Exhibit No.:
Issues: Income Taxes, Injuries and Damages, Rate Case Expense, Materials Management System, Miscellaneous Expenses
Witness: Doyle L. Gibbs
Sponsoring Party: MO PSC Staff
Case No.: GR-98-374

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

DOYLE L. GIBBS

LACLEDE GAS COMPANY

CASE NO. GR-98-374

Jefferson City, Missouri
August, 1998

DIRECT TESTIMONY

OF

DOYLE L. GIBBS

LACLEDE GAS COMPANY

CASE NO. GR-98-374

Q. Please state your name and business address.

A. Doyle L. Gibbs, 815 Charter Commons Drive, Suite 100B, Chesterfield, Missouri 63017.

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

A. I am employed by the Missouri Public Service Commission (Commission) as a Regulatory Auditor.

Q. Please describe your educational background.

A. I attended the University of Missouri - St. Louis, where I received a Bachelor of Science degree in Business Administration with a major in Accounting in 1976. I passed the Uniform Certified Public Accountant examination in May 1988. I have been licensed as a Certified Public Accountant in the state of Missouri since February 1989.

Q. What has been the nature of your duties while in the employ of this Commission?

A. I have conducted and assisted with the audits and examinations of the books and records of utility companies operating within the state of Missouri.

Q. Have you previously testified before the Commission?

A. Yes, I have. Please refer to Schedule 1, attached to this direct testimony, for a list of cases in which I have previously filed testimony.

Q. With reference to Case No. GR-98-374, have you made an investigation of the books and records of Laclede Gas Company (Laclede or Company)?

A. Yes, with the assistance of other members of the Commission Staff (Staff).

Q. With reference to Case No. GR-98-374, what are your primary areas of responsibility?

A. My primary areas of responsibility in this case are:

Income taxes

Injuries and Damages (I&D)

Rate case expense

Materials Management System

Miscellaneous expenses

Q. What Accounting Schedules are you sponsoring in Case No. GR-98-374?

A. I am sponsoring the following Accounting Schedules:

Accounting Schedule 1	Revenue Requirement
Accounting Schedule 9	Income Statement
Accounting Schedule 10	Adjustments to Income Statement

Accounting Schedule 11	Income Tax Calculation

In addition, I am sponsoring the balances for Materials Management System Costs Deferred and Deferred Income Taxes included on Accounting Schedule 2, Rate Base.

Q. Please list the adjustments to the Income Statement you are sponsoring.

A. I am sponsoring the following adjustments to the Income Statement contained in Accounting Schedule 10:

Miscellaneous Expense	S-14.3 and S-15.23
Injuries and Damages	S-15.17
Rate Case Expense	S-15.26
Capitalized Depreciation	S-16.2
Current Income Tax Expense	S-22.1
Deferred Income Tax Expense - Debit	S-23.1
Deferred Income Tax Expense - Credit	S-24.1
Deferred ITC Amortization	S-25.1

Q. Please discuss the Accounting Schedule 1.

A. Accounting Schedule 1, Revenue Requirement, shows the calculation of the Staff's recommended revenue requirements for the Company based on the rates of return sponsored by Staff witness David P. Broadwater of the Financial Analysis Department.

Q. Please discuss Accounting Schedule 9.

A. Accounting Schedule 9 is the Income Statement. Column B of Accounting Schedule 9 reflects the actual income statement as recorded by the Company for the test year ended February 28, 1998. Column C summarizes the adjustments proposed by the Staff to reflect known and measurable events through the update period, June 30, 1998, which are added to the test year amounts in column B to develop the "As Adjusted" income statement under column E.

Q. Please discuss Accounting Schedule 10.

A. Accounting Schedule 10, Adjustments To The Income Statement, itemizes the adjustments summarized in column C on Accounting Schedule 9, the Income Statement.

