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Missouri Public
Service Commission

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's) Tariff to Revise Natural Gas Rate) Case No. GR-99-315 Schedules.)

A F F I D A V I T

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

Douglas H. Yaeger, of lawful age, being first duly sworn, deposes and states:

1. My name is Douglas H. Yaeger. My business address is 720 Olive Street, St. Louis, Missouri 63101; and I am Chairman, President & Chief Executive Officer of Laclede Gas Company.

2. Attached hereto and made a part hereof for all purposes is my direct testimony, consisting of pages 1 to 23, inclusive.

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.

Douglas H. Yaeger
Douglas H. Yaeger

Subscribed and sworn to before me this 11th day of March, 1999.

JOYCE L. JANSEN
Notary Public — Notary Seal
STATE OF MISSOURI
St. Louis County
My Commission Expires: July 2, 2001

Joyce L. Jansen

Exhibit No.:	
Issue:	Policy
Witness:	Douglas H. Yaeger
Type of Exhibit:	Direct Testimony
Sponsoring Party:	Laclede Gas Company
Case No.:	GR-99-315

LACLEDE GAS COMPANY

GR-99-315

DIRECT TESTIMONY

OF

DOUGLAS H. YAEGER

March 1999

DIRECT TESTIMONY OF DOUGLAS H. YAEGER

Q. Please state your name and business address.

A. My name is Douglas H. Yaeger, 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 in the position of Chairman of the Board, President and Chief Executive Officer.

Q. Please state your qualifications and experience.

A. I received a Bachelor of Science Degree in Business Administration in 1971 from Miami University, in Oxford, Ohio. In 1976, I graduated from Saint Louis University, St. Louis, Missouri, where I received a Master of Business Administration Degree. In May of 1992, I completed the Advanced Management Program at the Harvard Business School, in Boston, Massachusetts.

During most of the period from July 1971 through November 1990, I was employed by Mississippi River Transmission Corporation (MRT), an interstate natural gas pipeline which primarily serves the Greater St. Louis Metropolitan Area. While employed at MRT, I held various positions in that Company's rates, regulatory affairs, gas supply, sales, marketing and accounting departments. At the time I left MRT, I held the position of Executive Vice

President, with management responsibility for the areas of marketing, planning, budgets and administration, transportation and exchange and information services.

I joined Laclede as Vice President-Planning in December of 1990. From September 1992 to September 1995, I served as Vice President and then Senior Vice President-Operations, Gas Supply and Technical Services. In September 1995, I was elected to the position of Executive Vice-President - Operations and Marketing, where I assumed management responsibility for both operations and the Company's marketing activities. With my election to the position of President and Chief Operating Officer, effective in December of 1997, I assumed overall management responsibility for all of the Company's day-to-day operation. I was elected to my current position effective January 1, 1999 and assumed the position of Chairman of the Board on January 28, 1999.

Q. Have you previously testified before this Commission?

A. Yes, I submitted pre-filed testimony and participated in the proceedings in Case No. GA-89-126 regarding the initial application of Missouri Pipeline Company (MPC) for certificate authority to transport natural gas in the State of Missouri. I also submitted pre-filed testimony in Laclede's three most recent general rate case proceedings, Case Nos. GR-94-220, GR-96-193, and GR-98-374.

