Exhibit No.:
Issues: *Affiliated Operations; HVAC and Home Sale Inspection; Injuries and Damage; Insurance; 401(k) Expenses; Pensions and OPEBs; Non-Qualified Pension Plan Expenses; and Income Taxes*
Witness: *Paul R. Harrison*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Direct Testimony*
Case No.: *GR-2007-0208*
Date Testimony Prepared: *May 4, 2007*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

PAUL R. HARRISON

LACLEDE GAS COMPANY

CASE NO. GR-2007-0208

Jefferson City, Missouri
May 2007

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Q. Please state your name and business address.

A. Paul R. Harrison, P. O. Box 360, Jefferson City, Missouri 65102.

Q. By whom are you employed and in what capacity?

A. I am a Utility Regulatory Auditor for the Missouri Public Service Commission (PSC or Commission).

<u>BACKGROUND OF WITNESS</u>

Q. Please describe your educational background.

A. I graduated from Park College, Kansas City, Missouri, where I earned a Bachelor of Science degree in Accounting and Management in July of 1995. I also earned an Associate degree in Missile Maintenance Technology from the Community College of the Air Force in June 1990.

Q. Please describe your work background prior to working at the Commission.

A. Prior to coming to work at the Commission, I was the manager for Tool Warehouse Inc. for four and one-half years. As the manager, I supervised eight sales representatives and managed merchandise and inventory in excess of $1.5 million.

Prior to that, I was in the United States Air Force (USAF) for 23 years. During my career in the USAF, I was assigned many different duty positions with varying levels of responsibility. I retired from active duty on May 1, 1994 as Superintendent of the

321st Strategic Missile Wing Missile Mechanical Flight. In that capacity, I supervised 95 missile maintenance technicians and managed assets valued in excess of $50 million.

Q. Please describe your duties while employed by the PSC.

A. My duties at the Commission include performing audits of the books and records of regulated public utilities under the jurisdiction of the PSC, in conjunction with other Commission Staff (Staff) members. Acting in that capacity, I am also required to prepare testimony and serve as a Staff expert witness on cases involving the ratemaking issues that I am assigned.

Q. Have you previously filed testimony before this Commission?

A. Yes. Schedule 1 lists the cases in which I filed testimony, the issues that I have been assigned to and the small informal cases that I have completed.

Q. Did you make an examination and analysis of the books and records of Laclede Gas Company (Laclede, Laclede Gas or Company) in regard to matters raised in this case?

A. Yes, in conjunction with other members of the Staff. I specifically examined information provided by the Company in response to Staff data requests, portions of the Company's general ledger, other Company financial and statistical reports, as well as workpapers supplied by Laclede to support its case filing. I also examined the Company's Securities and Exchange Commission (SEC) filings and other information contained on the Company's website.

Q. What knowledge, skill, experience, training or education do you have in these matters?

A. I have performed duties as a Utility Regulatory Auditor within the Auditing Department at the Commission since January 18, 2000. In addition to acquiring general knowledge of these topics through my education, I've acquired experience in prior rate cases before the Commission as well as through formal and informal training.

Q. Please describe the formal training for your position that you have received.

A. I attended the National Association Regulatory Utilities Commissioner's (NARUC) Water Rate School in San Diego, California in May of 2000. I also attended NARUC's "On The Missouri" 2003 seminar conducted in Jefferson City, Missouri in January 2003.

Q. Please describe the informal training for your position that you have received.

A. I have successfully completed each of my assigned issues, as listed in Schedule 1, and have had the opportunity to interact with other auditors concerning these and other issues that involved the Auditing Department of the Commission.

I have attended in-house training classes, reviewed Auditing Department position papers, training manuals and technical manuals pertaining to the ratemaking issues in this and other cases.

I have reviewed the Commission's Report and Orders, testimony and transcripts of cases filed by this and other utilities within the jurisdiction of this Commission

EXECUTIVE SUMMARY

Q. Please summarize your direct testimony in this proceeding.

A. The purpose of my testimony is to sponsor and discuss the following Staff Income Statement adjustments, which appear on Accounting Schedule 10, Adjustments to Income Statement:

Affiliated Operations	S-16.29
Injuries and Damages	S-16.10
Insurance	S-16.21
401(k) Expense	S-16.6
Pension Expense	S-16.3 and S-16.18
OPEBs - FAS 106 Expense	S-16.5
Non-Qualified Retirement Plans	S-16.4
Current Income Taxes	S-20.1
Deferred Income Taxes	S-21.1

I am also sponsoring Accounting Schedule 11, Income Tax.

<u>AFFILIATED OPERATIONS</u>

Q. Can you provide a description of Laclede's affiliated operations?

A. Yes. Beginning September 1, 2001, Laclede and its former subsidiaries were reorganized under a holding company structure. Under this new structure Laclede Gas, as well as its former subsidiaries, became subsidiaries of The Laclede Group. The following is a description of the subsidiaries contained within The Laclede Group structure, other than Laclede Gas:

Laclede Investment LLC is a non-regulated wholly-owned subsidiary of Laclede Group, which invests in other enterprises and has made loans to several joint ventures engaged in real estate development.

Laclede Energy Resources, Inc. (LER) is a non-regulated wholly-owned subsidiary of Laclede Investment LLC, which is engaged in non-regulated efforts to market natural gas to both on-system utility transportation customers and customers outside of Laclede Gas' traditional service area and related activities.

Laclede Gas Family Services, Inc. is a non-regulated wholly-owned subsidiary of LER, which is a registered insurance agency in the state of Missouri.

Laclede Pipeline Company (Laclede Pipeline) became a Federal Energy Regulatory Commission (FERC) regulated wholly-owned subsidiary of Laclede Group in April 2006. This subsidiary operates a propane pipeline that connects the propane storage and vaporization facilities of Laclede Gas to third-party propane supply terminal facilities located in Illinois.

Laclede Development Company is a non-regulated wholly-owned subsidiary of Laclede Group, which participates in real estate development, primarily through joint ventures.

Laclede Venture Corporation is a non-regulated wholly-owned subsidiary of Laclede Development Company, which offers services for the compression of natural gas to third parties who desire to use or to sell compressed natural gas for use in vehicles.

On January 28, 2002, Laclede Group completed its acquisition of 100% of the non-regulated stock of SM&P, one of the nation's major underground locating and marking service businesses. SM&P, a Carmel, Indiana-based company, operates across the mid-western states. Locators mark the placement of underground facilities for providers of telephone, natural gas, electric, water, cable TV and fiber optic services so that construction work can be performed without damaging buried facilities.

