Exhibit No.:	
Issue:	**Return on Equity, Depreciation Reserve, Income Taxes, Deferred Taxes, SERP, Property Taxes**
Witness:	**James A. Fallert**
Type of Exhibit:	**Rebuttal Testimony**
Sponsoring Party:	**Laclede Gas Company**
Case No.:	**GR-2002-356**

LACLEDE GAS COMPANY

GR-2002-356

REBUTTAL TESTIMONY

OF

JAMES A. FALLERT

August, 2002

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-2002-356

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 part hereof for all purposes is my rebuttal testimony, consisting of pages 1 to 25, inclusive; and Rebuttal Schedules JAF 1-5.

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

James A. Fallert

James A. Fallert

Subscribed and sworn to before me this 1st day of August, 2002.

Joan T. Roeper

JOAN T. ROEPER
Notary Public — Notary Seal
STATE OF MISSOURI
St. Louis County
My Commission Expires: June 9, 2003

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REBUTTAL TESTIMONY OF JAMES A. FALLERT

General Information

Q. Please state your name and business address.

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

Q. Are you the same James A. Fallert who previously filed direct testimony in this case on behalf of Laclede Gas Company ("Laclede" or "Company")?

A. Yes.

Purpose of Testimony

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my testimony is to respond to the direct testimony of Commission Staff ("Staff") witness Roberta McKiddy and Office of Public Counsel ("Public Counsel") witness Mark Burdette. In so doing, I will relate some information which Laclede believes is critical to the Commission's consideration of the return on equity recommendations made by Staff and Public Counsel witnesses in their direct testimonies. The fundamental technical weaknesses in their recommendations are detailed in the rebuttal testimony of Company witness Kathleen McShane. My testimony will provide an analysis of the weighted cost of equity consistent with the methodology employed by the Staff in the recent AmerenUE rate case, Case No. EC-2002-1 and address the impact of the Staff and Public Counsel recommendations on the Company's credit ratings.

Additionally, my testimony will respond to the direct testimony of Commission Staff witness Rosella Schad, specifically as it relates to the ratemaking treatment of the depreciation reserve under Commission rules, the direct testimony of Staff witness John Cassidy as it relates to income taxes on inventory capitalized and income taxes on cost of removal, the direct testimony of Staff witness Stephen Rackers as it relates to deferred tax balances on Accounting Authority Orders ("AAO"s) in rate base, the direct testimony of Staff witness Janis Fischer as it relates to Supplemental Retirement Plan ("SERP") expense, and the direct testimony of Staff witness Leasha Teel as it relates to property taxes.

Summary of Rate of Return Review

Q. Please summarize the results of your review of the weighted cost of equity recommendations submitted by Staff and Public Counsel in this case.

A. By way of background, Mr. Ronald Bible, who is manager of the Staff's Financial Analysis Department, provided an analysis of the weighted cost of equity of comparable companies in his surrebuttal testimony in the recently-concluded AmerenUE rate case, Case No. EC-2002-1. Laclede was a party in that case. While the Staff witness in this case, Ms. Roberta McKiddy, cited numerous comparisons in her testimony, she apparently did not perform the analysis that Mr. Bible performed in the Ameren UE case. I have performed that same calculation for this case.

Q. What does it show?

A. It clearly demonstrates that, based on Mr. Bible's methodology, the rate of return recommendations of the Staff (and also the Public Counsel for that matter) for Laclede in this case are significantly below the level being granted in other jurisdictions. This results from return on equity and equity ratio recommendations that are both significantly below average. The combination of these two factors results in rate of return recommendations that are true outliers and cannot be considered reasonable. By contrast, the Company's rate of return request in this case is clearly in the mainstream.

Q. Please summarize your conclusions regarding the impact of Staff and Public Counsel's rate of return recommendations in this case on the Company's credit ratings.

A. By their own calculations, the Staff and Public Counsel recommendations imply a downgrade of Laclede's credit rating of at least three notches from current levels. This would be in addition to the recent downgrade of one notch by both Moody's and Standard & Poor's.

Q. What would be the impact of the downgrade implied by Staff and the Office of the Public Counsel's rate of return recommendations in this case?

A. Such a downgrade would result in substantially less financing flexibility and higher borrowing costs. I am concerned that the increased risk could make it extremely difficult for the Company to secure the capital it needs to finance its ongoing construction and safety programs on satisfactory terms, particularly at times when credit markets are constricting as they are today.

<u>Comparison of Weighted Cost of Equity to Other Companies</u>

Q. On page 41 and 42 of her direct testimony, Staff witness McKiddy discusses a review that she performed comparing various financial measures of Laclede to comparable companies. Do you believe that Ms. McKiddy's analysis has covered all of the pertinent comparisons?

