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| Exhibit No.: | |
| Issue: | Test Year and Update, Accounting Schedules, Uncollectible Accounts, Pensions and OPEBs, Wages, AMR, Taxes |
| Witness: | James A. Fallert |
| Type of Exhibit: | Direct Testimony |
| Sponsoring Party: | Laclede Gas Company |
| Case No.: | GR-2007-0____ |
| Date Testimony Prepared: | December 1, 2006 |

LACLEDE GAS COMPANY

GR-2007-0____

DIRECT TESTIMONY

OF

JAMES A. FALLERT

DECEMBER 2006

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 responsible for the Company's accounting, budgeting, management information reporting, and financial planning functions.

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. 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. 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, GO-2004-0443, GR-2005-0284, and GC-2006-0318.

## PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony?

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

1. Recommendations regarding test year, update, and true-up;
2. Adjustments to utility operating income;
3. Level and treatment of uncollectible accounts expense;
4. Cold Weather Rule Amendments;
5. Pension expense and assets;
6. Post retirement benefits other than pensions;
7. 401(k) expenses;
8. Board of Directors fees,
9. Wages and salaries;
10. Automated Meter Reading ("AMR");

11. Incentive compensation plan/Bonus plan/Equity plan;

12. Non-utility allocations;

13. Taxes other than income taxes;

14. Income taxes;

15. Proposed tariff change;

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 also 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 Company's actual operating results as recorded on the books for the twelve months ended September 30, 2006, 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 reflect the status of the item 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, 2006 and to provide for reasonable changes which will be known and measurable by March 31, 2007, or, in certain instances, July 31, 2007. 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, 2006 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 as well as the most recent results that were available in sufficient time to prepare 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, 2006 test year data. This is the same approach used in the Company's recent rate cases (*See* 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 and GR-2005-0284).

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

A. The Staff should look at the latest information available prior to filing its testimony in this proceeding. Such information would most likely be available following the closing of March 31, 2007 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, 2007. 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, 2007 and July 31, 2007. 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 changes in account balances of customers participating in the Cold Weather Rule.

## 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, 2006 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, 2006.

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 witnesses in their testimony.

## UNCOLLECTIBLE ACCOUNTS EXPENSE

Q. Please describe your adjustment to uncollectible accounts expense.

A. I am sponsoring Adjustment 4.a. to Customer Accounts Expense, relating to Uncollectible Accounts Expense in the test period.

Q. Is the Company proposing a change in the traditional treatment of uncollectible accounts expense in this proceeding?

A. Yes. Company Witness Michael T. Cline has filed tariffs proposing to shift collection of the portion of uncollectible accounts expense that is comprised of gas costs into the Purchased Gas Adjustment Clause ("PGA"). Such tariff change has the net effect of reducing the uncollectible accounts expense included in base rates. Such change has therefore been reflected in Adjustment 4.a.

Q. Why has the Company proposed this change in the regulatory treatment of uncollectible accounts?

A. We believe that the gas cost portion of uncollectible accounts expense is most appropriately recovered through the PGA, consistent with the treatment afforded all other gas costs. The clear intent of the PGA is to permit recovery of all gas costs incurred by the Company, subject to a review of the prudence of such costs. Simply because a customer ultimately fails to pay for such gas costs does not in any way change the character or nature of the costs. Given this consideration, there is no sound reason why such gas costs, in contrast to all other gas costs, should be recovered through base rates where they are subject to over- or under-recovery due to weather or other factors.

Q. But wouldn't recovery of this gas cost through the PGA eliminate the Company's incentive to collect delinquent accounts from its customers?

A. No, not at all. The portion of uncollectible accounts attributable to Laclede's margin would remain a component of base rates. Such amount in this case is over $4 million, which provides considerable incentive for the Company to continue its aggressive collection efforts.

Q. Total uncollectible accounts, including gas costs, have been included as a component of base rates for many years. Why are you suggesting a change to this longstanding practice now?

A. Uncollectible accounts are influenced by many factors, the most significant of which is the cost of gas. The extreme volatility in gas prices experienced in recent years has had a similar impact on uncollectible accounts. This subjects the Company and its customers to the risk of substantial over- or under-recovery of these costs.

