Exhibit No.:	
Issue:	Test Year, Update and True-Up; Accounting Schedules; Pension plan Expenses; OPEBs; Wages; Taxes
Witness:	James A. Fallert
Type of Exhibit:	Direct Testimony
Sponsoring Party:	Laclede Gas Company
Case No.:	GR-2005-_______
Date Testimony Prepared:	February 18, 2005

LACLEDE GAS COMPANY

GR-2005-________

DIRECT TESTIMONY

OF

JAMES A. FALLERT

FEBRUARY 2005

Direct Testimony of James A. Fallert

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DIRECT TESTIMONY OF JAMES A. FALLERT

General Information/Qualifications

Q. Please state your name and business address.

A. My name is James A. Fallert, and my business address is 720 Olive Street, St. Louis, Missouri 63101.

Q. What is your present position?

A. I am Controller for Laclede Gas Company ("Laclede" or "Company").

Q. Please state how long you have held your position and briefly describe your responsibilities.

A. I was appointed to my present position in February, 1998. In this position, I am directly responsible for the Company's customer accounting functions, and also participate in the preparation and review of financial statements, budgets, and financial plans.

Q. What is your educational background?

A. I graduated from Southeast Missouri State University in 1976 with the degree of Bachelor of Science in Business Administration, majoring in administrative management. In 1981, I received a Master's Degree in Business Administration from Saint Louis University.

Q. Will you briefly describe your experience with Laclede prior to becoming Controller?

A. I joined Laclede in July, 1976, and held various staff and supervisory positions in the Methods and Procedures Department, Internal Audit Department, and Budget Department until April, 1988, when I was promoted to the position of Manager of Budget and Financial Planning. I held this position until being promoted to Manager of Financial Services in February 1992. I was elected Controller effective February 1, 1998.

Q. Have you previously filed testimony before this Commission?

A. Yes, I have, in Case Nos. GR-90-120, GR-92-165, GR-94-220, GR-96-193, GR-98-374, GR-99-315, GR-2001-629, GR-2002-356, GT-2003-0117, and GO-2004-0443.

Purpose of Testimony

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to present evidence to the Commission covering the following:

1. Recommendations regarding test year, update, and true-up
2. Adjustments to Utility Operating Income
3. Uncollectible Accounts
4. Emergency Cold Weather Rule
5. Pension Expense and Assets
6. Post Retirement Benefits Other Than Pensions
7. Benefit Plan Trustee Fees and 401(k) Expenses
8. Wages and Salaries

9. Incentive Compensation Plan
10. Non-Utility Allocations
11. Gas Safety and Copper Service Replacement Accounting Authority Orders
12. Taxes Other Than Income Taxes
13. Income Taxes
14. Proposed Tariff Changes Regarding Collection Practices

Q. Please list the schedules you are sponsoring.

A. The following schedules were prepared by me or under my supervision: Schedule 4 contains the income statement for the test year, a summary of normalization and annualization adjustments, and the resulting Pro Forma Income. Schedule 5 contains detail of the adjustments that are summarized on Schedule 4, and which are sponsored by various Company witnesses. Schedule 6 contains the calculation of income taxes included on Schedule 4.

I am sponsoring several rate base items listed on Schedule 1, as well as various adjustments listed on Schedule 5. Specific items are detailed later in my testimony.

Test Year, Update, and True-Up

Q. What test period has Laclede used in this filing?

A. We have used the actual operating results as recorded on the books for the twelve months ended September 30, 2004, as a starting point. As is usually done in rate cases, we have made adjustments to this period to reflect normal operations. We have also "annualized" certain items. This means that we have made adjustments to treat the status at the end of the period as though it existed for twelve months. We have made other adjustments to provide for changes which have occurred since September 30, 2004 and to provide for reasonable changes which will be known and measurable by March 31, 2005, or, in certain instances, July 31, 2005. These adjustments to the test period reflect data that are more contemporaneous to the time when rates will go into effect.

Q. Why was the historical test year ending September 30, 2004 selected?

A. This period represented the most recent annual period ending in a quarter for which actual booked results were available prior to this filing and which allowed sufficient time for preparation of the filing.

Q. Would it be appropriate for the Commission Staff to update the test period for this case?

A. I believe that the Staff should, as it has in the past, look at subsequent months to confirm the appropriateness of the Company's adjustment to the September 30, 2004 test year data. This is the same approach used in the Company's recent rate cases (Case Nos. GR-90-120, GR-92-165, GR-94-220, GR-96-193, GR-98-374, GR-99-315, GR-2001-629, and GR-2002-356).

