Exhibit No.:	
Issues:	Net Salvage/Depreciation: Overview; Detrimental Impact to Utility and Customers Caused by Reduced Cash Flow
Witness:	Barry C. Cooper
Sponsoring Party:	Laclede Gas Company
Type of Exhibit:	Supplemental Direct Testimony
Case No.:	GR-99-315
Date Testimony Prepared:	August 20, 2004

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. GR-99-315

SUPPLEMENTAL DIRECT TESTIMONY

OF

BARRY C. COOPER

ON

BEHALF OF

LACLEDE GAS COMPANY

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SUPPLEMENTAL DIRECT TESTIMONY
OF
BARRY C. COOPER

Q. Please state your name and business address.

A. My name is Barry C. Cooper and my business address is 720 Olive Street, St. Louis, Missouri 63101.

Q. By whom are you employed and in what capacity?

A. I am employed by Laclede Gas Company ("Laclede" or "Company") in the position of Chief Financial Officer. In this capacity, I have ultimate responsibility for the Company's accounting, customer accounting, budgeting, financial planning, treasury functions, financing activities, investor relations and information systems.

Q. How long have you held your current position?

A. I was elected to my current position in September 2002 upon joining Laclede.

Q. What was your professional experience prior to assuming your current position with Laclede?

A. From 1995 to 2002, I was employed by GenAmerica Corporation. During my tenure at GenAmerica, I served in a number of positions, including Vice President-Finance, Vice President & Controller and Consultant to the Chief Executive Officer. My responsibilities included internal and external financial reporting, business planning, forecasting and budgeting, capital planning management, treasury and accounting services. Prior to joining GenAmerica, I was a Senior Manager in the Audit Practice with the big four accounting firm KPMG Peat Marwick LLP. While at KPMG, I specialized in financial services, mergers and acquisitions, and business process re-engineering for a number of large business clients.

Q. What is your educational background?

A. I received a Bachelor of Science degree in Business from Southeast Missouri State University in Cape Girardeau, MO in 1981. I subsequently obtained a Masters in Business Administration from Northwestern University in Chicago, IL in 1998.

Q. Do you belong to any professional societies?

A. Yes, since 1984 I have been a member of the American Institute of Certified Public Accountants and the Missouri Society of Certified Public Accountants.

Q. Have you previously submitted testimony before this Commission?

A. No.

I
PURPOSE OF TESTIMONY

Q. What is the purpose of your supplemental direct testimony in this proceeding?

A. The purpose of my supplemental direct testimony is to provide an overview of the reasons why Laclede believes the Commission should reaffirm its use of the method that has traditionally been employed by the Commission for determining how such costs will be handled for ratemaking purposes (hereinafter the "Standard Method"). In doing so, I will also highlight the primary reasons why we believe the Commission should reject the method that the Commission Staff has proposed for addressing net salvage costs – an approach that, in contrast to the Standard Method, makes no attempt to recognize and account for the costs that will be incurred to retire the assets that are currently being used to serve Laclede's customers. In addition, I will discuss in greater detail why Commission approval of Staff's method would have a detrimental impact on Laclede's financial capabilities to meet its public utility obligations and ultimately increase the cost of providing service to our customers.

Q. Are there any other Laclede witnesses addressing this issue?

A. Yes. Laclede witnesses R. Lawrence Sherwin and William M. Stout will provide additional support for the reasons we believe it would be both inappropriate and counter-productive for the Commission to adopt Staff's method for addressing this important element of the Company's cost of service.

II
OVERVIEW

Q. Please provide the Commission with an overview of why the Standard Method for determining the net salvage component of depreciation is preferable to the Staff's method.

A. There are a number of reasons why the Commission should reaffirm its use of the Standard Method, in lieu of the method proposed by the Staff. I have to begin by noting that in my 20 plus years of dealing with the financial needs and characteristics of various businesses, both in public accounting and industry, I have never encountered a less suitable methodology for allocating the cost of a fixed asset than the one proposed by the Staff in this proceeding. One of the underlying principles of fixed asset accounting is that you select a method of depreciation that spreads the cost of the asset over the asset's useful life. In contrast to other businesses, many of the assets used in providing natural gas service have retirement or removal costs at the end of their useful service lives that exceed their salvage value. Traditionally, this Commission and others have recognized and spread this net salvage cost over the life of the asset so that those benefiting from it pay for it. The Staff's method does not, however, since it only recognizes the net salvage costs being incurred by Laclede on facilities that have already been retired. Because Staff's method ignores the very real costs that decades of experience have shown will need to be incurred to retire the facilities that are being used today to serve our customers it is a method that does not even try to allocate cost responsibility in a rational or equitable manner. Simply put, it is critical that the Commission approve the use of the Standard method for reasons that are both numerous and compelling in my view.

