.
Q And now would you do the same for the five years before that?
A Starting with 1994?
Q Whatever the last year is.
A 2,697,391 for the years 1994, 1993, 1992, 1991, and 1990.
Q Okay. Thank you. Now, Commissioner Clayton did ask you yesterday if Staff doesn't have a chance to true things up in the -- in rate

cases, for instance. Do you recall those questions?

A Yes.

Q Again, looking at a Schedule WMS-4-1, just for illustrative purposes, are you with me?

A Yes.

Q Okay. Assume you're in 1999.

A Okay.

Q And we're just considering the property that's in service in 1999, is that correct, on the schedule?

A Yes.

Q In order -- where -- at what year in this exhibit would you be comfortable in saying that the estimate was or was not accurate? That is --

A In the year after I can see the results.

Q Well, if you look on that second page, by the time you get down -- say in 2070, there's not very much remaining. It's --

A I'm sorry, I'm --

Q No, no. Exhibit 4-1.

A Oh. Okay, I'm sorry, I didn't

return to it. Okay.

Q So we're -- we're standing in -- or viewing things from 1999. We know the property that's in the account, we know what the account balance is in 1999. Okay? And we're going to try to determine if the net salvage accrual over time is actually a good estimator of the net salvage costs. How far out would you have to go in order to be comfortable with such a comparison?

A Well, to actually know, you'd have to be beyond the point where any plant today is no longer in service.

Q On the exhibit, that would be the year 2080?

A Yes.

Q Might it be possible, given the balances that -- and the relative magnitude of numbers, that maybe 2050 or 2030, 2040, you might get a pretty good feel for accuracy?

A If you had all the numbers and could start evaluating them, you would start to be getting a feel for it.

Q But standing in -- or viewing the account from 1999, of course, you don't have any of the actuals to match to the estimates?

A No, I do not have that.

Q I think Mr. Lowery asked you if the standard approach or standard method removes volatility. Do you recall that question?

A Yes.

Q I will ask you if the standard method masks volatility rather than removing it.

A I think that was why I was having the difficulty with the question, because it does mask it.

Q And would an average also mask the volatility?

A No.

Q An average would -- an average -- strike that.

The volatility in the account is going to exist no matter how rate payers are charged; is that correct?

A That is correct.

Q And we use a trend or an average to -- to mitigate the volatility as far as rates charged customers; isn't that correct?

A That is correct.

MR. SCHWARZ: Thank you. I'm through.

JUDGE DIPPELL: Thank you.

Commissioner Murray, did you still have another question you wanted to ask?

COMMISSIONER MURRAY: I did. I'm sorry, but that's one of the perks of being a Commissioner, you can ask questions any time, and Mr. Schwarz raised a couple of things that I need to clarify.

BY COMMISSIONER MURRAY:

Q Miss Schad, you were asked by Mr. Schwarz, and I'm quoting from his question, he said, there were questions to you yesterday about cash flow and the impacts of depreciation on cash flow. Do you recall those?

Yes.

And another question, would you agree that both you and Mr. Stout concur that cash flow is not a consideration in calculating depreciation rates?

And then your answer was, I would.

Do you recall that?

A Yes.

Q In Mr. Stout's testimony on page 27 of his supplemental direct, he was asked the question, should the need for cash flow to meet infrastructure issues be a requirement for a utility using the standard straight line whole life method incorporating the accrual for net salaries. Did you see that?

A Yes.

Q And then his answer was, no. In my opinion, it should not. The utilities should be permitted to use the standard approach regardless of their cash flow needs. Although there are cash flow benefits to the use of the standard approach that will make it easier for utilities to invest in infrastructure improvements, its merit rests on the systematic and rational allocation of net salvage for an asset to the periods during which the asset provides benefits to customers. This is good regulatory accounting and sound rate making practice.

Do you see that answer?

A I do.

Q And I went through his testimony quickly after you were asked that question here today to see if there were any other references to cash flow in his testimony, and I did not find any, but I don't know how you interpret that to say that he agreed that there should be no consideration of cash flow in calculating depreciation rates.

A In calculating a depreciation rate, I have set parameters and --

Q I'm asking how you interpret that Mr. Stout said that cash flow should not even be a consideration. I read it that he said it should not be a requirement. Where do you find that he said it shouldn't be considered?

A Okay. The difference between the consideration and the requirement would impose on the analyst a way in which to incorporate it. And I do not have that -- the -- the consideration, if it is to be done, I need a tool in order to be able to do it.

Q Okay. That's you. I'm asking you how you say that Mr. Stout said that it should not even be a consideration in the calculation of depreciation. And that is what your answer said. I don't know, maybe you didn't hear the question exactly or what, but I just want to clarify where you -- where you are, what you are basing that on, that that's Mr. Stout's position.

A That it should not be considered.

Q Yes.

A If I have interpreted that difference, then I would say that I would not be able to confirm him having said that.

Q Okay. And then I want to ask you just a couple of questions about that WMS-4-1 that you were just talking about.

A Yes.

Q Mr. Schwarz asked you about the zero balance at the end and how it came out to zero. Do you recall that?

A Yes.

Q And you indicated that the estimates would have had to have been perfect for it to come to zero. Is that right?

A Yes.

Q And if they were not perfect at the time of retirement, would there be an adjustment made and the difference amortized over some period?

A Into the year 2080, I would assume that would be correct.

Q So, then, eventually, it will come to zero?

A Well, I don't know if it will come to zero, I can't predict that.

Q Well, is it not adjusted in order to achieve that result? Is that not the purpose of the adjustment?

A It is if -- if I have the means in order to determine that.

Q Well, if it's retired, don't you have a means to determine what the actual cost of retirement was?

A I don't have the means to -- for all -- for each of the different vintages, I don't have the means to take and know what the actual was and know what the estimated was. Unfortunately, I don't have that -- I don't have that universe of data.

Q Okay. And just one more question. If you look at that WMS-4-1 again, and you were attempting to look at year '99 -- or at year '99 determine whether the estimated life of the property being year 2080 were accurate. Could you do that in '98 or '99?

A No, I could not.

Q So that's the same as not being able to accurately estimate the value cost of the net salvage in the year '98 or '99, is it not?

A I could not accurately estimate the

average service life, that is correct.

Q So depreciation always includes some form of estimate that is not verifiable at the time the estimate is made; is that right?

A That is correct.

COMMISSIONER MURRAY: Okay. Thank you.

JUDGE DIPPELL: Thank you.

Were there any other Commissioner questions? Commissioner Davis?

BY COMMISSIONER DAVIS:

Q Miss Schad, when you refer to Staff or when Mr. Schwarz refers to Staff, and you seem to respond to the questions like everyone here knows who the Staff is, could you please enlighten me as to who these Staff people are?

A For purposes of depreciation, it's myself, Guy Gilbert, Jolie Mathis, Greg Macias, and our manager, Lisa Kremer.

COMMISSIONER DAVIS: Thank you.

JUDGE DIPPELL: Is there any other Commission questions?

Q (BY COMMISSIONER DAVIS) I have -- and is there unanimous agreement under -- with -- amongst the Staff members that you just referenced

that -- I can't remember the witness in the '99 case.

COMMISSIONER DAVIS: What was his name, Judge? Paul Adam.

Q (BY COMMISSIONER DAVIS) That, you know, Paul Adam's methodology and your methodology are the way to go?

A Commissioner, it is.

COMMISSIONER DAVIS: Thank you.

COMMISSIONER CLAYTON: Was your question that it was unanimous among the Staff?

COMMISSIONER DAVIS: Yes.

COMMISSIONER CLAYTON: And your answer was yes?

THE WITNESS: Yes.

BY COMMISSIONER CLAYTON:

Q Was there not testimony just the other day that this was an evolving process and there was disagreement among the Staff? Didn't we hear testimony about that yesterday?

A Maybe upon understanding the question, I'm seeing it as the concept of on a current basis, and then how do you fine tune current. Should you put some small -- should there be inflation. Should there be some small, minute adjustments in order to make the current --

Q I don't need an explanation, I think I just want to -- the Staff working on this depreciation issue, I mean, do you all -- is there disagreement about what method to use in general on rate cases, or is there -- is it unanimous in the department that this method that you have adopted as part of your testimony is the method that should be used? Do you understand my question?

A I think I do, and you can tell me if I don't. We've got two concepts going on. One is in the accrual, but achieving the current level; and one is expensing it, but achieving the current level. So as --

Q So there are two concepts? There's agreement on the one concept and disagreement on the second concept? Or -- is that what you're getting at?

A I -- there is agreement that it needs to be on the current level. And to the extent of it being in the accrual or expensing, I believe that -- I don't know how to say this.

The reason that we -- we supported this '99 case, it was on the current level, and that's a concept. But there's been -- there's so much confusion about how much is in the reserves because we don't separate the two, we have evolved to separating it, expensing it, achieving the same purpose. But expensing it and the accrual is two different concepts, Commissioner.

Q I agree with one thing that you said in there, and that's lots of confusion, especially on my part.

A So this is acceptable in the sense if you're going to have it in the accrual, it is acceptable to us as a Staff. If we can get the reserve reflecting original costs and the amount of cost of removal being expensed, that is even more acceptable.

Q So you do support the accrual method if Staff would feel more certain with certain variables?

A Yes. It could be in the accrual if we could separate it. And we -- we still calculate the net salvage percentage such that it derives a current level. But identify it as such. Identify how much it's going to be and identify how much it's going to be for the original cost.

COMMISSIONER CLAYTON: Okay. Thank

you.

JUDGE DIPPELL: Is there anything further? Mr. Davis?

COMMISSIONER DAVIS: One moment, please.

COMMISSIONER CLAYTON: Can I ask a question while you do that?

COMMISSIONER DAVIS: Go ahead.

Q (BY COMMISSIONER CLAYTON) The number that we are fighting over on this issue, where does it go in the rate making formula? It goes in both the rate base calculation and in the add back in component of depreciation?

A The depreciation expense --

Q For the -- for the net salvage component. Where does it go?

A In the depreciation expense.

Q Okay. So that is the -- the add back in to the rate base calculation?

A Yes.

Q And then it's also taken out of rate base within -- within the rate base calculation. Correct?

A The depreciation expense that flows into the reserve is off savings rate base. I don't see how it's --

Q So you have plant in service and subtract off this amount for net salvage, right? In your rate base calculation? So it's subtracted out before you -- no?

A I don't believe so.

COMMISSIONER CLAYTON: I want to ask somebody that. Can I ask Counsel that, Judge?

JUDGE DIPPELL: I think you can ask Counsel that.

COMMISSIONER CLAYTON: Tim, is that right? It's subtracted out?

MR. SCHWARZ: I, as an attorney, will not be a witness in the case. Mr. Oligschlaeger is an accountant, a CPA, and I think he would be able to answer such a question, assuming that he testifies.

COMMISSIONER CLAYTON: Thank you.

MR. BYRNE: Your Honor, if you'd like to hear from me, I'll tell you. My understanding is that the net salvage goes into the depreciation expense, but then the depreciation reserve is -- the total depreciation reserve is deducted from the rate base.

COMMISSIONER CLAYTON: So it

increases depreciation, so your plant in service increases the number that you subtract out before you multiply it times the embedded cost of capital, correct?

MR. BYRNE: Correct.

COMMISSIONER CLAYTON: And then you add it back in as an expense under the accumulated depreciation?

MR. BYRNE: They're two separate things.

COMMISSIONER CLAYTON: I understand. You call it an expense, but it's added back in?

MR. BYRNE: Yes.

COMMISSIONER CLAYTON: Okay. Thank you. Does anyone else want to comment on that? I'm really not trying to ask --

MS. O'NEILL: No.

COMMISSIONER CLAYTON: Just wanted to make sure I got that right.

Q (BY COMMISSIONER CLAYTON) Miss Schad, if I could ask this question. In the '99 case, what was the dollar amount of Staff's position that -- that expense totaled out to be in taking the average of the net -- cash net salvage -- or net cost of removal expense? And a general

number. I mean, is -- you don't have to get the exact figure, but within a million.

A I know that the -- the issue, because not all accounts were being -- only three account -- accounts were being affected, and for those accounts it was -- I think the difference was about -- the difference was about 2.3 million. I do not know without looking it up, I do not know what Staff's dollar amount was.

Q Okay. So the difference is the $2.3 million. Okay. Do you know if there's any way to track moving forward whether the difference between these two methods would increase over time or would -- would narrow over time as you -- as you went out on the X axis of a graph? Is there any way to estimate that?

A Well, Staff's number would be increasing, because cost of removal is increasing. The rate at which, as Mr. Stout pointed out, that ratio was increasing, the -- the difference between those two rates of increase, I cannot tell you how much difference is going to be. I do think it's going to diverge. It's going to grow more.

Q It's going to increase, the gap will

increase?

A Yes.

Q And, of course, that increase would occur as your number of customers would also be growing that would be sharing in that expense. Right?

A That is correct.

Q So the more customers that you have in the -- as your -- as your overall rate base would be growing, the impact would also be decreasing on a customer. Right?

A It -- it may decrease, it may just stabilize, depending on how -- how large account system grow. I mean, there's -- it's not infinite growth that the system can take as far as customers.

COMMISSIONER CLAYTON: That's all I have.

COMMISSIONER DAVIS: Thank you, Commissioner Clayton.

BY COMMISSIONER DAVIS:

Q Okay. So, Miss Schad, let me see if I understand something you said a little bit earlier. It seems to me the primary -- your -- one of your primary objections to the way Laclede

calculates their depreciation is the fact that they don't use the sinking fund method of depreciation where -- whereby they would set aside a fixed portion of money in a separate pot to cover future net salvage; is that correct?

A That is a concern, yes.

COMMISSIONER DAVIS: No further questions.

JUDGE DIPPELL: Okay. Do I have any other Commission questions? All right.

Will there be any further cross based on those questions from Public Counsel?

MS. O'NEILL: Your Honor, if I thought I could clarify a concern, I would do it, but I don't think I can either, so no questions.

JUDGE DIPPELL: Would Ameren have anything further?

MR. LOWERY: Little bit. I won't give a number, though.

RECROSS EXAMINATION BY MR. LOWERY:

Q Miss Schad, I believe you were talking with Commissioner Clayton about -- you were going through the roster of Staff's current depreciation Staff, and maybe that was Commissioner Davis, actually.

