Exhibit No.:	
Issue:	**Weather Mitigation**
Witness:	**Michael R. Spotanski**
Type of Exhibit:	**Surrebuttal Testimony**
Sponsoring Party:	**Laclede Gas Company**
Case No:	**GR-2002-356**
Date:	**August 23, 2002**

LACLEDE GAS COMPANY

GR-2002-356

SURREBUTTAL TESTIMONY

OF

MICHAEL R. SPOTANSKI

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Tariff to Revise Natural Gas Rate Schedules.	)))	Case No. GR-2002-356

AFFIDAVIT

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

Michael R. Spotanski, of lawful age, being first duly sworn, deposes and states:

1. My name is Michael R. Spotanski. My business address is 720 Olive Street, St. Louis, Missouri 63101; and I am Vice President-Finance of Laclede Gas Company.

2. Attached hereto and made a part hereof for all purposes is my Surrebuttal Testimony, consisting of pages 1 to 12, inclusive.

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.

Michael R. Spotanski

Michael R. Spotanski

Subscribed and sworn to before me this 22ND day of August, 2002.

Joyce L. Jansen

JOYCE L. JANSEN
Notary Public — Notary Seal
STATE OF MISSOURI
ST. CHARLES COUNTY
My Commission Expires: July 2, 2005

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SURREBUTTAL TESTIMONY OF MICHAEL R. SPOTANSKI

Q. Please state your name and business address.

A. My name is Michael R. Spotanski, and my business address is 720 Olive Street, St. Louis, Missouri 63101.

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

A. I am employed by Laclede Gas Company ("Laclede" or "Company") in the position of Vice President-Finance. In this capacity, I am responsible for the Company's accounting, customer accounting, budgeting, financial planning, and management information reporting functions.

Q. How long have you held your current position?

A. I was elected to my current position in December 2000.

Q. What is your professional experience with Laclede prior to assuming your current position?

A. I joined Laclede in 1981 as a Staff Auditor and held various positions in the Company's Internal Audit and Finance departments. In 1988, I was promoted to Manager of Financial Planning. In that position, I had responsibility for the financial aspects of rate case analyses, various financial forecasts and monitoring regulatory trends and developments. In 1992, I was named Senior Rate Analyst in the Gas Supply and Regulatory Affairs Department. My primary responsibilities in that position included the preparation and submission of cost of service studies for use in allocating the Company's costs of providing utility service in general rate proceedings. I became Manager of Gas Supply Planning in 1996 in which I assumed responsibility for developing and reviewing various components of the Company's gas supply planning and procurement process. I was then promoted to the position of Assistant to the President in 1998 and in 1999 to the position of Assistant Vice President-Finance. I held that position until being elected to my current position in December 2000.

Q. What is your educational background?

A. I received a Bachelor of Science degree in Accounting from Southern Illinois University at Carbondale in 1982.

Q. Have you previously submitted testimony before the Missouri Public Service Commission ("Commission")?

A. Yes. I have filed testimony in a number of Commission proceedings relating to cost of service, gas supply and financial matters, including Case Nos. GR-90-120, GR-92-165, GR-92-314, GR-94-220, GR-96-193, GR-98-374, GA-99-107/GA-99-236, and GA-2002-429.

PURPOSE OF TESTIMONY

Q. What is the purpose of your surrebuttal testimony in this proceeding?

A. The purpose of my surrebuttal testimony is to respond to the claims made by Commission Staff ("Staff") witness James Russo and Public Counsel witness Ryan Kind regarding Laclede's right to a reasonable opportunity to recover its costs and the effect of weather on that opportunity. I will also address their contentions regarding the Company's financial condition and the need for a weather mitigation solution to address the deterioration that has occurred in that condition as a result of the impact of weather.

REASONABLE OPPORTUNITY TO RECOVER COSTS

Q. At the outset, please explain what you mean by "cost?"

A. "Cost" means all costs of doing business. The Company's authorized rate of return, also referred to as the "cost of capital," is a cost of doing business.

