BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

FILED
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Missouri Public
Service Commission

In the matter of Laclede Gas Company's)
Tariff to Revise Natural Gas Rate)
Schedules.)

Case No. GR-99-315

A F F I D A V I T

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, consisting of pages 1 to 23, inclusive; and Section C - Schedules 1, 2, 15, 18 and 20.

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 10th day of March, 1999.

PATRICIA P. HICKS
Notary Public — Notary Seal
STATE OF MISSOURI
City of St. Louis
My Commission Expires: June 27, 2002

Patricia P. Hicks

Exhibit No.:	
Issue:	Test Year, Update and True-Up Accounting Schedules Deferral Mechanisms
Witness:	James A. Fallert
Type of Exhibit:	Direct Testimony
Sponsoring Party:	Laclede Gas Company
Case No.:	GR-99-315

LACLEDE GAS COMPANY

GR-99-315

DIRECT TESTIMONY

OF

JAMES A. FALLERT

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 St., St. Louis, Missouri 63101.

Q. What is your present position?

A. I am Controller of Laclede Gas 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, customer accounting, budget, and financial planning functions.

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, and GR-98-374.

<u>Purpose of Testimony</u>

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. Wages and Salaries
4. Supplemental Employee Retirement Plan (SERP) and Directors' Pensions
5. Incentive Compensation Plan
6. Tracker Deferral Mechanisms
7. Cost Deferral Mechanisms
8. Information Systems Maintenance Expense

Q. Please list the schedules you are sponsoring.

A. The following schedules were prepared by me or under my supervision:

Section C, TEST YEAR UTILITY OPERATING INCOME AND ADJUSTMENTS: Schedules 1, 2, 15, 18, and 20. These schedules contain the income statement as well as supporting detail for the wage and salary adjustment, SERP and Directors' pension adjustment, and amortization of deferrals made pursuant to accounting authority orders granted by the Commission. The income statement and adjustments are described 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 December 31, 1998, 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 December 31, 1998 and to provide for reasonable changes which will be known and measurable by March 31, 1999. These adjustments to the test period reflect data that are more contemporaneous to the time when rates will go into effect.

The proposed test year ended December 31, 1998 is formally recommended in a separate pleading filed concurrent with this testimony.

Q. Why was the historical test year ending December 31, 1998 selected?

A. This period represented the most recent annual period 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 adjustments to the December 31, 1998 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 and GR-98-374).

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, 1999 or April 30, 1999 business, depending upon the procedural schedule established in this case. The Company's filed case includes the estimated effect of a March 31 update, but it would be appropriate to update to April 30 if time permits. The Company also proposes certain reasonable isolated adjustments which will occur subsequent to the update period, but which will be in effect during the period new rates from this proceeding are in effect.

Q. Do you have any additional comments?

A. Yes. Company witness D. H. Yaeger discusses how the effect of cost increases and the use of historical test periods can make it difficult for the Company to recover its costs. These considerations underscore the importance of updating financial information and recognizing reasonable isolated adjustments in the ratemaking process.

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

A. Yes. There are several significant events which are anticipated to occur in the months subsequent to the update period. These include, but are not limited to, possible issuance of common equity and first mortgage bonds, implementation of a new lock box agreement for processing of customer payments, implementation of computer systems which have been developed in anticipation of the Year 2000 (including, without limitation, a new general ledger system expected to go on line this spring), a possible change in the annual assessment paid to the Commission, and changes in the labor rates paid under the Company's union labor contracts. Laclede continues to believe that such items can reasonably be included as isolated adjustments, and would be willing to explore means of including them without the need for the time and expense of a true-up audit and hearing. However, the Company believes that the significance of these items makes a true-up essential if they cannot be included by other means.

A true-up is formally requested in a separate pleading filed concurrent with this testimony.

Adjustments to Utility Operating Income

Q. Please explain what is contained in Schedule 1 of Section C.

A. This schedule shows the amounts recorded in the Company's books and records for the year ended December 31, 1998 for all the items of utility operating revenues and operating expenses and shows as a final total 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 December 31, 1998. The adjustments shown in the second column are listed and summarized on Pages 1 through 5 of Schedule 2 of this Section. Each of these adjustments is described by the sponsoring Company witness and most are detailed on Schedules 3 through 24.

Q. Please summarize the adjustments to utility operating expenses which you are sponsoring on Schedule 2 of Section C.

A. I am sponsoring adjustments to wages and salaries, SERP and Directors' pensions, and amortization of balances deferred pursuant to trackers and accounting authorizations previously approved by the Commission in Case Nos. GR-96-193 and GR-98-374.

Wages and Salaries

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

A. Adjustment 5 on Schedule 2 of Section C is made to reflect known and measurable changes in the level of wages and salaries applicable to operation and maintenance expense. Detail for this adjustment is shown on Schedule 18 of Section C.

