Exhibit No.:	
Issue:	***Cost of Capital***
Witness:	***Roberta A. McKiddy***
Sponsoring Party:	***MoPSC Staff***
Type of Exhibit:	***Corrected Direct Testimony and Schedule Pages***
Case No.:	*GR-2002-356*
Date Testimony Prepared:	***June 20, 2002***
Corrected Direct Testimony Prepared:	*July 31, 2002*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REDLINED PAGES OF CORRECTED DIRECT TESTIMONY AND SCHEDULES

OF

ROBERTA A. McKIDDY

LACLEDE GAS COMPANY

CASE NO. GR-2002-356

Jefferson City, Missouri
June 2002

Corrected July 31, 2002

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

A. The purpose of my testimony is to recommend to the Commission a fair and reasonable rate of return to be applied to the Missouri jurisdictional rate base of Laclede Gas Company ("Laclede").

Q. Have you prepared any schedules to your analysis of the cost of capital for Laclede?

A. Yes. I am sponsoring a study entitled "An Analysis of the Cost of Capital for Laclede Gas Company, Case No. GR-2002-356" consisting of 33 schedules which are attached to this direct testimony (see Schedule 1).

Q. Based on your analysis, what do you conclude is the cost of capital for Laclede?

A. I conclude that the current cost of capital for Laclede is in the range of ~~7.37~~ 7.36 to ~~7.79~~ 7.78 percent.

ECONOMIC AND LEGAL RATIONALE FOR REGULATION

Q. Why are the prices charged to customers by utilities such as Laclede regulated?

A. A primary purpose of price regulation is to restrain the exercise of monopoly power. Monopoly power creates the ability to charge excessive or unduly discriminatory prices. Monopoly power may arise from the presence of economies of scale and/or from the granting of a monopoly franchise.

For services that operate efficiently and have the ability to achieve economies of scale, a monopoly is the most efficient form of market organization. Utility companies can supply service at lower costs if the duplication of facilities by competitors is avoided. This

Assuming that the various forms of capital are within a reasonable balance and are costed correctly, the resulting total weighted cost of capital, when applied to rate base, will provide the funds necessary to service the various forms of capital. Thus, the total weighted cost of capital corresponds to a fair rate of return for the utility company.

CAPITAL STRUCTURE AND EMBEDDED COSTS

Q. What capital structure have you employed in developing a weighted cost of capital for Laclede?

A. I employed Laclede's capital structure at March 31, 2002 for purposes of my analysis. Schedule 10 presents Laclede's capital structure and associated capital ratios. The resulting capital structure consists of ~~41.85~~ 41.75 percent common stock equity, ~~0.19~~ 0.18 percent preferred stock, ~~41.16~~ 41.05 percent long-term debt and ~~16.80~~ 17.01 percent short-term debt.

Q. What was the embedded cost of long-term debt for Laclede at March 31, 2002?

A. I determined the embedded cost of long-term debt at March 31, 2002 for Laclede to be 7.63 percent (see Schedule 11).

Q. Please describe Laclede's short-term debt outstanding as of March 31, 2002.

A. As of March 31, 2002, Laclede had ~~$114,884,692~~ $116,600,077 of short-term debt outstanding. Staff derived this number by calculating a 13-month average of Laclede's monthly short-term debt balances less a 13-month average of Laclede's monthly Construction Work in Progress (CWIP) balances in order to accurately reflect a full twelve months of activity in the short-term debt account. Staff has traditionally considered Gas Safety Deferrals as an extension of CWIP. Therefore, Staff also made allowance for a customer base, low market risk, competitive gas space-heating rates, diverse supply sources, and significant gas storage capacity. In addition, Laclede's largely residential customer base limits it susceptibility to economic downturns and mitigates vulnerability to threats from other energy providers." [Source: *Standard and Poor's Summary of Laclede Gas Company*, Ratings Direct, May 3, 2002.]

RATE OF RETURN FOR LACLEDE

Q. Please explain how the returns on common equity you have developed for each capital component will be used in the ratemaking approach Staff has adopted for purposes of developing the appropriate revenue requirement for Laclede's Missouri natural gas distribution operations.

A. Staff has adopted the cost of service ratemaking approach in this case. This approach develops the public utility's revenue requirement. The cost of service (revenue requirement) is based on the following components: prudent operation costs, rate base and a return allowed on the rate base (see Schedule 32).