Q. Please explain.

A. Similar to the employees, who expect compensation for their efforts, and to the meter manufacturer, who expects compensation for its product, lenders and stockholders expect compensation for the capital they provide. Hence, the reasonable level of return authorized by the Commission is simply part of the cost of service. This is confirmed by Staff's own witness, Roberta McKiddy, on Schedule 32 to her direct testimony in this case, where she shows that Revenue Requirement = Cost of Service, which equals prudent operating costs, including depreciation and taxes, *plus Earnings Allowed on Rate Base.*

Q. Does Staff witness Russo agree with this basic concept?

A. It appears that Mr. Russo may not agree with this concept. Instead, he may be under the impression that Laclede's cost of service includes only its operating expenses and cost of debt, and does not include the return on equity portion of the cost of capital. This is evident by his statement on page 2, line 33 of his rebuttal testimony where he states that "the Company is including return on equity when it uses the term cost." Further, on page 4, lines 15 to 20 of his rebuttal testimony, Mr. Russo states that Laclede witness Yaeger's comment that the Company is not achieving its authorized rate of return "bolsters Staff's belief that the Company has recovered its expenses and is attempting to further bolster its bottom line for the direct benefit of the Company's shareholders at the expense of its ratepayers." Mr. Russo continues on line 21, indicating that "In fact, Laclede has had a profit for at least the last four years."

Q. What do you conclude from his statements?

A. Apparently, Mr. Russo believes that Laclede is entitled to only recover its operating expenses, and that shareholders should provide capital with no expectation that they would be fairly compensated for it. In reality, if Laclede recovered none of its cost of capital, Laclede's ability to borrow money would evaporate. Nor would Laclede be able to turn to equity markets to raise capital, because with no earnings and no dividend, Laclede stock would have no value.

Q. Has Laclede had positive net income over the past four years?

A. Yes, but it has not earned its authorized rate of return in any of those years and will not earn its authorized rate of return this year.

Q. What is the significance of this situation?

A. Obviously, the Company cannot continue indefinitely, year in and year out, to earn less, and in some cases, much less, than what the Commission has determined to be its reasonable and necessary cost of providing utility service, much of which is mandated by Commission rules.

Q. Public Counsel witness Kind and Staff witness Russo assert at pages 10 and 4 of their respective rebuttal testimonies, that the Company is entitled only to a reasonable opportunity to earn its authorized rate of return, and not to a guarantee of earning that return. How do you respond?

A. Laclede does not seek a guaranteed rate of return, nor does it expect the Commission to grant one. But it does expect the Commission to guarantee an opportunity to earn its authorized rate of return, as instructed by Mr. Kind in his "Intro to Utility Regulation 101" at page 10, lines 3-9. And yet when an extraordinarily warm winter occurs -- an event over which the Company has no control -- it cannot be honestly stated that Laclede has a reasonable opportunity to earn its Commission authorized return.

Q. Please explain why such an event deprives the Company of a reasonable opportunity to earn its authorized return.

A. For example, Laclede lost over $10.8 million as a result of the impact of weather this past winter. This figure represents the pre-tax dollar impact on Laclede due solely to the effect of weather from October 2001 through March 2002. To put this shortfall in perspective, I would note that the amount of under-recovery experienced by the Company as a result of this weather event is nearly equivalent to the expenditures which the Company must make on an annual basis to replace 8,000 copper service lines pursuant to its copper service replacement program and to complete virtually all of its other mandated pipeline replacement work. Put another way, such an amount represents nearly all of the payroll costs the Company incurs on an annual basis to staff both its Customer Relations Department (including operation of the Company's call center and interfaces with the Company's customers) and the multiple departments that provide the Company's gas supply and control functions (i.e., operation of the Company's distribution facilities and the purchase, dispatch and flow control of the Company's gas supplies).

Q. Could the Company have made up this shortfall through cost savings or other revenues?

A. No. Furthermore, since the effect of weather on usage is beyond the control of the Company, it makes no sense to allow these weather events to single-handedly jeopardize the financial health of the Company.