PURPOSE OF TESTIMONY

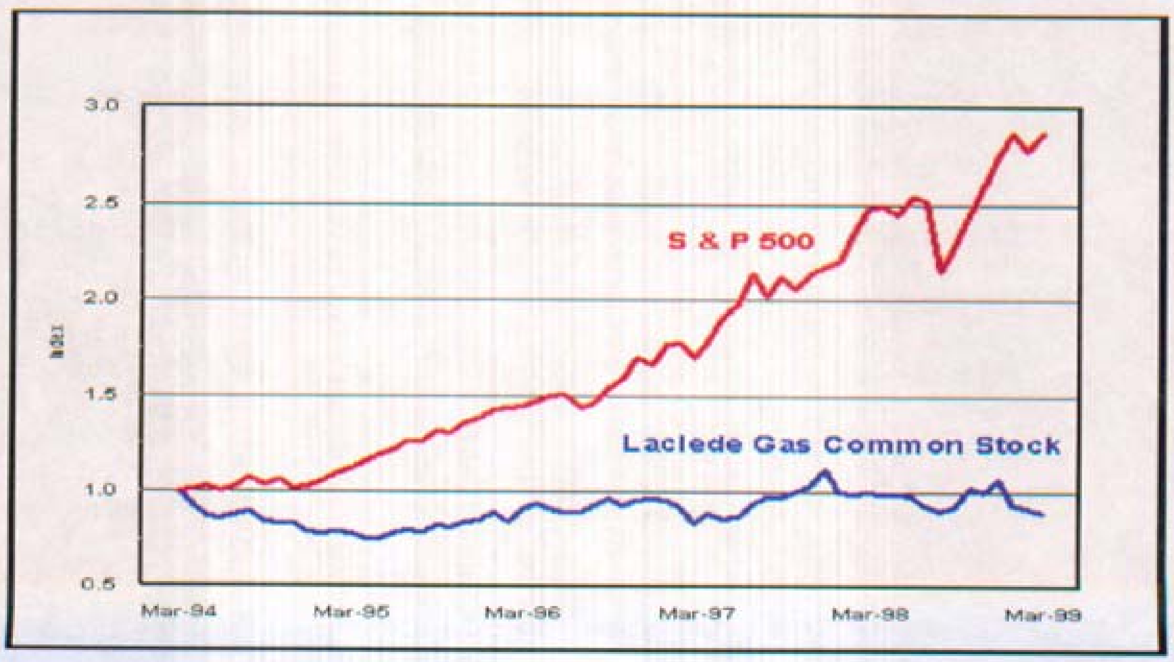
Q. What is the purpose of your testimony in this case?

A. My testimony will cover three general areas. First, I will address two issues which are of particularly critical importance to Laclede's continued ability to remain a financially strong and independent Missouri utility. One involves the need to establish a fair and realistic return on equity for Laclede that takes into account the unprecedented disparity between the real world returns which exist in the financial markets today and those proposed by Staff. The other concerns the need to adopt a ratemaking approach to address the impact of weather trends and fluctuations -- an approach that effectively deals with the chronic underrecovery of certain fixed costs and the severely negative earnings impact arising from a decade and a half of excessively warm weather. Second, I will provide a brief overview of the other reasons underlying the Company's request for a general increase in rates, including an explanation of the additional operational risks and responsibilities that Laclede and other local distribution companies (LDCs) face in today's changing business and regulatory environment. Third, I will address the efforts Laclede has undertaken to respond to this changing environment and outline the steps which I believe the Commission must take to enable Laclede to maintain the financial resources required to meet its public service obligations.