A Yes.
Q And you were talking about the evolution of Staff's approach and opinion, how they deal with net salvage. Correct?
A Correct.
Q Do you recall yesterday when we agreed that Mr. Gilbert in 1997, who is currently on Staff and was at that time, recommended use of the standard approach rather than the approach Mr. Love had recommended in 1990 and '93 and rather than the approach that you and Mr. Adam recommend. Do you recall that?
A Yes.
MR. LOWERY: That's all I have.
JUDGE DIPPELL: Thank you. Is there any further cross examination from Laclede? Based on these last Commissioner questions?
MR. PENDERGAST: No, Your Honor.
JUDGE DIPPELL: Thank you. Is there any further redirect from Staff?
FURTHER REDIRECT EXAMINATION BY MR. SCHWARZ:
Q As between the standard method and Staff's approach, is the Staff of the same opinion that Staff's approach is better? At the -- current Staff.

A Yes.

Q And is Mr. Gilbert now your manager?

A He's our engineering supervisor, yes.

Q Yes. And that's the same Mr. Gilbert who testified in the earlier case?

A It is.

MR. SCHWARZ: That's all.

JUDGE DIPPELL: Okay. Miss Schad, I believe we are finished with you.

THE WITNESS: Okay.

JUDGE DIPPELL: You may be excused. We are going to take just a five minute break and then we will come back and get started with Staff's next witness.

At 10 o'clock, however, I will have to stop again and we will take another 15 minute break at that time, and Judge Thompson will join you and I will leave you. So let's go off the record.

(Off the record.)

JUDGE DIPPELL: I'm going back on the record. Okay. Um, during the break, Mr. Lowery approached me and suggested perhaps that Exhibit 148 had never been entered into evidence.

I guess technically that's Staff's exhibit so I should wait for Mr. Schwarz to show up to ask him if he will offer that.

MR. LOWERY: And here he is.

JUDGE DIPPELL: And there he is. Mr. Schwarz, Mr. Lowery approached me at the break and suggested that perhaps Exhibit 148, even though it's sort of incorporated as part of Miss Schad's testimony, just to clarify on the record should be offered into evidence. Would you agree --

MR. SCHWARZ: 148?

JUDGE DIPPELL: Yes, that was Miss Schad's exhibit during her testimony.

MR. SCHWARZ: I would offer it into the record if such an offer would be tendered.

JUDGE DIPPELL: Would there be any objection to that exhibit?

MS. O'NEILL: No.

JUDGE DIPPELL: All right, then, I will receive Exhibit No. 148. All right.

Let's go ahead, then, and get Mr. Oligschlaeger set up for Judge Thompson.

MR. SCHWARZ: Has he been sworn?

JUDGE DIPPELL: Oh, I'm sorry.

(Witness sworn.)

MARK L. OLIGSCHLAEGER, testified as follows:

DIRECT EXAMINATION BY MR. SCHWARZ:

Q Would you state your name for the record, please?

A My name is Mark L. Oligschlaeger.

Q And by whom are you employed?

A I am employed by the Missouri Public Service Commission.

Q In what capacity?

A I am a regulatory auditor.

Q And are you the same Mark Oligschlaeger who has caused to be prefiled in this case supplemental rebuttal testimony?

A Yes, I am.

Q And if I asked you that -- do you have any corrections to make to that testimony?

A No, I do not.

Q If I asked you the same questions today as are set forth in your testimony, would your answers be the same?

A Yes, they would.

Q And are those answers true and correct, to the best of your information and belief?

A Yes, they are.

MR. SCHWARZ: I would offer Mr. Oligschlaeger's testimony into the record, and tender him for cross examination.

JUDGE DIPPELL: Thank you. Is there any objection to Exhibit No. 142?

MS. O'NEILL: No, Your Honor.

MR. BYRNE: No.

JUDGE DIPPELL: Then I will admit Exhibit No. 142 into the record.

Is there any cross examination from Public Counsel?

MS. O'NEILL: No, Your Honor.

JUDGE DIPPELL: Is there cross examination from Ameren UE?

MR. BYRNE: Yes, Your Honor.

JUDGE DIPPELL: Okay. I'm going to let you get started, Mr. Byrne, and I'll cut you off in about ten minutes.

MR. BYRNE: Maybe I'll be done. Maybe not.

CROSS EXAMINATION BY MR. BYRNE:

Q Good morning, Mr. Oligschlaeger.

A Good morning.

Q I would like to ask you a couple

questions about the scope of your testimony. Would it be fair to say that you are not a depreciation expert?

A Specializing in depreciation, that would be fair, yes.

Q Okay. I mean, in other words, like you're not a depreciation engineer, for example?

A I have knowledge of depreciation expense just from my work as a regulatory auditor, but in terms of specialized knowledge in depreciation, education, no.

Q No training specifically in depreciation or anything?

A No, I do not have.

Q And my understanding is your background is as an accountant, right?

A That is correct.

Q The testimony previously has shown that the Staff has had a number of versions of its treatment of net salvage over the years, starting with Mr. Love in 1990 and then Mr. Adam's approach in this case, and then I think there's yet another approach that's currently being used. Is that fair to say?

A I believe so.

Q And can you explain the difference between all those approaches?

A Start -- I don't necessarily have the detailed knowledge of what was proposed by the Staff in the 1990 case by Mr. Love. My general recollection is he continued to reflect net salvage as a component of the overall depreciation rate, but calculated that component based upon the recent historical experience of that company in the area of net salvage, and he also incorporated, I believe, use of inflation factors.

In the 1999 Laclede case for which we are here today, I believe, again, Mr. Adam proposed to incorporate net salvage as a component of depreciation rate based upon recent historical experience of Laclede in the area of net salvage.

Since that time, I believe the -- in subsequent cases, the Staff has not incorporated net salvage directly as a component in the depreciation rates it recommends, but instead has recommended that the Commission recognize net salvage in rates as a -- as an expense item.

Q Okay. Would it be fair to characterize the Staff's treatment of net salvage in this case as a cash approach? As opposed to an

accrual approach?

A I believe it has characteristics of both. But including net salvage in the overall depreciation rate, even if it's not calculated according to the standard method, the impacts of that net salvage would still be reflected in the depreciation reserve, and I believe that has the general characteristics of accrual accounting.

However, as I noted before, the means by which the Staff estimated the net salvage percentage was based upon the recent cash outlays of the Company. So it also would have aspects of cash accounting.

Q Okay. And I think there's been some testimony about this before, but I'll ask you, since you're an accountant, would you agree that the uniform system of accounts, and in particular I think it's General Instruction 11, mandates accrual accounting?

A Yes, I believe it calls for accrual accounting in terms of the recording of the revenues, expenses, and capital investment of the utilities.

Q Okay. Would you agree that the adoption of the Staff approach rather than the

standard methodology reduces cash flows for utilities?

A Yes.

Q And to the extent that a utility's cash flows are reduced, where would it get the cash to make up for that reduction? What are the possible sources?

A Well, I think in the context here, you're talking about a reduction of cash flows from the company's current customers. If that flow is reduced, then the company would presumably seek the money from its investors and -- the bondholders and shareholders of the company.

Q Would you agree that cash flow is an important consideration for credit rating agencies who are assessing the creditworthiness of a utility?

A I believe that is something they would consider important in assessing the utilities.

Q Yeah, I -- I think Mr. Baxter, on behalf of the Company, testified that it was a very important consideration. Would -- would you agree with that or not?

A Well, the -- important versus very

important? It's something credit rating agencies would be concerned with and the primary focus of their analysis. I could agree with that.

Q Okay. And I -- maybe this is just obvious, but the more cash flow you have, the better your credit profile; is that true?

A I -- in terms of the credit rating agencies, yes.

Q Okay. And is it true that -- and I guess conversely, the lower the cash flow, the worst credit profile from the standpoint of the credit rating agencies?

A All else being equal, yes.

Q Okay. And to the extent you have a poor credit profile, would it be fair to say that that would tend to increase the cost of debt available to a utility?

A It's my understanding that the cost of debt depends upon the ratings that are granted by the agency in question. So to the extent a cash flow consideration would cause a downgrade or conversely an upgrade, then that may have a direct impact on the cost of debt.

Q Okay. And would it be fair to say that if a credit rating was lower, or a credit

profile was worse, that would make the stock of a utility less attractive to shareholders?

A My presumption is that equity investors in a utility would be interested in, among other things, the cash flow of the company. And, again, the higher the cash flow from their perspective, the better.

Q Okay. And would it be fair to say that measures that reduce cash flows for Missouri utilities as compared to utilities operating in other states would cause Missouri utilities to be looked on less favorably by credit rating agencies?

A I think credit rating agencies, if they looked at the aggregate of all factors affecting the cash flows of Missouri compared to other jurisdictions, and if Missouri had less cash flow as a result of the aggregate of all the things that impact those cash flows, then the credit rating agencies would take that into account.

Q Would you agree that utility cash flows is a relevant consideration for the Commission to take into account in setting rates?

A It is one of the relevant

considerations, yes.

Q Do you have your testimony with you?

A Yes, I do.

Q On page 4, lines 6 through 9, you talk about -- you answer question -- well, let me just read it.

The question says, why are depreciation deferred taxes and return on equity sources of cash to the utility?

And the first paragraph, the answer says, these items provide cash to a utility because there is no contemporaneously required cash outlay by the Company associated with these rate elements.

Have I read that accurately?

A Yes, you have.

Q And isn't it true, though, that there are some outlays that are -- that are required all the time by utilities, even if they're not specifically associated with those elements?

A I think I can agree with that.

Q I mean, for example, doesn't a utility regularly have to service its debt, pay interest, repay the principal on any debt it may

have?

A Yes. I think the distinction I was trying to draw here is a utility may receive rates and cash for payroll expense, and the expectation is they would turn around and pay those dollars to its employees.

When the utility receives dollars coming in for depreciation expense, there's -- there's nothing to write a check for that's directly related to depreciation. The utility has discretion on what they do with those funds.

Q But would you agree that one of the requirements of a utility is that it has to invest in its infrastructure?

A I think that's true.

Q And I -- the way I look at it, there's two possible sources of requirements -- I mean, isn't one requirement that they're obligated to provide safe and adequate service to their customers?

A Yes, they are.

Q So you got to put whatever plant is necessary in service to meet that obligation?

A That's true.

Q And, then, isn't it true that

sometimes there are specific investment commitments that utilities make in regulatory proceedings?

A That has happened.

Q And like, for example, Ameren has agreed to an infrastructure investment commitment in its last rate case?

A Yes.

Q And do you know how much that commitment was?

A Reading Ameren's annual report, I think it referenced a figure of 2.7 billion over a number of years.

Q Okay. So -- so that's a commitment for an outlay of funds?

A Yes.

Q Okay. Would you agree that the infrastructure investments in terms of new plant and retirement costs for both Laclede and Ameren UE far exceed the depreciation that they receive in any given year?

A Can you repeat that question, please?

Q I'm not sure I can. Would you agree that the infrastructure investments consisting of

both new plant put in service and retirement costs for both Laclede and Ameren UE in any given year far exceed the depreciation that they collect?

A The data I have looked at, and that is primarily based on looking at the annual reports of these companies, would indicate that the amount of their annual construction budgets would exceed the amount of depreciation expense they are reflecting on their books.

Q Would -- would you agree with the characterization that it far exceeds it?

A Well, for Laclede, and I'm probably more familiar with Laclede than UE, I believe their construction budget is roughly twice what their annual depreciation bookings currently are.

Q Okay. And you don't know for Ameren UE?

A Not off the top of my head.

JUDGE DIPPELL: Okay, Mr. Byrne, I'm going to cut you off there and we're going to take a 15 minute break at which time Judge Thompson will take my place. So let's go off the record.

(Off the record.)

JUDGE THOMPSON: I believe, Mr. Byrne, you were crossing Mr. Oligschlaeger. Is that correct?

MR. BYRNE: Yes, Your Honor.

JUDGE THOMPSON: Please proceed.

Q (BY MR.BYRNE) Mr. Oligschlaeger, would you agree that a utility's infrastructure needs -- is a relevant consideration for the Commission to consider in developing depreciation rates?

A It can be one of many relevant considerations, yes.

Q Okay. And wasn't it -- just so you know where I'm coming from, wasn't it a consideration that the Commission specifically discussed in that St. Louis County Water Company case from a couple years ago?

A The 2000 case?

Q Yes.

A Yes, the Commission made the tie between the two.

Q Okay. And you don't think that -- do you agree that it's appropriate to make that tie, at least in some cases?

A That the Commission has the discretion to do so, yes, I would agree.

Q Okay. But -- but do you think it's

appropriate?

A To consider the cash flow needs associated with an infrastructure program in developing its position on an item like net salvage, the Commission has done so, and I don't have a problem with them doing that.

Q Okay. What is the matching principle in rate making?

A The matching principle in rate making is generally thought to be that the revenues collected by a company should generally match and be related to the expenses incurred by the company in a particular period.

Q And you agree that the matching principle is a consideration that -- that the Commission should take into account in setting rates?

A Yes.

Q Okay. What's your understanding of intergenerational equity?

A Intergenerational equity, I'm not sure there's a textbook definition of that. My take on that is that is a concept of a long-term matching of the right revenues to the right expenses over a number of years.

Q Okay. And would you agree that intergenerational equity is a -- is a principle that should be considered in setting rates?

A It is one of several principles or goals that should be balanced by the Commission in determining just and reasonable rates.

Q Would it be fair to say intergenerational equity -- let me suggest my definition and see if you might agree with it. Would a fair definition be to set rates that -- that fairly allocate costs to various rate payers over a period of time?

A I can accept that.

Q Okay. On page 9 of your testimony, line 12 or thereabouts, the -- the question says, does the standard approach for collecting net salvage cost in rates provide the utilities for strong incentives for efficient operations?

And your answer is no, and then it goes on to explain.

Is that correct?

A Yes.

Q And do you have any specific evidence that either Laclede or Ameren UE has been inefficient in incurring retirement costs for its

assets?

A Up to this point?

Q Up to this point.

A No, I do not.

Q Okay. How about any other utility? Do you have any evidence that any utility has been inefficient in incurring retirement costs?

A I haven't particularly made an analysis of that point, but I am not aware of any utility.

Q Okay. And let me ask you this. At least in between rate cases, if the standard approach is used, wouldn't a utility have an incentive to be efficient because it -- in retiring property, because then it could use that -- the cash that it would have otherwise spent on retirements for other purposes?

A Under the standard approach, because typically the cash receipts from customers for cost of removal are not used for cost of removal and salvage purposes, the moneys would come -- would generally be considered to come from the utility shareholders. I will concede that there may be some incentives for efficiency there if the utility is reluctant to tap shareholder funds for that purpose.

Q Okay. Fair enough. And even under the Staff's approach where you're treating net salvage costs on a cash basis, depending on where the company is in the rate making process, could there be disincentives for efficiency? Like, for example, if the utility's in the test year, maybe there's less of an incentive to be as efficient as if they're not in the test year?