A. No. I don't believe that Ms. McKiddy has adequately analyzed the impact of her capital structure recommendations on return on equity as it compares to other companies. In fact, her approach appears to be inconsistent with the approach which the Staff recently took in another case.

Q. Please explain.

A. I have reviewed the surrebuttal testimony of Staff witness Ronald Bible in Ameren's case, Case No. EC-2002-1. Mr. Bible performed such a comparative review in that case and argued "***it is not return on equity but the weighted return on equity or weighted cost of equity, and how it fits into the overall rate of return and before tax rate of return, that is important.*** Failure to examine all these factors will result in a flawed rate-of-return study." (See Bible Surrebuttal, page 10, line 21 – page 11, line 2). Mr. Bible went on to compare the weighted cost of Ameren's equity to comparable companies to support his rate of return recommendation in that case.

Q. Has Ms. McKiddy performed any such comparative analysis in connection with her direct testimony in this case?

A. Apparently not. I say this because she has offered nothing in testimony or her workpapers to indicate that she has done so. If she had performed such an analysis she could have only concluded that her return on equity recommendation in this case is totally out of the mainstream and woefully inadequate.

Q. Would such an analysis have an impact on her rate of return recommendation in this case?

A. Yes. Ms. McKiddy's rate of return recommendation for Laclede in this case would be substantially higher if she had used Mr. Bible's methodology.

Q. Please explain.

A. Schedule 2 of Mr. Bible's surrebuttal testimony in the AmerenUE case details an analysis that he performed in which he compared the historical weighted cost of equity in prior rate case decisions across the country with that of his recommendation in that case. I have attached a copy of this schedule to my testimony as Rebuttal Schedule JAF-1. Mr. Bible summarized this schedule as follows on page 13 of his surrebuttal testimony:

"Table 2
Regulatory Research Associates (RRA)
Major Rate Case Decisions

	ROR%	ROE%	Eq. As % Cap. Struc.	Weighted Cost of Equity
RRA Avg.	9.33%	11.46%	46.12%	5.28%
Bible Rec.	8.31%	9.41%	59.08%	5.56%"

Mr. Bible went on to explain his belief that this analysis supported the reasonableness of his return on equity recommendation in the Ameren case since it produced a weighted cost of equity in line with the authorized returns that other utilities have received.

Q. Please continue.

A. In connection with my rebuttal, I have performed a virtually-identical analysis to that performed by Mr. Bible, substituting gas utility returns for the electric utility returns used in his study. The results are detailed in my Rebuttal Schedule JAF-2, and summarized below:

Regulatory Research Associates (RRA)
Major Rate Case Decisions

	ROR%	ROE%	Eq. As % Cap. Struc.	Weighted Cost of Equity
RRA Average	9.29%	11.30%	47.90%	5.41%
RRA (2002)	8.97%	11.22%	49.44%	5.55%
Staff High	7.79%	9.75%	41.85%	4.08%
OPC High	8.06%	10.20%	38.71%	3.95%
Company	9.01%	11.75%	42.40%	4.98%

Q. What do you conclude from this analysis?

A. Staff's high end return on equity recommendation for Laclede in this case of 9.75% produces a weighted cost of equity for the Company which is 1.33%

less than the ten year average of returns granted to other gas utilities and 1.47% less than the 2002 average. Furthermore, Staff's high end recommendation produces a weighted cost which is 1.48% less than the midpoint recommended by Staff for AmerenUE as set out in Mr. Bible's surrebuttal testimony filed in Case No. EC-2002-1 on June 24, 2002. Clearly, Staff's recommendation in Laclede's case is totally inadequate, and the Public Counsel's weighted cost of equity is even lower than Staff's. The only return on equity recommendation in this case which has any reasonable relationship to that of others within the industry based on Staff member Bible's methodology as used in the Ameren case is that of Laclede witness Kathleen McShane. In fact, the Company's requested rate of return in this case results in a somewhat lower than average weighted return on equity using Staff's own analytical methodology, and also produces an overall rate of return in line with industry norms.

Q. What would be the impact on revenue requirement in this case if Staff had filed a rate of return recommendation consistent with the results of this analysis?

A. I believe that the weighted cost of capital is the most appropriate measure for determination of such impact. Increasing the before tax weighted cost of capital in this case to the level suggested by Mr. Bible's methodology would have the following effect on Staff's high end revenue requirement recommendation:

	RRA 10-Year Average	RRA 2002 Average	AmerenUE Staff Midpoint
Before Tax Weighted Cost of Capital	12.66%	12.43%	11.77%
Staff High End – Laclede Case No. GR-2002-356	10.33%	10.33%	10.33%
Increase in Cost of Capital	2.33%	2.10%	1.44%
Rate Base – Staff Direct Filed Case	622,897,000	622,897,000	622,897,000
Increase in Revenue Requirement	$14,514,000	$13,081,000	$ 8,970,000

Q. Do you have any other comments based on this analysis?

A. This analysis reveals clearly that the rate of return recommendations of both Staff and Public Counsel in this case are extreme outliers in relation to returns being granted across the country. The recommended returns on equity and equity ratios are both considerably lower than average, resulting in a double whammy to the recommended cost of capital for Laclede. The Company's requested cost of capital would place our returns in the mainstream, although still somewhat less than average.