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

A. The Company's current labor contract with its Laclede Division union employees includes, among other changes, 2.5% annual increases in wage rates effective August 1, 1997, August 1, 1998, and August 1, 1999. Laclede Division contract wages charged to operation and maintenance were normalized to include the current labor contract provisions which were effective August 1, 1998, 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 of the impact of the change in labor contract provisions which will occur on August 1, 1999.

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

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

Q. What was the purpose for these adjustments?

A. The weather during the test year ended December 31, 1998 was considerably warmer than normal. In fact, the period was among the warmest years on record in Laclede's service area. As a result, the manpower requirements needed to operate the system were not consistent with normal operations. Additionally, an unusually large proportion of Information System's personnel have been allocated to capital work during the test year as new systems are developed in response to the Y2K problem. This further explains the unusually low proportion of payroll allocated to operations and maintenance during the test period. With the implementation of these systems in the months ahead, these employees' time will once again be charged to operations. I have used a five-year average for overtime and operations and maintenance expense in order to adjust the expense associated with manpower requirements to a more representative 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 of 2.5% effective April 15, 1998 in accordance with the current labor agreement for that Division. In addition, this adjustment increases wage expense for the effect on operation and maintenance expense of the increase in labor rates which will occur on April 15, 1999 under the provisions of the current labor contract. Additionally, the operation and maintenance percent was adjusted to a five-year average for the reasons discussed earlier in my testimony.

Q. Please explain the adjustment to management salaries.

A. Management salaries were adjusted to reflect anticipated salary levels at March 31, 1999. Additionally, Missouri Natural Division management salaries were increased to reflect an anticipated increase on July 15, 1999. All Missouri Natural Division management employees' salaries are adjusted each July 15. The Company will quantify the actual amount of this increase when it becomes known. The operation and maintenance percent for management salaries was also adjusted to a five-year average.

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

A. Yes, I have included the effect of an additional Company holiday on Martin Luther King Day in wages and salaries charged to operation and maintenance.

Q. Why are you including a cost to Laclede associated with this holiday?

A. The Company's current labor agreement with locals 5-6 and 5-194 of the Oil, Chemical, and Atomic Workers, ratified by these unions on June 30, 1997, includes the addition of a holiday on Martin Luther King Day for each employee. Under the terms of the agreement, the first such holiday was celebrated on January 15, 1999. Laclede has also extended this benefit to management employees. It is necessary to adjust test year payroll to replace the man hours lost as a result of celebration of this holiday since there was no Company holiday on Martin Luther King Day in effect during the test year. For example, the addition of this holiday required the Company to schedule a Saturday in January 1999 as a regular billing day in order to maintain its billing schedule. This caused departments operating the billing system to schedule overtime work on that Saturday.

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 sponsored by Company witness R. L. Krutzman and in the 401(k) adjustment sponsored by Company witness S. M. Kopp.

<u>SERP and Directors' Pension Expense</u>

Q. Please explain the adjustment to SERP and Directors' pension expense.

A. Adjustment 4.c. detailed on Schedule 15 of Section C, adjusts test year pension expense to reflect the estimated cost of benefits provided by the SERP and Directors' pension plans.

Q. What basis of accounting was used to determine pension expense for these plans?

A. As authorized by the Commission in the Company's last three general rate proceedings (Case Nos. GR-94-220, GR-96-193 and GR-98-374), SERP and Directors' pension expenses have been calculated on a "payment" basis.

Q. Does calculation of these costs on a payment basis allow for appropriate recovery of these costs?

A. Yes, when combined with the implementation of a tracker deferral mechanism as discussed later in my testimony.

Q. How was the level of SERP and Directors' pension cost included in cost of service determined?

A. SERP and Directors' pension cost represents the annualized level of payments currently being made to retirees pursuant to the provisions of these plans.

<u>Incentive Compensation Plan</u>

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 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 sponsored earlier in my testimony. The retirement portions are normalized by Company witness M. D. Waltermire in his adjustment regarding pensions and postretirement benefits.

<u>Tracker Deferral Mechanisms</u>

Q. Please define a "tracker" as the term is used in your testimony.

A. A tracker is a deferral mechanism in which a specified amount of expense is designated as being recovered in rates authorized by the Commission. Actual costs above or below this amount are deferred for subsequent recovery from or return to ratepayers in a future rate case. Trackers can result in the creation of either regulatory assets to be recovered from ratepayers or regulatory liabilities to be returned to ratepayers.

Q. What trackers are currently in use by Laclede?

A. Laclede is currently employing two trackers which were reauthorized by the Commission in its previous rate case (Case No. GR-98-374). These trackers were established in Case No. GR-94-220 and continued in Case No. GR-96-193. The trackers are for SERP and Directors' pension costs, and postretirement benefits other than pensions (OPEB).