Q. What was the purpose of your examination of the Company's affiliated operations?

A. The purpose was to determine if Laclede's cost of service included any costs related to non-regulated operations. If Laclede's cost of service included any non-regulated costs, then the Company's utility ratepayers would be subsidizing these non-regulated subsidiary operations.

Q. How was the review conducted by the Staff?

A. The Staff submitted data requests, conducted meetings with the Company and reviewed the Company's 2002 though 2006 Cost Allocation Manual (CAM) submissions to the Commission, SEC filings and Board of Directors meeting minutes.

Q. What were the results of this review?

A. The Company's CAM submissions show that Laclede Gas provides business and service development, strategic development and planning, corporate communication, customer services, executive, finance and accounting, human resources, information systems, internal audit, legal, marketing, payroll, purchasing, tax, and treasury and risk management functions in support of Laclede Group non-regulated affiliates. During the test year, Laclede Gas was allocated $269,164,941 or approximately 90.94 percent of all affiliated costs. In comparison, the Laclede Group and its non-regulated affiliates were allocated $26,806,199 or approximately 9.06% of all affiliated costs. $24,056,868 of the Laclede Group's non-regulated allocations was energy related costs, which consist of the cost of off-system sales and capacity release transactions allocated to LER. Excluding these energy-related costs, the remainder of the Laclede Group non-regulated allocation amounts to approximately $2,749,331, or 1.60%. In other words, 98.4% of total Laclede Group costs (excluding energy related costs) are charged to the regulated Laclede Gas operations.

Q. What concerns does the Staff have with the Company's allocation process?

A. The main concern that the Staff has with the Company's allocation process is the allocation of labor related costs. During fiscal year 2006, the Company spent $151,303,563 on labor related costs. Of this amount, 98.91% or $149,658,091 is directly or indirectly assigned to Laclede Gas. In comparison, approximately 1.09% or $1,645,472 of this amount is assigned to the Laclede Group non-regulated subsidiaries. Many of the Laclede Groups non-labor cost allocation methodologies are, in turn, based upon the labor allocation, so that if labor costs are not charged correctly this failure affects non-labor cost allocations as well. To obtain a better understanding of how labor costs were allocated between the affiliates during the test year, the Staff sampled some of the timecards submitted in the test year by Laclede Group officers and executives with responsibilities over both regulated and non-regulated operations. The time cards reviewed by the Staff indicate possible problems with the amount of time charged by officers and executives to non-regulated Laclede Group affiliates. For example, the Executive Vice-president of Energy and Administration Services for Laclede Gas, Mr. Kenneth J. Neises, records directly 97.18% of his time to the regulated utility, Laclede Gas. This individual is also the Vice President of LER, and the full-time general manager of LER reports directly to him. However, the Vice-president of LER directly records only 1.49 % of his time to the non-regulated Laclede Group affiliate, LER. LER's revenue stream to Laclede in the test year was approximately $690 million, compared to Laclede Gas' $1,141,011.

Q. Does the Staff have concerns with the Company's current methods of allocating costs to the Laclede Group non-regulated subsidiaries?

A. Yes. The Staff believes that use of new approaches for allocating costs between Laclede Group's regulated and non-regulated operations should be considered, particularly for labor costs. Among other approaches, these might include:

1) use of periodic time studies by employees to determine proper allocation of employee time to Laclede Group affiliates;

2) use of "positive" time reporting techniques instead of "negative" time reporting approaches; and

3) consideration of multiple allocation factor approaches (i.e., "three-factor" formulas) for allocating indirect/overhead costs, instead of basing such allocations solely on labor charges.

Q. Is the Staff proposing a specific adjustment for affiliated transactions in this proceeding?

A. Yes. The Staff is proposing an adjustment to the amount of the salary of the Executive Vice President of Energy and Administration Services for Laclede Gas that is included in this rate case. As previously mentioned, Mr. Neises in the test year recorded directly only 1.49% of his time to the non-regulated utility, LER. The Staff is recommending that 20% of his salary be allocated to LER. This percentage is based upon Laclede Management's Organizational Chart. The Executive Vice President of Energy and Administration Services for Laclede Gas, Mr. Neises, supervises and manages the Tariff and Rate Administration, Laclede Energy Resources, Gas Supply, Industrial Relations and the Corporate Communications Departments. The Staff believes Mr. Neises has direct responsibility for these five areas of operation and allocated his salary evenly between them.

Therefore, this adjustment decreases the amount of his salary that is included in the Staff's cost of service by one fifth.

Please refer to the direct testimony of Staff Auditing witness Mark L. Oligschlaeger for a further discussion of the Staff's recommendations in this proceeding concerning Laclede Gas' affiliated transactions.

Q. Are there any other affiliated matters you would like to address in this testimony?

A. Yes. In past Laclede rate proceedings, the Staff has always included Laclede Pipeline Company operations above-the-line in the determination of revenue requirement for Laclede Gas. In other words, the pretax net income realized by Laclede Pipeline has always been included as an offset to the revenue requirement of Laclede Gas. Laclede Pipeline sought FERC jurisdiction in April 2006. FERC agreed with Laclede Pipeline's request and ordered in Docket No. IS06-201-000 that Laclede Pipeline should be put under FERC jurisdiction. For this reason, the Staff has not included in this case Laclede Pipeline's pretax net income as an offset to the revenue requirement.

HVAC AND HOME INSPECTION SERVICES

Q. Please describe the Company's Heating, Ventilation and Air Conditioning (HVAC) and home sale inspection activities.

A. HVAC maintenance and repairs and home sale inspections are performed by Laclede Gas personnel. These services are non-regulated, but have been traditionally treated above-the-line for financial reporting and ratemaking purposes. The Commission does not establish the prices charged for these services. The Staff made a recommendation in Case No. GR-2002-356 that all revenue and expense associated with these activities should be a component of the Company's annual CAM submission required under Commission rules. The Staff's review of revenues and expenses for HVAC verified that these costs are now included in Laclede's CAM. The Staff's audit also verified that the Company's booked revenues for these services exceed their associated expenses. Staff Auditing witness Kimberly K. Bolin annualized the revenues for home sale inspections during this rate case.