Credit Ratings

Q. What are the current credit ratings of Laclede?

A. Staff witness McKiddy correctly noted that Standard & Poor's recently downgraded Laclede's senior debt rating to A+. However, her reference to Mergent (i.e. Moody's) rating of Aa3 is out of date. On May 2, 2002, Moody's downgraded Laclede's senior debt rating to A1, citing "continuing concerns regarding Laclede's weakened credit measures due to increased earnings pressure and near-term regulatory risks." Moody's went on to say "This past winter's warm weather and insufficiency of regulatory support on the part of its regulators (as exhibited by the rejection of the Company's successful Gas Supply Incentive Plan), have affected Laclede's cash flows and further hampered its operating and debt coverage ratios relative to its historical measures and those of its peers." The full text of Moody's news release is attached to my testimony as Rebuttal Schedule JAF-3.

Q. Has Moody's indicated a possibility of further downgrades?

A. Yes. Moody's has indicated that "The outlook remains negative due to regulatory risk."

Q. Have you reviewed the impact that Staff's recommendations would have on the credit ratings of Laclede?

A. Yes, I have. I have reviewed Ms. McKiddy's analysis of interest coverage ratios that would result from her recommendation. The resulting ratios of 2.61x to 2.79x fall in the BBB range of 1.8x to 2.8x designated by S&P for companies with Laclede's level of business risk. Thus, even Ms. McKiddy's own calculation implies a three notch self-fulfilling downgrade from the current A+ level (i.e., from A+, to A, to A-, to BBB+).

Q. Does Ms. McKiddy's analysis reflect the full extent of ratings downgrade implied by her rate of return recommendation?

A. No, I do not believe it does. Her simplified analysis uses marginal tax rates rather than effective rates, and excludes some utility interest charges, such as customer deposits. Refining the calculations for these items would further reduce the indicated coverage ratios.

Furthermore, as Ms. McKiddy points out, rating agencies examine numerous factors in addition to interest coverage in assessing a company's credit rating. Some of the most important such factors are cash flow coverage ratios. Laclede tends to have relatively low cash flow measures since its depreciation rates are among the lowest in the country.

Q. What are the credit ratings of the comparable companies identified by Ms. McKiddy?

A. The average rating of the seven companies is A.

Q. Have you examined the return required in this case to produce interest coverage consistent with an A rating?

A. Yes, I have. My Rebuttal Schedule JAF-4 details a recalculation of Ms. McKiddy's interest coverage analysis at a return on equity necessary to produce coverage of 3.1x, which is the midpoint of Standard & Poor's range for A rated companies with Laclede's level of business risk. This analysis indicates that an 11.4% return on equity would produce interest coverage sufficient to maintain an A rating, based on Ms. McKiddy's simplified methodology.

Q. Ms. McKiddy at page 33, line 21 of her direct testimony notes that her recommendation "allows enough earnings power for Laclede to meet its Net Earnings Requirement of two times the amount of the annual interest requirements pursuant to provisions of its Supplemental Indenture (Source: Company Response to Staff Rate Request No. 3805). Thus, the pro forma pre-tax interest coverage test shows that Staff's recommended return on common equity permits enough earnings potential for Laclede to meet its capital costs based upon the return on common equity range for Laclede referenced above." Do you agree with Ms. McKiddy's statement?

A. Absolutely not.

Q. Why not?

A. The net earnings requirement in the Indenture defines the <u>minimum</u> level of interest coverage under which the Company would be permitted to issue first mortgage bonds under the Indenture under the <u>worst</u> of conditions. It is not an appropriate measure for an allowed return. Ms. McKiddy's return recommendation results in coverage levels that bring the Company uncomfortably close to the point where it could not even issue first mortgage bonds in certain plausible adverse situations. The net earnings required referenced in the Company's Indenture has no relevance to an appropriate return on equity, which should be based on the accepted legal standards for what constitutes a fair and reasonable return.

Q. Did Public Counsel witness Burdette perform any analysis of the impact of his recommendation on Laclede's interest coverage?

A. Yes. Mr. Burdette calculated coverage ratios of 2.51x to 2.58x based on his return recommendations (Schedule MB-11). Notably, however, Mr. Burdette did not comment on these ratios in his direct testimony. I would note that Mr. Burdette's calculated interest coverage ratios are even lower than those produced by Ms. McKiddy's recommendation.