Q. How did you calculate the level of bad debt expense to be included in base rates?

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, 2006 were allocated between the portions applicable to gas cost and distribution margin by comparing gas cost to net revenues. Net revenues used for this calculation are customer revenues less Transportation and Interruptible rate revenues, and less gross receipts tax expensed. The distribution margin portion was then divided by net revenues for the three years ending November, 2005. This calculation results in the percentage loss factor used to determine normalized bad debts applicable to the distribution margin and therefore recoverable through base rates. Future allocations of write-offs between distribution margin and gas cost would be calculated in the same manner.

Q. Why are different time periods used for purposes of determining the uncollectible accounts 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 distribution margin portion of 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, lesser 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 such payments, 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. All of these factors, in addition to increases and decreases in gas prices, have historically caused significant volatility in uncollectible accounts.

Q. Do you have any other comments regarding the appropriate method for recovery of uncollectible accounts?

A. Yes. In the event that the Commission does not choose to include the gas cost portion of bad debts in the PGA, then Laclede would propose as an alternative an uncollectible accounts expense tracker. Under such mechanism, the Company would be authorized to defer for recovery from, or return to, customers in a subsequent general rate case proceeding, 90% of the difference between the cumulative monthly net write-off amounts reflected in the base rates established in this case and the cumulative monthly net write-off amounts actually experienced subsequent to the effective date of rates in this case. Such deferred amounts, either negative of positive, would be amortized over a three year period as a component of the rates established in the next general rate proceeding.

Q. Why would the mechanism only defer 90% of the difference between the amount of this expense included in rates and the amount actually incurred by Laclede?

A. Once again, by only deferring for future inclusion in rates a portion of any change which occurs in this expense item, the tracker mechanism ensures that the Company will retain an incentive to pursue collection and other activities designed to mitigate the level of uncollectible expense it incurs.

Q. Is there any precedent for such a tracker mechanism?

A. Yes, such a tracking mechanism is very similar to ones that have previously been used by this Commission to address other volatile cost items that can also increase or decrease dramatically because of changes in market conditions and other factors beyond the control of the Company and are therefore difficult to predict with any precision when establishing rates. Among these are pension expense and even uncollectible expense increases associated with changes to the Commission's Cold Weather Rule.

Q. What would be the appropriate level to be included in base rates in the event that the Commission does not provide for recovery of the gas cost portion of bad debts through the PGA?

A. The percentage loss factor analysis, as described above, results in a total normalized bad debt level of $14,091,000, which would be the appropriate level to be included in base rates in the absence of PGA recovery.

**COLD WEATHER RULE AMENDMENTS**

Q. Please describe the Cold Weather Rule Amendments approved by the Commission in Case Nos. GX-2006-0181 and GX-2006-0434.

A. In Case No. GX-2006-0181, the Commission 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 retain service from January 1, 2006 through March 31, 2006. In Case No. GX-2006-0434, the Commission adopted certain of these terms on a permanent basis effective November 1, 2006 and also prescribed a specific mechanism designed to provide for the recovery of costs related to the amendments.

Q. Have you calculated the costs related to the amendments to the Cold Weather Rule?

A. Yes. Such costs have been calculated at $4,709,000 pursuant to the methodology prescribed in the rule. I have included a three year amortization of such amount in cost of service as part of adjustment 4.a., which includes an amount to reflect carrying costs at the Company's short-term borrowing rate for the period over which the amount will be recovered.

Q. Please continue.

A. It is important to realize that the cost of the amendment as calculated above is based on the status of participating customers' accounts at this point in time. Since additional activity will occur on these customers' accounts during the course of this case, the cost of the emergency and permanent amendments should be recalculated and adjusted upward or downward in the future as additional information becomes known. Laclede recommends that these costs be reexamined in a true-up.

## QUALIFIED PENSION AND OPEB EXPENSE FOR FINANCIAL REPORTING PURPOSES

Q. What basis of accounting does Laclede use to determine pension and other postretirement benefits ("OPEBs") 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. Laclede calculates its OPEBs expense on an accrual basis in accordance with Statement of Financial Accounting Standard No. 106, Employers' Accounting for Postretirement Benefits Other Than Pensions ("FAS 106"), which measures OPEB cost in much the same manner as FAS 87 measures pension cost. Laclede was first required to adopt the provisions of FAS 106 effective October 1, 1994.