A That would imply that a utility might wish to drive up the test year costs beyond what they would normally be. There perhaps is an incentive for that, but I don't have evidence it happened and I hope it doesn't happen.

Q Me, too. And would it be fair to say that if a utility was inefficient in incurring retirement costs for assets, the Commission would have the authority to make rate adjustments to keep customers whole from that inefficiency?

A Well, under the standard approach, I would think such adjustments would have to be made directly to depreciation rates, but I assume that's an option.

Q Okay. They would have the power to do that?

A I would presume they would.

Q At the bottom of page 9 and the top of page 10, I think you're -- and, really, I'm looking at the top of page 10, I think you're suggesting that the customers' cost of capital is higher than utility's; is that fair?

A I think that's a reasonable assumption to make.

Q Okay. But would you agree that it is just an assumption and you do not have any evidence one way or the other on that?

A I have not attempted to do a general study on what overall customer cost of capital is at this time or at any other time.

Q If -- if one measure of a customer's cost of capital was the opportunity cost to that customer of putting the money in a checking account or savings account or a certificate of deposit, wouldn't it be fair to say that those interest rates are lower than the utility's cost of capital?

A If you were to make the assumption that that was the relevant cost of capital, while that may be the relevant cost of capital for some group of customers, I can assure you that is not my relevant cost of capital.

Q And I think you have agreed that under the standard approach for treating net salvage, any prepayments of the net salvage costs effectively earn a return for customers equal to the company's overall rate of return?

A That's the way the rate making process operates in this state, yes.

Q Okay. And I think -- well, is it your opinion that estimates can be used in the rate making process if they are reasonably reliable?

A I think that's a fair characterization.

Q Okay. And I guess to the extent that estimates are used, would it be fair to say the degree of reliability should be taken into account by the Commission?

A Definitely.

Q Okay. And have you done any analysis of the reliability of Laclede's estimates of its net salvage costs in this case?

A No, I have not.

Q Okay. And are you aware of any evidence, even though you haven't done a study,

are you aware of any evidence of any problem, any specific problem with the reliability of the estimates that they have made?

A I am not aware of any study that would establish their accuracy or lack of accuracy.

Q Would you agree with, I think Mr. Stout testified to this and I think Miss Schad did too, that net salvage costs are increasing?

A That's my general understanding.

Q And my understanding is, based on their testimony, that not only are they increasing in absolute dollars, but also they are increasing as a percentage of original cost of the plant?

A I -- I know that Mr. Stout testified to that effect in this proceeding.

Q Well, do you know if that's true?

A I just -- I don't have any firsthand knowledge myself of whether that's true or not.

Q Okay. But you will agree that they're increasing?

A Over time, yes.

Q Okay. Let me go back to estimates for a second and try to explore a little bit where else in the rate making process the Commission

uses estimates.

I think there -- there's been a lot of testimony that they use estimates in computing, or estimating the average service life for property in the depreciation calculation. Is that -- do you agree with that?

A Yes.

Q And I guess to the extent that they have adopted the standard method in the past, they -- they've used estimates in calculating net salvage; is that correct?

A Yes.

Q And did -- are -- to your knowledge, are estimates used in calculating pension expense for utilities?

A Yes, they are.

Q What kind of estimates are used in that calculation?

A Perhaps I should make a distinction. Our current policy in terms of rate making is to tie the rate making allowance for pension expense to cash contributions to the pension trust fund.

So -- now, those cash contributions are established in part by projections of the future earnings of the fund and the future necessary cash outlays to the utility's employee. So yes, estimation is part of that.

Q And are those long-term estimates?

A Yes.

Q Are they using like actuarial tables to see how long people live and things like that?

A It's my understanding such devices are used, yes.

Q Okay. How about return on equity? Are there any estimates in the process of the Commission determining a return on equity for utilities?

A It's my understanding that short-term estimation of earnings and dividends are used as well as historical measurements of those items in coming up with at least the Staff's recommendations in these areas.

Q Are you familiar with a discounted cash flow method of calculating return on equity?

A Superficially.

Q Well, let me ask you this. It's my understanding that the discounted cash flow method, and just tell me if you know whether this is true or not, but it's my understanding that the discounted cash flow method incorporates an

estimate in the growth of the utility's earnings that extends in perpetuity. Is -- do you know if that's true?

A I don't know to what degree historical data is used in making that estimate.

Q Okay. But would you agree that they are estimating the growth in earnings in perpetuity, even if it's based on historical data?

A Again, just based on a superficial knowledge, which is basically reading the testimony filed in this area over the years, that sounds accurate.

Q Okay. How about inflation? Is inflation estimates -- are inflation estimates incorporated into the DCF model?

A I don't know.

Q How about the case of a nuclear decommissioning fund? Are there estimates that are used in determining how much electric utility's contribution to a nuclear decommissioning fund should be?

A Yes.

Q What kinds of estimates are those?

A Again, it's an estimation of what the future cash outlay will be for those decommissioning activities and also incorporating the expected earnings within the trust fund over the period of time necessary.

Q And those by their nature are long-term estimates, isn't that fair to say?

A Again, I would agree with that.

Q Are there any other examples you can think of estimates being used in the rate making process? Beyond just like a test year type of estimate.

A Certainly the current policy in regards to medical costs, or OPEBs as they're sometimes called, is somewhat similar to the pension estimation process.

Q On pages 12 and 13 of your testimony, you are suggesting that if the Commission decides to retain the standard approach to treating net salvage, they should consider requiring utilities to establish a segregated fund for those dollars; is that correct?

A Yes.

Q Okay. And would it be fair to say, and I guess I'm basing this on your testimony in your deposition, that you don't -- you haven't figured out all the details as to how that fund

would operate?

A Well, I personally am not an expert in the operation of trust funds, so I think that would probably involve the need for further discussion, yes.

Q Okay. So right now it's just an idea rather than a concrete specific proposal?

A Yeah -- not all the -- I'm not aware of all of the details necessary to go about establishing this kind of procedure. I think it would require further work from the parties, yes.

Q Okay. Fair enough. And, I guess, would it be fair to say that the reason for having such a segregated fund was to make sure that the money was available -- well, the money that the utility had collected for net salvage was available when it came time to salvage the plant?

A That the money would be available for the activities for which the collection was intended, yes.

Q Like the costs of retiring plant, for example?

A Yes.

Q Okay. And isn't it fair to say there would be costs associated with having such a

fund?

A I believe so.

Q Have you done any study of these costs?

A Not specifically, no.

Q Would it be fair to say that you would likely have to pay fees to set up the fund in the first instance?

A That's my understanding.

Q And would you also have to pay someone to manage the fund, like a trustee?

A I believe so.

Q And isn't it likely for a fund like this, that there would be transaction fees when money was put in or withdrawn?

A I don't know specifically. That sounds like a reasonable assumption.

Q And -- and wouldn't it be fair to say if the Commission established such a fund, there would be a lot of transactions as money was collected for net salvage and then individual pieces of property were retired?

A I would assume so.

Q And, I mean, I'm just sort of comparing it in my mind to the nuclear decommissioning fund where money goes in, but it doesn't come out until one time at the end of the nuclear plant's life. Is that a fair --

A Well, that's a fair characterization. You also have the example of the pension trust funds where I assume disbursements are made periodically to pay the benefits to the utility retirees.

Q Isn't there an additional cost to rate payers of a segregated fund? And I guess by that, I mean the return that rate payers would realize from those prepaid net salvage amounts would be limited to the return earned on the segregated fund less any costs?

A I hate to ask you, could you repeat that?

Q I don't think I can. Let me start over. You agreed previously, did you not, that under the standard method to the extent that customers pay net salvage costs ahead of the company expending them, they effectively earn the overall rate of return because it's a deduction from rate base. Is that fair to say?

A That's correct.

Q Okay. But my understanding is if a

separate segregated fund was established, they would no longer earn the return of the utility, and, instead, they would earn whatever return was earned by the segregated fund less any costs of operating the segregated fund. Is that true?

A I believe that is true.

Q Okay. And that's likely to be a lot less than the utility's overall rate of return, is it not?

A I'm not sure how likely it is to be a lot less. We have had many years of very healthy pension fund earnings, for example, in the state, and in recent years that has turned around. In terms of the -- a long-term average or earnings to be expected from such a fund compared to the utility's authorized returns, I'm not sure I could make an estimate of that.

Q Wouldn't you want the money to be invested in very conservative investments to make sure that it's there when it's needed?

A I think there would need to be some policies in terms of what the specific trust fund could invest in and so on. Whether it would be, say, as stringent as a pension fund, I don't have an opinion on that at this time.

Q Don't pension fund assets get invested in the stock market? Some of them, at least?

A To some degree, yes.

Q And if you -- in your segregated fund, you wouldn't want to invest that money in the stock market, would you?

A If you're asking for personal investment advice from me, I would think some level of risk associated with the stock market might be appropriate. I don't believe you should put 100 percent of your funds --

Q Maybe you already answered this, but in general, would it be fair to say that the investments should be conservative?

A I think there should be investment policies that are reasonably intended to ensure that the funds are there for the required purpose. If that requires a conservative -- so-called conservative approach, so be it. I -- that's -- like I said, those are the details that would need to be worked out.

Q Okay. So you don't know whether -- I mean, you don't know whether it should be invested in conservative investments or not?

MR. SCHWARZ: I'll object, asked and answered.

JUDGE THOMPSON: Read back, please.

THE REPORTER: "So you don't know whether -- I mean, you don't know whether it should be invested in conservative investments or not?"

JUDGE THOMPSON: Objection is sustained. Please proceed.

Q (BY MR.BYRNE) Okay. Let me ask you this. If the Commission could satisfy itself through other means that utilities will have the financial wherewithal to meet their financial retirement obligations, might it be appropriate for the Commission to avoid incurring the costs of establishing a segregated fund?

A I'll answer that by saying there could be other means out there of which the Commission would -- should consider. However, I do not believe that a return to the status quo of no restrictions on the use of this cash obtained for the utilities would be appropriate.

Q To your knowledge, has Ameren UE or Laclede ever, since they started in business, both of them over a hundred years ago, failed to meet

their obligations to retire property?

A I'm not aware of any such failure.

Q Do you have any reason to think that they will fail to meet their retirement obligations in the future?

A I certainly don't think there's any intent or expectation they will fail; however, both Mr. Fetter and Mr. Baxter in their testimony raised the problem of such levels of increasing costs in the future that it is purported to cause so-called rate shock.

And whether the Commission decides to deal with rate shock in the fashion which the companies suggest, which is the standard method, that still will leave the problem of how you obtain shareholder financing of those amounts under the conditions set out by Mr. Baxter and Mr. Fetter.

Q I think -- were you in the room when Mr. Baxter testified?

A Yes, I was.

Q And I think he testified that Ameren UE at least had no interest in double collecting money from rate payers, and, I guess, if you -- if you would assume with me that the Commission's not

going to permit Ameren UE to double collect the money from rate payers, can you make that assumption?

A I can assume.

Q And the Commission would have the power to stop any utility from double collecting net salvage costs, wouldn't it?

A The ultimate decision would be theirs, yes.

Q And let me ask you this. What if the Commission could assure itself that the utility had rate base that was unencumbered by debt sufficient to pay the cost of any net salvage in the future, any accrued but not yet paid net salvage?

Wouldn't that be a safeguard that would provide some level of assurance that even if all else failed, even if the utility squandered all their money, they could still, if they had to, borrow against the unencumbered rate base to pay those net salvage costs? Wouldn't that be a protection?

A I cannot speculate in terms of the financial health of any particular utilities many years in the future. That's affected by many things. Whether that specific protection you were talking about would -- would help, I don't have an opinion on it, haven't really thought about it.

Q But it might help.

A It's possible.

Q Okay. Do you know if any other states that use the standard method for net salvage have required utilities to establish segregated funds?

A No, I do not.

Q I think you agreed before that there was a general upward trend in net salvage costs; is that correct?

A I believe so.

Q But my understanding is the Staff's method uses a multi year average of cash expenses in calculating net salvage costs. Is that true?

A In past cases, on a going forward basis, we would look at the historical experience of the cash flow outlays for that purpose, and it could be that the test year amount in some circumstances may be a reasonable rate making allowance.

Q Well, let me ask you in this case, what'd you do? Didn't you do a five year average

of cash outlays?

A I didn't do anything. I believe the Staff in this case recommended a five year average.

Q And in Case No. EC-2002-1, Ameren UE's most recent electric complaint case, didn't the Staff propose a ten year average of cash outlays, if you know?

A I don't know.

Q Can you name me any case where the Staff method did something other than have a multi year average of cash outlays?

A I am not aware of any, and as long as the expense tends to be volatile from year to year, that would normally be the expectation.

Q Were you in the room when Miss Schad testified this morning?

A Yes, I was.

Q Do you recall in response to Mr. Schwarz -- one of Mr. Schwarz's questions, she said in 2002, Ameren UE's net salvage was increasing, but overall rates decreased, do you remember that?

A Yes.

Q Isn't it true that Ameren UE uses

the standard method for handling net salvage costs?

A That's my understanding.

Q Okay. Let me ask you, on page 3 of your testimony, line 9 -- well, really, the sentence starts on line 5. You say, the fundamental issue in this proceeding is whether the utilities should recover estimated net salvage costs from customers over the estimated useful life of the asset (the Company proposal or what they term as the, quote, "standard approach," unquote) or recover net salvage costs from customers only when a cash outlay is required at the end of the useful life of the asset. Is that an accurate reading of your sentence?

A Yes.

Q And I guess you're recommending that only -- only when the cash outlay is required is when we should recover it. Is that true?

A As a general principle, yes.

Q But wouldn't that same logic suggest that when cash outlays are made for new plant, for investment in infrastructure, wouldn't that same logic suggest that we ought to recover those cash outlays immediately?

A If you would look at the sentence in isolation, yes. But that is not the Staff because we look at this -- Staff position because we look at this and we recommend the Commission look at this as a balancing of several interests, including the need for costs to be known and measurable at the time they go into rates, as well as the need to spread costs out over the appropriate -- what's been called appropriate generations of customers.

In regard to plant expenditures, the cost up front is known indefinite, and we believe it is a reasonable balancing of all the different interests, or the different rate making goals that the Commission must look at to spread those costs over the estimated useful life of the asset.

Q But the costs of plant that's put in service, that's known and measurable at the time it's put in service, isn't it?

A That is correct.

Q And it's a cash outlay, isn't it?

A Yes, it is.

Q Okay. Let me ask you a couple more questions on the segregated fund.

One of the issues has been that the

utilities have raised in this issue is the diminution of cash flows from the Staff's approach. Is that fair to say?

A That's one of the issues.