In addition, Laclede Gas sells natural gas appliances (e.g., water heaters, dryers, gas grills) on a non-regulated basis. The revenues and expenses associated with the sales of natural gas appliances are recorded below-the-line as merchandising activities on the Company's books and are not included in Laclede Gas' ratemaking process. The Company also reports this information in its CAM. The Staff reviewed how the Company was booking its direct and indirect costs associated with retail sales of appliances. From its audit, the Staff has concluded that these non-regulated revenues and expenses are separately tracked and appropriately reported below-the-line in the Company's books.

INJURIES AND DAMAGES

Q. Please explain the Staff's proposed adjustment to injuries and damages expense.

A. Adjustment S-16.10 was made to normalize Laclede's injuries and damages expense. The Staff analyzed the levels of actual payments of injuries and damages made by Laclede since the last rate case. The Staff then compared that level to the amount booked in the test year for injuries and damages. This analysis indicated that since the Company increased its deductible in October 2001, an upward trend in the injuries and damages costs has occurred. Since these costs have experienced a constant upward trend, the Staff believes that the test year level of actual claims payments is most representative of costs on a goingforward basis. Therefore, the Staff adjusted the test year amount to the actual amount that the Company paid for injuries and damages.

Q. Why did the Staff use the Company's actual test year payments instead of the expense amount accrued on the Company's books for rate purposes?

A. The Staff used actual payments (cash basis of accounting) for this item because the costs are known and measurable. Use of the cash basis of accounting also allows for review of source documentation supporting the actual payments made by the Company, and allows for examination of a history of past claims payments. Contrary to the cash basis of accounting, the accrual basis of accounting recognizes revenues when earned, rather than when collected, and expenses are recognized when incurred, rather than when paid. The accrual amounts on utilities books represents a budgeted or estimated level of future injuries and damages payments. It's been a long standing policy of this Commission that utility costs must be "known and measurable" before they are included in the utility's cost of service.

Q. Please define the term "known and measurable".

A. A "known and measurable" expense is an expense that is: 1) "known," meaning that the amount did or definitely will be an actually incurred cost, and 2) "measurable," meaning that the rate impact of the event giving rise to the change in expense levels can be calculated with a high degree of accuracy.

INSURANCE

Q. Please explain your adjustment to insurance expense.

A. Adjustment S-16.21 was made to annualize the Company's cost of insurance, which is charged to the FERC Uniform System of Account Nos. 924 and 925. Included in this annualization were the following types of insurance: excess liability, director's and officer's liability, general liability, fiduciary liability, punitive liability, primary and excess property insurance, worker's compensation, executive life insurance, blanket crime insurance, travel insurance and self insurer's tax.

Q. How did the Staff determine the level of insurance premiums to include in its annualization?

A. The Staff based its annualization of the cost of insurance on current insurance premiums. This annualization is representative of the insurance premiums that the Company actually paid during the test year. The premium levels on which the Staff based its annualization were in effect as of March 31, 2007, the end of the test year update in this proceeding.

401(K) RETIREMENT PLAN

Q. How did the Staff annualize Laclede's 401(k) expenses?

A. Adjustment S-16.6 reflects the increase in expenses for the 401(k) Wage and Salary Deferral Savings Plans, which have been adjusted based on the Staff's annualized payroll for each payroll category. Under the 401(k) Plan, employees have the option of deferring for receipt in the future a portion of their salaries or wages. The Company matches a percentage of the amount that the employees defer. The Staff developed a ratio based on the September 2006 Company contributions to actual payroll for each payroll category plan. The ratios were then multiplied by the Staff's annualized payroll for each payroll category to calculate the annualized Company contribution. Staff Auditing witness "Kofi" Agyenim Boateng sponsored the Staff's annualization of payroll for this rate case.

PENSION EXPENSE

Q. What level of pension expense is the Staff proposing in this case?

A. The Staff is proposing that Laclede continue the method that was agreed to in a Partial Non-unanimous Stipulation And Agreement from Laclede Case No. GR-2005-0284. In that case, the Staff proposed to continue the method of calculating pension expense according to the Employee Retirement Income Security Act of 1974 minimum (ERISA minimum) method. The provisions of Title I of ERISA, which are administered by the U.S. Department of Labor, were enacted to address public concern that funds of private pension plans were being mismanaged and abused. ERISA was the culmination of a long line of legislation concerned with the labor and tax aspects of employee benefit plans. The ERISA minimum funding method is designed to ensure that a utility's pension fund is adequate to meet current and future pension obligations. In addition, for Laclede FAS 88 transactions occur when employees request lump sum pension payments upon retirement in exchange for the full settlement of Laclede's retirement obligation to them.

Q. Is the ERISA minimum method for calculating pension expense different from the current method employed to determine pension expense for financial reporting purposes?

A. Yes. For financial reporting purposes, companies are required to use Statement of Financial Accounting Standards No. 87, *Employers' Accounting for Pensions* (FAS 87) to determine booked pension expense. Beginning in 1994 and continuing until 2002, the FAS 87 method was used to set Laclede's rates to cover pension expense.

Q. Please explain the provisions of the Stipulation And Agreement in Laclede's last rate case that pertained to treatment of pension and OPEB expense.

A. The portion of the Nonunanimous Stipulation And Agreement filed in Case No. GR-2005-0284 relating to pensions and OPEBs (pp 6-8) is attached as Schedule 2.

Similar language can be found concerning pension costs in the Stipulation And Agreement from Laclede's prior rate case, No. GR-2002-356.

Q. How are ERISA minimum contributions used to determine an annual level of pension cost for ratemaking purposes?

A. The Staff performs an analysis of the actual fund contributions required under ERISA regulations. If the annual contributions have been relatively stable in regard to the amount of the contribution required, then the most recent contribution may be used to set the annual level of pension cost to be included in cost of service. However, if there has been significant annual volatility (fluctuation in the level of contributions from year to year) in the annual fund contributions, then a multi-year average may be appropriate for determining a normalized level of pension expense for ratemaking purposes.

Q. What level of pension expense is the Staff recommending for Laclede's pension expense in this proceeding?

A. The Staff is recommending that the ERISA minimum amount of $3,233,269 be included in rates in this case, along with continuation of the "tracker" mechanism established in the last two Laclede rate case proceedings. This amount is based upon the $835,235 projected cash contribution for the plan year 2006-2007 that are reflected in a letter to Laclede dated April 2, 2007 from Laclede's actuary, Towers Perrin. Added to this amount is the prepaid pension asset amortization amount of $2,398,034 that has been included in rates in Laclede's last two rate cases. Therefore, the total pension cost recommended by the Staff in this case is $3,233,269.