Q. Please briefly describe the cost measurement objectives of FAS 87, FAS 88, and FAS 106.

A. One of the primary objectives is to ensure that pension and OPEB costs are assigned to the time periods in which benefits are earned. Another objective of these statements is to provide a basis for ensuring comparability of reported pension and OPEB cost between different companies, and consistency in amounts reported from period to period by an individual company.

Q. Please continue.

A. FAS 87 and FAS 106 establish the basic framework for calculating and accruing net pension and OPEB cost. They attempt to recognize the compensation cost of an employee's benefits over the approximate working life of that employee. Pension and OPEB costs are 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 liabilities are netted against changes in the value of plan assets to determine periodic net 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 and FAS 106 also provide 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.

Q. Are any changes to FAS 87, FAS 88, and FAS 106 anticipated?

A. Yes. The FASB recently issued SFAS No. 158, "Employers Accounting for Defined Benefit Pension and Other Postretirement Plans", which, among other things, requires that certain pension and OPEB balances previously disclosed only in the footnotes to the financial statements, be included on the balance sheet. Furthermore, the FASB has initiated a project that will re-examine all of the cost measurement principles expressed in FAS 87, FAS 88, and FAS 106. It is likely that this effort will result in a new standard that will replace FAS 87, FAS 88, and FAS 106. At this time, however, existing accounting standards are still in full force and effect.

## QUALIFIED PENSION PLAN EXPENSE FOR REGULATORY PURPOSES

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 terms of the stipulation and agreements approved in the Company's 2002 rate case (No. GR-2002-356) and continued in the Company's subsequent rate case (GR-2005-0284).

Q. Why were rates set on an alternative basis in those cases?

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. This methodology was continued in GR-2005-0284, except that the allowance in rates was increased to $4.1 million to reflect the fact that contributions to the pension funds had increased to about $.7 million.

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. The methodology has also resulted in a slow but steady decrease in the prepaid pension asset included in rate base, since it has provided for rate recovery in excess of cash contributions.

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

A. Laclede proposes the continuation of the successful ratemaking mechanism implemented in Case No. GR-2002-356 regarding pension expense. Such mechanism should continue to defer the difference between pension expense calculated pursuant to FAS 87 and FAS 88 (or any successor issued by the FASB) and the amount included in rates. We have included pension expense in rates of $6.2 million in this case, in Adjustment 5.a.

Q. Why have you increased the pension expense recovery from the $4.1 million included in GR-2005-0284?

A. While contributions to the Company's pension funds are currently less than $1 million annually, we expect that such contributions will increase substantially in the future. It would be desirable to increase rate recovery now so that rates and cash contributions will be more in sync when such increase in contributions occurs. Moreover, in the interim period prior to when such contribution increases occur, the additional amounts reflected in rates will serve to decrease the prepaid pension asset at a slightly quicker pace, consistent with the objectives established in the 2002 rate case.

## 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 are entitled to benefit payments 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 5.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 has resulted in the creation of the net prepaid pension asset, has 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, 2007 accrued pension liability balances against estimated March 31, 2007 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 Nos. GR-2002-356 and GR-2005-0284 discussed above). Balances for the SERP and Directors Plans are excluded since rate recovery for these plans has been based on actual payments rather than expense recovery.

**OPEBs**

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, postretirement benefit expense was calculated on an accrual basis in accordance with FAS 106. Pursuant to such authorization, Laclede calculates FAS 106 on a financial reporting basis that comports with the requirements of FAS 106, and a regulatory basis that includes an amortization basis not permissible under FAS 106. The regulatory basis is included in the Company's rates, and the difference between the two is deferred as a regulatory asset or liability. Normalization of FAS 106 expense based on the most recent actuarial valuation is included in Adjustment 5.b. FAS 106 measures OPEB cost in much the same manner as pension cost is measured by FAS 87.

Q. Have previous Commission Report and 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?

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. You mentioned earlier that the FASB has initiated a project to re-examine the cost measurement principles expressed in FAS 106. What impact will this have?

A. It is likely that FAS 106 will be superseded by a new standard. The calculations related to OPEB expense may change significantly.