Q. Will the approval of the Company's proposed weather mitigation clause ("WMC") or proposed weather mitigation rate design provide Laclede with an earnings guarantee?

A. No. Even with weather as a neutral factor, Laclede could easily fail to recover its authorized costs, including its cost of capital, if it experienced higher than expected costs, or if it received lower than expected revenues.

Q. Please explain.

A. Higher than expected costs could arise and repeatedly have arisen in a variety of areas. Some examples are: (1) wages and salaries; (2) medical insurance; (3) workers compensation; (4) interest owed on borrowings; (5) injuries and damages; (6) liability insurance premiums; (7) materials and supplies; (8) maintenance costs; (9) property taxes; (10) regulatory assessments; and (11) office supplies. Laclede could also receive lower than expected revenues due to items such as: (1) customer contraction, meaning a net loss of customers in Laclede's service area; (2) reduced demand by commercial/industrial customers; (3) competition from providers of alternate fuels; (4) customer conservation; and

(5) increased appliance efficiency. Further, even if billed revenues met expectations, Laclede could experience higher than expected uncollectibles.

Q. Will either of the Company's weather mitigation proposals permit Laclede to escape the impact of these changes in costs and revenues?

A. No. As a result, neutralizing weather in no way guarantees earnings for Laclede. Additionally, the Company welcomes the opportunity to manage those revenue and expense items that it has some ability to control.

Q. Is there another frame of reference that is helpful in putting the impact of weather on the Company in perspective?

A. Yes. The FERC Uniform System of Accounts defines an extraordinary item as one that, among other things, has a financial impact equal to or greater than 5% of net income. For nearly a decade now, the Commission has recognized that events which have a financial impact on the utility greater than 5% of the utility's net income are extraordinary enough to be eligible for deferral consideration and potential future recovery under the Commission's standards and criteria relating to accounting authority orders.

Q. Is this significant?

A. Yes.

Q. Why?

A. It is all well and good to suggest, as Mr. Kind has, that the Company should continue to be subject to some degree of risk. However, such comments must be put into perspective. The fact of the matter is that the Company will continue to be subject to significant risk, even if one of its proposed weather mitigation measures is approved. Indeed, under the Company's weather mitigation rate design proposal, the Company would still face the prospect of losing as much as $1-2 million dollars of pre-tax earnings due to warmer than normal weather -- an amount that in itself is close to meeting the Commission's definition of an extraordinary impact. And this is in addition to all of the other risks of cost increases and revenue losses that I identified earlier. There is simply no viable reason for Mr. Kind to suggest that, in addition to these revenue and expense risks, the Company should also continue to be exposed to the prospect of losing an additional 20% or more of its net income due to an extreme weather event.

Q. Has weather had this kind of impact on the Company?

A. Yes. The winter of 2001-02, which was the fifth warmest in the past 102 years, and was 16% warmer than normal, impacted Laclede's pre-tax earnings by approximately 25%, far in excess of the level required to be considered an extraordinary item.

Q. Could the Company mitigate the impact of weather by obtaining weather insurance, as suggested by Public Counsel witness Kind at page 12, line 8 of his rebuttal testimony?

A. Laclede explored the possibility of purchasing weather insurance, but determined it to be an expensive alternative that exposed the Company to significant counterparty risk. More importantly, there is simply no reason to have the Company and its customers pay millions of dollars for weather insurance when a cost free solution like either of the Company's weather mitigation proposals can be easily implemented, and indeed have been implemented, in one form or another, in other jurisdictions.

FINANCIAL IMPACT OF WEATHER ON LACLEDE

Q. Both Mr. Kind and Mr. Russo suggest that weather has not had a serious impact on the Company's financial ability to meet its public service obligations. Would you agree?

A. No. Laclede's financial parameters have deteriorated significantly due, in large part, to the adverse impact of weather on the recovery of its costs of providing utility service. As I noted previously, this past winter was the fifth warmest in the past 102 years. Additionally, 6 of the 10 warmest winters of the past century in the St. Louis area have occurred since 1990.