Q. Please discuss Accounting Schedule 11.

A. Accounting Schedule 11, Income Tax, shows the calculation of the Missouri jurisdictional current income tax expense for the test year, as adjusted through June 30, 1998, and the current income tax requirements for the range of equity returns sponsored by Staff witness Broadwater.

Q. Please explain the mechanics employed in Accounting Schedule 11 to calculate current income tax expense.

A. Net operating income (NOI), as calculated on Accounting Schedule 9, Income Statement, is the starting point of the test year income tax calculation (column B) on Accounting Schedule 11. The NOI for each rate of return (Line 1, columns C, D and E) was calculated on Accounting Schedule 1, Revenue Requirement. The applicable current and deferred income taxes are added back to NOI to determine the NOI before income taxes (NOIBT). NOIBT is then adjusted for various tax timing differences to determine the amount of taxable income. The Federal, State and City of St. Louis income taxes are calculated based on current statutory rates applied to the taxable income after allowances for applicable income tax deductions and credits. City and State income taxes are deductible in the determination of Federal taxable income. City and one-half of Federal income taxes are deductible for State taxable income. Federal and State income taxes are not deductible for City income tax purposes, but a tax credit is granted for the lesser of: 1) 25 percent of the City income tax before any tax credit; or 2) 20 percent of payroll earnings tax (PET).

Q. What is the justification for the additions and subtractions that were used to adjust NOIBT?

A. In general, the justification for any difference between NOIBT (as reported on the books and adjusted by the Staff) and taxable income is dictated by the Internal Revenue Code (Code). These differences are referred to as timing differences or Schedule M items. Schedule M is the Federal tax form in which the Company annually reconciles the difference between book income and taxable income. The Staff has added or subtracted the Schedule M items from NOIBT which are necessary for ratemaking purposes.

Q. Please discuss the depreciation adjustments to NOIBT.

A. Tax depreciation, not book depreciation, is the appropriate expense for tax purposes. Therefore, book depreciation must be added to, and tax depreciation deducted from, NOIBT to properly state taxable income. A difference exists between book and tax depreciation because the depreciable tax basis for plant is normally less than the book basis due to expenditures historically capitalized for book purposes, but expensed in the year incurred for tax purposes. In addition, the Code provides for a quicker recovery of the tax basis plant investment through the use of accelerated depreciation methods. Total tax depreciation is the sum of the two components entitled "Tax straight line depreciation" and "Excess tax depreciation," lines 17 and 18, on Accounting Schedule 11.

Q. Why is tax depreciation separated into the components tax straight line and excess?

A. Each of these components of tax depreciation has a distinct impact on total income tax expense. Straight line is the equivalent of book depreciation, restated to reflect the tax basis of the plant in service, and is provided "flow-through" rate treatment. The difference between total tax depreciation and tax straight line depreciation, identified as excess tax depreciation, is required by the Code to be "normalized."

Q. What is meant by the terms "flow-through" and "normalization?"

A. Flow-through is the tax treatment that equates the amount provided by the ratepayer for income tax expense with the amount paid to the taxing authority. Under normalization, the impact of a tax timing difference on current income tax expense is offset by the creation of a deferred income tax expense. The ratepayer provides the funds to the Company as if the tax timing difference did not exist.

Q. How were the two components of tax depreciation determined?

A. The Company provided the tax basis of plant for each class of property by vintage year and the applicable accelerated and straight line depreciation rates were applied. The tax straight line depreciation was calculated using the open-ended method as prescribed on Attachment 2 to the Stipulation and Agreement from the Company's 1994 rate case, Case No. GR-94-220. The open-ended method of depreciation calculates tax straight line depreciation by property account without regard to its vintage until the book rate is set to zero.

Q. Please describe the other adjustments to NOIBT to compute taxable income on Accounting Schedule 11.

A. The additions to NOIBT include the following:

1. **Contributions in Aid of Construction (CIAC)** - The Company receives CIAC from customers to provide services in areas where it would otherwise be uneconomical for the Company to expend its own funds. For tax purposes, Laclede is required to report CIAC as revenue when received from customers. For book purposes, CIAC is credited to a plant account which reduces rate base.