Q. Do you have any other comments regarding Mr. Burdette's calculation of interest coverage?

A. Yes. While Mr. Burdette's calculations indicate that his recommended return would result in a credit rating of BBB for Laclede, he has excluded other BBB rated companies from his selection of comparable companies.

Q. Please summarize your conclusions regarding the impact of Staff and Public Counsel's return recommendations on Laclede's credit ratings.

A. By their own calculations, Ms. McKiddy and Mr. Burdette's rate of return calculations result in coverage ratios implying a downgrade of Laclede's credit ratings by <u>at least</u> three notches, and very possibly more. Credit rating agencies have recently demonstrated a willingness to impose multi-notch reductions. The implied BBB ratings are well below those of the comparable companies selected by these witnesses. I believe that these results further demonstrate the inadequacy of the rate of return recommendations of Staff and the Office of the Public Counsel in this case.

<u>Accumulated Depreciation for Calculation of Revenue Requirement</u>

Q. What is the purpose of this portion of your rebuttal testimony?

A. I will discuss additional considerations relating to Staff's proposed treatment of the Company's depreciation reserve as reflected in the direct testimony of

Rosella Schad. Company witness R. L. Sherwin also discusses this and other depreciation issues in his rebuttal testimony.

Q. How has the Staff treated the depreciation reserve in this case?

A. As discussed more thoroughly in Mr. Sherwin's Rebuttal Testimony, the Staff has proposed a theoretical reserve adjustment which reaches back to make adjustments based on past collections of net salvage cost.

Q. What is the Commission's rule that specifies ratemaking treatment of depreciation reserves?

A. The applicable rule is 4 CSR 240-10.020. This rule prescribes that in the process of setting utility rates, the appropriate treatment of the depreciation reserve is to impute a credit to rates equal to 3% of the depreciation reserve.

Q. Has this rule been followed in recent years?

A. No. Instead of following this rule, the Commission's practice has been to subtract the accumulated depreciation from gross plant in the determination of rate base, effectively imputing a credit on the reserve equal to the pretax rate of return used in the rate calculation.

Q. Have you calculated the effect in this case if rates were established in compliance with 4 CSR 240-10.020?

A. Yes. My Rebuttal Schedule JAF-5 shows the effect on revenue requirement of calculating rates in compliance with this rule. Based on the March 31, 2002 updated depreciation reserve, compliance with the rule would increase revenue requirement by $26,977,801 based on Staff's high end recommended rate of return or $34,161,904 based on Laclede's recommended rate of return.

Q. Do these amounts reflect the impact of past non-compliance with 4 CSR 240-10.020?

A. No. These amounts would apply only to the current revenue requirement in this case. The amounts would exceed the entirety of Staff's claimed depreciation reserve imbalance if one attempted to reach back to recognize these past differences, but reaching back would be just as inappropriate in this instance as it is with Staff's theoretical reserve adjustment.

Q. Has the Company's rate request included the effect of compliance with this rule?

A. No. Laclede has voluntarily included a credit in rates based on recent Commission practice despite the fact that it would be legally entitled to recovery pursuant to the rule. However, the Company cannot support the theoretical reserve adjustment proposed by Staff witness Rosella Schad. The theoretical reserve adjustment would move the Company's rate treatment of the depreciation reserve even farther from the rule. The Company urges the Commission to reject Staff's proposed theoretical reserve adjustment as an even greater deviation from 4 CSR 240-10.020.

Income Taxes - Inventory Capitalized

Q. Please describe the tax treatment applicable to natural gas and propane inventory.

A. Certain costs related to acquisition and injection of gas for inventory purposes are expensed when incurred for book purposes but capitalized for tax purposes and deducted at the point of inventory withdrawal. This creates a book/tax timing difference.

Q. What impact does this accounting have on the Company's books?

A. In any particular period, current taxes payable will be affected by an addition or deduction, depending upon the timing and amount of the inflows and outflows of these capitalized costs related to gas inventories. An offsetting deferred tax entry is made to income taxes (i.e., the expense is normalized), and a deferred tax balance exists on the books which consists of the cumulative book/tax timing difference.

Q. How does the Company include this item in its calculation of income taxes for ratemaking purposes?

A. The Company followed the above-described accounting. We included a current tax deduction based on the book/tax timing difference in the test year, and normalized that deduction with an offsetting deferred tax entry. The cumulative book/tax timing difference (which essentially represents tax deductions not yet taken) was included as an item of rate base since the Company has not yet received the benefit of those tax deductions.

Q. How has Staff treated this item in its filing?

A. Staff witness John Cassidy has "flowed through" this item, in effect recognizing only the current tax deduction. Staff has not included any rate base impact.

