Exhibit No.:
Issues: *Accounting Authority Orders*
Witness: *STEPHEN M. RACKERS*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Rebuttal Testimony*
Case No.: *GR-99-315*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

STEPHEN M. RACKERS

LACLEDE GAS COMPANY

CASE NO. GR-99-315

Jefferson City, Missouri
August, 1999

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LACLEDE GAS COMPANY

CASE NO. GR–99–315

Q. Please state your name and business address.

A. Stephen M. Rackers, 815 Charter Commons Drive, Suite 100 B, Chesterfield, Missouri 63017.

Q. Are you the same Stephen M. Rackers who has previously filed direct testimony in this case?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. My rebuttal testimony will address the testimony of Laclede Gas Company (Laclede or Company) witness James A. Fallert regarding Accounting Authority Orders (AAOs).

Q. What are the AAOs that have been previously authorized for Laclede?

A. In Case No. GR-98-374, the Missouri Public Service Commission (Commission) authorized (or reauthorized) the following AAOs:

1) Safety Replacement Program (Safety)– deferral of property taxes, depreciation expenses, other expenses and carrying costs associated with the replacement of gas lines and mains;

2) Manufactured Gas Plant (MGP) – deferral of the costs incurred, net of payments received, associated with manufactured gas operations and plant sites;

3) Year 2000 - deferral of property taxes, depreciation and amortization expenses, other expenses and carrying costs associated with the Company's efforts to make its computer systems year 2000 compliant;

4) Other Post-retirement Employee Benefits (OPEBs) – deferral of the difference between the amount established for ratemaking purposes and the contributions made by Laclede to its external fund for this item; and

5) Directors Pension and Supplemental Retirement Benefit Plans (SERP) – deferral of the difference between the amount established for ratemaking and the payments made by Laclede for this item.

Q. Do you agree with the statements of Company witness Fallert on pages 17 through 22 of his direct testimony regarding the recovery of the amounts deferred through AAOs and the continuance of deferral authority in the future?

A. No. With the exception of the Safety deferral, the Staff recommends no recovery of the deferred balances. The Staff also recommends that the AAOs for MGP, Year 2000, OPEBs and SERP be discontinued as of July 31, 1999, the end of the true-up period in this case. The Staff believes that the current circumstances do not justify the special treatment afforded by the AAO mechanism for these particular items.

Q. What treatment is the Staff recommending for the Safety deferrals?

A. As stated in my direct testimony, the Staff, in accordance with the Commission precedent established in Case No. GR-98-140 for Missouri Gas Energy Company, has included a ten-year amortization of the Safety deferrals and no inclusion of the unamortized deferral balance in rate base.

Q. Why has the Staff proposed different treatment for the Safety AAO as compared to Laclede's other current AAOs?

A. The Safety deferral should be viewed differently than the other AAOs. It was instituted to address the additional costs that are being incurred as a result of Commission mandated safety rules. These rules required the systematic replacement of cast iron mains, replacement and/or cathodic protection of unprotected steel mains, replacement of Company owned yard lines and surveying of buried fuel lines in an effort to address the issue of public safety with regard to natural gas service.

Q. What are the specific reasons the Staff does not agree with Mr. Fallert's proposal for recovery of the amounts deferred pursuant to the non-Safety AAOs?

A. The following is a list of reasons, which will be discussed further in my rebuttal testimony, regarding why the Staff has not recognized the non-Safety AAOs:

1) The individual actual deferral balances at the end of the update period, March 31, 1999, and the expected deferral balances at the end of the true-up period, July 31, 1999, for the MGP, Year 2000 and OPEB AAOs are not material;
2) The amount the Staff has included for SERP sufficiently recognizes incurred and ongoing payments;
3) The MGP AAO deferrals include no recognition of recovery from insurance companies or other liable entities that may significantly reduce the balance;
4) The Year 2000 AAO is being used by the Company in an inappropriate attempt to defer expenses related to the purchase of new hardware and software;

5) The OPEB and SERP AAOs represents a preference enjoyed by Laclede that does not exist for any other Missouri utility; and

6) The Company is using numerous AAOs in an attempt to circumvent regulatory lag.

Q. Please discuss the Staff's materiality criteria.

A. The Commission has ruled that costs must be extraordinary to qualify for AAO treatment. The Staff believes that a cost should be material to a company's net income to constitute an extraordinary item. Therefore, if an item in not material, it should not be classified as extraordinary and should not receive the special treatment afforded by an AAO.

Q. In the Staff's opinion, when is a cost material with regard to the extraordinary classification?

A. This Commission has adopted the Federal Energy Regulatory Commission Uniform System Of Accounts (USOA). The USOA allows the deferral of costs, which meet an extraordinary threshold of 5% of annual net income, without the prior approval of the Commission. The Staff is using this basis to determine materiality as it relates to most extraordinary items. The Staff calculated a five-year average of 5% of net income to determine the materiality threshold for Laclede.