PREPAID PENSION ASSET

Q. Please explain the term "prepaid pension asset" as it applies to pension cost under FAS 87.

A. A prepaid pension asset is established on the balance sheet when the cash contributions to the pension fund exceed the pension cost recorded on the income statement under FAS 87. The prepaid pension asset is increased in subsequent years when the cash contributions to the fund exceed the FAS 87 expense on the income statement. The prepaid pension asset is reduced in years when the pension cost under FAS 87 exceeds the cash contribution to the pension fund.

Any gain or loss resulting from a FAS 88 transaction is also included under the FAS 87 pension cost in determining the net impact on the prepaid pension asset in any given year.

Q. Please explain the regulatory implications of the prepaid pension asset.

A. With regard to major utility companies in Missouri, prepaid pension assets have resulted primarily from calculation of a negative pension expense under FAS 87 and a zero ERISA minimum contribution since the adoption of FAS 87 for setting rates for most major utilities in this State. Reflection of a negative pension expense in rates has the effect of reducing a utility's cash flow. The excess of fund assets over the pension liability in prior years could not be withdrawn and used to offset the negative cash flow that resulted from reflecting a negative pension cost under FAS 87 in setting rates. The prepaid pension asset, in effect, represents a future cash flow benefit which, in theory, should be received by the utility over the estimated average service life of the employees used to accrue pension cost. In other words, there should not be any permanent difference between the recognition of the pension liability for financial reporting over the service life of employees and the funding of the same liability over the long term.

Q. How has the prepaid pension asset been treated in rates since the Stipulation And Agreement in Case No. GR-2002-0356 changed the method used to determine pension expense for ratemaking purposes from FAS 87 to the ERISA minimum approach?

A. Laclede's prepaid pension asset is, in effect, the opposite of the accumulated deferred income tax reserve. Deferred income taxes represent income taxes paid through rates that exceed the Company's current income tax liability. The deferred taxes represent a cash flow benefit to the utility and are returned to customers over the life of the assets generating the accelerated tax deductions used in calculating current income tax. The prepaid pension asset represents the accumulated reduction in rates that has occurred as a result of reflecting negative pension cost in rates under FAS 87 for Laclede from the mid-1990s to 2002. As long as FAS 87 ratemaking for pensions was maintained for Laclede, the prepaid pension asset was considered to be a temporary timing difference that would reverse over time. With a change in pension cost determination to the ERISA minimum funding requirement in Laclede's 2002 rate proceeding, the only mechanism to reverse the prepaid pension asset was to amortize the balance over a reasonable period of time.

Q. Explain the relationship between Laclede's prepaid pension asset at March 31, 2007, and its cost of service for this case.

A. Laclede's prepaid pension asset at March 31, 2007, represents the accumulated difference between FAS 87 and FAS 88 pension cost and cash contributions to the pension fund since 1987, when Laclede adopted FAS 87 for financial reporting purposes. However, FAS 87 was not used for ratemaking purposes for Laclede prior to September 1, 1994, the effective date of rates in Case No. GR-94-220. The prepaid pension asset included in rate base should include only the accumulated difference between FAS 87 pension costs included in rates and the cash contributions to the pension fund since September 1, 1994.

The March 31, 2007 prepaid pension asset must also be adjusted to exclude the impact of all FAS 88 gains recognized from September 1, 1994, through September 1, 1996. Prior to September 1, 1996, which reflects the effective date of the rates from Case No. GR-96-193, FAS 88 gains were not included in Laclede's cost of service in a rate case. Therefore, the prepaid pension asset balance at March 31, 2007 should also exclude the impact of all FAS 88 gains recognized from September 1, 1994, to September 1, 1996.

Q. For purposes of this case, how is the prepaid pension asset treated given the Staff's position on pension?

A. Since the Staff has adopted Minimum ERISA for pension expense, the unamortized prepaid pension asset included in the Staff's rate base has continued to be included in expense through an amortization. This asset will be included in rate base in any future Laclede rate/complaint case until it is fully amortized.

Q. Is this position consistent with the agreement signed by the Staff and Company regarding the pension issue in Case No. GR-2005-0284?

A Yes it is.

OPEBS - FAS 106

Q. Please explain adjustments S-16.5.

A. This adjustment annualizes other post-employment benefit (OPEB) expense as calculated under Financial Accounting Standard No. 106, *Employers ' Accounting for Postretirement Benefits Other than Pensions* (FAS 106), for Laclede's employees. OPEB expense reflects Laclede's current liability to provide retiree medical payments to its current employees as well as its retired employees.

Q. How did the Staff determine the level of OPEB expense to include in this case?

A. The Staff used the FAS 106 cost level as reflected in a letter to Laclede from Laclede's actuary, Towers Perrin, dated November 14, 2006. This letter provides the level of FAS 106 OPEB expense booked by the Company for the test year ended September 30, 2006. The Staff is recommending that the OPEB expense amount identified in this letter of $5,413,260 be included in rates in this case.

Q What are rate "tracker" mechanisms?

A. Rate "trackers" are used to monitor and record the prospective differences between certain expenses included in rates and the actual expenses incurred by the utility. The intent behind use of tracker mechanisms are to ensure that a utility ultimately recovers no more or no less of a cost in rates than it actually incurs. As applied to FAS 106 expense, a tracker would monitor and record the amount of OPEBs included in Laclede's rates and the amount of Laclede's ongoing funding of OPEBs expense in external trust mechanisms. A tracker mechanism has been in place for Laclede's pension expenses in its last several cases.

Q. What is the Staff's position on use of rate trackers?

A. Generally, the Staff opposes their use to set rates, since trackers serve to eliminate in entirety a utility's risk of incurring a different level of expense than the level recovered in its rates. It should not generally be the purpose of rate regulation to guarantee a utility's rate recovery of some or all of its costs. However, the Staff does not necessarily oppose the use of a tracker mechanism for OPEBs, similar to the tracker mechanism already in place for pension expense, under the explicit condition the utility commit to ongoing funding of its external trusts for OPEBs in the amount of its annual FAS 106 expense calculations over time. Because funding of OPEB expense in this matter may lead to significant cash flow impacts on a utility due to the difference of the amount of rate recovery for OPEB expense and the amount the utility contributes to external funds, the use of a tracker mechanism might be appropriate to avoid placing the utility into potential cash flow difficulties. Conversely, if a utility chooses to only externally fund its FAS 106 expense in the amount of its rate allowances for this item, there will be no significant cash flow impact on the utility as its funded amounts will generally equal its rate allowance for OPEBs. Accordingly, use of a tracker mechanism is not justified in that circumstance.