Q. Please explain what information you believe Staff should review.

A. The Staff should look at the latest information available prior to its filing. Such information would most likely be available following the closing of March 31, 2005 business, depending upon the procedural schedule established in this case. The Company's filed case includes the estimated effect of a March 31 update.

Q. Is the Company requesting a true-up in this case?

A. Yes. Laclede requests a true-up through a date no earlier than July 31, 2005. It is essential that the most recent available information be included in the calculation of rates. Additionally, there are several significant events that will occur between the proposed update period of March 31, 2005 and July 31, 2005. These include, but are not limited to, changes in labor rates paid under the Company’s union labor contracts, a possible change in the annual assessment paid to the Commission, changes in the annual contracts with health maintenance organizations, changes in insurance premiums, and expensing of stock-based compensation pursuant to new accounting rules.

Adjustments to Utility Operating Income

Q. Please explain what is contained in Schedule 4.

A. This schedule shows the amounts recorded in the Company’s books and records for the year ended September 30, 2004 for all the items of utility operating revenues and operating expenses as well as a final total for the Company’s utility operating income for that period. The second column shows a summary of the normalization and annualization adjustments made to the actual test year results to arrive at the third column, which is the pro forma statement of operating income for the year ended September 30, 2004.

Q. Please explain what is contained on Schedule 5.

A. The adjustments shown in the second column of Schedule 4 are listed and detailed on Pages 1 through 5 of Schedule 5. Each of these adjustments is described by the sponsoring Company witness in their testimony.

<u>Uncollectible Accounts Expense</u>

Q. Please describe your adjustment to uncollectible accounts expense.

A. I am sponsoring Adjustment 3.a. to Customer Accounts Expense, relating to Uncollectible Accounts Expense in the test period.

Q. Why is this adjustment necessary?

A. This adjustment reflects a normalized level of expense. Calculation of this amount is determined by multiplying the "percentage loss factor" times applicable normalized Company revenues.

Q. How was the percentage loss factor derived?

A. Uncollectible account write-offs for the three years ending September 30, 2004 were divided by net revenues for the three years ending November, 2003. Uncollectible accounts included in this calculation were reduced for the impact of the uncollectibles caused by the Emergency Cold Weather Rule, since these amounts are not indicative of ongoing levels and are to be separately collected pursuant to the mechanism specified in Case No. GR-2001-629. Revenues used for this calculation are customer revenues less Transportation, Large Volume and Interruptible rate revenues, and less gross receipts tax expensed. This calculation results in the percentage loss factor used to determine normalized bad debts.

Q. Why have you used a three-year average to determine the percentage loss factor?

A. Natural gas prices increased dramatically in the 2000-2001 winter. Prices have remained high and are generally expected to remain at high levels. The three-year average includes the periods subsequent to this significant change in the environment under which the Company currently operates, and is therefore most appropriate for determination of the percentage loss factor.

Q. Why are different time periods used for purposes of determining the uncollectible account and revenue amounts used in the calculation?

A. There is generally a ten-month lag between the revenue period when the customer is rendered service and the period when the customer's account will be written off. Uncollectible accounts written off for the year ending September are, therefore, compared with revenues for the year ending the prior November because such a ten-month lag period allows us to better compare write-offs with the revenue period that actually generated the write-off amount.

Q. Does this pro forma level of Uncollectible Accounts Expense include the effect resulting from higher revenues associated with this rate request?

A. Yes. The Company is entitled to recognition of the increased bad debt expense from higher revenues associated with this rate request.

Q. Are you aware of any other factors that could significantly affect Laclede's uncollectible accounts expense in the future?

A. In general, the Commission's rules regarding service disconnection and restoration are the most significant factors influencing uncollectible accounts. Other major factors include the economy in the service area, the collection policies of the Company, and the level of energy assistance (heat grant) payments. A major cut in grants, or a shortfall between the level of energy assistance available and the growing amount required by customers, would have a significant adverse impact on Laclede's uncollectible accounts.

Q. Is the Company proposing any alternative treatment of uncollectible expense in this proceeding?

A. Yes. Company Witness Michael T. Cline has filed specimen tariffs proposing to shift collection of the portion of uncollectible accounts related to gas costs into the Purchased Gas Adjustment Clause. Such tariff change, if approved, would have the net effect of <u>reducing</u> the uncollectible accounts expense included in base rates. Such change, if approved by the Commission, should therefore be reflected in Adjustment 3.a.