Q. Please continue.

A. In her direct testimony, Company witness Patricia Krieger presents a chart demonstrating the degree day variations from NOAA normals since 1985. In addition to the warm temperatures experienced since 1990, that chart also shows that each of the six years from 1985 to 1990 was warmer than the NOAA 30-year normals. In summary, 13 of the last 18 years have been warmer than normal with six of those being among the top 10 warmest this century. This concentration of warmer than normal winters has cost Laclede tens of millions of dollars. Continuation of this trend, particularly in the current economic environment, will threaten the Company's ability to obtain, on reasonable terms, the financial resources necessary to meet its public utility obligations.

Q. Can Laclede's borrowing power be impacted by lower earnings caused by weather?

A. It can and it has. The Company's credit ratings have been under extreme pressure this year. For example, the ratings applicable to the Company's first mortgage bonds were downgraded by one notch this past spring by both Standard & Poor's and Moody's. The downgrades were to A+ (Standard & Poor's) and A1 (Moody's). On August 6, 2002, Moody's again downgraded our first mortgage bonds. This downgrade of <u>two</u> notches took the rating down to A3. At the same time, Moody's downgraded the Company's commercial paper rating from P-1 to P-2.

Q. What reasons did Moody's provide for these actions?

A. Moody's said the following in their news release announcing the August 6 downgrades:

> "The Company's debt protection measures have been in decline for the past 3 years. Its earnings and cash flow remain very sensitive to weather fluctuations and it is still operating without approval of a weather mitigation clause in spite of having experienced weather that was 16% warmer than normal during the past heating season."

Q. What is Moody's current outlook for the Company's credit ratings?

A. Moody's indicated that the outlook is now stable, but indicated that this outlook is based on their assumption that the Company will be able to implement a regulatory solution for the weather problem for the coming heating season. If such a solution is not forthcoming, Moody's will again review the ratings, and further downgrades could occur.

Q. What is the impact of this reduction in credit ratings?

A. This reduction will and, in fact, already has caused an increase in the cost of both short-term and long-term debt for the Company. It makes it more difficult to secure the financing that the Company requires to fund its operations and capital programs, and unfortunately increases the chance that, during difficult times in the capital markets, the required financing may not be available.

Q. Public Counsel witness Kind states on page 13 of his rebuttal testimony that the lack of a WMC has not caused Laclede to cut its dividend. Is this true?

A. Yes, Laclede has still paid its dividend. However, according to Laclede's SEC filings, for the twelve months ended June 30, 2002, Laclede Group's net income was $1.19 per share, while its dividend remained at $1.34 per share. Obviously, this kind of result, which shows earnings that are not even sufficient to cover the Company's dividend, let alone fully fund the Company's Cost of Service, as defined on page 3 above, is not sustainable.

OTHER MATTERS

Q. Witness Kind argues that mitigating weather should be accompanied by a reduction in the Company's rate of return (rebuttal testimony, page 20, lines 8-10, and page 23, lines 9-13). Do you wish to respond?

A. Yes, but only to say that although I do not agree with Mr. Kind, his argument is no longer relevant to the case because the parties have settled on revenue requirement in a manner that, for due consideration, settled the rate of return issue with the understanding that the weather mitigation clause and weather mitigation rate design issues would be left for resolution on their own merits.

Q. How do you respond to Mr. Russo's argument that the weather mitigation clause gives Laclede the initiative to lower its cost of service and thereby overearn?

A. Regardless of the existence of a weather mitigation clause, Laclede is always incented to lower its cost of service since Laclede will absorb all cost increases and retain all cost savings in its distribution cost of service between rate cases. In view of this consideration, it makes no sense to suggest that the existence of a weather mitigation clause, or for that matter, any other weather mitigation measure, would have any effect on this incentive.

Q. Does this conclude your testimony?

A. Yes it does.