Q. Which method is preferable?

A. The Company's normalization method produces the most reasonable results. The Staff's use of flow through accounting can result in significant variations from period to period due simply to the vagaries of changes in storage costs, and injection/withdrawal timing. In fact, this case provides an excellent illustration. The current tax deduction in the test year was $1,389,000. This amount was included in the Company's filing. By March 31, 2002, this deduction had declined to $85,000.

Q. Has the Staff included the March 31, 2002 amount in its filing?

A. No. At this point, the Staff has declined to update this item.

Q. Is there any reason that this item should not be updated consistent with the rest of the case?

A. No.

Q. Is Staff's treatment of this item consistent with its past practice?

A. No. In Laclede Gas Case No. GR-2001-629, Staff used a five-year average of current inventory capitalized.

Q. What would be the result if such treatment were used in this case?

A. This would result in an addition to taxable income of $45,000.

Q. What is your recommendation regarding the appropriate tax treatment for inventory capitalization?

A. The Commission should adopt the Company's normalization method. This results in an increase in income tax expense of $533,000 (revenue requirement of $868,000) and an addition to rate base of $1,325,000. If the Commission chooses to implement the Staff's flow-through method in this case, then the tax deduction should be updated to March 31, 2002 levels in order to match this expense to the rest of the case. This results in a $500,000 increase to income tax expense (revenue requirement of $814,000).

Q. Should this item be included in the true-up?

A. Yes.

<u>Income Taxes - Net Cost of Removal</u>

Q. Please describe this issue.

A. Staff witness John Cassidy has included in his filed case the tax effect on the amount of deductible net cost of removal actually incurred during fiscal 2001. Subsequent to its filing, Staff has revised its position to include a tax effect on the booked amount of cost of removal in the update period. The Company proposes to include the actual cost of removal deductible for tax purposes as updated through March 31, 2002.

Q. Why are book expense and tax deductible cost of removal different?

A. There are two primary differences. The first relates to the treatment of overheads and interest for tax purposes and is not an issue in this case. The second relates to removal cost which has been previously deducted and, therefore, is not currently deductible when incurred. Staff's deduction based on book cost of removal essentially deducts these amounts twice.

Q. You said that some of the incurred removal costs have been previously deducted. How does this occur?

A. This occurs for older vintage property which is depreciated for tax purposes at straight-line rates, which are the same as the book depreciation rates. Since the book/tax depreciation rates until recently included an allowance for cost of removal, the tax deduction related to that property has already been taken and, thus, cannot be taken again when the removal cost is actually incurred.

Q. How are these costs accounted for?

A. These costs are applied to the tax depreciation reserve since they have already been deducted. They are <u>not</u> deducted for tax purposes.

Q. Why is Staff's tax treatment of these costs inappropriate?

A. As I mentioned above, Staff includes a deduction for costs which have already, previously been deducted.

Q. Has Staff used this inappropriate methodology in the past?

A. No, and since this treatment was not used in their direct filed case, I am not certain of the reason. However, I presume that Staff has changed its position due to the change in accounting implemented in the Company's previous rate case wherein cost of removal is now treated as an item of expense on the books of the Company.

Q. Does this change in book accounting justify Staff's use of book cost of removal as tax deductible cost of removal?

A. No. The change in book accounting does not change the fact that the Company has previously deducted a portion of these costs and, therefore, cannot do so a second time.

Q. What is the impact of correcting Staff's double count of these tax deductions?

A. Income taxes in this case should be increased by $924,000, resulting in additional revenue requirement of $1,505,000.

Deferred Taxes on AAOs in Rate Base

Q. Please describe this issue.

A. On page 7, lines 13-15 of his direct testimony, Staff witness Stephen Rackers proposes to exclude from rate base the balances related to accounting authority orders (AAOs), but include as an offset to rate base the associated deferred taxes.

Q. Please explain how these AAO balances arise.

A. The costs deferred pursuant to these AAOs include depreciation expense, property taxes and carrying costs, or operating expenses incurred by the Company in providing utility service. These costs have not been funded by nor recovered from ratepayers, but have been borne by the shareholders. However, through the AAO process, the Commission has permitted the Company to defer these costs for later recovery through rates. Hence, the Company does not recognize these costs when incurred, but instead defers

A. Absolutely none. The deferred tax offset to rate base is created by the existence of the rate base item. There is no basis for excluding a rate base addition (the AAO balances) from cost of service while simultaneously including an offset (the deferred tax offset) that is based on that addition.

Q. How are deferred taxes related to AAO balances calculated?

A. The deferred taxes are equal to the AAO balance multiplied by the tax rate. Staff witness Rackers has calculated such balances as follows:

	GR-99-315	GR-2001-629	Total
AAO Balance	$10,537,042	$2,801,312	
Income Tax Rate	x38.5596%	x38.5596%	
Deferred Tax Balance	$ 4,063,041	$1,080,175	$5,143,216

The Deferred Tax Balance is clearly a product of the AAO balance and the tax rate. If there is no AAO balance in rate base, there can be no deferred tax balance.