Q And wouldn't it be fair to say, too, that if a segregated fund was established, that would not help the problem with cash flows for the utilities?

A That is correct because the cash would be saved or preserved or safeguarded so that it could be used for the eventual cash outlay for which it was intended.

Q So from a credit rating agency standpoint, if they're looking at a utility's cash flow, they're not going to count the money that's in a segregated fund that the utility can't use.

A And from the interest of the credit rating agency, which is more narrow than what we would suggest the Commission must take into account, that is true.

MR. BYRNE: I think that's all I have. That is all I have. Thank you, Mr. Oligschlaeger.

JUDGE THOMPSON: Thank you, Mr. Byrne.

Mr. Pendergast?

MR. PENDERGAST: Thank you, Your Honor. With your permission, I'd like to distribute a possible exhibit.

JUDGE THOMPSON: Absolutely. Let's see. This will be, I believe, No. 150. How shall we describe this, Mr. Pendergast?

MR. PENDERGAST: Staff recommendation in Case No. GF-2004-0025.

JUDGE THOMPSON: Okay.

CROSS EXAMINATION BY MR. PENDERGAST:

Q Good morning, Mr. Oligschlaeger.

A Good morning.

Q I'd like to begin by asking you a couple of questions about some of the safeguard principles you've been discussing, and, of course, you discuss in your testimony one potential safeguard to assure that amounts collected for net salvage costs will be there when those costs are incurred. Is that correct?

A Yes.

Q And would you say that essentially when you are collecting money for net salvage under the standard approach, that that's basically, in your view, a precollection or a

borrowing of money from customers?

A It's a precollection from customers in the sense that you get the money before, and in many cases years before you have to expend those funds for the purpose for which they were collected.

Q And the idea is that in effect, or in a way, you'll pay it back when it comes time to actually pay for the removal cost that it was collected for?

A Pay it back. To the customers?

Q Well, you will go ahead and use it for the purpose that you collected it for. Would that be fair?

A It is the intent you get it in rates for that purpose and you will use it for that purpose?

Q Yes.

A I think that's generally an expectation you make in the rate making process.

Q And would you agree with me that one of the sources of money that utilities use for those kind of purposes as well as general capital expenditures comes from financings that authorize the utility to go out and borrow money in the

capital markets?

A To use for the purpose of -- cost of removal in particular?

Q For general purposes, for capital expenditures, and I think you've also said that the utility may have to borrow money in the future to pay for cost removal. Is that correct?

A Under the standard approach, yes.

Q Okay. And I'd like to refer your attention now to what I handed you previously. Could you identify that document for me?

A The document is labeled Staff Recommendation, and it pertains to Case No. GF-2004-0025.

Q And does this look like a Staff recommendation in a financing case involving Laclede Gas Company?

A Yes.

Q Just looking at the caption, can you determine what amount of financing authority Laclede was requesting in that case?

A Yes, it appears to be seeking authorization to issue first mortgage bonds.

Q Okay. In what total amount?

A And perhaps also common stock, but

the total amount was not to exceed 270 million.
Q Okay. And would you agree with me that that 270 million is significantly in excess of whatever amounts Laclede has accrued for net salvage costs?
A You mean to date?
Q Yes.
A I don't know what amount you have accrued to date for net salvage costs.
Q So you wouldn't be able to make that comparison?
A No.
Q Okay. Let me ask you, if I can, whether, to your knowledge, when a utility borrows money, or asks for Commission authorization to borrow money from third parties, whether it needs to state what utility purposes that money will be used for?
A It is my understanding that as a normal convention of these applications, there is somewhat of a description of the intended use of the funds. I am not aware of whether there is a legal requirement that such a description must be made or not.
Q Okay. But at least a practice of

describing what utility purposes that money that's being authorized by the Commission will be used for?

A Yes, in my experience.

Q Okay. And would it be fair to say that Staff has an interest in ensuring that if debt borrowings and other kinds of financings are authorized by the Commission, that they will be used for those purposes?

A I think we have a general interest in that question.

Q Okay. And if I could refer you to several pages back, the Staff memorandum that was filed in that case, do you have that?

A Yes, I do.

Q And who was that Staff memorandum signed by?

A My copy indicates Mr. Ron Bible and Mr. Thomas Schwarz.

Q Okay. And Mr. Ron Bible is who?

A He is the manager of our financial analysis department.

Q Okay. And there's no need to identify Mr. Schwarz, is there?

A No.

Q No. And if I could refer you to that memorandum; in that memorandum, does the Staff set forth various conditions that it was requesting the Commission impose on Laclede as a condition for approving the financing request?

A Let me take a second to look through it.

Q Certainly.

A Yes, it appears that the Staff recommended a number of conditions to the Commission be adopted in order to approve the Company's application.

Q Okay. And as we've already covered before, basically Laclede was coming to the Commission saying, I want you to authorize me to go out and borrow or issue stock up to $270 million; the Staff came back and said, I've got some conditions I want you to impose presumably, as we've covered before, to ensure that that money would be used on utility purposes, or for utility purposes. Would that be correct?

A That appears to be accurate.

Q And I'd like to refer you, if I could, to page 3 of 4 of the Staff memorandum, and if you could look at the bottom paragraph there after condition No. 11? And would that paragraph that begins, upon further reflection -- well -- and ends with, company structure on the other end, reflect the fact that Staff was referring to changes that occurred in the natural gas industry -- or in the energy industry period when it made these recommendations?

MS. O'NEILL: Your Honor, I don't know if this is an objection because I don't know if this has been offered, but the case number on the top of that page isn't the case number at the beginning of this pleading.

The pleading that -- the Staff recommendation that Mr. Pendergast is showing the witness is Case No. GF-2002-0025 -- 4, and the number I have at the top of my page 3 of 4 of the Staff memorandum is EF-2000-385.

MR. PENDERGAST: She caught me. What can I say. I think what we have here is somebody on the Staff didn't make a complete change to the word processor when they issued this recommendation and perhaps had the wrong case number at the top, but I believe if you look at the text of the memorandum, it refers repeatedly to Laclede Gas Company.

MR. SCHWARZ: Staff will so concede.

MS. O'NEILL: I won't object, then.

JUDGE THOMPSON: So, Mr. Schwarz, you're conceding the authenticity of this document?

MR. SCHWARZ: I am conceding the authenticity and, as signatory, will take responsibility for the typo.

JUDGE THOMPSON: Very well. Please proceed.

THE WITNESS: If I remember your question correctly, I would agree that the paragraph you specified refers to events within the energy -- or appears to refer to events within the energy industry in the last two years prior to the filing of this memorandum, which I assume was in 2003 or 2004.

Q (BY MR. PENDERGAST) Okay. And do you have any knowledge of what those events may have been?

A I certainly had knowledge of many events that impacted those industries. Which specific ones are being referred to in this paragraph, I could speculate.

Q Please do.

MR. SCHWARZ: Objection.

Q (BY MR. PENDERGAST) Okay. Regardless of what those events may have been in, apparently Staff was perceiving these as conditions that were suitable and appropriate and necessary to address them. Would you agree with that?

A I would agree with that generally.

Q Okay. And if you look at the conditions, is there anything in those conditions that indicate that Staff believed it was necessary at least to the point of making it a formal condition that Laclede agreed to take the $270 million in proceeds which it was borrowing from third parties to meet its public utility obligations and put them in a segregated fund?

A Not by my cursory reading of this document, but I am not aware of whether any part of the 270 million requested was intended for long-term purposes in which the moneys would be retained for a period of time by Laclede before expending it for the intended purpose.

Q Okay. With that caveat, though, you don't see anything in the conditions that would suggest a segregated fund was being requested by

Staff?

A No.

Q And just based on your general knowledge of utility financings, is it typical to use the proceeds of those financings for long-term capital investments?

A Well, for -- I believe it's typical to use them for cash investment in various items which in turn will serve the company in the form of assets over a long period of time.

Q In fact, I believe you say in your own rebuttal testimony that it's not atypical for utilities to use short-term debt to finance their construction and then replace that short-term debt with longer term debt. Is that correct?

A That's correct.

Q Okay. And first mortgage bonds would probably be considered longer term debt?

A Yes.

Q Okay. Would it be fair to say that rather than proposing some segregated fund, that the conditions that Staff thought were appropriate and sufficient for this $270 million in borrowings consisted primarily of assurances reflected, for example, in page 1 -- I mean in condition No. 1 on

page 2 and condition No. 11 on page 3, that Laclede agreed it would use the proceeds of those financings solely for its regulated operations?

A That appears to be the point to which those recommendations is -- is concerned, yes.

Q Okay. And as far as some kind of quantitative measure of whether or not Laclede actually was using the proceeds for regulated purposes, I'd like to direct you to paragraph -- or condition No. 6. Do you have that at the top of page 3?

A Yes.

Q And can you read that for us?

A Condition No. 6 reads as follows. Quote, "Laclede Gas Company's total borrowings, including all instruments, shall at no time exceed Laclede Gas Company's regulated rate base," closed quote.

Q Okay. What's your sense from having read that what that's designed to do?

A Well, it appears to correlate, or set a cap on Laclede Gas Company's total borrowing, so such borrowings do not exceed Laclede Gas Company's regulated rate base. Is that what you're asking?

Q Yes.

A Okay.

Q Is that a rough way of saying if we're going to go ahead and give you authority to go out and borrow money, we want to make sure it's being spent on utility related functions; and one way of making sure of that is that your rate base be at least as great as what your borrowings are that you're making under the Commission's authorization?

A I assume that was the intent.

Q Okay. And, once again, this was being offered as one of a number of conditions to ensure that the money that Laclede was borrowing would actually be used for that purpose?

A Well, this sets an overall cap on the borrowing. I don't know whether that in and of itself would ensure that the borrowing is used for the intended purposes.

Q Well, at the very least, it was consistent with what we've talked about being Staff's general desire; would you agree with that?

A I would agree it is generally consistent with that desire, yes.

Q And at least what we can tell from these conditions here, it was the one quantitative measure that's included in there to meet that particular objective; is that correct?

A Well, if you want me to read each of the other ten conditions more closely in order to verify that, I can do that.

Q Well, we'll let the record speak for itself. But you're not aware of any others based on your cursory review at this time?

A Based on my cursory review, no.

Q Okay. Let me ask you about 6, then. To the extent that total borrowings could not exceed Laclede's regulated rate base, is it your understanding that under the standard method, any accruals that Laclede has made for net salvage costs go into the depreciation reserve and are ultimately used as a deduction to rate base under standard Commission practice?

A Whatever the amount of accrued net salvage allowed in rates would have the effect of reducing rate base.

Q Okay. So to the extent that we're accruing for net salvage under the standard method, the rate base limitation that we've talked about on the total amount of borrowings that you can have would get tighter; is that correct?

A Yes, and that would be a concern.

Q Well, to the extent that it got tighter, would that act as an additional check on ensuring that the money that you are borrowing is being used for regulated purposes?

A It would act as a check on that. That would also restrict your ability, as I understand it, in the future to borrow for the purpose of financing cost removal activities.

Q Okay. But -- but it would -- it would go ahead and be a self-enforcing mechanism that would ensure that the money that we are borrowing is being used for regulatory purposes. Is that correct?

A In general terms, beyond the context of the net salvage issue we are discussing, I would agree with that.

Q And you testified in deposition that prior to making your recommendation in this case as far as what kind of safeguard you thought was necessary if the Commission were to go with the standard method that you had not reviewed these financing conditions; is that correct?

A These particular financing conditions?

Q Yes.

A That is correct.

Q Okay. Were you aware that they were applicable to Laclede?

A I was not aware of the existence of this particular financing docket. I think that's safe to say.

Q Okay. Are you aware of whether similar conditions are applicable to Ameren UE?

A I am not aware of them.

Q Okay. You indicate that deferred taxes are also a source of cash flow to the utility; is that correct?

A Yes, I do.

Q And could you explain for the Commission how deferred taxes come about?

A Deferred taxes come about because the current IRS code allows utilities to deduct certain items for tax purposes at different times than when they are required to expense them for financial reporting purposes. And in general, or in aggregate, the IRS allows those deductions to occur prior to the expensing of some items for financial reporting purposes.

For that reason, a utility's taxable income is generally a lesser amount than its net income. However, when normalization of tax timing differences is used in the rate making process, that bases the amount of income tax expense on the book net income of the company, not its taxable net income.

And for that reason, the amount of taxable income collected in rates by the utility tends to exceed the amount it is required currently to turn over to federal, state, and applicable local taxing authorities.

Q Could we boil that down to basically say that as a result of that particular treatment that you so thoroughly described, that utilities are collecting more in rates for their tax liabilities than they are actually incurring at a given time?

A That is the typical situation, yes.

Q And the theory would be that over time, Laclede or any other utility would be collecting less in rates than what its tax liability is?

A I'm sorry, can you repeat the last

question?

Q Yes. You're collecting now more in rates than what your tax liability is. The theory would be that over time, you will eventually be collecting less in rates than what your tax liability is so that it all evens out?

A On the basis of an individual tax timing difference considered over time, that is true. In the aggregate, as Laclede makes new investments and attains new tax timing benefits through normalization of deferred taxes, Laclede and most utilities will always have more income tax moneys coming into it, rates, than it would have to pay out.

Q So even though you may always have more, that method is appropriate to use, in your view?

A To a large degree, I believe the normalization treatment is mandated by -- by current law.

Q Okay. And -- and the purpose of that law, again, as we discussed during deposition was what?

A It is my understanding the purpose of that law was to provide utilities with funds that they could use to invest into their operations.

Q Okay. Well, in any event, utilities are collecting more in rates than what their actual tax liability is, and on the theory that at least with a particular set of transactions that will reverse itself at some point down the road and the utility will be collecting less in rates than its tax liability?

A That's correct.

Q Okay. And do you know how big these deferred taxes are?

A These deferred taxes for major utilities amount to the millions of dollars and are reflected as an offset to the utility's rate base.

Q Much like net salvage costs are as part of the depreciation in Missouri?

A Precollections of income taxes and precollections of net salvage would both be used as a reduction to rate base.

Q And as we discussed in your deposition, at least up to this point, Staff has not found it necessary or appropriate to require that those collections for future tax liabilities,

if you will, be placed in the segregated fund?

A No, it is not. That relates back to my earlier explanation. To the extent this kind of favorable tax treatment has been granted to utilities so that they can invest into their operations, then requirement for a segregated fund in that instance would be counter to that intent.

Q Okay. Is that -- is that the main reason why Staff has not done that? I mean, are you aware of an analysis that Staff did and said, we would have done a segregated fund but for that consideration?

A I am not aware of that kind of analysis.