CRITICAL ISSUES

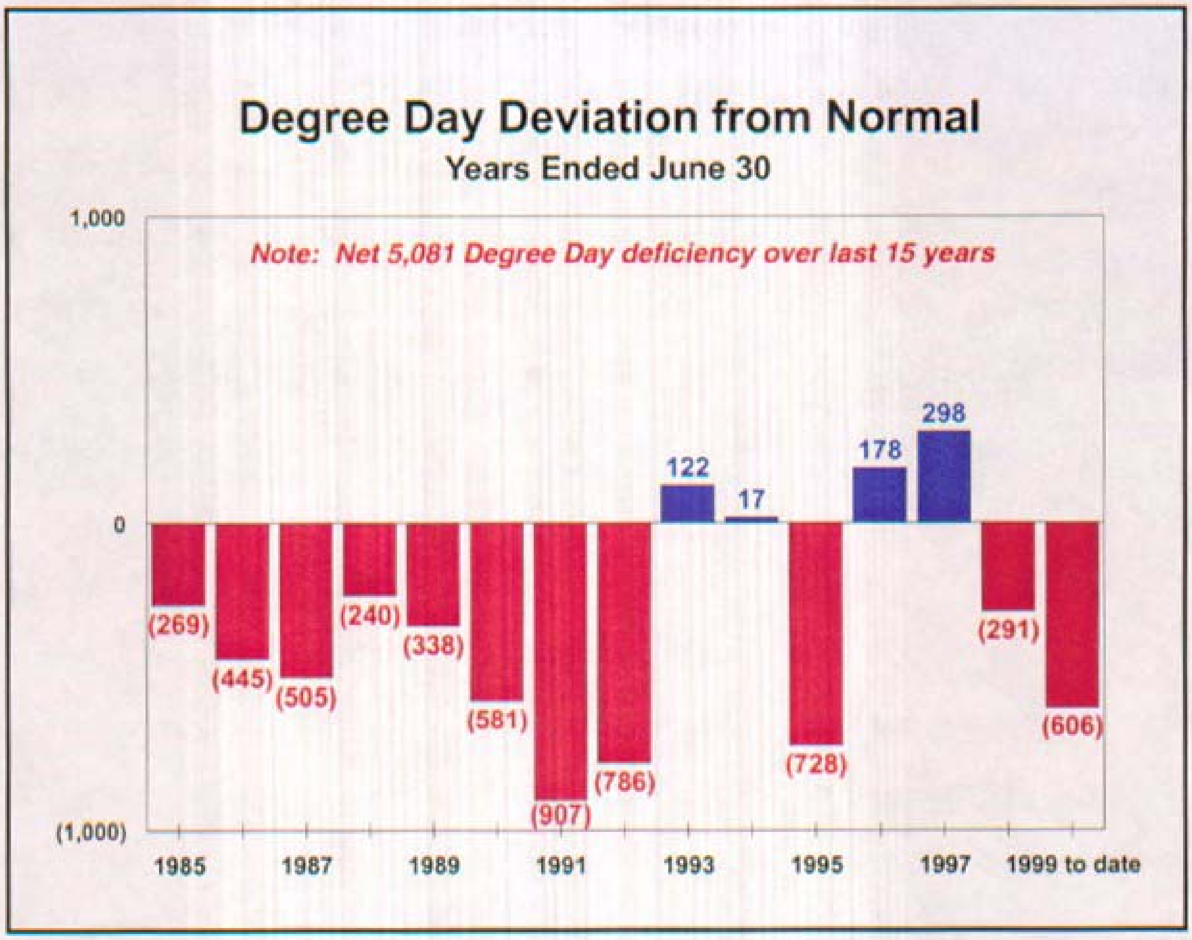
A. You indicated that there were two issues of particular importance in this proceeding. Please discuss them.

Q. The first involves the need for a practical re-examination of how the Company's future return on equity should be determined in light of the unprecedented economic conditions prevailing in the financial markets today. As shown in the graph presented below, the traditional methods used by the Staff in this area have led to the anomalous and disastrous result of driving down the returns generated for Laclede at the very time that the overall returns earned by the non-utility segment of corporate America have increased to near record levels.



This disparity between real world returns and those generated under Staff's Discounted Cash Flow (DCF) method (calculated on market value but then inappropriately applied to book value) has been substantial enough in Laclede's last two rate cases that even the Staff has submitted testimony recognizing the inadequacy of the indicated returns and the need to deviate from them. Recent financial results suggest that the problem has only grown worse. As discussed in the direct testimony of Laclede witnesses Olson and McShane, it is simply unreasonable to expect that LDCs, which are riskier than ever before, will be able to continue to attract capital with authorized jurisdictional returns that are capped at sixty percent (or less) of the average returns being earned by other firms in today's environment. In view of these considerations, Laclede believes the time has come for this Commission to move towards a comparable earnings approach in setting Laclede's allowed return on equity as supported by the Company's testimony.