Q. Has Staff differentiated the deferred tax treatment of different types of AAO balances?

A. Not in this case. However, in Laclede's 1999 rate case (GR-99-315) Staff applied this mismatched treatment only to AAO balances associated with the Gas Safety AAO. Other balances were not similarly treated. In fact, Staff had mistakenly included the deferred tax offset related to Year 2000 deferrals in rate base in its original filing in that case, and later corrected it. Mr. Rackers noted in his surrebuttal testimony in that case (at page 13, line 6): "The deferred taxes associated with the Year 2000 AAO were mistakenly included in the accumulated deferred tax balance the Staff is proposing as an offset to the rate base. The Staff will correct this item when it files updated accounting schedules."

Q. Were deferred taxes related to AAO balances included in the determination of rate base in Case No. GR-99-315?

A. No. None of these deferred taxes were included in that calculation.

Q. Please comment on Staff's proposal to include the mismatched rate base offset in this case.

A. The 1999 rate case established a framework for the treatment of the substantial AAO balances which had accumulated to that point. The parties in that case agreed to numerous provisions which significantly reduced the economic value to the Company of these AAO's including:

- elimination of four of the five AAOs;
- 15 year amortization of all AAO balances then outstanding, except for the gas safety AAO, which is being amortized over 10 years;
- no rate base recovery on outstanding AAO balances;
- an imputed $157,000 annual reduction for 15 years in the Gas Safety AAO to cover theoretical maintenance savings (this is in addition to a 1% reduction of the interest rate used for accrual of interest expense for this same purpose); and,

– an additional $33,000 annual reduction for the term of rates in GR-99-315 to cover additional maintenance savings.

It would be totally inappropriate to further reduce the economic value of these AAOs by imputing a deferred tax offset not included in GR-99-315.

Q. You mentioned a $33,000 annual reduction for the term of rates in GR-99-315 related to maintenance savings. What is the treatment of that item in the current case?

A. Staff has proposed to continue the reduction in cost of service of $33,000. However, Staff has provided no rationale for this adjustment, and I urge the Commission to reject it.

Q. Please summarize your position regarding Staff's treatment of deferred taxes on AAO balances.

A. Staff's adjustment is incorrect. It is totally inappropriate to include a deferred tax offset in rate base when the item upon which the offset is based is itself excluded from rate base. In any event, this mismatched treatment is unfair to the Company since it significantly reduces the economic value of AAOs that were already substantially reduced in the Company's 1999 rate case. In that case, the carefully crafted resolution of the then outstanding AAO issues excluded from rate base both the AAO balances and the related deferred taxes.

SERP Pension Expense

Q. What is the issue in this case regarding this expense item?

A. Laclede filed for recovery of these expenses on a FAS 87/88 basis, but has agreed to include an amount in rates based on payments to participants, which is Staff's preference. The remaining issue is the appropriate calculation of a normal payment amount for inclusion in cost of service.

Q. How has Staff calculated SERP payments in this case?

A. Staff witness Janis Fischer has used the test year actual payments.

Q. Does this generate a reasonable normalized payment amount?

A. No, it does not. The reason is because of the irregular pattern of payments made under the SERP. SERP payments are subject to extreme volatility due to the occasional payment of lump sums under the plan. The test year included no lump sums and, therefore, is significantly less than the amount of payments which would be expected over the long term.

Q. What do you recommend?

A. I recommend the use of a ten-year average of SERP payments to generate a normalized payment amount in this case. This adjustment would add $508,000 to Staff's calculation of SERP payments.

Q. Five-year averages are used for normalization periods in many rate case adjustments. Why do you recommend a ten-year average for SERP payments?

A. I believe that the sporadic and occasional nature of these payments support the use of a longer averaging period. I would note that the use of a five-year average in this case would have increased the adjustment to Staff's calculation of SERP cost by $917,000.

Property Tax

Q. Please describe the issue regarding property taxes.

A. Laclede's direct filing included the impact of estimated assessments as of January 1, 2002 for property tax payments. Staff witness Leasha Teel's direct filing was based on January 1, 2001 assessments.

Q. Have actual assessments as of January 1, 2002 become available subsequent to these filings?

A. Yes. Most assessments are now known.

Q. Has Staff included the effect of the January 1, 2002 assessments in its updated case?

A. No.

Q. Should the impact of these January 1, 2002 assessments on property taxes be included in the case as updated through March 31, 2002?

A. Yes. These are known and measurable costs which the Company is incurring, and which have reasonably been included in rates in past cases. The impact of including these costs is an increase of $287,000 in revenue requirement.