2. **Miscellaneous Non-deductible Expenses** - This category includes such items as travel, meals, dues, gifts and lobbying expenses and are only 50% deductible for tax purposes. An add back to NOIBT is necessary to reflect the limit imposed by the IRS. The Staff amount reflects only the add back of those expenses considered

allowable for ratemaking ignoring such items as lobbying, gifts and other expenses ordinarily disallowed.

3. **Inventory Overheads Capitalized** - Some costs related to storage gas must be recognized in inventory for tax purposes but are expended on the books. The amount expended on the books must be added back to properly reflect taxable income.

The remaining subtractions from NOIBT include:

1. **Interest expense** - Interest is a below-the-line expense on Laclede's income statement and is not reflected on the Staff's Income Statement, Accounting Schedule 9. However, interest expense is a deduction for tax purposes. Interest expense was calculated by multiplying rate base by the Staff's calculated weighted cost of debt which is sponsored by Staff witness Broadwater. This method of determining interest expense is known as interest synchronization because the interest used in the calculation of income tax expense is matched with the interest expense the ratepayers are required to provide to the Company in rates. Interest synchronization has been consistently used by the Staff and adopted by the Commission in past orders.

2. **Administrative and General (A&G) Costs Capitalized** - The Company is allowed to expense a portion of A&G costs for tax

purposes which are capitalized on the books. The Staff deduction in the tax calculation reflects the test year A&G expenses capitalized on the books that are deductible for income tax purposes adjusted for the changes reflected in the A&G expense adjustment S-15 contained in Accounting Schedule 9, Income Statement.

3. **Transfer of Services** - The cost for certain main replacements are expensed on the tax return while the costs are capitalized on the books. The amount that is tax deductible is subtracted from NOIBT.

4. **Cost of Removal** - These costs are included in depreciation expense over the life of the depreciable property on the books but are deductible on the tax return in the year incurred.

Q. Regarding the adjustments to arrive at taxable income, you indicated that the excess tax depreciation was normalized. What treatment is being proposed by the Staff for the other additions or subtractions made to NOIBT?

A. It is the general policy of the Staff to provide flow-through treatment for all tax timing differences that are not required to be normalized by the Code.

Q. Please discuss the items of rate base you are sponsoring.

A. Line 18 on Accounting Schedule 2, Rate Base represents the June 30, 1998, unamortized balance for the deferred materials management systems (MMS) costs. The costs to develop the MMS, which was deferred on the books of the Company, were expended in 1990 and 1991 in response to recommendations made by the Staff as a result of a management audit (Case No. GO-85-63), to create a computerized tracking system for materials and supplies.

Line 29 on Accounting Schedule 2, Rate Base, reflects the balance of accumulated deferred income tax at June 30, 1998, that Staff has determined is appropriate for rate making purposes.

Q. What is the composition of the deferred income taxes included in rate base?

A. The balance of deferred income taxes included on Accounting Schedule 2 is composed of the accumulated deferred income tax balances related to CIAC, depreciation, pre-1971 investment tax credit (ITC), transfer of services and pensions. In addition, the deferred income tax balances related to Laclede Pipeline Company (LPC) have been included in rate base consistent with the income statement treatment related to LPC.

Q. Why have the deferred taxes related to transfer of services and pensions been included in rate base?

A. In the stipulation and agreement, attached to the Report and Order for the Company's last case, Case No. GR-96-193, specific reference was made on page 17 to normalization of transfer of services and pensions (paragraph 15). The balance of deferred income taxes related to transfer of services included in rate base reflects only the balance of deferred taxes associated with the accumulated timing difference since the implementation of the rates established in Case No. GR-96-193. The Staff is proposing flow-through of the timing difference for transfer of services going forward.