The second major issue concerns the need to adopt sensible ratemaking measures that will give the Company a reasonable opportunity to avoid the huge financial losses which have been experienced over and over again during the past fifteen years because rates have failed to adequately recognize the effects of an incredibly long and severe period of warmer weather on the Company's revenues and hence its earnings. As shown below, the deviation between so-called "normal weather" and the weather actually experienced by the Company has been profound.



This one factor alone, has resulted in a net loss to the Company of over $23 million in the past fifteen years -- an amount that approximates an entire year's worth of earnings. The Company's rate design proposal, discussed in the direct testimony of Laclede witnesses K. J. Neises and M. T. Cline, together with its recommendation for normalizing weather based on recent history as discussed in the testimony of Laclede witness P. A. Krieger, offer a rational and equitable approach towards reducing the impact of positive and negative variations from normal weather for both the Company and its customers.

If the Company is to have the resources required to meet its fundamental public service obligations, it is imperative that the Commission approve the Company's proposals for rectifying the critical deficiencies in these two areas.

OTHER REASONS FOR PROPOSED INCREASE

Q. What other factors have contributed to Laclede's request for an annual revenue increase of approximately $30.5 million in its tariff filing of January 26, 1999?

A. Although the Company continually works to control its costs and is constantly seeking new ways to enhance its revenues, it has little choice but to pursue rate relief given the changing multiple environments within which it operates.

Q. Please explain.

A. It is important to recognize that Laclede provides service in a highly mature and saturated market, a portion of which is constantly relocating to the remote reaches of its service area. As a result, the real opportunities for customer growth within our service area are limited. Moreover, the modest customer growth that Laclede does experience is offset by the fact that the per customer use of natural gas continues to decline as customers replace their older gas equipment with newer and more efficient appliances and equipment. Historically, the combination of these factors has resulted in an average growth rate in natural gas volumes for Laclede of about one percent per year.

At the same time, Laclede, like other LDCs, continues to experience moderate but persistent increases in its payroll, operations and maintenance expenses, and materials and supplies costs. Costs have also risen as a result of the continuing obligation to monitor and replace mains, service lines and other facilities at replacement costs that, due to the passage of time and inflation, are frequently much greater than the original dollar cost of the property being replaced. Unfortunately, unlike the technologically-driven telecommunications industry or even the electric industry with its access to significant depreciation-driven cash resources, neither the modest market growth, nor the limited productivity gains achievable in the natural gas distribution business, are sufficient to offset these upward cost pressures. Under such circumstances, periodic rate relief is the only alternative available for ensuring that Laclede, as an independent Missouri utility, will have the financial resources required to meet its public utility obligations on a sustainable basis.

Q. Please explain to what extent customer migration is occurring in the St. Louis Metropolitan Area.

A. From 1960 to 1990, for example, over 350,000 residents, or nearly half of the City's entire population, left the City of St. Louis for surrounding counties or other areas. Moreover, since 1990 alone, an additional 55,000 residents have moved out of the City. Indeed, according to recently reported figures, even the population of St. Louis County itself has begun to decline as residents continue to move away from traditional residential areas. This migration is commonly referred to as the "urban sprawl" phenomenon.

Q. How does "urban sprawl" contribute to Laclede's need for rate relief?

A. Customer migration has a two-fold effect. On the one hand, the Company receives no net increase in load when customers simply move from one part of its service territory to another. In fact, overall load may actually decrease to the extent customers move into newer, more energy-efficient housing stock or, in some cases, leave our service territory altogether. On the other hand, our overall cost of service goes up since the Company must incur the new costs required to provide service in the areas to which these customers have moved, along with the fixed cost responsibility necessary to maintain service in its traditional markets. While we have not made a detailed study to determine whether and to what extent other Missouri utilities have been affected by this type of customer migration, I strongly suspect that few, if any, have been impacted to the same degree as Laclede.