Q. If the Commission were to grant Laclede use of a rate tracker mechanism for OPEBs in this proceeding, what conditions should be placed upon that use?

A. Again, Laclede should commit to full funding of its external trusts for OPEBs in the amount of its annual FAS 106 calculations, whether such accruals increase or decrease from year to year. If this condition is met, the Staff recommends that the difference between OPEBs rate recovery and OPEBs funding requirements be deferred as a regulatory asset/liability and tracked in the same manner that the difference between Laclede's pension expense recovered in rates and its contributions to its pension trust funds are currently tracked, per the stipulations in Laclede's last two rate cases. Any such deferral would be subject to recovery from, or payment to, ratepayers in future Laclede rate cases.

<u>NON-QUALIFIED PENSION PLAN EXPENSE</u>

Q. Please discuss the adjustments the Staff made to the test year expenses for certain "non-qualified" benefit plans for Laclede's employees.

A. The Staff has proposed adjustments to allow Laclede to recover only actual payments made to employees rather than accruals for four specific benefit plans.

Q. Why has the Staff used actual payments for these four benefit plans?

A. Certain management employees and members of the board of directors receive benefits under the Supplemental Employee Retirement Program (SERP), Directors Retirement Program, Group Insurance Program and the Senior Officers Life Insurance Program. The provisions of FAS 87 and FAS 106 are used to calculate the annual expense accrual for each of these plans. Due to the fact that the benefits from these four retirement programs are not available to a broad range of employees, these programs are designated as "non-qualified" plans.

Q. What makes a plan non-qualified and what are the implications of a plan not being qualified?

A. A qualified plan is one in which the contributions to the plan are tax deductible and the earnings of the assets in the plan are tax-exempt. In a non-qualified plan, only the amounts paid to beneficiaries are tax deductible.

Section 401 of the Internal Revenue Code lists requirements that a plan must meet to be qualified. Two of the more prominent features of a qualified plan are:

1. That the company cannot divert assets in the trust for any other purpose than the meeting of the obligations of the plan; and

2. The plan must be available to a broad range of employees.

Due to the fact that these four retirement programs are designated as non-qualified plans, the annual FAS 87 and FAS 106 costs are calculated differently for these programs than for the regular retirement plans.

For the Company's regular retirement programs, the earnings on the assets being accumulated to pay benefits are used as a reduction to the annual cost. For example, the expected earnings on assets for the Company's regular pension plans may approach or exceed the total annual costs for these plans. However, for the non-qualified plans, the earnings on the accumulated assets are not included in the FAS 87 or FAS 106 calculations of annual retirement cost and, therefore, are not used to reduce the actual cost of the plans. Therefore, the Staff believes that an actual payments method for rate recovery is more appropriate for the non-qualified plans. Staff used a five-year average of actual payments made in calculating the annual cost of the SERP and Directors Retirement Plan.

Q. Why did the Staff use a five-year average in calculating Laclede's SERP and Directors Retirement Plan?

A. The Staff used a five-year average of actual payments up through the update period to normalize these expenses. The normal monthly payment for the SERP Plan is approximately $18,626. However, a large portion of the benefits paid from the SERP tend to be in the form of one-time lump sum payments. The Staff used the five-year average to spread these one-time lump sum payments in conjunction with the monthly payments over a period of time to establish a normal level for this expense. The Staff's five-year average produces a monthly average of $30,291, or an annual amount of $363,492, for the SERP. The Staff's five-year monthly average for the Directors Retirement Plan produces approximately $7,210 or $86,520 annually.

The Staff believes that actual payments method is appropriate for the Group Insurance Program and the Senior Officers Life Insurance Program reflected in a letter to

Laclede from Laclede's actuary, Towers Perrin, dated November 14, 2006 and has included that amount in calculating its annual cost for these programs.

INCOME TAXES

Q. Please discuss the adjustment you are sponsoring for current income tax expense in this case.

A. The adjustment to current income tax expense is identified as adjustment S-20.1 on Accounting Schedule 10. Adjustment S-20.1 adjusts current income tax to reflect the difference between the test year's adjusted income tax computed on Accounting Schedule 11, Income Tax, and the current income tax expense recorded during the test year.

Q. Please explain how the current income tax expense is calculated on Accounting Schedule 11, Income Tax.

A. Net operating income (NOI), as calculated on Accounting Schedule 9, Income Statement, is the starting point of the test year income tax calculation (column B) on Accounting Schedule 11. The NOI for each rate of return (Line 1, columns C, D and E) was calculated on Accounting Schedule 1, Revenue Requirement. The applicable current and deferred income taxes are added back to NOI to determine the net operating income before income taxes (NOIBT). NOIBT is then adjusted for various tax-timing differences to determine the amount of taxable income. The federal and state income taxes are calculated based on statutory rates applied to the taxable income after allowances for applicable income tax deductions and credits. State income taxes are deductible in the determination of federal taxable income. One-half of federal current income taxes are deductible for state taxable income.

Q. What is the justification for the additions and subtractions that were used to adjust NOIBT?

A. The Internal Revenue Code (Code) dictates what is appropriately included, or deducted, in the determination of taxable income. The adjustments made to NOIBT are necessary to reconcile the income reported on the income statement with the taxable income determined in compliance with the Code. These adjustments are commonly referred to as tax-timing differences or Schedule M items. Schedule M is the federal tax form on which the Company reconciles the difference between book income and taxable income. The Staff has added or subtracted the timing differences from NOIBT that are necessary for ratemaking purposes.

Q. Please discuss the adjustments to NOIBT.

A. The adjustments to NOIBT related to depreciation are reflected in three separate line items on Accounting Schedule 11. Line number 10 is an addition to taxable income for the annualized depreciation and amortization included in book income. Line numbers 18 and 19, tax straight line depreciation and excess tax depreciation, respectively, reduce taxable income to reflect the depreciation and amortization that is deductible for tax purposes.

Q. Why have three separate adjustments been used to adjust taxable income for depreciation?

A. Depreciation could have been presented as a single net adjustment to taxable income. However, presenting the adjustment for depreciation using three components provides a clearer illustration of how taxable income is developed and the impact these components have on tax expense.