Q. What is the purpose of the SERP/Directors' Pension Tracker?

A. Recovery of these costs has been established on a payment basis, meaning that the cost recovery included in the calculation of rates has been based on a normalization of actual dollars paid out in benefits. Actual payment levels can be extremely volatile from period to period, in particular due to the timing and amount of lump sum benefits paid under these plans. The tracker permits accurate recovery of these costs regardless of the changes in the actual amounts being paid.

Q. What is the purpose of the OPEB Tracker?

A. Laclede adopted Statement of Financial Accounting Standard No. 106 (FAS 106), "Employers' Accounting for Postretirement Benefits Other Than Pensions" in fiscal 1994. This standard changed the accounting for OPEBs from a payment basis (in which amounts expensed were based on actual benefit payments) to an accrual basis (in which expenses are based on actuarial calculations of the benefits being earned by active employees and those owed to retirees). In 1994, the Missouri Legislature passed a statute mandating the use of FAS 106 in ratemaking if the costs were funded in an independent funding mechanism. Laclede's rates in Case No. GR-94-220 were based on FAS 106, and the Company established the aforementioned funding mechanisms. At the time of adoption of FAS 106 for accounting and ratemaking purposes, there was concern among the participants in Case No. GR-94-220 that FAS 106 costs would be unacceptably volatile, and the tracker mechanism was implemented as a means to ensure accurate recovery of FAS 106 costs in rates.

Q. Please describe the adjustments you have made in regard to the trackers discussed above.

A. The following adjustments on Schedule 2 of Section C provide for recovery over a five-year period of payments of amounts deferred to Account No. 182.3 pursuant to the trackers. Detail of these adjustments is included on Schedule 20 of Section C.

1. Adjustment 6.e. provides for return of OPEB credit balances to ratepayers deferred pursuant to authority granted in Case No. GR-96-193. These amounts were not addressed in Case No. GR-98-374, but the Commission authorized the balance to be rolled forward for consideration in the instant case.
2. Adjustment 6.c. provides for recovery of SERP/Directors expenses deferred pursuant to authority granted in Case No. GR-96-193. These amounts were handled in a manner similar to the above in Case No. GR-98-374.
3. In Case No. GR-98-374, the Commission "granted accounting authorization to continue to defer and book to Account 182.3 for inclusion in rates established in Laclede's next general rate case proceeding" the difference between the cumulative OPEB contributions made by the Company and the cumulative allowance specified in the order. Adjustment 6.f. provides for recovery of amounts deferred pursuant to this authority.
4. In Case No. GR-98-374, the Commission "granted accounting authorization to continue to defer and book to Account 182.3 for inclusion in rates established in Laclede's next general rate case

proceeding" the difference between the SERP payments made by the Company and the cumulative allowance specified in the order. Adjustment 6.d. provides for recovery of amounts deferred pursuant to this authority.

Q. Why did you use a five-year period for amortization of these balances?

A. While the trackers approved in Rate Case No. GR-98-374 may technically warrant a shorter recovery period, Laclede believes that five years provides a relatively timely recovery of these balances while avoiding too great an impact on current rates. The five year amortization period is consistent with Commission practice in other areas such as amortization of gains and losses under FAS 87 and FAS 106.

Q. Are you sponsoring any other adjustments relative to these trackers?

A. Yes. I have included the outstanding balances in rate base.

Q. Does Laclede propose that the tracker deferral mechanisms established in Case No. GR-94-220 and continued in Case Nos. GR-96-193 and GR-98-374 relating to SERP and Directors' pension cost and OPEBs continue to be used?

A. Yes, it does. Laclede believes that the reasons which justified the initial grant of this authority by the Commission continue to exist. Accordingly, Laclede requests that the Commission authorize the continued use of such tracker deferral mechanisms for a period beginning with the update or true-up period of this proceeding and continuing through the effective date of new rates established in its next general rate case proceeding.

<u>Cost Deferral Mechanisms</u>

Q. What cost deferral mechanisms are currently being used by Laclede?

A. The Commission authorized three such deferrals in Laclede's previous rate case (Case No. GR-98-374). These deferrals relate to Laclede's Safety Replacement Program (SRP), Manufactured Gas Plants (MGP), and Year 2000 Costs (Y2K). The SRP and MGP deferrals were originally authorized in Case No. GR-94-220, and were reauthorized in Case No. GR-96-193 and GR-98-374. The Y2K deferral was newly authorized in Case No. GR-98-374.