Normalization of a timing difference can occur in one of two ways: 1) the timing difference can be used in the determination of current taxable income and a deferred tax expense calculated for the timing difference; or 2) by omission. In either case, the combined tax expense for current and deferred will be the same. Pension expense has been effectively normalized by its omission from the tax calculation. The deferred tax balance in rate base reflects the accumulated deferred income tax expense related to the rate base component for the prepaid pension asset, discussed in the testimony of Staff Accounting witness Steve M. Traxler.

Q. Please explain miscellaneous expense adjustments S-14.3 and S-15.23 to the income statement.

A. These adjustments represent the removal of test year operating expenses which are miscellaneous in nature and have no apparent demonstrable benefit to the ratepayer. These adjustments include costs for items such as athletic tickets, sponsorship of sporting/social events, theater tickets, contributions, etc. Also during the review of miscellaneous expenses, the Staff discovered charges of $20,000 that would be more appropriately assigned below-the-line to merchandising activities. These merchandising expenses included in utility income, however, have not been eliminated to be consistent with Staff's adjustment S-21.1 to include revenues and expenses associated with merchandising activities above-the-line. Please refer to the testimony of Staff Accounting witness John M. Bozckiewicz for an explanation of adjustment S-21.1.

Q. Please explain your adjustment to injuries and damages.

A. Adjustment S-15.17 adjusts injuries and damage expense to reflect a four-year average of actual payments. The adjustment amount is the difference between the actual average payments and the test year accrued provision.

Q. Why has the Staff used a four-year average of actual payments?

A. The Staff reviewed the actual injuries and damages payment history for the past nine-year period beginning in 1989. As can be seen on Schedule 2 attached to my testimony, an upward trend in cash payments existed during this time frame with considerable fluctuation during the last three years. A three-year average would over-emphasize the peaks in cash payments that have occurred in two of the last three years and a five-year average would under-emphasize the apparent trend in rising cash payments related to injuries and damages. A four-year average is a conservative approach that will help mitigate the impact of the fluctuation that has occurred in the last three years without under-emphasizing the cost trend.

Q. How did you determine the annualized level of rate case expense?

A. The adjustment to annualize rate case expense, S-15.26, reflects half of the actual costs incurred by the Company related to its 1994 rate case filing, Case No. GR-94-220. The Company is generally filing on a bi-annual cycle. Therefore, half of the cost related to a rate case represents an average annual level.

Q. Why did you use the cost incurred by the Company in its filing in Case No. GR-94-220?

A. The Company's estimate of the current case approximates the cost the Company had estimated for Case No. GR-94-220. Because of the similarities in the estimates between these two cases, it is the Staff's opinion that the actual costs incurred related to the Company's filing in Case No. GR-94-220 provides the best estimate of the cost for the current proceeding. The Staff is willing to update this amount when more current information becomes available.

Q. Explain your adjustment to capitalize depreciation expense.

A. Adjustment S-16.2 capitalizes a portion of the annualized depreciation expense calculated on Accounting Schedule 7, Depreciation Expense, related to vehicles and power operated equipment. The actual test year depreciation capitalization rate was applied to the annualized depreciation for vehicles and power operated equipment to calculate adjustment S-16.2

Q. How was the income tax adjustment you are sponsoring for current income tax expense quantified?

A. The adjustment to current income tax expense, adjustment S-22.1, was determined by subtracting the test year recorded income tax expense from the current income tax calculated on Accounting Schedule 11.

Q. Please discuss adjustment S-23.1.

A. Adjustment S-23.1 reflects the annualization of deferred income tax expense - debit for the tax timing differences related to tax depreciation and the reversal of prior year deferrals related to CIAC.

Q. Please describe adjustment S-24.1.

A. Adjustment S-24.1 adjusts deferred income tax expense - credit to reflect the current provision for the deferral of the timing difference related to CIAC and the amortization, or reversal, of prior years' tax deferrals related to depreciation and transfer of services. Similar to the previous discussion regarding deferred income taxes included in rate base, the deferred tax expense amortization related to transfer of services reflects only the amortization of the income tax deferrals since the implementation of the rates established in Case No. GR-96-193. The deferred tax amortization (reversals) of prior deferrals contained in both adjustments S-23.1 and S-24.1 reflect the composite tax rate at which the timing differences were originally deferred.