Q. Please summarize those reasons for the Commission.

A. There are six major reasons why I believe the Commission should conclude that the Standard Method is vastly preferable to the one proposed by the Staff:

First, there is an abundance of authority that supports the efficacy and reasonableness of the Standard Method as a means of determining what level of net salvage costs should be included in rates as supported by witness Stout and others. In addition to its long use by this Commission, the Standard Method has been and continues to be used by the vast majority of regulatory jurisdictions in the United States. As a result, the Standard Method reflects the collective judgment and long experience of a broad array of regulatory authorities regarding how net salvage costs should be handled for public utilities. In contrast, the Staff's method appears to have been developed with virtually no analysis of its suitability for addressing net salvage costs and without any evidence to show that the Standard Method was not producing an appropriate estimate of such costs. Indeed, the fact that the Commission has not yet been able to provide an adequate explanation of why Staff's method is appropriate – despite repeated efforts do so in the five plus years since this issue was first addressed by the Commission – only reinforces the view that Staff's method is fundamentally flawed.

Second, Staff's method is premised almost entirely on the proposition that the Standard Method does not result in an estimate of net salvage costs that is certain enough to be used for ratemaking purposes. As both Laclede witnesses Sherwin and Stout explain, however, the Standard Method is based on decades worth of historical data that captures, in a very conservative manner, the impact that inflation and other factors have on the net salvage costs that will actually be incurred to retire or remove facilities that are in place today. In contrast, by only recognizing the net salvage costs associated with plant that has been retired in the past, Staff's method produces an estimate of net salvage costs that, as a matter of mathematical certainty, will not reflect the actual net salvage costs that will be incurred in the future to retire plant in service today.

Third, to the extent that estimates used for determining net salvage costs vary from the actual net salvage costs experienced at the time current plant is retired, then the Standard Method is vastly preferable given its inherent safeguards. By including net salvage as a component of depreciation rates, the Standard Method ensures that the utility will never over or under collect its net salvage costs or, put another way, that the ratepayer will never under or overpay for such costs. This is due to the fact that, as a component of depreciation rates, any difference between estimated and actual net salvage experience will be tracked and ultimately reconciled back to zero through periodic adjustments in those depreciation rates. In addition to this safeguard, any temporary difference between estimated and actual net salvage costs is also reflected in the depreciation reserve which, in turn, is deducted from the utility's rate base pursuant to standard Commission practice. As a result, ratepayers are compensated (at the utility's overall rate of return) for the "use" of their money during those times when the utility's outlays for net salvage are less than what has been included in depreciation rates. In contrast, the Staff's method has none of these safeguards. Instead, any difference between its backward-looking estimate of net salvage costs and actual net salvage costs are either absorbed by the utility or borne by the customer. In short, Staff's method responds to the uncertainty inherent in any estimating process by making certain that there will be winners and losers if estimates do indeed vary from actual experience, while the Standard Method ensures that everyone will be made whole under such a scenario.

Fourth, by estimating what the net salvage costs will be for facilities currently in service, and by ensuring that those costs are included in rates as the facilities are used up, the Standard Method does a much better job of ensuring intergenerational equity and complying with the basic principle that those benefiting from, or causing, a cost should generally pay for it. In contrast, by only recognizing the net salvage costs associated with facilities that have already been removed from service, the Staff method effectively jettisons these principles by making future customers responsible for the cost of facilities that are being used to serve customers today. Indeed, Staff's method effectively ensures that no one, except by pure happenstance, will ever pay for the cost of the facilities that are being used to serve them but instead only for those facilities that were used to serve others.

Fifth, by excluding any consideration of the net salvage costs that will be incurred in connection with facilities that are in service today, the Staff's method significantly decreases the cash flows supporting the Company's investment in utility facilities. This reduction in cash flow increases costs for customers in two ways. First, it requires that Laclede finance an ever greater proportion of its capital requirements through external financing rather than internally generated funds. Each of these financings impose an added cost on both Laclede and its customers. Second, by contributing to an ongoing decline in the amount of cash available to cover such investments, the Staff's method has a decidedly negative impact on the basic financial parameters that investors and rating agencies rely on in assessing whether to invest in Laclede and at what price. All other things being equal, it virtually guarantees that Laclede will pay more for debt financing than non-Missouri utilities who are competing for the same investment dollars.

Finally, because the Staff's method also involves a second step under which rates and cash flow are eventually reduced even further to "return" monies that were supposedly collected to recover the level of net salvage costs derived under the Standard Method, it will tend to exacerbate all of the shortcomings described above to the detriment of both the utility and its customers.

Q. In view of these considerations, what in your view is the appropriate course of action for the Commission to take in this proceeding?

A. Taken alone, each of the considerations discussed above would warrant the Commission's continued use of the Standard Method. When considered in combination, however, I believe the justification for such an outcome is overwhelming. Accordingly, I urge the Commission to do what the vast majority of state regulatory bodies have done and continue to do, namely reaffirm that the Standard Method provides the most appropriate way for allocating net salvage costs in a manner that is consistent with the interests of utility shareholders and customers alike. Indeed, I believe such an outcome is especially important in light of the financial considerations discussed below.