Q Okay. And I thought you told me during your deposition that the reason that you didn't believe a fund was necessary in that particular instance where customer amounts are being precollected was because utilities don't really have much discretion in whether to pay their tax bill, but they do have discretion on whether to make the expenditures necessary to do the removal costs. Am I misremembering that?

A No. They -- the utilities certainly have greater discretion in regard to the amount and timing of their cost removal activities than they would in terms of the amount of taxes due taxing authorities.

Q Okay. Were you here in the room the other day when Commissioner Davis asked Mr. Schwarz a question about whether or not Staff's approach to depreciation would give utilities an incentive or investors an incentive to invest their funds in jurisdictions other than Missouri because of more favorable tax -- or more favorable depreciation treatment in those jurisdictions?

A I believe I was in this room, yes.

Q Okay. Do you recall Mr. Schwarz indicating that utilities have an obligation, legal obligation to provide safe and adequate service and suggesting that that wasn't really a concern?

A I'm not sure I remember exactly what Mr. Schwarz stated in response and I probably would not accept that characterization, per se. That it was not a concern.

Q Well, is it your view, then, that utilities do have discretion on whether to invest their money in those kind of activities, and, therefore, to the extent depreciation curve is

less favorable in Missouri that they would have an incentive and investors would have an incentive to spend it elsewhere? Is that your testimony?

A In terms of the amount of capital investment a utility makes for any specific jurisdiction, I don't believe there is any rule or statute out there that calls for a specific set of capital additions to be made at this time for this purpose. So to some degree, a utility has discretion in regards to the amount of funds it uses for that purpose.

Now, that is under -- or, obviously, the other perspective is the requirement to provide safe and adequate service remains and the utility is responsible for ensuring that level of service is provided.

Q Okay. So, in your view, there would be some discretion, and to the extent that discretion exists, if a utility believes that there's more favorable treatment of its investment someplace else, it would have, at least all else being equal, an incentive to invest there as opposed to where it has less favorable treatment. Would you agree with that?

A I would think the incentive itself

exists. Whether it would be appropriate to act on the incentive or not is a different question.

Q Okay. Fair enough. The three sources of cash flow that you talked about included not only these deferred taxes which we just discussed and, of course, depreciation which we have discussed in great detail, but also the return on equity component; is that correct?

A That's correct.

Q And, as we discussed earlier, reductions in cash flow is a result of lower return on equities and have the same kind of impacts from a financial perspective as reductions in cash flow related to depreciation policies. Is that correct?

A In general, the higher the return on equity, the higher the cash flow, though that's somewhat dependent upon the utility's dividend policy.

Q But, generally speaking, a higher return is going to generate more cash flow and a lower return is going to generate less cash flow?

A I can agree with that.

Q Okay. And we had some discussion about what Staff's approach has been to setting

return on equities in various cases. Do you recall those discussions?

A In -- in my deposition?

Q Yes.

A Yes, I do.

Q And in evaluating the impact, and I believe you said earlier that cash flow is one consideration that the Commission should take into account in looking at how it's going to set rates, should it take a broad view and look at both what's happening with the return on equities as well as what's happening with depreciation policy?

A If the Commission has an interest in a particular cash flow situation of a company, yes, both depreciation and return on equity would figure into that.

Q Okay. And should it also figure into it when determining what policies it wants to implement in general in a particular area?

A You mean cash flow? Or --

Q Well, what -- what policies it wants to go ahead and implement with depreciation should have some sense of what it's doing on return on equity and how those two fit together.

A I -- I believe they would be free to

make that connection. I'm not sure I would be comfortable recommending that they do.

Q Okay. Fair enough. And as we established in your deposition, at least based on your experience, from a cash flow and return standpoint, you're aware that the Staff has generally been recommending return on equities that are lower than what's being granted on average in other jurisdictions?

A There was evidence in the recently concluded -- or I don't know if it's concluded legally, Missouri Gas Energy case that appeared to establish that.

Q Okay. And you have nothing really to dispute the fact that when it comes to the depreciation policies, the cash flow being generated by Staff's approach on that also results in depreciation rates in cash flow that's generally less than what's being provided to other utilities in other jurisdictions?

A Well, what I will state, the standard method would be expected to provide utilities that are regulated under that method to have more cash flow than those under methods similar to the Staff's proposal.

Q Okay. But -- but do you have any reason to doubt that under Staff's proposal, we're dipping below the average of what's happening in other jurisdictions?

A My only basis for that belief would be the data that I think was included in Mr. Stout's testimony, direct or rebuttal, in this proceeding.

Q You don't have any data to dispute that?

A I don't have any data to dispute that.

Q Okay. Now, I'd like to ask you a couple of questions about if the Commission decides that considerations like that are a relevant thing to take into account, I believe you indicated in your testimony that if the Commission thought a utility was having cash flow problems or that cash flow was a concern that it could adopt a standard method. Is that correct?

A It could adopt -- well, yes, similar to what it did in the year 2000 St. Louis County Water case. I would also add there are probably other means by which the Commission could address those cash flow problems without directly affecting net salvage policy as well.

Q Well, let's talk about one of those means. I believe Mr. Schwarz suggested something to the Commission either yesterday or the day before about the Commission authorizing a surcharge on all customer bills to provide additional moneys for investment, I guess, in plant, and that that would be treated as a contribution. Do you recall that?

A Yes.

Q Okay. And I'd like to ask you a little bit about that. Let's assume that you get that contribution from customers. Does that mean that instead of taking a piece of plant and recovering it over 30 years, you're basically telling the customer, you know, pay for $6 million of that and pay for it right now?

A Pay for $6 million of what?

Q Plant.

A Of plant?

Q Yeah.

A To fully finance an individual piece of property, or group of properties? Um, that could be one purpose of the surcharge, or the purpose of the surcharge could be generally to increase the company's cash flow in general to meet its plant needs or cash flow needs.

Q Well, if you're talking about a contribution, a contribution, for example, in aid of construction generally means that it's being spent on a physical asset; is that correct?

A That's -- that's my general understanding.

Q Okay. Now, I'd just like to ask you, what sense does it make to have a customer, say, in one year go ahead and pay for a contribution to pay the entire cost of a plant that's going to be used to serve customers for 30 or 40 years? Do you think that makes sense?

A I -- certainly it's not part of the traditional rate making process, and I would presume that the circumstances facing that particular utility would have to be fairly unusual to justify that kind of treatment.

Q Well, do you think that having a customer pay in advance the entire capital cost of an asset that's going to be used for 40 years is better than the standard approach where you take those same capital costs and spread them out over 40 years and recover the net salvage costs

associated with that?

A The standard approach which we typically use would be much fairer. I might add, I did not personally understand Mr. Schwarz's scenarios to be quite as restrictive as I think you are assuming.

Q But you would consider the standard approach to be much fairer?

A Than precollection from customers of the entire cost of an asset, yes, I do.

Q Okay. Thank you. Do you know what -- you were asked some questions about the decommissioning fund that Ameren UE has; do you recall those?

A By Mr. Byrne?

Q Yes.

A Yes.

Q Do you know what they earn on that fund?

A No.

Q Now, you also mentioned the ISRS mechanism, infrastructure system replacement surcharge mechanism, do you recall that in your testimony?

A Yes.

Q And I believe during your deposition, you indicated that you weren't aware of how much of Laclede's capital budget was actually subject to that ISRS mechanism; is that fair?

A That's fair.

Q Okay. And you are aware that even with that mechanism, there's still a lag between the time Laclede places facilities in the ground and when it recovers on those facilities.

A In some cases a short lag, but there is a lag.

Q And you've also indicated, you had some comments about spending money that you're collecting from customers for unregulated activities. You had no specific knowledge of what Laclede's involvement in unregulated activities has been, did you?

A At the time of the deposition?

Q Yes.

A At that time, not detailed knowledge. I've since read Laclede's annual report, and to the extent such things are mentioned there, I have knowledge of those.

Q Okay. But you -- you don't have any

basis for concluding that Laclede has utilized money that it's collected for net salvage costs for purposes of financing its unregulated activities?

A In the past, no. My point -- my testimony was to state that there were no restrictions that might prevent that in the future.

Q Okay. You were asked some questions about estimates, and you talked in terms of the various other areas where the Commission Staff has used estimates and the Commission has routinely set rates based on those estimates. Do you recall?

A Yes.

Q Let me ask you this. To your knowledge, what analysis has the Staff done and the Commission done of the accuracy and efficacy of those estimates that are used in these other areas?

A In most of these areas, pensions and the nuclear decommissioning funds and so on, the precollection is based upon legal requirements. And, for example, in the case of pensions, to the extent the earnings of the trust fund varies over time, then that will affect the amount of expense collected on an ongoing basis. So there's kind of a self correcting mechanism, if you will, in those fund -- in those kinds of situations.

Now, if we would go back and, for example, in the case of a pension trust fund, say we estimated that it would earn an 8 percent return, last time we set rates, it now looks like a 6 percent return, that kind of comparison really doesn't affect the amount of the rate treatment of that cost going forward.

Q And does the fact that there is this self correcting mechanism, is what you're trying to suggest make you less concerned about whether the -- those estimates are -- can be deemed to be completely accurate?

A Well, any time estimates are used in the rate process, there is a need for a periodic true-up, review, or self correcting estimates to make sure that rates are not grossly over or understated because the estimates were faulty. So yes, you need to have those.

Q Okay. And what I'm asking you is the fact that those exist make you more comfortable in using estimates?

A As compared to if they didn't exist? Yes, I would agree with that.

Q Okay. You also mentioned some concerns about -- well, I shouldn't say "concerns." You also indicated that Staff's expensing approach would provide utilities with additional incentives to minimize their net salvage costs; is that correct?

A I believe there's greater incentives using the expensing approach than using a precollection approach.

Q Okay. And that's because you've set a level, and if the utility can beat it, it gets to retain the benefit; and, conversely, if it goes over that amount, it has to absorb the difference. Is that correct?

A The regulatory lag --

Q Yes.

A The impact of that, yes.

Q Yes. And would you also agree that just looking at it from an incentive standpoint, that if the Commission were to allow us to expense our whole capital budget of $50 million a year, that we would have additional incentives there to reduce our capital costs?

A If you were outside a rate proceeding, there may be some incentives in that direction. Obviously, those incentives are only one part of the -- the balancing interest that the Commission faces in setting rates.

Q Sure. Just -- just as with net salvage costs. Would you agree with that?

A That is true.

Q Okay. And even though it would provide the Company with greater incentives, that's not a recommendation you would make to the Commission, is it?

A Absolutely not.

Q Okay. And would you generally agree with me that when it comes to issues of precollection and prefunding and that sort of thing, that as a general matter, utilities are prefunding or laying out a lot more cash than the customer is giving the utility in the form of a precollection?

A Typically utilities have a positive rate base, which means their shareholder provided funds exceed the funds used for capital investment purposes obtained from customers, so I would agree with you.

Q Uh-huh. And, you know, that's expressed in what your net base is basically, wouldn't it?

A Yes.

Q And for a utility like Laclede that's got a $700 million net rate base or thereabouts, that would mean that after you take into consideration everything we precollected from the customer in the form of net salvage costs or what have you, we're still laying out $700 million more than what we've taken in. Is that right?

A You have $700 million of net shareholder investment in your utility operations. If your numbers are accurate.

Q Yeah. Meaning we spent $700 million more than what we collected so far?

A Yes. I would agree with that.

Q And we're trusting that, over 30 or 40 or 50 years, that money will come back to us. Is that correct?

A I think you have solid grounds for that trust, yes.

Q Okay. And that trust is bottomed on our belief that the Commission will treat us fairly, that they will set rates that are adequate

to allow us to recover that investment, albeit over 40, 50, or 60 years. Is that correct?

A That's correct, and I would also add it should be buttressed by at least the current situation where customers do not have effective competitive choices in regard to their natural gas service.

Q Well, customers have choices over the long term, don't they?

A They could.

Q Okay. And do you think it's appropriate, with this much larger investment that utilities need to recover from their customers over time, that they don't require some sort of segregated fund or special mechanism to do that, that they can rely on the Commission's supervision and desire to establish just and reasonable rates for that return?

A If you're suggesting that somehow a mechanism could be set up where each customer would have a trust fund to put aside money to pay your future set service and so on, I don't think that is -- that would be a practical or a necessary thing to do.

Q Okay. So in -- in that respect, you

don't believe that those kind of protections are necessary for us to be assured that we will get a return of our investment?

A No, I do not.

MR. PENDERGAST: I have no further questions. Thank you.

JUDGE THOMPSON: Thank you.

Questions from the bench? Commissioner Murray.

COMMISSIONER MURRAY: Thank you.

BY COMMISSIONER MURRAY:

Q Good morning, Mr. Oligschlaeger.

A Good morning, Commissioner.

Q Were you a witness in the original GR-99-315 case?

A No, I was not.

Q Have you been a witness in other depreciation -- for the depreciation issue in other cases?

A No.

Q How did you develop your position on a treatment of net salvage?

A In regard to the standard approach versus the Staff approach?

Q Yes.

A Just based upon my general knowledge of rate making, reading the testimony over the years, discussion with other Staff members and so on.

Q Okay. You were talking -- you were asked earlier about the effect on borrowing of the utility that the standard method and the Staff's method have. Do you recall those questions from Mr. Pendergast?

A In general, yes.

Q Okay. Let's take a -- an asset that's -- the original -- or group of assets, say, the original cost is $100,000. And the -- under Staff's method -- and I'm going to try to make this even more simple and just say that Staff's method is just going to expense versus put anything into the fund. That asset has an estimated life span of ten years. So after five years, there would be $50,000 in rate base. Is that correct?

A If no provision is made for net salvage in the depreciation rate, that would be correct.

Q So the company, based on that alone, would be -- would have $50,000 of rate base against which it could borrow?

A Yes.

Q And under the standard method, assume the $100,000 asset and a $1,000 cost of removal. I'm sorry, a $10,000 cost of removal. At the end of year five, that rate base would be equivalent to 45,000, would it not?

A That is correct.

Q So the company could only borrow against $45,000 of rate base under the standard method?

A That is correct. Under the type of conditions that were apparently imposed upon Laclede.

Q Yeah.

A Yes.

Q Then under the Staff's approach -- and I'm taking this on to the further approach that's -- that's been implemented or been attempted to be proposed following this Laclede case. If the Company -- when the Company incurs an expense for removal, retirement and/or removal, in order to recover that expense, the Company would have to time its rate cases, wouldn't it?

A Well, it would book that amount as

an expense, as with all of its other items treated as expense, and to the extent that, for example, cost of removal, there was a sharp increase in that cost that caused their earned return, rate of return to decrease, that may lead them to file for new rates.