<u>Emergency Cold Weather Rule Amendment</u>

Q. Please describe the Emergency Cold Weather Rule Amendment ("Emergency Amendment") approved by the Commission in Case No. AX-2002-203.

A. The Emergency Amendment significantly relaxed the terms under which customers who had service discontinued as a result of nonpayment or were in threat of disconnection for nonpayment could regain or maintain service during the 2001 – 2002 heating season. Laclede Gas adopted the terms of the

Emergency Amendment in the tariffs approved in its 2001 rate case (No. GR-2001-629). The Company implemented the provisions of these tariffs on November 20, 2001, and the tariffs formally became effective on December 1, 2001.

Q. What recovery mechanism for the cost of the rule was included in Case No. GR-2001-629?

A. It was generally recognized that the terms of the Emergency Amendment would cause a significant increase in the Company's bad debts. The Stipulation & Agreement in Case No. GR-2001-629 included a methodology for the eventual determination of the cost of the Emergency Amendment upon its expiration on September 30, 2003. An annual amount of $750,000 for the recovery of these costs was included in rates effective December 1, 2001. The Stipulation & Agreement from the 2001 case specified an eventual reconciliation of the costs of the Emergency Amendment and the amounts recovered. The annual recovery amount of $750,000 was continued in the Company's 2002 rate case (GR-2002-356).

Q. What amount have you included in rates related to such recovery in this case?

A. I have calculated the cost of the Emergency Amendment pursuant to the "Dollar & Measurement Matrix" included in the Stipulation and Agreement in Case No. GR-2001-629. Such cost is calculated as $2,722,199. Based on the $750,000 annual recovery in effect since December 1, 2001, the Company will have collected $2,750,000 as of the July 31, 2005 true-up date that we have requested in this case, resulting in an overrecovery of $27,801 as of that date. Pursuant to the Stipulation & Agreement in case No. GR-2001-629, I have reduced the balance associated with the Safety Replacement Accounting Authorization by $27,801 in order to give effect to this overrecovery in this case.

<u>Qualified Pension Plan Expense for Financial Reporting Purposes</u>

Q. What basis of accounting does Laclede use to determine pension expense for financial reporting purposes?

A. Laclede calculates its pension expense on an accrual basis in accordance with Statement of Financial Accounting Standards No. 87 (FAS 87), "Employers' Accounting for Pensions," and Statement of Financial Accounting Standards No. 88 (FAS 88), "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination of Benefits." These standards were developed by the Financial Accounting Standards Board (FASB), which has responsibility for establishing Generally Accepted Accounting Principles (GAAP) to be followed by all companies that are publicly traded in the United States. Laclede was first required to adopt the provisions of these statements effective October 1, 1987.

Q. Please briefly describe the cost measurement objectives of FAS 87 and FAS 88.

A. One of the primary objectives of FAS 87 and FAS 88 is to ensure that pension cost is assigned to the time periods in which pension benefits are earned.

Another objective of these statements is to provide a basis for ensuring comparability of reported pension cost between different companies, and consistency in amounts reported from period to period by an individual company.

Q. Please continue.

A. FAS 87 establishes the basic framework for calculating and accruing net pension cost. It attempts to recognize the compensation cost of an employee's pension benefits over the approximate working life of that employee. Pension cost is based on the valuation of two separate components: 1) plan liabilities for benefits earned by employees; and 2) qualified plan assets, if any, to pay such benefits. Changes in the value of pension liabilities are netted against changes in the value of plan assets to determine periodic net pension cost. Depending on the magnitude of the changes in these two components, total net pension cost may result in either expense or income to a company. FAS 87 also provides for systematic recognition (i.e., amortization) of gains and losses arising from differences between a plan's expected and actual experience.

FAS 88 is merely an extension of the FAS 87 measurement process. It generally requires immediate recognition of all or part of that portion of the FAS 87 gains and losses that have not been recognized as of the date certain specific types of pension plan transactions or events occur. In Laclede's case, this could occur when lump-sum benefit payments are made to retirees in exchange for the full settlement of the Company's retirement obligation to them.

<u>Qualified Pension Plan Expense for Regulatory Purposes</u>

Q. Does Laclede use the calculation of pension expense for financial reporting purposes as described above in setting customer rates?

A. No. Rates were set on an alternative basis pursuant to the stipulation and agreement in the Company's previous rate case, No. GR-2002-356.