Q. Does this conclude your rebuttal testimony?

A. Yes.

Regulatory Research Associates (RRA)
Major Rate Case Decisions
April 10, 2002

	ROR %	ROE%		Eq. As % Cap. Struc.	Weighted Cost of Equity	Weighted Cost of Debt & Preferred
1991	10.45%	12.55%	(45)*	43.80%	5.50%	4.95%
1992	10.01%	12.09%	(48)	44.69%	5.40%	4.61%
1993	9.46%	11.41%	(32)	47.40%	5.41%	4.05%
1994	9.29%	11.34%	(31)	45.15%	5.12%	4.17%
1995	9.44%	11.55%	(33)	45.90%	5.30%	4.14%
1996	9.21%	11.39%	(22)	44.34%	5.05%	4.16%
1997	9.16%	11.40%	(11)	48.79%	5.56%	3.60%
1998	9.44%	11.66%	(10)	46.14%	5.38%	4.06%
1999	8.81%	10.77%	(20)	45.08%	4.86%	3.95%
2000	9.20%	11.43%	(12)	48.85%	5.58%	3.62%
2001	8.96%	11.08%	(16)	47.20%	5.23%	3.73%
**2002	8.51%	10.87%	(5)	46.15%	5.02%	3.49%
		Total	285			
Average	9.33%	11.46%		46.12%	5.28%	4.04%
Ameren midpoint EC-2002-1	8.31%	9.41%		59.08%	5.56%	2.75%

	Ameren	RRA 2002 **
Weighted Cost of Equity	5.56%	5.02%
times Tax Multiplier	1.6231	1.6231
	9.02%	8.15%
plus Weighted Cost of Debt and Preferred	2.75%	3.49%
equals Before Tax Weighted Cost of Capital	11.77%	11.64%

* Number of observations each period indicated in parenthesis.

** First quarter 2002, Jan-Mar.

This is Schedule 2 from the surrebuttal testimony of Staff witness Ronald Bible in Ameren Case No. EC-2002-1.

Regulatory Research Associates (RRA)
Major Rate Case Decisions
Gas Utilities
July 9, 2002

	ROR%	ROE%	*	Eq. As % Cap.Struc.	Weighted Cost of Equity	Weighted Cost of Debt & Preferred
1992	10.10%	12.01%	(29)	46.64%	5.60%	4.50%
1993	9.44%	11.35%	(45)	46.15%	5.24%	4.20%
1994	9.51%	11.35%	(28)	48.12%	5.46%	4.05%
1995	9.64%	11.43%	(16)	49.98%	5.71%	3.93%
1996	9.25%	11.19%	(20)	47.69%	5.34%	3.91%
1997	9.13%	11.29%	(13)	47.78%	5.39%	3.74%
1998	9.46%	11.51%	(10)	49.50%	5.70%	3.76%
1999	8.86%	10.66%	(9)	49.06%	5.23%	3.63%
2000	9.33%	11.39%	(12)	48.59%	5.53%	3.80%
2001	8.51%	10.95%	(7)	43.96%	4.81%	3.70%
**2002	8.97%	11.22%	(7)	49.44%	5.55%	3.42%
		Total	(196)			
Average	9.29%	11.30%		47.90%	5.41%	3.88%
GR-2002-356 Recommendations:						
Staff High	7.79%	9.75%		41.85%	4.08%	3.71%
OPC High	8.06%	10.20%		38.71%	3.95%	4.11%
Laclede	9.01%	11.75%		42.40%	4.98%	4.03%

	RRA Avg.	RRA 2002	Staff High	OPC High	Laclede
Weighted Cost of Equity	5.41%	5.55%	4.08%	3.95%	4.98%
times Tax Multiplier	1.6231	1.6231	1.6231	1.6231	1.6231
	8.78%	9.01%	6.62%	6.41%	8.08%
plus Wtd Cost of Debt and Preferred	3.88%	3.42%	3.71%	4.11%	4.03%
equals Before Tax Wtd Cost of Capital	12.66%	12.43%	10.33%	10.52%	12.11%

* Number of observations each period indicated in parenthesis.
** First and Second Quarters, Jan. - June.

This Schedule recreates the analysis performed by Staff witness Ronald Bible in his surrebuttal testimony in Ameren Case No. EC-2002-1, as applied to the return recommendations in Laclede Gas Case No. GR-2002-356.