Q. Please describe adjustment S-25.1 to amortize ITC.

A. The Staff has made no adjustment to the test year recorded level of ITC amortization

Q. Does this conclude your prefiled 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 Sheets Designed to Increase Rates for Gas Service Provided to Customers in the Missouri Service Area of the Company.	))))	Case No. GR-98-374

AFFIDAVIT OF DOYLE L. GIBBS

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Doyle L. Gibbs, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Direct Testimony in question and answer form, consisting of 14 pages to be presented in the above case; that the answers in the foregoing Direct Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Doyle L. Gibbs
DOYLE L. GIBBS

Subscribed and sworn to before me this 13th day of August, 1998.

Toni M. Willmeno
Notary Public

My Commission Expires: ____________

TONI M. WILLMENO
NOTARY SEAL
NOTARY PUBLIC
STATE OF MISSOURI

TONI WILLMENO
NOTARY PUBLIC STATE OF MISSOURI
COUNTY OF CALLAWAY
MY COMMISSION EXPIRES JUNE 24 2000

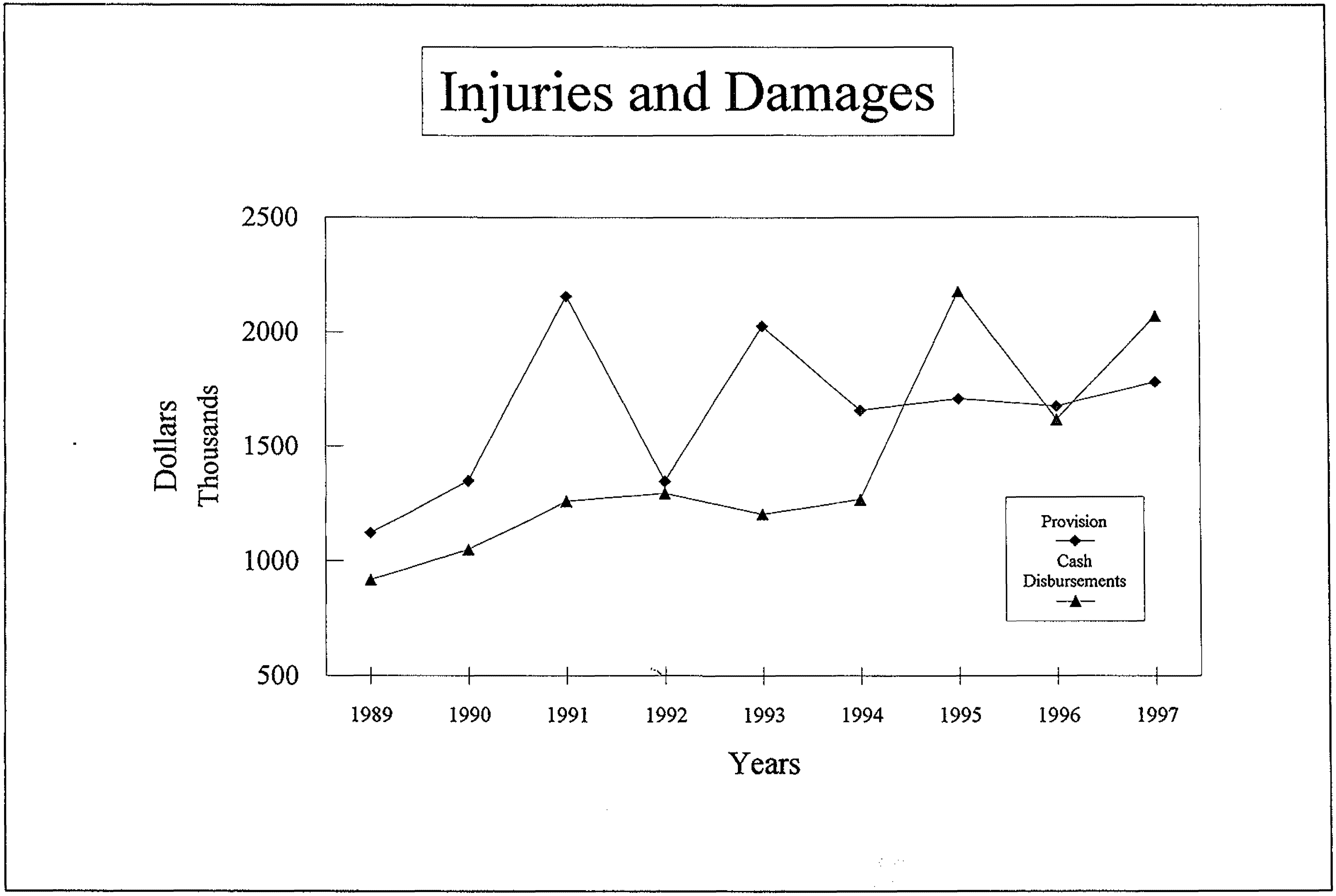
RATE CASE PROCEEDINGS
DOYLE L. GIBBS

Company	Case Number
Arkansas Power & Light Company	ER-85-20
Arkansas Power & Light Company	ER-85-265
Associated Natural Gas Company	GR-79-126
Capital City Water Company	WR-82-117
Citizens Electric Cooperative	ER-79-102
Citizens Electric Cooperative	ER-81-79
Empire District Electric Company	ER-95-279
Laclede Gas Company	GR-77-33
Laclede Gas Company	GR-78-148
Laclede Gas Company	GR-80-210
Laclede Gas Company	GR-81-245
Laclede Gas Company	GR-82-200
Laclede Gas Company	GR-96-193