Q. Why were rates set on an alternative basis in that case?

A. Prior to the 2002 case, the Company's rates were based on pension expense as calculated pursuant to FAS 87 and FAS 88. Our experience during those years was that FAS 87 and FAS 88 had produced unacceptable volatility and cash flow effects in setting rates. We expressed these concerns in that case, and subsequently worked with the Staff to develop an alternative ratemaking framework that we believe is in the best interests of the Company and its customers.

Q. Please describe the current ratemaking treatment of pension expense.

A. In GR-2002-356, pension expense included in rates was based on the expected level of cash contributions into the pension trusts, plus an additional allowance to amortize the existing prepaid pension asset on the Company's books. Laclede's rates in GR-2002-356 were based on an expected cash contribution of zero (based on the ERISA minimum funding calculation), plus an allowance of $3.4 million for amortization of the prepaid pension asset. The difference between pension expense as calculated pursuant to FAS 87 and FAS 88 for financial reporting purposes and pension expense included in rates is deferred as a regulatory asset or liability.

Q. Has the current ratemaking treatment of pension expense had the intended effect?

A. Yes, this methodology has been advantageous to both the Company and customers by providing for consistent rate recovery of pension expense.

Q. Please describe the adjustment that you have included in this case for pension expense.

A. Laclede Gas Company proposes the continuation of the successful ratemaking mechanism implemented in Case no. GR-2002-356 regarding pension expense. We have included pension expense in rates of $4.4 million in this case.

Q. Why have you increased the pension expense recovery from the $3.4 million included in GR-2002-356?

A. The expected contribution to the Company's qualified pension plan trusts applicable to fiscal 2005 is expected to be about $1.0 million, compared with zero included in rates in GR-2002-356. At a minimum, the level of pension expense included in rates should be increased to recognize this change and thereby maintain the $3.4 million annual amortization of the prepaid pension asset.

Q. Please continue.

A. The $1.0 million expected funding level is an estimate at this writing but is expected to be precisely determined during the pendancy of this case. The final amount of pension expense included in rates can then be adjusted accordingly. Adjustment 4.a. adjusts pension expense to normalized levels.

Non-Qualified Pension Plan Expense

Q. Please describe the Company's non-qualified pension plans.

A. These plans include the Supplemental Retirement Plan (SERP) and the Retirement Plan for Non-Employee Directors (Directors Plan). The SERP provides benefits pursuant to the formulas in the qualified retirement plan that would otherwise not be allowed due to IRS limitations. The Directors Plan provides a retirement benefit for non-employee directors who have satisfied certain service requirements.

Q. What is the basis for rate recovery of the costs associated with these plans?

A. Pursuant to agreements in past rate cases, we have calculated the costs of these plans based on the actual benefit payments made to participants of the plans. I have used a 10-year average of such payments to perform this calculation.

Q. Why did you choose a 10-year average to determine the appropriate cost of these plans?

A. These plans have relatively few participants who retire at sporadic intervals. Additionally, a large portion of the benefits paid from the SERP tend to be in the form of one-time lump sum payments. Therefore, it is necessary to examine a long period of time in order to determine an appropriate normalized level of payments made by these plans. Normalization of these expenses is also included in Adjustment 4.a.

Prepaid Pension Asset

Q. You are also sponsoring the inclusion of the Company's net prepaid pension asset in rate base. Please describe what this amount represents.

A. While the Company accrues pension expense or income on its books subject to the accounting rules, it also must contribute sufficient funds to the trusts to ensure the trusts' ability to satisfy the plan liabilities. Usually, there will be a timing difference between when pension expense (or income) is accrued and when cash contributions, if any, are required to fund benefits. To account for these timing differences, a company will record a prepaid asset or an accrued pension liability on its balance sheet for each of its pension arrangements.

At any point in time, the balance in the prepaid pension asset account represents the amount by which aggregate contributions and pension income exceeds aggregate pension expense recognized. Correspondingly, accrued pension liabilities result when the opposite situation occurs.

Q. Why is it appropriate to include the net prepaid pension asset in rate base?

A. Over the years, the Company has recognized significant net pension plan gains on its books. As a result, ratepayers during that period have benefited from the inclusion of lower pension costs (or higher credits) in rates. However, the recognition of these gains, which have resulted in the creation of the net prepaid pension asset, have not resulted in additional cash flow to the

Company. This is because the gains that have been recognized relate to assets held under a pension trust arrangement. Such assets cannot be withdrawn without incurring severe penalties. The net effect of this treatment has been to lower the Company's revenue requirement and, therefore, its cash flows.