Q. Are there any regulatory considerations that have affected the Company's need to seek periodic rate relief?

A. Yes. The most notable factor has been the Company's consistent inability to receive in rates the full level of costs it incurs to provide its utility service. Because rates in Missouri are based on historical costs, they are, by definition, inadequate to cover the Company's actual cost of providing service from the moment they first become effective. Indeed, the Commission itself has recognized this problem in the recent past by finding that the return on equity requirements for at least one Missouri utility should be adjusted upward to compensate for the additional risks associated with operating in a jurisdiction that does not utilize forward-looking test years. Unfortunately, the problems associated with using an historical test year have been compounded by the frequent failure of the Staff to recommend inclusion in rates even those known and legitimate costs of doing business which are certain to be incurred by the Company once the rates go into effect, such as identifiable labor costs adjustments agreed to in multi-year bargaining contracts, monitoring, repairing and replacing its distribution system facilities, with special emphasis on our aggressive efforts regarding direct buried copper services, and maintaining the natural gas inventories necessary to meet the gas supply needs of the Company's customers.

Q. Hasn't the decline in the inflation rate over the past several years served to ameliorate the financial impact of these regulatory policies?

A. Although moderating inflation levels have helped to reduce the adverse effects of these regulatory policies, any benefit from a lower inflation rate has been largely offset by other factors. As I previously noted, these include the more than a decade long occurrence of warmer than normal temperatures which has deprived the Company of over $23 million in net margin revenues which were assumed in rates and the rate design in effect during this span, as well as the increase in the competition for capital experienced by the Company as a result of the unprecedented dynamics which currently prevail in the financial markets.

Q. In addition to its inability to recover its cost of providing service, does Laclede also face increased risks in today's operational, business and regulatory environments?

A. Without question, the risks facing Laclede have increased in virtually every aspect of its business, from the procurement of gas supplies to the delivery of gas service to the end-consumer.

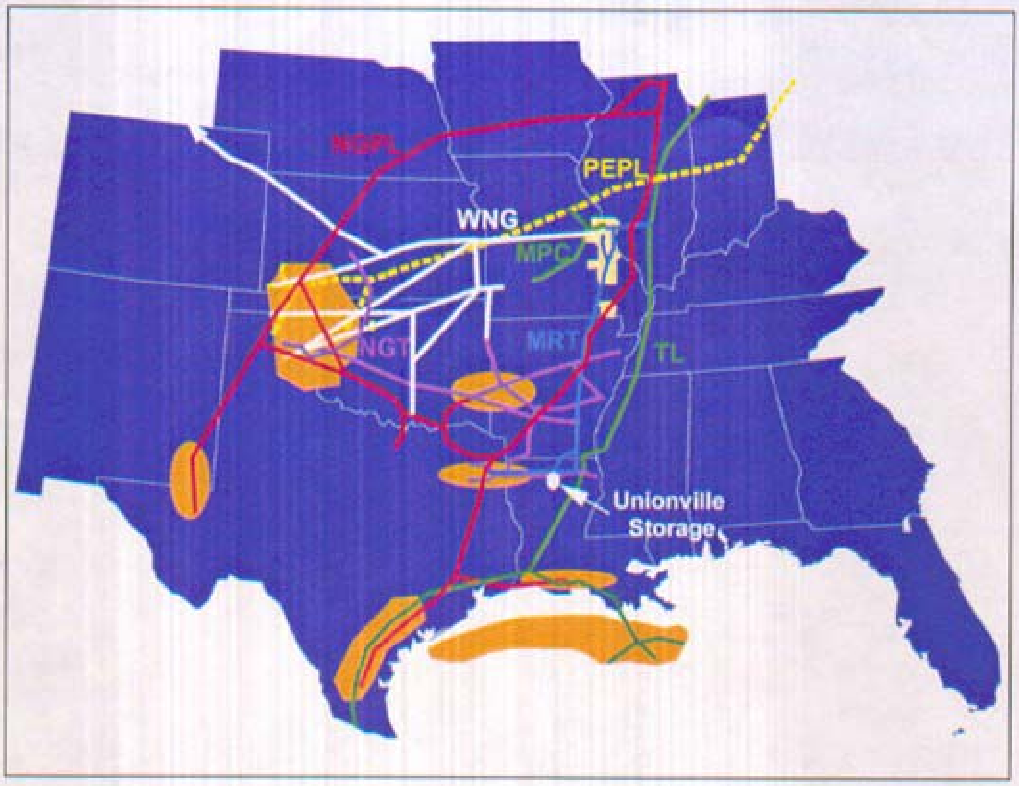
Q. How have the risks increased in the gas supply end of Laclede's business?