Q. Could this cause any problems with the current ratemaking arrangement?

A. Yes. Any new standard could result in expense that is substantially different that that calculated pursuant to FAS 106. Therefore, the amount allowed in rates could be much different than expense calculated under the new standard, resulting in significant over or under recovery.

Q. What do you propose in response?

A. I recommend that the Commission adopt a ratemaking methodology similar to that successfully used in relation to pensions. The Commission should designate a fixed amount included in rates based on the most recent calculation of expense pursuant to the FAS 106 methodology, and provide for deferral of the difference between that amount and expense as calculated pursuant to whatever FASB standard is in place following the effective date of rates in this case. Such deferral would be subject to recovery or payment in future rates.

## 401(k) EXPENSES

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 in Adjustment 5.c.

Q. Do you have any other comments regarding 401(k) expenses?

A. Yes. 401(k) expenses are a component of the Company's pension expense which is in addition to the qualified pension plan expenses discussed above. Companies and employees tend to consider these programs together as they consider the costs and the appropriate structure for delivery of retirement benefits. As companies such as Laclede review the structure of their retirement programs, future structural changes could result in changes in both the 401(k) and qualified pension plans, and therefore we recommend that the deferral mechanism currently in place for the qualified pensions be expanded to also encompass the 401(k).

**BOARD OF DIRECTORS FEES**

Q. Please describe your next adjustment.

A. Adjustment 5.l. normalizes retainer fees and meeting fees paid to the Board of Directors to current levels.

**WAGES AND SALARIES**

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

A. Adjustment 6 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, 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, 2006, 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, 2007, and also adjusts to the normal level of employees anticipated at March 31, 2007.

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 2.5% and clerical workers of 2.0% effective April 15, 2006 in accordance with the current labor agreement. In addition, this adjustment increases wage expense for the effect on operation and maintenance expense of an increase in labor rates on April 15, 2007 which will occur as a result of the labor contract. 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, 2007.

Q. Please explain the adjustment to management salaries.

A. Management salaries were adjusted to reflect anticipated salary levels at March 31, 2007. 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.

Q. Have you made any other adjustments to wages and salaries?

A. Yes. I have removed from cost of service the bonus plan and incentive compensation plan expense experienced in the test year.

**AUTOMATED METER READING ("AMR")**

Q. Please describe Laclede's efforts to install an AMR system.

A. On March 11, 2005, the Company entered into a 15-year agreement with Cellnet Technology, Inc. to provide meter readings on virtually all of the Company's meters (there will be about 1,000 commercial meters that will continue to be read manually). Under the agreement, Cellnet provides meter readings at a fixed cost per read and is responsible for ownership, installation, operation, and maintenance of the system. Cellnet began deployment of the system in July 2005 and is, at this writing, in the final stages of such deployment.

Q. Why did Laclede decide to pursue an AMR system?

A. AMR will provide a significant enhancement in customer service. Estimated readings will be essentially eliminated, customers will no longer incur service initiation fees in cases where it is not necessary to physically turn on the flow of gas, and customers will not be required to be present to provide access to Company employees to obtain meter readings.

Q. What adjustments to the test year are necessitated by implementation of AMR?

A. Adjustment 3.b. normalizes service initiation fees based on the lower level resulting from implementation of the system. Adjustment 4.d normalizes the fees paid to Cellnet to ongoing levels anticipated upon full implementation of the system, removes from the test year one-time expenses associated with notifying and informing customers of the AMR implementation, and removes from the test year dismissal pay paid to Meter Readers pursuant to the Company's labor contract with its union employees. Offsetting savings in manpower requirements are reflected in the employee levels included in my adjustment to wages and salaries.

## INCENTIVE COMPENSATION PLAN/BONUS PLAN/EQUITY PLAN

Q. Please describe Laclede's Incentive Compensation Plan.

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. 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.

Q. Please describe the Company's Bonus Plan.

A. This plan provides for a portion of certain executives' and employees' total compensation to be paid in the form of an annual bonus. Payment of such bonuses is dependent on achievement of initiatives that improve the efficiency of the Company's operations, which benefits Laclede's customers.

Q. Please describe the Equity Plan.

A. Under the Equity Plan, a portion of certain executives' and employees' compensation is paid in the form of stock options or performance contingent restricted stock. This plan is designed to align employees' interests with the long-term health of the Company.