Q. How does the materiality threshold you have calculated compare to the individual amounts deferred for the MGP, Year 2000 and OPEB AAOs?

A. The Staff's calculated materiality threshold is $1,341,000. This level must be compared to the after tax or net income effect of the amounts deferred. This is accomplished by multiplying the deferred amount by one minus the composite tax factor

(1-38.56% = 61.44%). The after tax amounts deferred under the MGP, Year 2000 and OPEB AAOs are $282,145, $17,440 and $62,987, respectively, at March 31, 1999, the end of the update period. At the end of the true-up period, July 31, 1999, the after tax amounts deferred under the MGP, Year 2000 and OPEB AAOs are expected to be $299,213, $226,099 and $445,440, respectively.

Based on the above calculations, the amounts deferred for the MGP, Year 2000 and OPEB AAOs were not material at the end of the update period and are not expected to be material at the end of the true-up period, either individually or in total.

Q. Is the SERP deferral immaterial?

A. No. However, in this rate case the Staff has recognized a five year average in expense ($932,401) that exceeds the five year amortization of the deferral sought by the Company plus the ongoing payments reflected in Laclede's adjustment ($843,848). Therefore, the amount the Staff included in the cost of service for SERP has the effect of providing recovery of prior deferrals and expected on-going payments. Including a ten-year amortization of deferred SERP expenses, which reflects Commission precedent, plus the ongoing payments reflected in the Company's case, would reduce the Staff's calculation of revenue requirement by approximately $400,000.

The reason the balance in the AAO is material is the result of the recent retirement of Mr. Robert Jaudes, Laclede's chief executive. Since this is not a recurring annual event at Laclede, some method of normalization must be used to adjust this level of SERP to a more representative amount. The Staff's treatment of this item is similar to the way other expenses exhibiting fluctuation have been normalized in this case.

Q. Has Laclede filed any claims for insurance reimbursement of the costs associated with MGP sites?

A. No. In addition, Laclede has not filed claims against other potentially liable entities. Therefore, providing recovery of the current balance would ignore potential future offsets and reduce the Company's incentive to pursue reimbursement from insurers and other liable entities.

Q. Why does the Staff believe the Company is using the Year 2000 AAO in an inappropriate manner?

A. Laclede has undertaken a comprehensive program to address the year 2000 problem as well as upgrade and replace its computer systems. As part of this program, the Company has modified some of its software to make various systems Year 2000 compliant. However, the vast majority of the amounts spent to date represent upgrade, enhancement and total replacement of various systems. As a result of the upgrading, enhancement and replacement, these systems will be Year 2000 compliant. This situation is addressed in the Company's response to Staff Data Request No. 110:

> The project referenced in the September 1996 Board of Directors' meeting was undertaken to address the Year 2000 data processing problem as well as to upgrade and replace the Company's aged general ledger and payroll systems. The general ledger system is being totally replaced by a new general ledger module, a fixed asset module, and a project cost management module. The new system will be Year 2000 capable. The existing payroll system is being modified, not only to make the system Year 2000 compliant, but also to provide additional enhancements. Other projects are also underway to modify, upgrade, and enhance the Company's mainframe hardware, operating systems, customer information and billing system, other feeder systems, and personal computer hardware and software. These projects are ongoing and the cost associated with these projects are included in the Company's response to Staff Data Request No. 112.

Q. What was the Staff's understanding of the use of the Year 2000 AAO, which was ordered in Case No. GR-98-374?

A. The Staff believed that this AAO would be used to accumulate depreciation and other expenses, property taxes and carrying costs associated with the modification of various Company software in an effort to make them year 2000 compliant. The Staff did not envision that the Company would use this AAO to accumulate costs associated with a comprehensive upgrade, enhancement and replacement its computer systems. Including in the AAO only the costs associated with modifying existing computer systems to make them year 2000 compliant would sharply reduce the amounts deferred. As a result, the amounts deferred for Year 2000 AAO would be even less material.

Q. Has the Company segregated the costs associated with modifying existing systems to make them year 2000 compliant from the costs associated with upgrade, enhancement and replacement its computer systems?

A. Yes. According to Generally Accepted Accounting Principles, the cost of modifying existing software to make them year 2000 compliant is expensed. Until July 1, 1998, the date that the Company received permission to defer expenses under the Year 2000 AAO, Laclede was tracking these amounts in maintenance work orders and expensing them. The AAO allowed the Company to capitalize the amounts incurred after July 1, 1998. Beginning July 1, 1998, Laclede accumulated these amounts in capital work orders and included them in plant when completed and placed in service. If the depreciation and other expenses, property taxes and carrying costs associated with these amounts were material, the Staff would not object to Laclede's Year 2000 deferral.