In consideration of the above, it is essential that the Company be provided with a return on its net prepaid pension asset in recognition of the fact that its investment in the asset has not been made with ratepayer provided funds, even while customers' rates have been reduced by the gains earned on those assets. This treatment is similar to the Commission's current treatment of deferred income taxes in rate base.

Q. How was the amount of the net prepaid pension asset included in rate base determined?

A. The prepaid pension asset included in rate base was calculated by netting estimated March 31, 2005 accrued pension liability balances against estimated March 31, 2005 prepaid pension asset balances, for all qualified retirement plans (including the regulatory asset or liability recorded pursuant to the regulatory treatment of pension expense specified in Case No. GR-2002-356 and discussed above). Balances for the SERP and Directors are excluded since rate recovery for these plans has been based on actual payments rather than expense recovery.

<u>Postretirement Benefits Other Than Pensions (OPEBs)</u>

Q. Please describe the types of OPEBs provided by Laclede to its employees when they retire.

A. Laclede provides certain health and life benefits to eligible employees retiring from active service.

Q. What basis of accounting was used to determine the amount of postretirement benefit expense to include in cost of service?

A. As previously authorized by the Commission[1], postretirement benefit expense was calculated on an accrual basis in accordance with Statement of Financial Accounting Standards No. 106 (FAS 106), "Employers' Accounting for Postretirement Benefits Other Than Pensions." FAS 106 measures OPEB cost in much the same manner as pension cost is measured by FAS 87.

Q. Have previous Commission Report & Orders contained any other conditions or authorizations pertaining to FAS 106?

A. Yes they have. Beginning with the Commission's Report and Order in Case No. GR-94-220, and continuing in all the Company's general rate proceedings thereafter, the Company has been directed to fund its annual FAS 106 OPEB expense levels in accordance with the provisions of Section 386.315 (RSMo. 2000), which requires the use of an external funding mechanism.

Q. Is Laclede currently funding its accrued FAS 106 costs in an external trust, or other external funding arrangement?

[1] See Case Nos. GR-94-220, GR-96-193, GR-98-374, GR-99-315, GR-2001-629, and GR-2002-356.

A. Yes it is. Consistent with the Commission's previous orders and Section 386.315, the Company is currently contributing its annual FAS 106 cost levels into three external trust arrangements. Disbursements from these trusts can only be used for the payment of OPEB obligations.

Q. Please describe the unrecognized (gain)/loss account maintained in the FAS 106 calculations.

A. Unrecognized gains and losses occur when actual experience varies from the actuarial assumptions used to determine the level of service, interest, and return included in FAS 106 expense. For instance, the actuarial assumption embedded in a particular annual calculation of expense may include an expectation of 5% annual increases in medical costs. To the extent that actual increases are greater than this assumption, an unrecognized loss is generated. Such gains or losses can be produced by a variety of factors, including cost differences, variations in asset returns, and demographic changes.

Q. What is the methodology for including these unrecognized gains or losses in expense?

A. FAS 106 requires amortization of the unrecognized (gain)/loss account. The Company's current amortization method for ratemaking purposes was prescribed by the Stipulation & Agreement in case No. GR-2002-356. This method requires five-year amortization of the most recent five-year average of the balance of unrecognized gains and losses.

Q. What has been the impact of this methodology on the Company's FAS 106 expense calculations?

A. The unrecognized (gain)/loss account has included increasing losses over the past several years as medical cost increases have outstripped the actuarial assumptions. The unusual methodology currently employed has flowed an increasing and unnecessarily large amount of these losses into the expense calculations. The amortization of unrecognized losses has increased from $227,000 in the fiscal 2002 valuation used in GR-2002-356 to $1,979,000 in the most recent fiscal 2005 valuation.

Q. Do you have any suggestions for improving this situation?

A. Yes. I recommend that the Commission adopt an alternative method for ratemaking purposes that amortizes unrecognized gains or losses only to the extent that they fall outside of a corridor determined as the higher of 10% of the accumulated benefit obligation of the plans, or 10% of the market related value of the plan assets. Furthermore, I recommend that any gains or losses falling outside of the 10% corridor be amortized over the average remaining service life of participants. These commonly used mechanisms tend to reduce year to year volatility in expense.

Q. What would be the impact of your proposed changes on the expense included in this case?

A. FAS 106 expense as calculated for ratemaking purposes under the current method is $7,934,000. My proposed methodology would reduce this expense to $6,822,000.