III
Detrimental Impact on Cash Flow and Financial Capabilities

Q. You previously mentioned the impact that Staff's method would have on Laclede's cash flow and financial capabilities. Would that impact be detrimental to both the Company and its customers?

A. Yes, it unquestionably would be.

Q. Please explain why.

A. As I previously indicated, the Staff's method would significantly decrease the cash flows supporting the Company's investment in utility facilities by excluding from rates the amounts necessary to pay for the net salvage costs that will be incurred in connection with facilities that are in service today.

Q. What impact would this reduction in cash flow have on the Company's customers?

A. The first way this reduction in cash flow would increase costs for customers is by requiring Laclede to finance an ever greater proportion of its capital requirements through external financing rather than internally generated funds. Obviously, capital is not free and each of these financings therefore impose an added cost on both Laclede and its customers.

Q. Does Laclede have significant capital requirements?

A. Yes, and those capital requirements are already significantly greater than the cash flows available to the Company to pay for them. Laclede currently incurs approximately $50 million annually in capital expenditures, a significant amount of which are for mandated programs such as our cast iron main, bare steel main, and copper service replacement programs. Current depreciation rates on all of the Company's facilities generate approximately $22 million annually in cash to support such expenditures. As a result, there are significant cash requirements to fund these programs that are not currently met through internally generated funds. Laclede has to frequently seek funds in the capital markets due to this cash flow shortfall. Every time Laclede must go to the capital markets to fund these expenditures, the Company and our customers must absorb the additional transaction and financing costs of obtaining funds in the capital markets. It should be noted that Laclede is not unlike other local distribution companies in being "cash-flow negative," but the Staff's method exacerbates this shortfall in comparison to our peers; a result that is not lost on those who choose between investing in Laclede and investing in our peers.

Q. Would the reduction in cash flows associated with Staff's method increase costs to customers in other ways?

A. Yes. By contributing to an ongoing decline in the amount of cash available to cover such investments, the Staff's method also has a negative impact on the basic financial parameters that investors and rating agencies rely on in assessing whether to invest in Laclede and at what price, which in turn increases borrowing costs. Laclede's financial parameters are already somewhat weak for its current ratings. Standard and Poor's, one of the major credit rating agencies, recently revised its ratings guidelines, de-emphasizing credit metrics such as pre-tax interest coverage and instead concentrating on Funds From Operations ("FFO") ratios. FFO ratios measure cash available to service the interest and maturity repayments of outstanding debt obligations. The primary components of FFO are: 1) net income; 2) depreciation and amortization; and 3) deferred income taxes. As depreciation is a primary factor in determining these coverage ratios, the Staff's proposed method has a material adverse impact on the ratios used in rating our debt. Relative to the credit metrics used by the rating agencies for utilities as a whole, the Staff's method would result in lower credit ratings, higher borrowing costs, and an increase in return requirement for "risk-averse" equity investors. Each of these factors will, in turn, produce a higher cost of capital and increased revenue requirements on our customers.

Q. Has the impact of Staff's method already had an influence on how rating agencies view Laclede?

A. Yes. Beginning in 2002, Moody's twice mentioned the treatment of depreciation as a factor, first when changing Laclede's outlook from stable to negative, and again when downgrading Laclede's debt rating – a downgrading that remains in effect today. I would note that the implementation of Staff's method has also been cited by rating agencies as a reason for downgrading other Missouri utilities.

Q. What conclusions do you believe the Commission should draw from these facts?

A. I believe these financial considerations are simply another factor that argues in favor of the Commission's retention of the Standard Method for addressing net salvage costs. Even if these considerations did not exist, the Standard Method would still be vastly superior to the method proposed by Staff in this proceeding for all of the reasons addressed in the testimony of our witnesses. But the case for retaining it becomes overwhelming in my view given the negative impact that Staff's method would have on Laclede's financial capabilities to meet its public utility obligations and on the ultimate cost of those services to our customers.

Q. Does this conclude your supplemental direct testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

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

AFFIDAVIT

STATE OF MISSOURI)
) SS.
CITY OF ST. LOUIS)

Barry C. Cooper, of lawful age, being first duly sworn, deposes and states:

1. My name is Barry C. Cooper. My business address is 720 Olive Street, St. Louis, Missouri 63101; and I am Chief Financial Officer of Laclede Gas Company.

2. Attached hereto and made a part hereof for all purposes is my supplemental direct testimony.

3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Barry C. Cooper

Subscribed and sworn to before me this 19th day of August, 2004.

KAREN A. ZURLIENE
NOTARY PUBLIC - NOTARY SEAL
STATE OF MISSOURI, CITY OF ST. LOUIS
MY COMMISSION EXPIRES FEBRUARY 18, 2008