Moody's Investors Service

Global Credit Research
Rating Action
2 MAY 2002

Rebuttal Schedule JAF-3
page 1 of 2

Rating Action: Laclede Gas Company

MOODY'S DOWNGRADES LACLEDE GAS COMPANY'S DEBT RATINGS (SR. SECURED TO A1); CONFIRMS COMMERCIAL PAPER RATING AT PRIME-1

Approximately $360 Million of Laclede Gas Company debt affected Approximately $500 Million of The Laclede Group's Newly-Registered shelf are affected

New York, May 02, 2002 -- Moody's Investors Service downgraded the senior secured ratings of Laclede Gas Company ("Laclede") to A1 (senior unsecured implied A2) while maintaining the commercial paper rating at Prime-1. At the same time it assigned a first-time senior unsecured debt rating of (P)A3 to the $500 million shelf of The Laclede Group, Inc. ("LGI"). The outlook remains negative due to regulatory risk.

Moody's rating action reflects its continuing concerns regarding Laclede's weakened credit measures due to increased earnings pressure and near-term regulatory risk. Laclede's earnings and cash flow are highly sensitive to weather and Laclede is operating without the benefit of a weather mitigation clause or some other mechanism that would reduce its weather exposure in this area. For the six months ended March 31, 2002, utility operating margins were down almost 20% from the comparable period in 2001 while Net Income for the Laclede Group was down 27%. Laclede is also in the midst of various regulatory proceedings with the Missouri Public Service Commission ("MPSC") including a weather mitigation clause in the pending rate case. Laclede expects the rate case to be resolved by the end of calendar year 2002. This past winter's warm weather and insufficiency of regulatory support on the part of its regulators (as exhibited by the rejection of the company's successful Gas Supply Incentive Plan), have affected Laclede's cash flows and further hampered its operating and debt coverage ratios relative to its historical measures and those of its peers.

LGI is a recently-formed holding company for various operating subsidiaries including Laclede and SM&P Utility Resources, Inc., an unregulated company acquired in January of 2002. The A3 rating reflects Moody's approach of rating the parent holding companies of regulated utilities one notch lower than the senior unsecured debt ratings of the regulated entity ("Laclede"). The new parent company rating also takes into account the relative stability of cash flows and investment grade credit quality required for Laclede by the Missouri Public Service Commission in its approval last July for the formation of the LGI parent holding company structure and the relatively marginal impact of the group's unregulated business line.

New ratings for Laclede are as follows: Newly assigned ratings for LGI shelf are as follows:

Senior secured debt - A1;Senior unsecured debt - (P)A3

Senior secured shelf - (P)A1;Subordinated debt and trust preferred securities - (P)Baa1

Senior unsecured shelf - (P)A2.Preferred stock - (P)Baa2

Confirmed ratings are as follows:

Commercial Paper - P-1.

Laclede Gas Company is a natural gas distribution company serving a territory in eastern Missouri, including St. Louis and is a utility regulated by the MPSC. It is the principal operating subsidiary of The Laclede Group, Inc. and is headquartered in St. Louis, Missouri.

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Rebuttal Schedule JAF-3
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Laclede Gas Company
Case No. GR-2002-356
Analysis of Staff Interest Coverage Calculation

		Staff Filing (from McKiddy Sch. 31)			Necessary To Maintain
		Low	Mid	High	Rating of A
	Return on Equity	8.75%	9.25%	9.75%	11.40%
1.	Common Equity	286,125,637	286,125,637	286,125,637	286,125,637
2.	Earnings Allowed	25,035,993	26,466,621	27,897,250	32,618,323
3.	Preferred Dividends	62,669	62,669	62,669	62,669
4.	Net Income Available	25,098,662	26,529,290	27,959,919	32,680,992
5.	Tax Multiplier	1.6231	1.6231	1.6231	1.6231
6.	Pre-Tax Earnings	40,737,043	43,059,062	45,381,081	53,043,742
7.	Annual Interest Costs				
	- Long Term	21,466,351	21,466,351	21,466,351	21,466,351
	- Short Term	3,840,595	3,840,595	3,840,595	3,840,595
	Total	25,306,946	25,306,946	25,306,946	25,306,946
8.	Available for Coverage	66,043,989	68,366,008	70,688,027	78,350,688
9.	Pro Forma Pre-Tax Interest Coverage	2.61	2.70	2.79	3.10
	Implied Credit Rating	BBB+	BBB+	BBB+	A

Note: This calculation is based on Staff's simplified analysis. The actual coverage would likely be lower because Staff uses the marginal tax rate rather than the effective rate and because Staff excludes certain utility interest expense, such as customer deposits, which should be included.

Laclede Gas Company
Case No. GR-2002-356
Impact of Commission Rule 4 CSR 240-10.020 on Revenue Requirement

	Staff High	Company
Depreciation Reserve at March 31, 2002 (from Staff EMS Run)	$ 374,172,000	$ 374,172,000
Authorized Pretax Rate of Return	10.21%	12.13%
Income Imputed Pursuant to 4 CSR 240-10.020	3.00%	3.00%
Difference	7.21%	9.13%
Additional Revenue Requirement to Comply with 4 CSR 240-10.020	$ 26,977,801	$ 34,161,904