Q So it may indeed affect timing of rate cases.

A Yes.

Q Do you agree that the costs of removal are generally increasing over time?

A Based on the data I have seen, generally over time there is volatility from year to year.

Q Is it true that sometimes the cost of removal can exceed the original cost of the asset?

A I believe that has been testified to by the depreciation witnesses in this case, yes.

Q What's the general policy reason for depreciating capital expenditures instead of expensing them in the year they're incurred?

A To spread the cost responsibility for those items over the different groups of customers that will use it over its expected life.

Q Is it partly to avoid rate shock?
A It would also -- well, I believe -- certainly. Capital investments sometimes can be lumpy in terms of if you get a lot in one year, sharply less the next year, and so on. So it's certainly more practical to treat it in the traditional manner.
Q You talked earlier about tax deferral treatment with Mr. Pendergast. Do you recall those questions?
A Yes.
Q And I believe you said that you think that treatment is currently mandated?
A In terms -- it's my understanding that the large tax timing differences such as the use of accelerated depreciation for tax purposes compared to straight line for book purposes, that there are mandates that require -- or that effectively require regulators to normalize that and provide the company with the additional funds.
Q And who -- where is that required?
A I believe it's required by the code. My general understanding is that Congress would have some role in those kinds of policies, but I

don't have detailed knowledge of that.

Q Okay. If -- if that policy, or if that requirement were to change and no longer be mandated, but just recommended such as, for example, has happened from time to time with the treatment of net salvage, that it's not really mandated, it's just recommended by the regulatory sources, would it -- would Staff then take the position that deferred taxes should be treated differently?

A Well, that's actually a very good question. When I came here to the Staff in 1981, there were not the same level of mandates at that time as there are now regarding normalization and tax timing differences, and the Commission had more leeway and discretion to choose whether to flow those benefits directly to customers or to normalize them and provide the benefits to the utilities. I'm not going to say there were no mandates, I think even at that time there were some restrictions on depreciation expense.

At that time, the Commission's policy was to flow through the rate impact of tax timing differences unless the company could demonstrate it had a cash flow problem in which the Commission then would consider, or would order normalization of those tax timing differences for which it had discretion to treat either way.

Q Okay. So I take that to mean that yes, you would look for a way to reduce the cash flow, if it were allowed?

A Based on our last position, I'm not sure if it was a Staff position or just a Commission policy, we would probably look at the cash flow needs of the utility in making the determination of whether discretionary tax timing -- what treatment discretionary tax timing differences would get.

Q What various ways are there to affect cash flow in a rate case?

A As I lay out in my testimony, the major components of customer supplied cash flow would be return on equity, deferred income taxes, and depreciation expense.

Q What about the way you set capital structure?

A You may need someone with more financial expertise than I have. To the extent the capital structure was set up to mirror the actual capital structure of the company, in other words, the rate capital structure versus their actual capital structure, I'm not sure that would have an actual cash flow impact.

Q If you had the choice between an actual capital structure of the utility before you, structure of the parent or a hypothetical capital structure, could a choice between those structures affect the cash flow?

A Again, that's not something I've given a lot of thought to. My offhand reaction is yes, it could.

Q What about the way you design rates? And by that, I'm speaking specifically of what if you had a choice of having more collected in fixed costs versus more collected in variable -- or -- let's see. Fixed customer charges versus -- I'm not sure how to say that. What -- there -- there is a way to divide the way the Company receives --

A Yes. Typically there is a fixed component of a customer bill and a variable component based on what the customer uses during the month of the billing period.

Q Yes. That's exactly what I meant. Thank you.

A And if -- you're asking me could

that -- those kinds of decisions have an impact on the cash flow?

Q Yes.

A Again, you're asking someone who is not a rate design expert necessarily. It's my understanding those could have an impact, they could go either way based upon weather patterns.

In other words, to the extent -- for example, for a gas utility, you have a higher fixed component. When they have unusually warm winter, they would receive more cash under that scenario than a company with bills that contained a higher variable component.

Q What about fuel adjustment clauses?

A Fuel adjustment clauses, if they were in effect and allowed, would allow the companies, I believe in general, quicker recovery of fluctuations in their fuel expense. So that would -- if that happened, that would have a cash flow impact as well.

Q Okay. Now, I may be going beyond your knowledge in some of these areas, but are you aware of any one of those rate cases used in which Staff has ever taken the position that would be beneficial to the utility in terms of cash flow?

A I can think of several. The recent credit rating agency reports I reviewed for Laclede Gas Company note favorably the adoption of, I think what's called the experimental rate design from the last 2002 Laclede Gas Company proceeding.

Also for some I believe electric companies, we have proposed the adoption of IEC charges, interim energy charges, which I believe the credit rating agencies have also favorably commented on.

Q Okay. And generally the Staff's depreciation method would be considered unfavorable in terms of cash flow to the utility, would it not?

A By credit rating agencies, yes.

Q And are you saying that you don't know enough about the way capital structure is set that you could give an opinion as to Staff's position on capital structure?

A I -- again, I would say broadly I believe that a decision -- if a decision was before the Commission on use of the hypothetical versus actual versus consolidated capital structure of the type that has been recently before it, my general thought is that might have an impact on the utility's cash flow depending on which way the Commission goes.

Q But you don't know, in terms of a position the Staff would be likely to take, whether or not it would be likely to be favorable to the utility or unfavorable?

A No, I do not.

Q How about ROE? Are you aware of any recent cases or trend with Staff in recommendation of ROE as that compares to ROE for other jurisdictions?

A The only evidence I'm aware of was the type that was introduced in the MGE rate case which showed that over the past several years, the Staff recommendations had been below an average of -- or maybe not recommendations, of Commission findings on ROE in other jurisdictions.

Q Other than the experimental rate design that you cited and the IEC for some electrics, are you aware of any instances in which Staff has recommended a favor -- a rate design that would be favorable to cash flow for the utility?

A I must state I don't have enough

knowledge of our positions on rate design over time to have myself individually a good feel for our position on things such as fixed versus variable bills and so on, so I would not be comfortable commenting on that.

Q Okay. What is Staff's position as to fuel adjustment clauses?

A My under -- they are prohibited under law in the state, so I'm not sure we have a position or that we would need to have a position on that.

Q So you don't know whether you would favor it or be opposed to it if it were allowed?

A No, I don't.

Q And the deferred taxes, I believe we've already talked about, that you might recommend treating it differently if that were not mandated?

A And that was obviously to some degree speculation on my part based upon what happened in the somewhat distant past. So I'm not going to say -- I don't have the power to establish our policy in those areas, so no.

Q Can you think of any other issues that would affect cash flow in a rate making

proceeding?

A No, I think they have been covered.

Q You indicated earlier in the answer to one question, I believe you said something to the effect of calling, quote, precollection from customers of the entire cost of an asset unfair. Do you recall saying something similar to that?

A Yes.

Q Isn't it true that the asset costs include the original cost of the asset plus whatever the cost to retire it is?

A Under an accrual basis of looking at that question, yes.

Q And the original cost is collected -- is expended up front; is that correct?

A Yes, it is.

Q And that's collected over time; is that right?

A In rates, yes.

Q And the cost of removal under the standard method is collected incrementally over time from the rate payers who use those assets; is that right?

A Under the standard method, yes.

Q Similarly to if a company has to --

or is allowed to collect deferred taxes?

A The -- the receipt of cash by the company for that asset would precede its expenditure, yes.

Q On page 5 of your testimony, you were asked a question on line 10, is it reasonable to expect a utility to require some of its cash flow from utility shareholders?

And your answer is yes, and then you go on to explain that answer a little bit.

And my question to you is, under the standard method of accounting for net salvage, how would Laclede's -- Laclede's depreciation expense compare to Laclede's annual construction budget?

A As I understand the numbers that have been introduced into evidence and have been discussed during this hearing, Laclede typically has an annual construction budget approximating $50 million, okay? I believe perhaps it was Mr. Sherwin or maybe Mr. Cooper indicated its annual depreciation expense currently is around $22 million.

If an entirety for all of Laclede's accounts it was granted the standard method of treating net salvage, my understanding from these

Laclede witnesses is that value would be around $7 million. Or perhaps it would be more accurate to say that was the value at the time of 1999. I do not know the current value of that.

Q So Laclede would be acquiring assets from its utility shareholders. Right?

A To make --

Q Or some of its cash flow?

A Under the standard method, they would receive 7 million in additional cash flow in customers, which would reduce the cash flow necessary to obtain by shareholders in the same amount.

Q And that doesn't go against your statement that it's reasonable for a utility to expect some of its cash flow from shareholders. They would indeed be doing that, would they not?

A Take into account, also, the return on equity and deferred income taxes, components of internally generated funds. Based on the recent credit rating agency reports, it appears that Laclede Gas group as an entirety, which is primarily Laclede Gas Company, is collecting enough internally generated funds to cover its construction budget and its dividend requirements.

Q So you're saying under the standard method that Laclede doesn't have to use external sources of funding to finance construction?

A I'm saying the statement in the credit rating agency report indicates -- I believe the report states that their internally generated funds cover almost all of its construction budget plus dividend payout. So there would still be some incremental level of shareholder investment necessary.

Perhaps there would be no incremental shareholder investment necessary if they also were receiving the benefits of the standard approach.

One final caveat, and I mentioned this before, the numbers I looked at pertain to Laclede Group in entirety which also contained some non-utility businesses. So my numbers are not specific to the utility.

Q And do you have numbers specific to the utility?

A They may -- I do not have them. I assume those would be available.

Q Do you assume they differ from the --

A The -- most of Laclede Group is made up of Laclede Gas Company so I would not expect the differences in the internally generated fund analysis would be major, but there may be some difference.

Q On page 9 of your testimony, you talk about Staff's approach being superior to the standard approach and encouraging greater efficiency in net salvage activities, and I'm reading right now on line 16. Because the utilities can receive a financial benefit if they're able to beat historical experience in the cost of removal expenditures. Do you see that?

A Yes.

Q What's the likelihood of beating historical experiences if the trend is upward?

A The trend is currently upward, and in terms of what the trend might be 20, 30, or 50 years from now, one does not know. So -- but I would agree the trend is currently upward.

Q And if indeed Laclede were able to beat the historical experience, wouldn't that result in the recovery amount that they were allowed in the next rate case to be even lower? So that once you raise that bar, you just keep

raising it?

A To the extent we would continue to use -- or to use multi year averages, for example, or even a test year amount, Laclede's efforts to restrain their spending on cost removal, which we would assume to be prudent in this example, would be reflected in an ongoing level on rates whenever rates were established the next time.

Q Okay. Page 11 of your testimony, at the top of the page, beginning on line 1 -- actually at line 5, you say, there is a cost to the customer of utilities maintaining high credit ratings, generally higher rates.

Isn't that in reality a circular argument? In other words, higher credit ratings, the company can access the capital markets at lower costs and, therefore, result in lower rates; but in order to keep the costs -- keep the credit ratings high, the rate can't be too low? I mean, aren't -- isn't that pretty much a circular argument?

A It could be. My real point here, I mean, we could have every utility in the state be graded triple A, the highest level of financial health. And in some respects that would be a wonderful thing, but there are tradeoffs involved and it could be that all the utilities in the state be double A or single A rated at a somewhat lower level of customer rates.

And probably our credit rating agencies, our equity investment raters, and our customers and so on may have a different perspective in terms of where the optimum level of financial health in relation to customer rates might be.

Q It really wouldn't be accurate, would it, to say that high -- maintaining high credit ratings results in higher rates as a general statement?

A I think what you're suggesting is the financial health might have, for example, lower debt costs associated with it?

Q Yes.

A And that is true, but those need to be also looked at in terms of the higher costs in other rate areas where that all washes out.

Q Just wanted to make sure you weren't making a general statement there that it costs customers more to maintain high credit rating.

A It could, and, again, there's a

balance there.

COMMISSIONER MURRAY: I think that's all I have. Thank you.

JUDGE THOMPSON: Thank you, Commissioner.

At this time we're going to take the lunch recess and return and continue with questions from the bench, and I think we will return at 1:30. All right? Very well. We are in recess at this time until 1:30.

(Off the record.)

(Exhibits 151 through 157 marked for identification.)

JUDGE THOMPSON: Okay. I believe we're ready for questions from the bench from Commissioner Gaw.

CHAIRMAN GAW: Thank you, Judge.

BY CHAIRMAN GAW:

Q Afternoon, Mr. Oligschlaeger.

A Good afternoon.

Q I'm going to start from the very, very, very basic place here. Okay? The general concept of depreciation, it involves the reduction in the value of an asset that is owned by a company. Is that -- starts -- does it start out

with that, that there's a reduction in that value every year over time?

A Over time, yes.

Q And so from an accounting standpoint, there are different -- different methodologies for how to estimate the diminishing of that value over time.

A Yes.

Q Of course, there are many, many different ways that are accepted practice to do that, would that not be correct?

A For financial reporting purposes, yes.

Q Well, there are all sorts of different accounting methodologies, aren't there?

A Yes.

Q Not only are there different methodologies from -- from the standpoint of you've got tax methodologies, you've got -- tell me some of them. What kind of different methodologies are there?

A Well, for regulatory purposes --

Q No, I'm not confining us to that. I'm asking you for every kind of accounting that you're aware of.

A Okay. I'll try to think back to my days --

Q Give me the general categories. You got regulatory, what else?

A Straight line accounting, which is also very common for financial reporting purposes. You have various ways, various means of accelerated depreciation; double declining balance is one that comes immediately to mind. And don't ask me in too much detail how that operates, it's been a few years since I've been in school.

But there are a number of methodologies that rely upon the assumption that most of the service value of an asset is extinguished within the early years of its life, and then that extinguishment on an annual basis gets less and less. Straight line, in contrast, assumes it's equal and ratable over the life.

Q Okay. All of those act as an estimate of some sort to what actually is occurring with the value of that property; is that correct?

A That is correct.

Q Now, in regard to regulatory accounting, as that -- that impacts more than, of

course, just something for the sake of what's on the books or for the sake of what taxes are paid, right?

A For regulatory accounting, it helps determine what cost of service should be.

Q Which in turn impacts how much the rates are for rate payers?

A Yes.

Q So if you -- if you have an asset that's going to be depreciated out, generally the methodology that's utilized is straight line for regulatory purposes?

A Yes.

Q When you get to the point of starting out, before you get into any salvage issues, then the concept would be at the beginning of time there was a certain amount of money that was invested in that asset?

A Yes.

Q And that you would then depreciate that over some estimated time of use or life.

A Yes.

Q Okay. To -- down to zero?

A Ultimately, yes.