As previously indicated, the Code is the basis for determining what is deductible for tax purposes. Therefore, to properly determine taxable income, book depreciation is added back and tax depreciation is deducted from NOIBT. Tax depreciation is presented as two separate components because each of these components has a distinct impact on income tax expense. Straight-line tax depreciation is the equivalent of book depreciation, restated to reflect the tax basis of plant in service, and is provided "flow-through" treatment. The difference between total tax depreciation and tax straight-line depreciation, identified as excess tax depreciation, is required by the Code to be "normalized."

Q. Why does a depreciable basis difference exist between the depreciable book basis and tax basis?

A. A difference exists between the depreciable book basis and the tax basis because the Code has allowed expenditures to be expensed in the year incurred for tax purposes that have been historically capitalized for book purposes. As a result, the tax basis is typically lower than the basis used to calculate book depreciation.

Q. What is the explanation for the difference between total tax depreciation and tax straight-line depreciation that you have identified as excess tax depreciation?

A. The Code provides for a quicker recovery of the tax basis plant investment through the use of accelerated depreciation methods. This will normally generate a larger depreciation deduction for tax purposes than depreciation calculated on a straight-line basis. As stated previously, there is a requirement that the tax depreciation in excess of tax-straight line be normalized.

Q. What is meant by the terms "flow-through" and "normalized?"

A. The term flow-through refers to the tax treatment that equates the amount provided by the ratepayer for income tax expense with the amount paid to the taxing authority. Under flow-through treatment, no deferred tax is created to offset the impact of the timing difference on current income tax expense. However, with normalization treatment, the impact of a tax timing difference on current income tax expense is offset by deferred income tax expense. Under normalization treatment, the ratepayer provides the funds to the Company as if the tax-timing difference did not exist.

Q. How were the two components of tax depreciation determined?

A. The Staff has used the relationship between the tax basis of Laclede's plant and the book basis of its plant as of September 30, 2006, the end of the test year in this case, as found in the Company's supporting workpapers for its income tax calculations in this proceeding. This ratio was then applied to the Staff's annualized book depreciation expense to derive its tax straight-line depreciation calculation. The Staff has requested updated information concerning the book/tax depreciation relationship from the Company, and may update its tax depreciation calculations at a later point once this additional information is received.

The Company's tax straight-line depreciation was calculated using the "open-ended" method, which calculates tax straight-line depreciation by property account without regard to its vintage until the book rate is set to zero.

Q. Please continue with your discussion of the other adjustments that have been made to NOIBT on Accounting Schedule 11.

A. Additions to NOIBT include contributions in aid of construction (CIAC), miscellaneous nondeductible expenses, inventory overheads capitalized, accounting authority order (AAO) amortization and pension expense. The adjustments to NOIBT that reduce current taxable income are interest expense, administrative and general (A&G) expense capitalized, transfer of services and cost of removal expense. A description of these adjustments and their development follows:

- **Contributions in Aid of Construction -** For tax purposes, when the Company receives CIAC from customers, the Company is required to report the CIAC as revenue. For book purposes, CIAC received is recorded as a credit to plant, which reduces the level of plant investment included in rate base. The Staff adjustment included on Accounting Schedule 11 is the test year ending September 30, 2006 level of CIAC.
- **Miscellaneous Non-Deductible Expenses -** This category includes such items as travel, meals, dues, gifts and lobbying expenses and are only 50% deductible for tax purposes. Therefore, one-half of the expenditures included in operating expense must be added back to NOIBT to reflect the limitation imposed by the IRS. The Staff adjustment to NOIBT reflects only the applicable addition of those expenses that have been allowed as an operating expense for ratemaking.
- **Inventory Overheads Capitalized -** Some costs related to storage gas are expensed for book purposes, but capitalized for tax purposes.
- **AAO Amortization -** This reflects the expense included in the income statement related to prior period expenditures that were deferred and now being amortized to expense. Although the expenditures were deferred on the books when occurred, they were recognized in the year incurred for

tax purposes. The AAO amortization needs to be added back to NOIBT to appropriately state the level of current taxable income.

- **Interest Expense -** Interest is a deduction for tax purposes that is not reflected as an operating expense (before income taxes) in the Staff's Income Statement, Accounting Schedule 9. Interest expense is calculated by multiplying rate base by the Staff's weighted cost of debt included in the overall rate of return sponsored by Staff witness Matthew Barnes of the Financial Analysis Department. This method of determining interest expense is referred to as interest synchronization because the interest used in the calculation of income tax expense is matched with the interest expense the ratepayers are required to provide to the Company in rates. Interest synchronization has been consistently used by the Staff and adopted by the Commission in past orders.
- **Administrative and General (A&G) Costs Capitalized -** The Company is allowed to expense a portion of A&G costs for tax purposes which are capitalized on the books. The Staff's deduction in the tax calculation reflects the test year A&G expenses capitalized on the books that are deductible for income tax purposes, as adjusted by the Staff's proposed A&G expense adjustments.
- **Pensions -** For tax purposes, pension expense is reported on a cash (or contributions) basis. Laclede's practice is to fund its pension plan at the minimum ERISA level. However, besides the minimum ERISA level the pension level recommended by the Staff in this case also contains a

component for amortization of the prepaid pension asset. This amortization is not currently tax-deductible. Therefore, the prepaid pension asset amortization that is included in the pension expense must be recognized as a tax timing difference.

- **Transfer of Services -** The cost of certain main replacements are capitalized on the books but expensed for tax purposes. The deduction reflects the test year amount capitalized on the books that is deductible for tax purposes.
- **Cost of Removal -** These costs have been historically included in depreciation expense over the life of the depreciable property on the books but are deductible on the tax return in the year incurred. The Staff used the actual test year level of tax deductible cost of removal.

Q. Regarding the adjustments to arrive at taxable income, which items does the Staff propose to apply flow-through treatment?

A. In addition to tax straight-line depreciation, the Staff has provided flow through treatment for miscellaneous non-deductible expenses, inventory overheads capitalized, interest, A&G expense capitalized, transfer of services and cost of removal. The Staff has normalized the remaining adjustments consisting of CIAC, AAO amortization, excess tax depreciation and pensions.

DEFERRED INCOME TAX

Q. Please discuss your adjustments to deferred income tax expense.

A. Adjustments S-21.1 adjust deferred income tax expense to reflect the impact on total tax expense of the tax timing differences that are being normalized, as previously discussed, with regard to the development of current taxable income. In general, a deferred income tax-debit reflects the normalization of tax timing differences that decrease current taxable income and, inversely, a deferred income tax-credit represents the normalization of tax timing differences that increase current taxable income. The accumulated deferred tax balances related to the tax timing differences that have been normalized were included in the determination of rate base.