Q. Please explain the deferral related to the Safety Replacement Program.

A. The Company incurs significant costs on projects related to this program 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. 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 orders in Case Nos. GR-96-193 and GR-98-374, Laclede has deferred and booked to Account 182.3 the costs incurred for replacement of service lines and replacement and cathodic protection of bare steel and cast iron mains, as well as associated work on other facilities. Such costs include depreciation, property taxes, and carrying costs which would normally have been expensed beginning with the in-service date. Costs deferred also include inspection of customer-owned buried fuel lines pursuant to the Commission's order in Case No. GO-95-362 and subsequent reauthorization in Case Nos. GR-96-193 and GR-98-374. Adjustment 6.g. on Schedule 2 of Section C includes recovery of costs deferred pursuant to authority granted in Case No. GR-96-193. This amount was not addressed in Case No. GR-98-374, but the Commission authorized the balance to be rolled forward for consideration in the instant case. Adjustment 6.h. provides for recovery of costs deferred pursuant to authority granted in Case No. GR-98-374, as estimated through March 31, 1999. Detail of these adjustments is included on Schedule 20 of Section C.

Q. Please explain the deferral related to MGP.

A. MGP costs arise as a result of federal and state environmental laws and regulations which require that certain wastes and by-products found at former MGP sites be remediated. The costs of this activity include, among others, all of the costs of: (1) the investigation, assessment, removal, disposal, storage, remediation or other treatment of residues, substances, materials and/or property that are associated with former manufactured gas operations or located on former manufactured gas sites; (2) the dismantling or removal of facilities formerly utilized in manufactured gas operations; (3) efforts to recover such costs from potentially responsible third parties and insurance companies; and (4) payments received by Laclede as a result of such efforts. A discussion regarding the nature of those MGP-related costs incurred by Laclede is contained in the testimony of Company witness C. R. Hoeferlin. Deferral of these costs is appropriate because they are not predictable in timing and amount as each MGP site can be very different in terms of its construction and operation, the nature and extent of any waste found, and the type and extent of any clean-up required. This mechanism is an appropriate means to ensure recovery of these costs.

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

A. Yes. Adjustment 6.i. on Schedule 2 of Section C includes recovery of costs deferred pursuant to authority granted in Case No. GR-96-193. This amount was not addressed in Case No. GR-98-374, but the Commission authorized the balance to be rolled forward for consideration in the instant case. Adjustment 6.j. provides for recovery of costs deferred pursuant to authority granted in Case No. GR-98-374, as estimated through March 31, 1999. Detail of these adjustments is included on Schedule 20 of Section C.

Q. Please explain the Y2K deferral.

A. Like most companies, Laclede has undertaken a comprehensive program to update, convert, and replace portions of its information systems to ensure that they will function adequately beyond the Year 2000. In Case No. GR-98-374, the Commission authorized the Company to defer property tax, depreciation and amortization, and all other expenses and carrying costs related to this program which normally would have been expensed on the in-service date. Laclede believes that the extraordinary nature and considerable cost of the Y2K program makes it an appropriate item for such treatment.

Q. Have you included such recovery in this case?

A. Yes. Adjustment 6.k. on Schedule 2 of Section C provides for recovery of costs deferred pursuant to authority granted in Case No. GR-98-374, as estimated through March 31, 1999. Details of this adjustment are included on Schedule 20 of Section C.

Q. Are you sponsoring any other adjustments related to the SRP, MGP, and Y2K cost deferral mechanisms?

A. Yes. I have included the outstanding balances in rate base.

Q. What amortization period have you used for recovery related to the SRP, MGP, and Y2K cost deferral mechanisms?

A. I have used a five-year amortization period for the same reasons cited in my previous discussion of trackers.

Q. Does Laclede propose that the SRP, MGP, and Y2K cost deferral mechanisms continue to be used?

A. Yes, it does. Laclede believes that the reasons which justified the initial grant of authority by the Commission continue to exist. Accordingly, Laclede requests that the Commission authorize the continued use of such cost deferral mechanisms for a period beginning with the update or true-up period of this proceeding and continuing through the effective date of new rates established in its next general rate case proceeding. However, the Company would support eliminating these mechanisms when the reasons prompting their implementation no longer exist.

Information Systems Maintenance Expense

Q, Please describe information systems maintenance expense.

A. These are costs incurred by the Company with various vendors for the maintenance of its computer hardware and software.

Q. Are any changes in the test year level of these costs anticipated?

A. Yes. As part of its efforts to address the Year 2000 problem and improve and upgrade its information systems, the Company is currently in the process of updating many of its hardware and software arrangements with outside vendors. These new arrangements are expected to result in changes in the level of expense devoted to information system maintenance costs compared with the level experienced in the test year.

Q. Have you made an adjustment to test year expense to reflect these changes?

A. No. At this time, the impact of these new arrangements is not readily quantifiable since the new systems are currently being developed and implemented. However, it is expected that, during the course of this case, the effect of such arrangements will become known. Laclede will include an adjustment for these items if appropriate when the case is updated and/or trued up.

Q. Does this conclude your testimony?

A. Yes.