Q. How was the amount of normalized OPEB expense to be included in the Company's cost of service determined?

A. Test year expense was adjusted to reflect the FAS 106 expense level for the fiscal year beginning October 1, 2004. Adjustment 4.b. reflects an increase in such expense based on the current methodology as prescribed in Case No. GR-2002-356. In the event that the Commission adopts the proposed changes to the amortization method, revenue requirement would be reduced by $796,000.

Q. Is FAS 106 expense an appropriate item to be included in the true-up that you have requested in this case?

A. Yes. The Company normally bases its annual valuation of FAS 106 expense on a June 30 measurement date, which is within the time frame requested in the true-up.

Benefit Plan Administrative Fees and 401(k) Expenses

Q. Please explain the adjustment to benefit plan administrative fees that you are sponsoring.

A. Adjustment 4.c reflects reduced pension administrative fees based on a change in the Company's policy regarding payment of these fees. These fees were previously paid by the Company and recorded as an operating expense as paid.

Certain of these fees are now paid directly by the pension trusts, resulting in a reduction in expense.

Q. What adjustment have you made to 401(k) expenses?

A. Company contributions to 401(k) Wage and Salary Deferral Savings Plans have been normalized to reflect the adjusted wage and salary levels.

<u>Wages and Salaries</u>

Q. Please explain the adjustment you are sponsoring related to the level of Laclede's wages and salaries.

A. Adjustment 5 on Schedule 5 is made to reflect known and measurable changes in the level of wages and salaries applicable to operation and maintenance expense.

Q. Please explain how the adjustment to Laclede Division contract wages is calculated.

A. The Company's current labor contract with its Laclede Division union employees includes, among other changes, 2.5% and 2.0% annual increases in wage rates for physical and clerical workers, respectively, effective August 1, 2004, August 1, 2005, August 1, 2006, and August 1, 2007. Laclede Division contract wages charged to operation and maintenance were normalized to include the current labor contract provisions which were effective August 1, 2004, in order to present the full twelve-month impact of changes in those provisions. In addition, this adjustment increases wage expense for the effect on operation and maintenance expenses of the change in labor contract provisions which will occur on August 1, 2005, and also adjusts to the normal level of employees anticipated at March 31, 2005.

Q. Have you made any other adjustments to Laclede contract wages?

A. Yes. I have adjusted the percent of test year payroll allocated to operation and maintenance accounts to a five-year average and also adjusted overtime hours to a five-year average level.

Q. What is the purpose of these adjustments?

A. The operation and maintenance expense percentage of overall payroll expense and overtime levels tends to vary from period to period. I have used a five-year average in order to adjust the expense associated with manpower requirements to a normal level.

Q. Please explain the adjustment to Missouri Natural Division contract wages.

A. Missouri Natural Division contract wages charged to operation and maintenance were normalized to give effect to the wage increase for field unit workers of 2.75% and clerical workers of 2.25% effective April 15, 2004 in accordance with the current labor agreement. In addition, this adjustment increases wage expense for the effect on operation and maintenance expense of an estimated increase in labor rates on April 15, 2005 which is likely to occur as a result of negotiations for a new labor contract. The true-up in this case should be adjusted to include the actual outcome of these contract negotiations. Additionally, the operation and maintenance percent and overtime were adjusted to five-year average levels for the reasons discussed earlier in my testimony related to Laclede contract wages. Also, employees were adjusted to a normal level expected at March 31, 2005.

Q. Please explain the adjustment to management salaries.

A. Management salaries were adjusted to reflect anticipated salary and bonus levels at March 31, 2005. The operation and maintenance percent for management salaries was also adjusted to a five-year average.

Q. Have you made adjustments for fringe benefits as a result of the wage and salary adjustments discussed above?

A. Yes. The impact of the adjustments on costs which are directly related to wages and salaries has been included in the FICA tax adjustment and in the 401(k) adjustment discussed elsewhere in this testimony.

Incentive Compensation Plan

Q. Please describe Laclede's Incentive Compensation Plan.

A. The Plan permits Laclede's Board of Directors to pay selected employees a portion of their salary and pension benefits in the form of share units. Employees who qualify receive quarterly payments which are the product of the share units and the Company's quarterly dividend paid on each common share of stock. Employees who meet certain criteria can continue to receive these payments after retirement. In addition, a deferred account is established for participating employees which accumulates the product of share units and retained earnings per share each year. The employee is paid the deferred amounts in retirement, if certain eligibility requirements are met.