Lake St. Louis Sewer Company	SR-80-189
Missouri-American Water Company	WR-89-265
Missouri-American Water Company	WM-93-255
Missouri-American Water Company	WR-93-212
Missouri-American Water Company	WR-97-237
Missouri-American Water Company	SR-97-238
Missouri-American Water Company	WO-98-204
Missouri Cities Water Company	WR-78-107
Missouri Cities Water Company	SR-78-108
Missouri Cities Water Company	WR-83-14
Missouri Cities Water Company	SR-83-15
Missouri Cities Water Company	WR-85-157
Missouri Cities Water Company	SR-85-158
Missouri Cities Water Company	WR-86-111
Missouri Cities Water Company	SR-86-112
Missouri Cities Water Company	WR-89-178
Missouri Cities Water Company	SR-89-179
St. Joseph Water Company	WR-77-226
St. Louis County Water Company	WR-78-276
St. Louis County Water Company	WR-83-264
St. Louis County Water Company	WR-87-2
St. Louis County Water Company	WR-88-5
St. Louis County Water Company	WR-94-166
Southwestern Bell Telephone Company	TR-79-213

RATE CASE PROCEEDINGS
DOYLE L. GIBBS

Company	Case Number
Southwestern Bell Telephone Company	TR-80-256
Southwestern Bell Telephone Company	TR-86-84
Union Electric Company	ER-77-154
Union Electric Company	ER-80-17
Union Electric Company	ER-81-180
Union Electric Company	HR-81-259
Union Electric Company	ER-82-52
Union Electric Company	ER-83-163
Union Electric Company	ER-84-168
Laclede Gas Company	GR-96-193
Atmos Energy Corporation/United Cities Gas Company	GM-97-70

SCHEDULE 2



Injuries and Damages
2500
2000
1500
1000
500
Dollars
Thousands
1989
1990
1991
1992
1993
1994
1995
1996
1997
Years
Provision
Cash
Disbursements