A. To understand the added risks in the gas supply area, it is helpful to begin with a brief description of the gas supply resources available to Laclede. Laclede contracts for the overwhelming majority of its firm pipeline transportation capacity - 670,418 MMBtu per day - through the facilities of MRT, an interstate pipeline company currently owned by Reliant Energy (formerly Houston Industries) and subject to regulation by the Federal Energy Regulatory Commission (FERC). MRT has two large underground gas storage facilities in North Louisiana as well as a smaller aquifer storage field in Western Illinois. MRT also provides direct access to small producing properties in North Louisiana, and has a variety of large interconnects with other major interstate pipelines, including the former NorAm Gas Transmission (now also part of Reliant Energy), Koch Gateway Pipeline, Natural Gas Pipe Line Company of America and Trunkline Gas Company (TGC). Through these interconnections, MRT's customers can access gas supplies and reserves from several major onshore and offshore producing areas.

Laclede also contracts for a much smaller portion of its capacity - 55,000 MMBtu per day - through MPC, an intrastate pipeline that began deliveries to the Company in January, 1990, and which is subject to the regulation of this Commission. MPC, which is a division of UtiliCorp United, Inc., has just one upstream interconnection with Panhandle Eastern Pipe Line Company (PEPL) through which MPC and its customers can access gas supplies.

Finally, Laclede concluded an Agreement last year with Williams Gas Pipelines Central, Inc. (Williams), another interstate pipeline. Under this Agreement, WNG began delivering up to 28,000 MMBtu per day to Laclede last fall through a converted products pipeline that is interconnected to the western side of Laclede's system in St. Charles County.

The following chart depicts the gas supply basins and pipeline transportation capacity, both the directly connected and the upstream feeder systems, which are incorporated into Laclede's current gas supply portfolio:



Q. How has the Company's use and management of these resources changed over the past several years?

A. As the Commission well knows, as a result of FERC Order No. 636, the responsibility for procuring and managing these gas supply resources has fundamentally shifted from the pipelines to LDCs. As a consequence, Laclede has had to enter into a multitude of direct arrangements with various producers and marketers of natural gas and match up these supplies with transportation capacity on the upstream pipelines which feed into MRT. In addition, Laclede has had to contract for transportation, both firm and interruptible, as well as firm storage service, on MRT's system and assume the responsibility for managing these resources on an hour-to-hour and day-to-day basis.

Q. How has this shift in responsibility increased the degree of risk faced by Laclede and other LDCs?

A. First, it has substantially increased the risks and uncertainties associated with obtaining a long-term gas supply -- a requirement that is vital to Laclede's business. In the past, the interstate pipelines had the obligation not only to secure adequate supplies on behalf of their LDC customers, but also to make sure they were delivered to the LDC's system as needed. The pipelines also had to cover all additional risks associated with these efforts. Today, that entire gas supply management risk falls squarely on LDCs. Unfortunately, this increased operational risk has been matched by an even greater uncertainty in the regulatory arena over how and whether LDCs can recover the millions of dollars in cost incurred to procure those supplies and services. That uncertainty is particularly acute today for Laclede given the lack of assurance as to how it will recover the overwhelming cost of doing its business.