Q. Have you included adjustments to test year expenses related to these plans?

A. Yes. I have removed expenses related to the equity plan from test year expenses in Adjustment 5.j. Expenses related to the incentive compensation and bonus plans have been removed from cost of service as part of the pension and wage and salary adjustments.

Q. Why have you excluded these expenses from cost of service?

A. The Company has proposed a comprehensive Regulatory Compact which would govern the provision of service to its customers for at least the next three years. Laclede believes that these plans provide significant value to its customers by encouraging retention of competent management and improvements in the Company's operations. Nevertheless, the Company is willing to exclude such costs as part of the shareholders' contribution to the incentive features of the overall Regulatory Compact proposed in this case.

## NON-UTILITY ALLOCATIONS

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

A. Adjustment 7.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.

## TAXES OTHER THAN INCOME TAXES

Q. Please describe the adjustments you have made to taxes, other than income taxes.

A. Adjustment 9.a. calculates the adjustment of property taxes and manufacturers' license expense to reflect the decrease in assessed value at January 1, 2006 and anticipated at January 1, 2007, and for the unrealized portion of such taxes applicable to net utility plant at March 31, 2007, at tax rates which were in effect during calendar year 2006.

Q. Please continue.

A. Adjustment 9.b. increases FICA expense to reflect the increased wage and salary level described earlier in my testimony and reflected on Adjustment 6. Adjustment 9.c. adjusts State Unemployment Taxes for the taxable wages and increased tax rate that will be effective January 1, 2007. Adjustment 9.d. reflects the increase in the City of St. Louis Payroll Expense Tax resulting from the wage and salary level changes made in Adjustment 6. Adjustment 9.f. reduces Missouri Corporate Franchise tax to a normal level.

## INCOME TAXES

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 10 on Schedule 5. Page 1 of Schedule 6 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 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 matches the lives used for calculating book depreciation as reflected in Adjustment 8.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.

## GAS SAFETY ACCOUNTING AUTHORITY ORDERS

Q. Please explain the deferrals related to the Gas Safety Replacement Program and Copper Service Replacement Program.

A. The Commission previously permitted deferral of costs related to these programs for recovery in subsequent rate cases since mandated replacements under these programs produce higher costs but have no effect on revenues. New deferrals under these AAOs were discontinued in the Company's 2005 rate case since the Infrastructure System Replacement Surcharge now provides a mechanism to provide for recovery of these costs.

Q. Have you included any adjustment related to amounts previously deferred under these accounting authority orders?

A. It is not necessary to make an adjustment to expense since the amortization expense included in the test year pursuant to past Commission orders is equal to a normalized amount going forward. However, I have included in rate base the outstanding balances accrued pursuant to the authority granted in prior cases.

## TARIFF CHANGE

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

A. Yes. I am proposing a change that would permit the Company to improve its practices related to collection of delinquent accounts. This change is detailed on specimen tariff sheet R-5-c attached to the direct testimony of Michael Cline.

Q. Please explain.

A. I propose a change to the Company's tariffs that will clarify the Company's right to collect a deposit from a potential customer in advance of establishing service. Such deposit would be subject to the existing rules regarding deposit assessment.

Q. Why in your view is the right to collect a deposit prior to initiating service necessary?

A. In a significant number of instances, customers who have their service connected or reconnected will fail to make any subsequent payment on their bills. Under these circumstances, the current ability to demand that a customer pay a deposit in installments is completed inadequate to protect the Company and its other customers from the creation of an uncollectible expense. Simply put, if the customer fails or refuses to pay his or her bill in its entirety, the customer will not be paying the deposit that is designed to guard against that very eventuality. Allowing the Company to collect such deposits up front would correct this obvious deficiency.

Q. Does this conclude your direct testimony?

A. Yes, it does.

**BEFORE THE PUBLIC SERVICE COMMISSION**
**OF THE STATE OF MISSOURI**

| | | |
|---|---|---|
| In the Matter of Laclede Gas Company's | ) | |
| Tariff to Revise Natural Gas Rate Schedules | ) | Case No. GR-2007-0___ |

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.

Jas A. Fallert
James A. Fallert

Subscribed and sworn to before me this 30th day of November, 2006.

Karen A. Zurliene
Notary Public

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