Q Now, then we -- then you add in the

question of whether or not there might be some value to that asset after it's done. Correct?

A Add in the question of what amount of resources will take to retire the asset. You're not even there yet, so yes.

Q What's the value of that property when it's completely -- when you get done, does it have any value?

A When it's through being in service, what residual value may it have, yes.

Q In other words, is reflecting a zero value an accurate representation of what the true value is of that -- of that asset?

A Yes. We try to determine that question.

Q Okay. Now -- so if there is no cost of removal associated with that asset, but there is some value to it, then you would -- when you're -- when you're doing the amount of depreciation on a straight line basis, you would be taking the amount of its initial value, less the estimated value at its retirement, and then amortizing that over the period of its life?

A Under the standard approach, you would do that.

Q Would you do it any -- well, okay, let's just keep down that road. Okay. Now, when you -- the -- the concept I am assuming -- let me ask you this. If you push away the -- the remaining value of the asset from the -- from the calculation, you -- you would -- would you ever under a straight line methodology go below zero for the value of that property?

A Under mass asset accounting, which is what we're talking about here, what this issue involves, which are a lot of things like poles and so on, which utilities have a lot of and they don't track for depreciation purposes on an individual asset basis, it's my general understanding we keep hitting the dollar value of the vintage of those assets with a depreciation rate, okay?

And I probably am not the best person to address this, perhaps Miss Schad would have been better. It's my understanding in some cases, the depreciation expense can continue on those assets past their estimated service life so that in essence in some cases more depreciation reserve may be reflected as an offset to rate base than what was in rate base as the original cost of the asset.

Q These even ignoring any salvage issue.

A That's before we get to salvage, yes.

Q Can you do any more explaining of that for me? How does that occur? How would that happen?

A Um, I believe that will occur when an asset's actual life exceeds its estimated life.

Q So there -- there would continue to be a depreciation of that asset in the account beyond -- so that it would actually have a depreciation that went below zero?

A Well, and, again, what would happen -- if you estimate a ten year life for an asset, after ten years, it's fully recovered for depreciation; but if it actually is in service for eleven years, another year of depreciation expense would be recorded related to that asset.

Q Why?

A Because that's the way mass asset accounting works, and that's probably the best answer I can give you. Beyond saying the same phenomena occurs on the other side of an asset, is retired after nine years when you expected the -- the service life to be ten years, then the opposite phenomenon would occur.

So, you know, if the average of that account still ends up being ten years in aggregate, then depreciation expense is not overaccrued. That's my understanding.

Q It's -- it's not helping my understanding at this point, unfortunately. So if -- if you have -- why -- why wouldn't you just allow the depreciation to go out and -- as you had originally assessed it? Even if it was continuing to be in use or even if it had been retired early?

A You're talking about a -- you apply a depreciation rate to a dollar value of the account year after year. Okay? And if that -- that dollar -- the account will still reflect that asset, I gave you an example, in year eleven, then it will still be hit by the annual depreciation rate previously authorized by the Commission and depreciation expense will still be recorded by the -- on the utility's books.

Q And I'm looking for an explanation about why we would do that. Why is that accepted practice?

A I believe it's an accepted practice because we do not track on an individual basis the assets. So when you take one out after year nine, there's no mechanism to -- on the books to stop depreciation on that particular asset. Or -- I'm sorry. That's probably a bad example.

There's no mechanism once the full ten year life has been recorded for depreciation purposes and it lasts another year to stop that depreciation expense on that asset that lived an unexpectedly long lived life.

Q I understand what you're saying, but I don't understand why that would be accepted practice.

A I think it's viewed as acceptable because the assumption is there will be an equal number of assets that won't live as long as the estimated life and it will all even out in the end.

Q Well, in the end is the thought that you would really never end up with a depreciation that was different than what you would have had if you had one asset that -- in that account and you only had one, that you would never actually, theoretically, all averaged out, be less than

zero?

A If you only had one asset in the account --

Q Would it be different than having one asset in the account in the end theoretically?

A I believe with life span property, which is tracked separately for depreciation purposes, and I can't say I'm absolutely sure, I believe the mechanisms do exist that once those assets are fully depreciated, depreciation stops on the utility's books. Okay?

Q All right. But what I'm asking you is over -- theoretically, even though individual assets may have -- may actually show up longer than or shorter than their depreciation amount, is it theoretically true that the assets would average out to the average life expectancy that they had originally been estimated to have?

A Theoretically, yes. In actuality, for that account, there may be a net overaccrual or underaccrual if the estimated life has been misestimated to a significant degree.

Q Okay. Well, I'm not sure how that practice came about, so --

A It predates me, too.

Q Okay. Well, if you -- if you're looking at the concept of depreciation, isn't the concept that the depreciation will be for the amount that you originally invested in the asset?

A The original cost, yes.

Q All right. Now, what I'm struggling with here is that now, if I understand it correctly, if the -- if the net cost of removal exceeds the value of the salvage value, that you're also adding that in to the amount of the depreciation?

A Under the standard approach, yes. You estimate that, and in that instance reduce -- or I'm sorry. Increase the original cost by that difference, and also depreciate that over the estimated service life.

Q Now, does -- you don't add the -- that negative net salvage value back in to the rate base, though, do you?

A No, I do not.

Q Okay. So you're actually depreciating it out faster, or more -- in a greater amount per year than you would otherwise under the standard method?

A Yes.

Q And then -- and once I do that, then I would assume that over the standard life, I'm actually always going to be less than zero in -- in that -- in that scenario? Because my depreciation at the end of the useful life will be more than the original value that you -- that you gave to that asset.

A At the very end of the process, that is true. When you actually retire the plant, you reverse the plant cost out and you reverse the reserve -- the impact on the reserve out so you are back at zero at that point.

Q When does that occur?

A When the plant is retired.

Q Now, this is money that's being captured from -- from rate payers while the depreciation is going on; is that right?

A Well, the -- while -- under the standard approach, while the plant asset is in service, yes.

Q All right. And if -- if a -- under -- when the original -- the cost of the original asset, that was paid for by the Company up front, correct?

A Yes.

Q And re -- and then the asset is depreciated out going forward. Correct?

A Yes.

Q Money -- and that allows -- that allows cash coming back into the Company during that period of time while it's being used?

A Right.

Q But the amount that it will take to actually retire that asset, that's not paid for by the Company at the time the asset is initially put in service.

A No. It is paid for at the end of its life when it's retired.

Q And how many years after that's put in service could we be talking about? In a range here?

A On the extreme end, I think I've heard discussions just in this hearing of 80 year lives.

Q Eighty years?

A And there could be more.

Q What kinds of assets are in the mass account?

A Things like poles, I assume things like meters. Those are two of the big things. I don't necessarily have a longer list for you, but -- generally things that -- that they're -- poles would be -- for -- every customer has a meter, you know, we're talking hundreds of thousands of meters, that's something that would be accounted for on a mass asset basis.

Q And mains and things of that sort?

A I believe mains would be covered as well.

Q Well, the concept initially of recapturing the money, it seems to me that there's a significant difference in recapturing money for things that you're using and getting an advance on something you might expend sometime in the future.

A I would agree.

Q So I'm -- I'm struggling with this concept that they're both being treated the same.

A Well --

Q With the standard method.

A Again, if you're talking about depreciation expense associated with assets for which the costs have been paid, you're returning moneys to the Company, it's a return of their investment.

Q Right.

A If you are talking about moneys they will expend at a later point in time, it's a precollection of costs that they will not expend for a number of years. And for all practical intents and purposes in the past, that has been used as an additional amount to invest back into the Company.

Q Is there a guarantee that that money will ever be used?

A For the purpose --

Q For the retirement?

A If they invest -- if they invest the moneys received in rates into, for example, additional plant asset accounts --

Q You're misunderstanding my question. Is there a guarantee that the amount estimated for the retirement will ever actually be expended?

A No, there is no guarantee either in the amount or timing or probably in some cases of whether the expenditure will occur at all.

Q So rate payers could be advancing money years in advance of something which may never actually be expended?

A That is a possibility. I think Ms. Schad's testimony is a concrete example of that phenomenon as it relates to Laclede Gas Company.

Q What part of her testimony are you referring to?

A It's in her supplemental rebuttal testimony. I can give you the page reference real quick, if you wish. Pages 11 and 12 of her supplemental rebuttal testimony. At the bottom of page 11.

Q Some of that's HC, it looks like. So is Staff suggesting that one of the reasons to look at its methodology is the certainty that comes about as a result of tracking what's actually removed rather than some estimate of something that may or may not ever occur in the future?

A That is one of our concerns, yes.

Q Do you know if -- well, let me ask you this, because this is -- I'm sure this has come up and I evidently missed it.

In regard to the original case, there was mention of the gas holding tanks. What occurred with that issue in this case?

A It is my understanding that is not at issue in this proceeding.

Q Do you know why?

A No, I don't. Perhaps my counsel could help you on that.

Q I could -- he's loving you doing that to him. I can ask that later, find out. But I was a little confused about it. But those are -- that's -- those assets dealing with the -- that treatment for those gas holding tanks, was it -- was it done differently by Staff in this case? In their approach on the mass accounts?

A Those are life span accounts, I believe, and I think there was a specific dispute in terms of the earlier proceedings as to when and if Laclede would expend moneys to remove those assets.

Q Do you know if those assets are still -- have been removed? The gas holding tanks?

A Last time I drove on I-44 into St. Louis, I believe they were still there.

Q Do you know under Missouri rate making practice what expenses are accounted for using the accrual method?

A Most items are accounted for using the accrual method. For -- to give you a very broad example, on rate cases?

Q Yes.

A Revenues would be reflected on the rate case that had been billed by the utility, but had not yet been received. Expenses would be reflected in the rate case that have been billed to the utility, but not paid by the utility. So it -- accrual is kind of the standard. There are some exceptions where we go to a cash basis.

Q Now, the things that you were just discussing, those are things that I would assume would occur in the short run where there would be, if not an extended period of many years before you, you actually collected the money or incurred, actually paid out the -- the cash for the expense, would that be accurate or not?

A Yes. Those are short-term accrual versus cash issues.

Q What about on long-term things?

A Where we are on a cash basis? Probably the best example I can give you, and this goes back a few years, has to do with post retirement medical benefits.

Q Explain what that is for me.

A That those are medical benefits a company will pay its retirees after their employment history with the utility is done.

Q Okay.

A In the early 1990s, financial reporting standards changed where utilities and other companies were required to accrue for those benefits when they were earned by the employees, okay? And that created a big, huge increase in expense compared to the cash outlays associated with those benefits.

Q Okay. What occurred when that issue first came about?

A Utilities sought recovery of those items on an accrual basis before the Commission in several rate cases. The Commission took a look at the issue, and the Staff and other parties initially argued that it was too speculative, talking about estimates 20, 30 years in advance, and urged the Commission to maintain a cash standard for that expense.

Q And what occurred in those cases, if you know?

A The Commission ruled in favor of the Staff and ruled in favor of a cash standard for rate making treatment of that item. Now, that's not the end of the story, because later on a legislature passed a law which basically mandated accrual rate making treatment for that item as long as the --

Q Let me ask you something about that. When was that legislation passed?

A 1994.

Q And so that the Commission -- the Commission had said, you're going to use a cash method because it's too speculative. Correct?

A Right.

Q The legislature then came back and interceded, the Missouri legislature, and said, we're -- we're going to say that you ought to allow them to do an accrual method. Correct?

A Yes.

Q And that was -- was that -- is that -- do you know the section on that?

A I'll have to refer that, again, to my counsel.

Q 386-314.2?

A I hate to say it sounds familiar, but it does.

Q And in that, did the legislature say there should be any special treatment of the funds that were accounted for by the accrual method?

A Yes, a requirement of utilities collecting that accrual method was that utilities had to set the funds aside in a trust type of situation where they would be preserved for future use for that purpose.

Q So in other words, is that -- is that similar at all to Staff's second approach suggested?

A Yes. Our alternative approach, yes, it would follow along the same lines.

Q Let me ask you about pensions. How -- how are they treated?

A Pensions are precollected from customers so that they can be placed in a trust fund, earn interest over time, and eventually disbursed from the trust fund to be paid to the utility retirees.

Q Is that done pursuant to any mandate?

A I believe there is a federal law that requires that the trust fund be set up by the utilities to fund the pensions.

Q And then there's the nuclear decommissioning fund as well. They have some similar characteristic?

A Yes, and that was, I think, set up by state statute.

Q I've been hearing some discussion about -- about deferred taxes and using the accrual method for deferred taxes. I didn't quite understand that.

A Okay. Deferred taxes -- perhaps I'll try to be shorter in my explanation than I was this morning -- are basically tax benefits that the IRS code grants utilities as well as other companies in general, that grant it more -- or the ability to deduct amounts prior to when they must be expensed for financial reporting purposes. Okay?

So that means taxable income will be lower than net income as a normal course for utilities and companies in general. However, rates are mandated to a significant -- utility rates are mandated to a significant degree to be based on book net income, the higher amount, so that income tax collections from customers are greater on an ongoing basis than income tax disbursements to the federal government, state government, and to the local governments where applicable.

That gives utilities a source of funds for a period of time before they have to be paid back to the various governmental authorities, and they can use those funds for investment purposes.

Q What's that period of time generally?

A Depend -- well, a lot of tax timing differences have to do with depreciation, and so you can assume that the -- over the average service life of the asset, you know, 30, 40 years.

Q And then how does that -- how does that -- again, where did that come from, that --

A That favorable treatment?

Q Yes.

A I believe the IRS code mandates it, and my general understanding is the U.S. Congress may have played a role in establishing that treatment.

Q It wasn't done by something that -- by a Commission decision specifically, then?

A No.

Q I was -- I've heard some discussion, I wasn't quite sure how we got into it, but I heard some discussion about the -- I think about

ISRS matters a little earlier, and I was just curious about a couple of things.

Before the -- before utilities were allowed to -- to implement an infrastructure and replacement surcharge, was the general concept of rate making in regard to assets coming in and out of service a -- one that was intended to be a balancing act between rate cases of retirements coupled with new assets coming on line? Do you know what I'm asking?

A Let me take a stab at it.

Q Yeah.

A Between rate cases, lots of things happen. Among them, new assets come on line and their costs are added to rate base. Old assets may be retired and their costs are removed from rate base. To the extent the additions exceed the retirements, rate base will increase over time, and the financial impact is such a utility will file for new rates to reflect that additional investment.

Q But between rate cases, the rates don't change, correct?

A That is correct.

Q In the traditional rate making.