Q. Please explain.

A. As this Commission is well aware, prior to the adoption of gas incentive plans in Missouri, Laclede and other large LDCs operated pursuant to a PGA/ACA process under which they could never recover more than their actual gas costs. At the same time, they faced the real possibility of substantial cost disallowances in the event their procurement actions or decisions were later deemed to have been imprudent. With the approval of the Company's Gas Supply Incentive Plan, prudence reviews of certain purchased gas costs were eliminated in favor of the performance benchmark contained in that Plan. As a result, while Laclede still faced the possibility of prudence disallowances in certain areas and the risk of a financial penalty if it failed to outperform the benchmark, it at least had some upside potential in the form of financial rewards for superior performance.

There is no certainty today, however, whether even this limited mechanism for achieving some degree of risk/reward parity in the gas procurement area will survive at all. Before the rates in this proceeding are even established, the initial term of the Company's GSIP is scheduled to expire. It is completely unclear at this point whether the GSIP will be continued at all or replaced with an entirely new incentive mechanism. Indeed, it is not even clear whether the Company may be required to revert to the old system under which it can only lose money as a result of its gas procurement efforts or even to the use of a rate case like process for recovering gas costs -- a result that could expose the Company and its customers to new risks in the form of millions of dollars of potentially unrecovered or overrecovered gas costs. What is clear, however, is that the degree of regulatory uncertainty and the risk posed by such uncertainty is increasing.

Q. Aside from these increased risks relating to the gas supply function, are there new risks faced by Missouri LDCs today in other areas of their business?

A. Yes. Over the past several years, there has been a substantial increase in efforts aimed at restricting the ability of LDCs and other utilities to engage in unregulated activities on reasonable terms. In the Missouri General Assembly, these efforts culminated in legislation that imposed certain restrictions on the ability of electric and gas utilities to sell, repair, and offer warranties on heating, ventilating, and air-conditioning equipment and appliances. Unfortunately, rules have recently been proposed in Missouri that, if ultimately adopted and upheld, would substantially expand and alter these restrictions in a manner that would make it very difficult for Missouri utilities to practically compete in this area. We have also seen proposals from various parties in the Commission's affiliate transaction workshop that would extend even more onerous restrictions to other unregulated activities -- a result that would make it extremely difficult, if not impossible, for Missouri utilities or their affiliates to effectively compete in unregulated markets. At the same time, however, pressure continues to be applied from certain quarters to introduce additional competition in markets that have traditionally been served on an exclusive basis by utilities.

Laclede strongly believes that many of these efforts are not in the best interests of its customers and will continue to challenge them for that reason. It is sufficient to note here, however, that such efforts undoubtedly contribute to a riskier environment for regulated utilities by diminishing the prospects for future business growth and by impairing the very ability of utilities to use their assets in the most efficient and productive manner possible for the benefit of the utility's customers and its shareholders.

RESPONSE TO CHANGING ENVIRONMENT AND REGULATORY RECOMMENDATIONS

Q. Mr. Yaeger, how has Laclede responded to these changes in its operational, business and regulatory environments?

A. In its efforts to meet the challenges posed by these fundamental changes, Laclede has adhered to a few basic principles. First, while we recognize that the search for "strategic growth opportunities" has become a fashionable pursuit in the utility industry, the Company believes that its first and most important responsibility is to ensure that our existing customers receive the best, most dependable service that can reasonably be provided. To that end, the Company has focused its efforts and attention on making certain that all of the routine activities and tasks required to provide quality service are not only done, but done well. While this emphasis on "sweating the details" may not be terribly exciting, it is the heart and soul of any serious commitment to provide customers with the type of superior service they have every right to expect. Whether it be arranging service with a new pipeline supplier so that the Company will be able to meet current and future changing demands of its customers or helping customers through our voluntary weatherization program, we believe the quality of the result is directly related to the quality of the effort.