Q. What are the eligibility requirements for employees to receive retirement benefits from the Plan?

A. No awardee whose employment with the Company is terminated, other than by retirement, disability, death or at his election following a hostile change in control, or who engages in any business which is competitive with the public utility business of the Company, is eligible to receive any payments under the Plan. All deferred compensation accrued prior to such termination or such competitive activity is forfeited.

Additionally, vesting requirements apply to new share units issued. Employees who are awarded new units must work a specified number of years depending upon their age in order to continue to receive the benefit of the share units after retirement.

Q. What is the purpose of Laclede's Incentive Compensation Plan?

A. The Plan provides Laclede's Board of Directors with a means of compensating selected executives in a manner which provides them an incentive to remain with the Company to retirement, and to keep working until normal retirement age rather than retiring early. The forfeiture and vesting provisions of the plan provide participants with a greater incentive to remain with Laclede than the alternative of straight salary and pension benefits. Additionally, the Plan provides participants with an incentive to maintain the Company on a financially sound basis since a portion of the participants' compensation is linked to the Company's financial results.

The Plan helps the Company attract and retain qualified key executives, without increasing the net cost to the Company, since such compensation would otherwise be paid in the form of ordinary salary and pension benefits in the absence of the Plan.

Q. Have you included adjustments to test year expenses related to the Plan?

A. Yes. The payments to current employees are normalized in the Wage and Salary adjustment discussed earlier in my testimony. The retirement portions are normalized in my adjustment regarding pension expense.

Non-Utility Allocations

Q. Please describe the adjustments to non-utility allocations included in this case.

A. Adjustment 6.a. normalizes the amount of expense allocated to the Company's merchandise operations. The adjustment to merchandise includes the removal from cost of service of the base salaries and associated expenses of Merchandise Sales Personnel.

Accounting Authorizations

Q. Please explain the deferral related to the Gas Safety Replacement Program (SRP) and Copper Service Replacement Program (CSRP).

A. The Company incurs significant costs on projects related to these programs which are performed pursuant to the Commission's gas safety rules. Since the Commission rules mandate replacement of existing facilities at considerably higher cost than those currently on the Company's books, these projects increase expenses but have no effect on revenues. Given the mandated and extraordinary nature of these programs, the Commission has permitted deferral of these costs and recovery in subsequent rate cases in order to afford the Company the opportunity to earn the return authorized by the Commission.

Q. Have you included such recovery in the instant case?

A. Yes. Pursuant to the Commission's order in Case No. GR-2002-356, Laclede has deferred and booked to Account 182.3 the costs incurred for replacement of bare steel service lines and replacement and cathodic protection of bare steel and cast iron mains, as well as associated work on other facilities (SRP) and replacement of copper service lines (CSRP). Such costs include depreciation, property taxes, and carrying costs which would normally have been expensed beginning with the in-service date. Adjustment 6.b. includes recovery of costs deferred pursuant to authority granted in Case No. GR-2002-356 through November 9, 2004 (deferrals ceased as of this date pursuant to the provisions of the Stipulation & Agreement in case No. GR-2002-356). Deferred costs in these calculations have only been applied to plant that had not yet been included in an Infrastructure System Replacement Surcharge (ISRS). As mentioned earlier in my testimony, the balance applicable to SRP was reduced by the amount of the overrecovery of Emergency Cold Weather Rule bad debts pursuant to the mechanism prescribed in Case No. GR-2001-629.

Q. Are you sponsoring any other adjustments related to these cost deferral mechanisms?

A. Yes. I have included the outstanding balance accrued pursuant to the authority granted in Case Nos. GR-2001-629 and GR-2002-356 as well as the associated deferred taxes in rate base. Additionally, I have reduced revenues required by $157,000 to reflect imputed maintenance savings resulting from the Program, pursuant to the Stipulation and Agreement in Case No. GR-99-315.

Q. What amortization period have you used for recovery related to these mechanisms?

A. I have used a five-year amortization period.

Q. Does the Company seek a continuation of the Gas Safety Accounting Authority Orders?

A. No. The ISRS addresses the same concerns that the Accounting Authority Orders were designed to address. Therefore, given the continued operation of the ISRS, the Company does not feel that it is necessary to continue the Gas Safety AAOs.

Taxes Other Than Income Taxes

Q. Please describe the adjustments you have made to Taxes, Other Than Income Taxes.

A. Adjustment 8.a. calculates the adjustment of property taxes and manufacturers' license expense to reflect the increase in assessed value at January 1, 2004, and for the unrealized portion of such taxes applicable to net utility plant at March 31, 2005, at tax rates which were in effect during calendar year 2004.