The Staff has made no adjustment to the test year level of Investment Tax Credit (ITC) amortization. The deferred income tax balance in rate base includes the unamortized pre-1971 ITC balance. Code restrictions prevent the use of post 1971 ITC balances to reduce rate base.

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-2007-0208

AFFIDAVIT OF PAUL R. HARRISON

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Paul R. Harrison, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Direct Testimony in question and answer form, consisting of 29 pages to be presented in the above case; that the answers in the foregoing Direct Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Paul R. Harrison

Paul R. Harrison

Subscribed and sworn to before me this 2nd day of May, 2007.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
County of Cole
My Commission Exp. 07/01/2008

D. Suzie Mankin

Notary Public

CASE PROCEEDING/PARTICIPATION

PAUL R. HARRISON

COMPANY	CASE NO.	TESTIMONY/ISSUES
Missouri Gas Energy	**GR-2006-0422**	**November 2006** **Rebuttal-** Environmental Response Fund, Manufactured Gas Plant **Litigated- Manufactured Gas Plant**
Missouri Gas Energy	**GR-2006-0422**	**October 2006** **Direct**– Revenues; Purchased Gas Adjustments; Bad Debt Expense; ECWR AAO Bad Debt: Rent; Pensions & OPEBS; Income Taxes; Franchise Taxes; Manufactured Gas Plant, and Case Reconciliation **Litigated- Emergency Cold Weather Rule** **True-Up - Revenues; Bad Debt Expense**
Empire Electric Company	**ER-2006-0315**	**July 2006** **Rebuttal-** Storm Damage Tracker
Empire Electric Company	**ER-2006-0315**	**June 2006** **Direct-** Tree Trimming Expense and Construction Over-Run Costs
Missouri Pipeline & Missouri Gas Company LLC	**GC-2006-0378**	**November 2006** Plant in Service, Depreciation Reserve, Depreciation Expense, Transactions & Acquisition Costs and Income Taxes

COMPANY	CASE NO.	TESTIMONY/ISSUES
New Florence Telephone	**TC-2006-0184**	**October 2006** Plant in Service; Depreciation Reserve; Depreciation Expense; Plant Overage; and Materials & Supplies
Cass County Telephone	**TC-2005-0357**	**July 2006** Plant in Service; Depreciation Reserve; Depreciation Expense; Plant Overage; Plant Held for Future Use and Missouri Universal Service Fund
Cass County Telephone & New Florence Telephone Fraud Investigation Case	**TO-2005-0237**	**May 2006** Fraud Investigation case involving Cass County Telephone and New Florence Telephone
Missouri Gas Energy	**GR-2004-0209**	**June 2004** **Surrebuttal** - Revenues and Bad Debt Expense **True-Up** - Revenues; Bad Debt Expense
Missouri Gas Energy	**GR-2004-0209**	**May 2004** **Rebuttal** - Revenues; Bad Debt Expense; and Manufactured Gas Plant **Litigated- Manufactured Gas Plant**
Missouri Gas Energy	**GR-2004-0209**	**April 2004** **Direct** – Revenues; Purchased Gas Adjustments; Bad Debt Expense; Medical Expense; Rents; and Income Taxes

COMPANY	CASE NO.	TESTIMONY/ISSUES
Union Electric Company d/b/a AmerenUE (Gas)	**GR-2003-0517**	**October 2003** **Direct** – Corporate Allocations; UEC Missouri Gas Allocations; CILCORP Allocations; Rent Expense; Maintenance of General Plant Expense; Lease Agreements; and Employee Relocation Expense
Union Electric Company d/b/a AmerenUE	**EC-2002-1**	**June 2002** **Surrebuttal** - Coal Inventory; Venice Power Plant Fire; Tree Trimming Expense; and Automated Meter Reading Service
Laclede Gas Company	**GR-2002-356**	**June 2002** **Direct** - Payroll; Payroll Taxes; 401k Pension Plan; Health Care Expenses; Pension Plan Trustee Fees; and Clearing Account: True- Up **– Payroll; Payroll Taxes; and Clearing Accounts**
Union Electric Company d/b/a AmerenUE (2nd period, 3rd EARP)	**EC-2002-1025**	**April 2002** **Direct** - Revenue Requirement Run; Plant in Service; Depreciation Reserve; Other Rate Base items; Venice Power Plant Fire expenditures; Tree Trimming Expense; and Coal Inventory
2nd Complaint Case, Union Electric Company d/b/a AmerenUE New Test Year ordered by the Commission.	**EC-2002-1**	**March 2002** **Direct** - Materials and Supplies; Prepayments; Fuel Inventory; Customer Advances for Construction; Customer Deposits; Plant in Service; Depreciation Reserve; Venice Power Plant Fire Expenditures; Tree-Trimming Expense; Automated Meter Reading Expense; Customer Deposit Interest Expense; Year 2000 Computer Modification Expense; Regulatory Advisor's Consulting Fees; and Property Taxes **Deposition – April 11, 2002**

COMPANY	CASE NO.	TESTIMONY/ISSUES
1st Complaint Case, Union Electric Company d/b/a AmerenUE	**EC-2002-1**	**July 2001** **Direct** - Materials and Supplies; Prepayments; Fuel Inventory; Customer Advances for Construction; Customer Deposits; Plant in Service; Depreciation Reserve; Power Plant Maintenance Expense; Tree-Trimming Expense; Automated Meter Reading Expense; Customer Deposit Interest Expense; Year 2000 Computer Modification Expense; Computer Software Expense; Regulatory Advisor's Consulting Fees; Board of Directors Advisor's Fees and Property Taxes. **Deposition – November 27 2001**
Union Electric Company d/b/a AmerenUE (2nd period, 2nd EARP)	**EC-2001-431**	**February 2001** Coal Inventory
Union Electric Company d/b/a AmerenUE (Gas)	**GR-2000-512**	**August 2000** **Direct** - Cash Working Capital; Advertising Expense; Missouri PSC Assessment; Dues and Donations; Automated Meter Reading Expenses; Computer System Software Expenses (CSS); Computer System Software Expenses (Y2K); Computer System Software Expenses (EMPRV); Generation Strategy Project Expenses; Regulatory Advisor's Consulting fees; Board of Directors Advisor's fees
SUMMARY OF SMALL RATE CASES WORKED		
Big Island Water & Sewer	**WA-2006-0480** **SA-2006-0482**	**January 2007** **Direct** - Certificate of Necessitate Application Case **Lead Auditor**