Q. Do you have any evidence suggesting that these efforts have, in fact, resulted in customers receiving quality service?

A. The litmus test for determining whether any Company has succeeded in this regard is, of course, the customer's perception of the quality of the service he or she receives. Although Laclede receives a substantial number of favorable letters and phone calls from its customers regarding the quality of the services it provides, customer satisfaction can also be gauged by the relatively low number of customers who find it necessary to complain about the Company's services. As this Commission knows, during the public hearings held in our last three rate case proceedings, only one or two customers at most testified unfavorably about Laclede's rates or services. For a Company with over 610,000 customers, I believe that is an extraordinary result. In addition, the annual number of informal inquiries or complaints received by the Commission's Consumer Services Department regarding Laclede have remained exceptionally low over the past eight years, with less than one-tenth of one percent of our customers expressing any type of dissatisfaction about the quality or price of the Company's services. Indeed, these numbers remained relatively constant even during the run up in gas prices during the early months of the 1996-1997 winter. While Laclede intends to continue its efforts to improve upon these low complaint levels, we believe our performance to date is indicative of a utility that not only strives for, but is successful at, delivering quality utility service.

Q. Does Laclede's emphasis on preserving and enhancing the quality of its everyday services mean that the Company has been less innovative in exploring new ways to benefit its customers?

A. Not at all. In addition to our focus on maintaining the quality of our existing services, we have also undertaken special initiatives designed to safeguard and, where possible, advance the interest of our customers in this changing environment. To ensure that all of our customers continue to have access to the essential services we provide, we have taken whatever steps are necessary, including the acquisition of new gas supply sources, to ensure the overall reliability of our gas supplies as we move into the 21st century. As discussed in the direct testimony of Laclede witness Moten, we have also taken a leadership role in making sure that our most vulnerable customers will continue to receive natural gas service through programs such as Dollar Help and by spearheading efforts to obtain public funding in the General Assembly for low income, disabled and elderly customers. The Company has also continued to make substantial contributions, in terms of dollars and time committed, aimed at improving the economic, social and educational fabric of the communities in which we operate.

Q. What has the Company done to reduce the cost of the services it provides?

A. While Laclede has always been very careful about how it spends its customers' dollars, it is probably unique among Missouri utilities in terms of the degree to which the Company has attempted to maximize the efficient use of its assets and then share the financial benefits of those efforts with its customers. Our current Gas Supply

Incentive Plan is the most prominent example of these efforts. With this Plan, Laclede has already managed to achieve nearly $73 million of identifiable savings and revenues in the gas procurement area, of which nearly 80% has or will be returned to the Company's customers. In the process Laclede has been able to retain for its Missouri customers and shareholders, most of whom live in Missouri, very real financial benefits that otherwise may well have gone to entities located out of state.

Laclede cannot, however, overcome the increasing external pressures presented by today's environment, absorb the severe negative earnings fluctuations caused by weather impacts, and still provide high quality service to its customers through the implementation of innovative programs which are deemed to be "limited" or "experimental" and may or may not be available in the future. Therefore, it is absolutely imperative that it receive fair and adequate regulatory treatment before this Commission.

Q. What steps does the Company believe the Commission should take to ensure such treatment?

A. As discussed throughout the testimony of other Company witnesses, there are a number of steps that the Commission can and should take to address these inadequacies in the current process. They include:

- permitting the inclusion in rates of known and legitimate future costs;

- basing weather normalization adjustments on reasonable assumptions reflecting current weather trends;
- adopting the Company's rate design proposal;
- adopting the Company's proposed treatment of the various safety, environmental, Y2K and employee benefit related costs deferred by the Company pursuant to accounting authorizations and tracking mechanisms previously granted by the Commission; and
- establishing an appropriate return on equity in this proceeding that reflects the realities of today's environment.

Q. Does this conclude your testimony?

A. Yes.