It is my responsibility to calculate and recommend a rate of return that should be authorized on the Missouri jurisdictional natural gas distribution rate base for Laclede. Under the cost of service ratemaking approach, a weighted cost of capital in the range of ~~7.37~~ 7.36 percent to ~~7.79~~ 7.78 percent with a midpoint of ~~7.58~~ 7.57 percent was developed for Laclede's Missouri natural gas distribution operations (see Schedule 33). This rate was calculated by applying an embedded cost of preferred stock of 4.95 percent, an embedded cost of long-term debt of 7.63 percent, an embedded cost of short-term debt of 3.343 percent and a return on common equity range of 8.75 percent to 9.75 percent to a capital structure consisting of ~~16.73~~ 17.01 percent short-term debt, ~~41.43~~ 41.05 percent long-term debt, 0.18

percent preferred stock and ~~41.66~~ 41.75 percent common equity. Therefore, I am recommending that Laclede Gas Company's Missouri natural gas distribution operations be allowed to earn a return on its original cost rate base in the range of ~~7.37~~ 7.36 percent to ~~7.79~~ 7.78 percent with a midpoint of ~~7.58~~ 7.57 percent.

Based on my analysis, I believe I have developed a fair and reasonable rate of return. When applied to Laclede Gas Company's Missouri jurisdictional natural gas distribution rate base, this recommended rate of return should allow Laclede the opportunity to earn the revenue requirement developed in this rate case.

ADJUSTMENTS

Q. Are you sponsoring any adjustment to Staff's revenue requirement run?

A. Yes. I am sponsoring adjustment S-15.17 ($225,337) to the Income Statement. During April 1999, Laclede issued 1,250,000 shares of common stock. In doing so, the Company incurred costs totaling $1,126,684 (i.e., flotation costs). It is Staff's position that flotation costs be recovered through rates as an above-the-line adjustment to operating expenses. Staff determined in Case No. GR-99-315 that the flotation costs associated with the April 1999 issuance should be amortized over five years, to avoid the possibility of over-recovery by the company. The amortization period for the flotation costs associated with the April 1999 issuance is set to expire April 2003.

TRUE-UP AUDIT

Q. Is the Staff proposing a true-up audit in this case?

A. Yes. I am recommending a true-up audit be performed for the purpose of updating the capital structure and associated embedded costs through July 31, 2002. This

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Average Net Short-Term Debt Outstanding
for Laclede Gas Company
(in thousands)

				Revised #		
	(1)	(2)		(3)		(4)
	Short-Term	Construction		Gas		Net
	Debt	Work-In		Safety		Short-Term
Month	(End of Month)	Progress	Orig. #	Deferrals (AAOs)	Orig. #	Debt
March 2001	$195,700	$4,274		$1,944		$189,482
April	$171,800	$4,932		$2,332		$164,536
May	$145,100	$5,831	~~$24,769~~	$2,469 *	~~$114,500~~	$136,800
June	$90,200	$6,305		$2,601		$81,294
July	$104,000	$6,382		$2,756		$94,862
August	$115,100	$8,406		$2,885		$103,809
September	$117,050	$6,189		$3,036		$107,825
October	$128,250	$6,394		$3,191		$118,665
November	$130,800	$6,754		$2,940		$121,106
December	$133,820	$7,105		$106		$126,609
January 2002	$120,430	$7,300		$125		$113,005
February	$99,020	$8,211		$141		$90,668
March	$75,600	$8,278		$182		$67,140
13-Month Average	$125,144	$6,643	~~$3,616~~	$1,901	~~$114,885~~	$116,600

Notes:

(1) Column 4 = Column 1 - (Column 2 + Column 3)

(2) 13-month average was utilized in order to reflect a full 12 months of activity.

(3) Column 3 represents Allowance for Gas Safety Deferrals financed at construction short-term debt rate.

Source: Laclede Gas Company's Month Ending General Ledgers and Data Request No. 3803.

* Typo corrected June 27, 2002. Original entry showed $24,769. This correction will impact 13-month average for Gas Safety Deferrals, Net Short-Term Debt for May 2001 and 13-month average for Net Short-Term Debt, which flows into Schedule 10 - Capital Structure for Laclede Gas Company as of March 31, 2002.

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Capital Structure as of March 31, 2002
for Laclede Gas Company

Capital Component	Orig. #	Revised Amount in Dollars	Orig. #	Revised Percentage of Capital
Common Stock Equity		$286,125,637	~~41.85%~~	41.75%
Preferred Stock		$1,266,375	~~0.19%~~	0.18%
Long-Term Debt		$281,378,589	~~44.16%~~	41.05%
Short-Term Debt	~~$114,884,692~~	$116,600,077	~~16.80%~~	17.01%
Total Capitalization	~~$683,655,293~~	$685,370,678	100%	100.00%

Gas Distribution Utility Financial Ratio Benchmarks

Adjusted Total Debt / Total Capital

		AA	BBB	A
Standard & Poor's Corporation's	Upper Quartile	53.67%		52.89%
Utilities Rating Service	Median	50.57%		50.50%
Financial Statistics, July 2000	Lower Quartile	47.20%		47.44%
	Upper Quartile		60.86%	
	Median		55.60%	
	Lower Quartile		51.86%	

Notes: See Schedule 13 for the amount of Preferred Stock outstanding at March 31, 2002.