COMPANY	CASE NO.	TESTIMONY/ISSUES
Aqua Missouri Water and Sewer	**QS-2005-0008** **QW-2005-009** **QS-2005-0010** **QW-2005-0011**	**October 2006** Plant In Service; Depreciation Reserve, Depreciation Expense, Rate Base; Revenues and Expenses **Lead Auditor**
Lake Region Water and Sewer Certificate Case	**WA-2005-0463**	**October 2006** Certificate of Necessitate Application Case **Lead Auditor**
Tri-State Utility Inc.	**WA-2006-0241**	**May 2006** Certificate of Necessitate Application Case **Lead Auditor**
Osage Water Company Environmental Utilities Missouri American Water	**WO-2005-0086**	**February 2005** Rate Base; Cost of Service; Income Statement Items; Pre-Post Sale of OWC, Sale of EU Assets to MAWC
North Suburban Water & Sewer	**WF-2005-0164**	**December 2004** Sale of All Stocks of Lake Region Water & Sewer to North Suburban Water & Sewer, Value of Rate Base Assets, Acquisition Premium **Lead Auditor**
Mill Creek Sewer	**SR-2005-0116**	**December 2004** Plant In Service: Rate Base: Revenues: and Expenses. **Lead Auditor**
Roark Water and Sewer	**WR-2005-0153** **SR-2005-0154**	**September 2004** Plant In Service: Rate Base: Revenues: and Expenses. **Lead Auditor**

COMPANY	CASE NO.	TESTIMONY/ISSUES
Osage Water Company	**WT-2003-0583** **SR-2003-0584**	**December 2003** Cost of Service; All Expenses related to Osage Water; Plant in Service; Depreciation Reserve & other Rate Base Items

SUMMARY OF NON-CASE RELATED AUDITS

January 2006 – Environmental Utilities and Osage Water Company Audit Concerning Provision of Service to Eagle Woods Subdivision and Disconnect Notice

November 2004 - Internal Audit of Public Service Commission (PSC) Fixed Assets, Physical Inventory Control Process and Location of Assets may occur between ACA cases, as well as balances remaining from prior periods (Tariff Sheet Nos. 18-b – 22);

(b) provide the Company with the opportunity to make up to three discretionary PGA filings each year in addition to one mandatory filing each November (Tariff Sheet Nos. 28-c and 28-c.1);

(c) reflect in the PGA/ACA and annually reconcile in subsequent ACA filings increases and decreases in the financing costs for gas storage inventories (Tariff Sheet Nos. 15, 17 and 28-h).

Pensions and Other Post-Employment Benefits

4. The Parties agree that the rates established in this case for the Laclede Division and Missouri Natural Division pension plans include an allowance of $4,052,902 (based on the fiscal 2006 ERISA Minimum Contribution of $652,902 as determined by the Company's actuary and a $3,400,000 amortization). Rate base is reduced annually by the amortization, plus or minus the difference between the minimum ERISA in rates and the minimum ERISA contributed to the pension fund.

The Parties further agree that Laclede Gas Company shall continue to be authorized to revert to the accounting policy it originally implemented upon adoption of FAS 87, for financial reporting purposes only, effective October 1, 2002, including without limitation:

(a) Market-Related Value implemented prospectively over a four-year period;

(b) Amortization of unrecognized gains or losses only to the extent that they fall outside of a 10% corridor as described in FAS 87 and FAS 106;

(c) Amortization of unrecognized gains or losses falling outside of the 10% corridor over the average remaining service life of participants.

5. The Parties further agree that gains and losses for all pension lump-sum settlements shall continue to be calculated only to the minimum extent permitted by FAS 88 and that the Company shall continue to be authorized to record as a regulatory asset/liability, as appropriate, the difference between the pension expense used in setting rates ($4,052,902 described above) and the pension expense as determined pursuant to FAS 87 and FAS 88. This regulatory asset/liability shall continue to be included in the Company's rate base in future rate proceedings. The prepaid pension asset on the Company's books at October 1, 2002, is the maximum amount that will be considered for inclusion in rate base in future rate proceedings, so long as the ERISA Minimum method of determining pension expense prescribed herein is in effect. The Parties further agree that the Company shall continue to reduce the rate base annually as described above in paragraph 4. The rates established in this case for the Supplemental Retirement Plan (SERP) and Directors Retirement Plan are based on actual payments to participants under these plans.

6. The Parties agree that the rates resulting from this case also make provision for the recovery of Other Post-Employment Benefits ("OPEBs") costs on a FAS 106 basis. The Parties further agree that the Company shall continue to be authorized to apply its accounting policy relative to OPEBs consistent with that specified for FAS 87 above, for financial reporting purposes only, as was initially effective October 1, 2002. For ratemaking and funding purposes, the OPEBs expense will continue to be determined using the market-related value implemented prospectively over

a four-year period and a five-year amortization of the most recent five-year average of the balance of unrecognized gains and losses, as calculated by the Company's actuary. The Company shall continue to be authorized to record the difference between OPEBs as calculated for rates and FAS 106 as calculated for financial reporting purposes as a regulatory asset/liability, as appropriate. The Company shall also calculate a prepaid OPEB asset/liability for the difference between OPEB funding and the FAS 106 expense reported for financial purposes, that completely offsets the regulatory asset or liability. The net of the OPEB regulatory asset or liability and the OPEB prepaid asset/liability will be included in rate base in future rate proceedings.

Depreciation Issues

7. The Parties agree that the depreciation rates, as set forth in Attachment 3 to this Stipulation and Agreement, which is hereby incorporated herein for all purposes, should be approved by the Commission and become effective on January 1, 2006. In compliance with the Commission's final order in Case No. GR-99-315, the depreciation rates authorized herein are designed, in part, to recover the net salvage cost of plant which shall no longer be treated as an expense for ratemaking or financial accounting purposes. Consistent with the Commission's decision in Case No. GR-99-315, the net salvage component will continue to be accounted for separately and specifically identifiable in the reserve for depreciation.

Accounting Authorizations/Reservation of Rights

8. The Parties agree that Laclede shall, for book purposes, be authorized to continue to normalize the income tax timing differences inherent in the recognition of pension costs, OPEB costs, and AAO recoveries as authorized in Paragraphs 4, 5, 6, and