Adjustment 8.b. adjusts for a decrease in Missouri franchise taxes to normalized levels.

Q. Please continue.

A. Adjustment 8.c. increases FICA expense to reflect the increased wage and salary level described earlier in my testimony and reflected on Adjustment 5. Adjustment 8.d. adjusts Federal Unemployment Taxes for the taxable wages and tax rate effective January 1, 2005. Adjustment 8.e. reflects the increase in the City of St. Louis Payroll Expense Tax resulting from the wage and salary level changes made in Adjustment 5.

<u>Income Taxes</u>

Q. Please describe Schedule 6.

A. Schedule 6 shows the calculations of the proper amount of income tax expense related to the adjusted Test Year and Pro Forma Utility Operating Income Statement. The resulting adjustment to income tax expense is included in Adjustment 9 on Schedule 5. Page 1 of Schedule 21 shows the differences in the recognition of revenue and expense for tax and book purposes, and the resulting calculation of taxable income.

Q. Do the pro forma adjustments listed on Schedule 5 also affect taxable income?

A. Yes. All of the pro forma adjustments affect taxable income, and consequently, they all affect either current or deferred income tax expense.

Q. Please continue.

A. Page 2 of Schedule 6 shows the calculation of the current, pro forma income tax expense. Finally, Page 3 of Schedule 6 shows the calculation of total income tax expense, including deferred income taxes and investment tax credit amortization. The pro forma investment tax credit amortization has been adjusted to match the lives used for calculating book depreciation as reflected in Adjustment 7.a.

Q. Are there any other items relevant to your testimony regarding the Company's calculation of pro forma income tax expense that you have not mentioned?

A. Yes. There are various items for which the timing of expense is different between financial reporting and tax reporting purposes. I have not included in the calculation of income tax expense on Schedule 6 the book to tax timing differences, known as Schedule M items, for which there is an equal and corresponding deferred tax offset unless the item appears in the determination of rate base. This treatment is done in this case for the purpose of brevity only. The situation exists because income tax rates have not changed in recent years and the Company's deferred tax balances for the omitted items have been provided at rates equal to current income tax rates. The Company hereby reserves the right to include the omitted Schedule M items in future filings before the Commission should income tax rate changes result in deferred tax balances which are not provided at then current rates.

Q. Are you sponsoring any additional adjustments?

A. Yes. I have included a reduction in rate base on Schedule 1 related to deferred income taxes resulting from tax timing differences on depreciation and other rate base items.

Tariff Changes

Q. Are you proposing any changes to the Company's tariffs?

A. Yes. I am proposing several changes that would permit the Company to improve its practices related to collection of delinquent accounts. These changes are detailed on specimen tariff sheets R-5, R-5-a, R-5-b, and R-12-a.

Q. Please explain.

A. I propose the following changes:

<u>New Customer Deposit Assessment Criteria</u>

This change would permit assessment of a prepaid deposit on new customers, and include a credit score provided by a national credit reporting bureau as one of the criteria for assessment of such deposit. This would permit the Company to target deposits on new customers that present the greatest risk of non-payment.

<u>Poor Pay Deposit Assessment Criteria</u>

Current tariffs permit assessment of a deposit equal to two times the highest bill incurred over a 12-month period on customers who have 5 delinquent bills in 12 months. We propose a change that would allow an alternative assessment of four times the average bill over the 12-month period. While the proposed alternative would be expected to produce a lower assessment in most instances, we are requesting this flexibility because the alternative can be more easily implemented mechanically by the Company's billing system.

Hours of Disconnection

We propose extending the hours during which disconnection of customer accounts for non-payment are permitted until 7:00 p.m. in order to allow the Company greater flexibility in the use of its collection workforce.

Q. Does this conclude your 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	)	Case No. GR-2005-
Gas Rate Schedules.	)	

AFFIDAVIT

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

James A. Fallert, of lawful age, being first duly sworn, deposes and states:

1. My name is James A. Fallert. My business address is 720 Olive Street, St. Louis, Missouri 63101; and I am Controller of Laclede Gas Company.

2. Attached hereto and made a part hereof for all purposes is my direct testimony, on behalf of Laclede Gas Company.

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.

Ja A. Fallert
James A. Fallert

Subscribed and sworn to before me this 18th day of February, 2005.

Joan T. Roeper

JOAN T. ROEPER
Notary Public — Notary Seal
STATE OF MISSOURI
St. Louis County
My Commission Expires: June 9, 2007