Q. How has the Company accounted for the amounts spent to upgrade, enhance and replace hardware and software systems?

A. From the beginning of the project, these amounts were accumulated in capital work orders and included in plant when completed and placed in service.

Q. How has the Company proposed to use the Year 2000 AAO with regard to the amounts spent on various hardware and software systems?

A. The Company intends to use the AAO to accumulate and defer carrying cost, property taxes and depreciation on not only the amounts incurred to modify existing software systems, but also the cost to upgrade, enhance and replace hardware and software systems. Laclede intends to continue this deferral until rates are established as a result of this case, even after these projects are completed and placed in service.

Q. Why is this inappropriate?

A. The costs incurred to upgrade, enhance and replace computer systems are no different from other plant expenditures. The Company is obligated to make additional investments to provide service to customers as plant wears out or becomes obsolete. Laclede has stated in response to data requests and in meetings that portions of aged computer systems needed replacement. In addition, some of these systems were not serviceable. The need to upgrade, enhance and replace various computer systems, as well as Laclede's intent to do so, regardless of year 2000, is conveyed in the following portions of the Company's response to Staff Data Request No. 158:

> The general ledger system was a batch system put in place and modified over the last several decades by personnel who are no longer with the Company. The information systems and user staff knowledge of the '50s – '60s technology and processes supporting such technology made upgrading such a system problematic. In addition, the business requirements were not being adequately met by the old system.
>
> Both the general ledger and payroll systems were the next set of applications on the information systems long-term plan for replacement.

Q. Are these expenditures extraordinary?

A. No. Extraordinary expenditures are defined as unusual in nature and infrequent in occurrence. The Staff does not believe that making needed upgrades, enhancements and replacements of hardware and software for aged computer systems is an unusual expenditure. All major utilities operating in Missouri make these kinds of expenditures. Considering the short depreciation and amortization lives that have been determined for these items, for Laclede the rates reflect five years for software and ten years for hardware, these expenditures are certainly not infrequent in occurrence. Laclede should not be allowed to use Year 2000 as a "hook" to justify special treatment of expenditures that other utilities do not receive.

Q. Please explain how the costs of upgrades, enhancements and replacements of computer systems should be treated for ratemaking.

A. Once these systems have been placed in service, depreciation and property tax accruals should be charged to expense and no additional carrying cost should be accumulated.

Q. Please explain why the Staff believes that Laclede is receiving a preference with regard to the OPEB and SERP AAOs.

A. For all other Missouri utilities, no mechanism exists to track and provide future recovery of past over or under recovery of OPEB or SERP costs. All other Missouri utilities' rates were established based on a level of OPEBs and SERP, as calculated by their actuary or as incurred on a payments basis. If the actual level of expense increased or decreased during the period rates were in effect, other Missouri utilities will either over or under recover their OPEB and SERP expense. The Staff knows of no reason why Laclede should receive preferential treatment of these expenses as opposed to other Missouri utilities.

Rates should be established based on the best estimates of ongoing expense levels in relationship to revenues and investment. Rates are established to provide the utility an opportunity to recovery its expenses and earn a fair rate of return. Allowing the future recovery of past over or under recovery of these expenses establishes an OPEB and SERP adjustment clause, effectively guaranteeing recovery. This is not appropriate ratemaking, in the Staff's opinion.

Q. Explain how the use of numerous AAOs circumvents regulatory lag.

A. It is first important to note that the Staff is not denying Laclede recovery of its ongoing costs. This issue involves an attempt by Laclede to add costs relating to the regulatory lag between cases for isolated items to its ongoing cost of service. The result of this attempt, if adopted by the Commission, will be that Laclede's ratepayers will be paying more than the Company's current cost to provide service to customers. While this may be acceptible in very limited circumstances, the Staff believes that the wholesale use of AAOs by Laclede, as seen in this case, is inappropriate.

Q. Please summarize your testimony.

A. For the reasons discussed above, the Staff recommends that Laclede should be denied recovery of its past deferrals for MGP, Year 2000, OPEBs and SERP. In addition, the Staff recommends that the Commission end the authority to defer costs pursuant to these AAOs as of the end of the true-up period, July 31, 1999.

Q. Does this conclude your rebuttal 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 OF STEPHEN M. RACKERS

STATE OF MISSOURI	)	
	)	ss.
COUNTY OF COLE	)	

Stephen M. Rackers, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 10 pages to be presented in the above case; that the answers in the foregoing Rebuttal 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.

Stephen M. Rackers

Subscribed and sworn to before me this 4th day of August 1999.

Notary Public, State of Missouri

My Commission Expires ________________

Randall Z. Wright
Notary Public, State of Missouri
County of Cole
My Commission Exp. 01/02/2001