A Yes.
Q So was the philosophy that at the last -- at the last rate case, we determined what the value of your assets were on -- on your books, and we implemented certain rates, and those were -- are going to stay in effect until the next rate case?
A That's correct.
Q Okay. In that interim period between those rate cases, there could be some, and probably would be some assets that would retire, correct?
A. Yes.
Q And there would be depreciation that would be going on between those rate cases shown on the books.
A Yes.
Q And, dually, if you added no new -- no new assets, no new infrastructure in that time frame, at any point in time, the Company would -- the Company's rate base would be decreasing, but the rates would be remaining the same?
A Yes.
Q And the -- going the other direction, if -- if you were adding new -- new

assets in, the books might actually show a rate base that was increased from the last rate case, but your rates would still be the same?

A That's correct.

Q Now, now we have the ISRS in the picture. What does that do to that traditional balance in regard to the rate payers and the Company?

A Well, to expand your earlier scenario, at the same time plants are being added and subtracted, customers may be being added as well, additional revenues coming on, you may have higher expenses, may have lower expenses. And in a rate case, you look at everything before determining whether rates should go up or down.

It's my understanding the ISRS legislation allows for plant to cover new additions that cover certain criteria without looking at the other financial revenue requirement factors that would normally be looked at in a rate proceeding such as revenue levels, expense levels, and so on.

Q You would also not look at the depreciation that would have occurred since the last rate case in regard to rate base; is that

correct?

A I believe that's correct under the ISRS legislation.

Q So doesn't that change the balance from what it was before the ISRS legislation was in effect?

A I would -- my own judgment is yes.

Q And in whose favor does it change the balance between the Company and the rate payer?

A That is a change that on balance is more favorable to the Company than to the rate payer, in my opinion.

Q Can you think of an opinion that you've heard of that would disagree with that?

A I believe I have heard opinions of utility officials that in the long run both customers and shareholders will be better off under this kind of approach.

Q Be better off --

A In the long run.

Q How, if at all, does that relate to what we're discussing on these depreciation accounts?

A Okay. The relationship -- and I

don't think it's a direct one. I mentioned it in my testimony because it is a recent impact that is favorable to the companies from a cash flow perspective, and obviously the companies arguing this issue tend to emphasize the negative impact of the Staff's proposed treatment of net salvage.

Now, credit rating agencies and so on, when they look at cash flow, they look at everything, the good, the bad, and the ugly. And, for example, in Laclede's case, credit rating agencies have favorably noted the findings of the ISRS as a positive financial impact for this company.

Q In the standard -- so-called standard method that's used, when the money for negative net salvage is collected during the depreciation of the asset, is there -- if -- if we assume that at some point in time a company were going to cease business, just stop business, would the -- if that had been the methodology that would have been employed, would the rate payers be ahead, behind, or equal in regard to the money that had been advanced under that methodology?

A Under the standard approach, under most conceivable circumstances, they will be behind in the sense that they will have advanced more money to the company for this purpose than the company will have expended.

Q And under Staff's approach, the first approach, where would we be?

A Well, since we intend -- or the goal is to make them whole for their cash flow expenditures, neither the company nor its customers will be in a plus or minus situation under the scenario you described.

Q What's the argument that -- that you think is most important for the Commission to consider against your second proposal? Isn't that a nice thing for me to ask you?

A In terms of the segregation of funds?

Q Yes.

A The companies have pointed out that there are definite costs associated with going the trust route, costs to pay the various expenses and the trustee and so on, that the return that will be gained on the assets in the fund may not be as great as the return -- or may not equal the return normally granted by this Commission to the utility for its overall rate of return and, therefore, the customers may be disadvantaged to some degree by that return differential.

And the other argument that they have used is that there's no evidence there will be a problem in the future paying these cost of removal amounts because there's been no problems in the past, and they will live up to their responsibilities to do what is right in terms of these removal activities.

Q What is your response to those arguments, again?

A My response would be on the first point in terms of the costs and so on of the trust, the cost to me is a secondary matter.

Companies are asking the Commission to okay receiving large streams of revenue from their customers on an ongoing basis, and it will go larger as time goes on, with no restrictions whatsoever on what they do with the funds.

So that to the extent problems occur in the future, because the amounts may be so great or so volatile or so on, funds -- the funds previously collected aren't going to be available for the most part because they're going to be invested in other assets and the hard infrastructure of the utility.

The Company must then fund these amounts through shareholder sources. And as we know, there are times when utilities' financial situation is such that they may not have easy access to the credit markets. Okay? We presume normally they will, and that's a fine presumption, but there will be exceptions. There have been exceptions in the past.

There's another problem. Let's say they, through the accrual method, okay, they collect funds up in advance and it turns out that they have overcollected from customers. And the Commission in its wisdom may find that an amortization of some of those overcollections back to customers would be appropriate. Okay?

But, again, the cash to make those refunds back won't be readily available because the funds for cost removal have been invested elsewhere. So those funds back to customers will be a cash flow detriment to the companies.

And I -- it is my belief and the Staff's belief that those scenarios can be avoided by segregating these funds so that they are collected and then maintained for the use -- the purpose for which the collection from customers were mandated. We think that's the better way to go.

Q Okay. So is this -- is -- that's your -- is that your second --

A Actually, I think I covered my second argument there, too.

Q But with your -- your answer on the last part, were you referring to your second alternative or your first one?

A The second, why these funds should be segregated and put in a trust.

Q So is this -- that methodology, a method to ensure that while there might -- the amounts might be estimated and collected up front, that there would be some protection for rate payers to assure them that the funds would actually be there when they needed to be expended?

A That is correct, yes.

Q It -- this may -- this question may be -- may not have a clear answer, but is there -- is there a -- is there an incentive or disincentive or no incentive to the standard method in regard to whether or not the retirements are done earlier or later in -- in a -- in time?

Whether the expenditures occur earlier or later?

A I -- that's a good question, and I think you're right, there's not a real clear answer because I think there's incentives that may go both ways.

Q Yes.

A Keeping in mind, again, that for practical purposes, future funding of cost of removal activities will come from shareholders, even if you allow the standard method. I think companies may be reluctant to tap shareholder sources at a later date in the same way they profess reluctance to tap them now for the ongoing financing of the company for this issue.

On the other hand, and to be fair, to the extent they don't expend the funds, then what I discussed earlier, the possibility of cash refunds or an amortization of depreciation reserve overaccruals may be ordered, and that's not something they would want either. So I'm not sure where it all washes out.

Q Well, if there were an asset whose retirement could be put off indefinitely, and I say, "retirement," taking it out of service and salvaging it, whatever needs to be done could be

put off indefinitely, would there be an incentive to put it off indefinitely under the standard method?

A I believe so because the cash from customers to pay for that retirement presumably will not be available because the customers have already paid once in cash already.

Q In other words, the money's already been collected, so if you can put off actually spending the money that's been collected, if you can do that, wouldn't that make sense to do that if you didn't have some -- somebody telling you you had to?

A I believe there is an incentive perhaps to push off those decisions, yes.

Q And is it accurate to say with some of the assets in the mass accounts, that those -- those things may never actually need to have any expenses incurred to do what was estimated to have to be done to get them out of service?

A This is mostly based upon Miss Schad's testimony, that they have options to not physically remove an asset when they retire it, which may be a less expensive course than, you know, full removal. And they may have collected the money --

Q For a full removal?

A -- while simply choosing to retire it in place.

Q All right. Now, I need to work through you -- with you just a little bit here on how Staff's first method here, not the -- not the segregation method, but the first method works in regard to the accounting that occurs. I'd like for you to walk through with me just a bit if you have -- how that -- how you actually do that.

Okay? And -- and I'm curious because you described earlier about the peaks and valleys that can occur if you look at the amount of expenditures that they are occurring every year on actual removal costs that might be attributable to that, or related to that account.

How does Staff average that out or take into account the amount so that it more accurately reflects what's going on, as we know rate cases are spread apart?

A Okay. I want to discuss our current approach to handling cost of removal in a rate case. Which isn't the exact same approach that was used in the Laclede Gas case. And if you want that explained, I can explain that.

Q I do need to understand that because it's been a source of confusion in this case. To me.

A Okay. In the GR-99-315 case, Staff's proposal, as I understand it, was to maintain a net salvage component to the depreciation rate. But instead of basing that component upon an estimated future -- future outlay of cost of removal, that component was based upon a recent historical average of actual cash expenditures for cost of removal, which was considerably less.

Okay? That -- so we -- the way I think of it, we kind of kept the forum of the standard approach while substantively moving to something close to cash accounting for that item.

Since then, we've eliminated the net salvage component of the depreciation rate for these mass accounts, and instead treat cost removal as a line item of expense like any other expense in a rate case, payroll expense, pension expense or whatever. So it's added depreciation entirely and it's an expense.

Now, to move on to your question.

Because cost of removal tends to be somewhat volatile from year to year, we will obtain the data in a rate case to look at the last five or ten years of historical experience.

Based upon what that data might show, in most cases we will probably choose to use a historical recent average over three years, five years, in some cases maybe ten years, as what we think a reasonable ongoing level of this expense will be.

There may be other cases where if the test year experience is right in line with what the averages would show, we may not -- we may choose not to adjust the cost removal at all and just leave it at a test year level.

That's the basics of what we look at in a rate proceeding.

Q Okay. Is that what's being proposed now by the Staff for this case?

A I believe that Mr. Adam's net salvage calculation in the '99 case was based upon a five year average of actual Laclede expenditures, past cash outlays, for cost of removal. So it's a multi year average.

Q All right. And how does that vary,

again, what he did in that case, vary from what you all are doing today when you're looking at cases?

A In terms of the dollar value, it should not vary, okay? You'll end up with the same mathematical result and revenue requirement.

There is one difference. If you leave the component in net salvage and depreciation expense, then the depreciation reserve will continue to reflect that accrual of that amount. That's the one difference.

Q All right. And Staff no longer does that?

A We no longer do that.

Q And in this case, are you -- are you proposing that new methodology be adopted for this -- for this case that was done two rate cases ago, or are you just backing up the work that was done at that time and waiting till the next rate case?

A This was an unusual proceeding. I think the answer to your question is the latter alternative. We are still supporting what was done in the '99 rate case.

Q But in a new rate case coming up, you would be proposing, if this were a new rate

case, the methodology that you described to me as your current method?

A I believe so since that's consistent with what we've done in more recent cases.

Q Okay. There was the MGE case that was recently -- not the MGE case. What was the case that you all recently settled with this in it? It was MGE, with the partial stip that was done. In this issue, what was the methodology used in that?

A If I recollect, I believe the Staff and the Company agreed upon a five year average of recent historical experience for cost of removal.

Q And was the amount reflected in accumulated depreciation or just treated as a pure expense?

A It was treated as a pure expense.

Q If this Commission entered -- entered an order in this case that went to the standard method and ordered that the books of Laclede be adjusted for that standard method, but determined that we could not retroactively adjust rates, what would that do to Laclede in the next rate case?

A If you ruled on the standard method,

did not change rates, either overall customer rates or depreciation rates?

Q **Yes.**

A I -- if I -- unless I misunderstand, I don't think it would do anything.

Q **Wouldn't their books be adjusted on their depreciation, and wouldn't there be a difference in the amount shown when you came to the next rate case on their depreciation accounts?**

A Well, it depend -- if you change the depreciation rates.

Q **Yes.**

A They would be increased, okay? At the same time, no change in overall customer levels would occur.

Q **Correct.**

A So what would happen is, number one, their earnings would be reduced to reflect the increased depreciation expense; however, rate base would also be reduced to reflect the higher monthly accruals of depreciation of the higher rates. And at the time of the next rate proceeding, rate base would be somewhat less than what it otherwise would be.

Q **So if we got to the next rate case,**

all other things being equal, if we went back and adjusted to what Laclede is asking us to do on this standard method, would the rate base not be less than if we left it like it was when Staff proposed it?

A If the rate -- if depreciation rates are increased currently, then rate base will be less at the time of the next rate case for Laclede Gas Company.

CHAIRMAN GAW: I think that's all I have right now. Thank you.

JUDGE THOMPSON: Thank you, Chairman Gaw.

Commissioner Clayton?

BY COMMISSIONER CLAYTON:

Q I've asked a lot of questions over the last couple of days, and I'm just going to go over a couple of the topics that I've previously discussed and see if you can try to address them.

If you don't know the answer or don't feel like it's your place or -- I guess what normally happens around here, people just say, I'll defer to so and so, you can do that.

A Even if there's no one to defer to?

Q Yeah. It doesn't happen in any

other court, but it happens here.

So, anyway, with previous witnesses I tried to explore a word that pops up in testimony, especially put on by both companies, Ameren and Laclede, with regard to safeguards that are included within the accrual method.

And I was wondering if -- I believe in your responses to Chairman Gaw, that I think I inferred that you believe that either there were no safeguards to protect an accurate collection of funds over time, or that the safeguards were simply not acceptable or there were none.

And I was wondering if you could address this term "safeguards" in the accrual method about whether there are any or whether there are other safeguards that we could implement here or order to -- to ensure that these amounts are accurate every time a case comes around.

A Okay.

Q That's a mouthful, so go for it.

A I understand. First of all, to make one point up front, to the extent these items are safeguards, they are present in any scheme of depreciation, whether you're talking about the standard approach, whether you're talking about the Staff's approach, or you're talking about a third approach.

Each of the items the Company talks about you would still expect to use and be present in the future in your regulatory proceedings. They're not something inherent to the standard approach.

Q Could you identify those, the things that you're kind of referring to there?

A I believe they've noted three safeguards, which is the updated filings of depreciation studies over time, the fact that retirements -- well, hold on just a minute. Okay. Updated depreciation studies was the first.

Q Okay.

A The second was that when plant is retired, the depreciation reserve will also be adjusted to reflect the retirement, and whether the -- and underaccrual or overaccrual occurs, that that will show up or -- at that point.

And, third, I believe the -- the third measure or customer safeguard is the fact that any underaccruals or overaccruals can be amortized back to the Company or to the customers if problems in estimation occur. Okay?

Q Each of those are available under this -- this accrual method that's been discussed? You would agree that each of these corrective measures would be available in the accrual method?

A Under the accrual method and the Staff method as well.

Q Okay. Is it your testimony that these corrective mechanisms are not sufficient to protect the rate payer?

A I -- that is my testimony, that I do not believe the existence of these safeguards justifies the adoptions of the Company's proposal.

Q Okay. And why is that? Why are they not sufficient? I guess identify the shortcomings of these corrective mechanisms.

A First of all, the updated estimates and changes to depreciation rates over time caused by conducting new depreciation studies, the thought and the hope is that as time goes on, better information can be obtained, more refined estimates can be made that hopefully will come closer to the match.

And perhaps that's a reasonable expectation, but I would note it's not a guarantee. The future is never foreseeable at any