See Schedule 11-1 for the amount of Long-Term Debt outstanding at March 31, 2002.

See Schedule 12 for the average amount of Short-term Debt outstanding net of Construction Work in Progress and Gas Safety Deferrals.

Source: Laclede Gas Company's Response to Data Request Nos. 3801.

* Correction made June 27, 2002. This revised amount flows from correction made to Schedule 12.

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Pro Forma Pre-Tax Interest Coverage Ratios
for Laclede Gas Company

			8.75%	**9.25%**	**9.75%**
1.	Common Equity (Schedule 10)		$286,125,637	$286,125,637	$286,125,637
2.	Earnings Allowed (ROE * [1])		$25,035,993	$26,466,621	$27,897,250
3.	Preferred Dividends (Schedule 13)		$62,669	$62,669	$62,669
4.	Net Income Available ([2] + [3])		$25,098,662	$26,529,291	$27,959,919
5.	Tax Multiplier (1 / { 1 - Tax Rate }) (Laclede's Tax Rate is 38.3886 per Steve Rackers, Staff Auditor)		1.6231	1.6231	1.6231
6.	Pre-Tax Earnings ([4] * [5])		$40,737,043	$43,059,061	$45,381,080
7.	Annual Interest Costs [$21,466,351 + (Interest on Long-term debt + Interest on Average Short-term debt)	~~$3,840,595~~ $3,897,941]	~~$25,306,946~~ $25,364,291 *	~~$25,306,946~~ $25,364,291 *	~~$25,306,946~~ $25,364,291 *
8.	Avail. for Coverage ([6] + [7])		~~$66,043,989~~ $66,101,334 *	~~$68,366,007~~ $68,423,352 *	~~$70,688,026~~ $70,745,371 *
9.	**Pro Forma Pre-Tax Interest Coverage** ([8] / [7])		**2.61 x**	**2.70 x**	**2.79 x**

Financial Statistics: Gas Distribution - Pretax Interest Coverage (x)

Standard & Poor's Corporation's Utilities Rating Service Financial Statistics - Gas Distribution July 2000	AA	A	BBB
Upper Quartile	**5.19x**	**4.94x**	**3.01x**
Median	**4.58x**	**3.89x**	**2.85x**
Lower Quartile	**4.19x**	**2.72x**	**1.98x**

NOTE: Item 7 = (Total from Column 3 on Schedule 11-1) + (Net Short-term debt from Schedule 12 * Average Interst Rate on ST Debt)

* Correction made June 27, 2002. This correction flows from correction made on Schedule 12.

Weighted Cost of Capital as of March 31, 2002
for Laclede Gas Company

Capital Component	Orig. #	Revised Percentage of Capital	Embedded Cost	Orig. #	Revised 8.75%		Orig. #	Revised 9.25%		Orig. #	Revised 9.75%	
				Weighted Cost of Capital Using Common Equity Return of:								
Common Stock Equity	~~41.85%~~	41.75% *	-----	~~3.66%~~	3.65%	*	~~3.87%~~	3.86%	*	~~4.08%~~	4.07%	*
Preferred Stock	~~0.19%~~	0.18% *	4.95%	0.01%	0.01%		0.01%	0.01%		0.01%	0.01%	
Long-Term Debt	~~41.16%~~	41.05% *	7.63%	~~3.14%~~	3.13%	*	~~3.14%~~	3.13%	*	~~3.14%~~	3.13%	*
Short-Term Debt	~~16.80%~~	17.01% *	3.343%	~~0.56%~~	0.57%	*	~~0.56%~~	0.57%	*	~~0.56%~~	0.57%	*
Total	100.00%	100.00%		**~~7.37%~~**	**7.36%**	*	**~~7.58%~~**	**7.57%**	*	**~~7.79%~~**	**7.78%**	*

* Correction made June 27, 2002. These corrections are a result of the correction made to Schedule 12.

Notes: See Schedule 10 for the Capital Structure Ratios

See Schedule 13 for the Embedded Cost of Preferred Stock

See Schedule 11-1 for the Embedded Cost of Long-Term Debt.

Laclede's Embedded Cost of Short-Term Debt is the average Short-Term Debt Interest Rate Paid for the 12 month Period Ended March 31, 2002, and was taken from the Company's Response to Staff's Data Information Request No. 3803.