BEFORE THE PUBLIC SERVICE COMMISSION

STATE OF MISSOURI

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TRANSCRIPT OF PROCEEDINGS

HEARING

August 30, 1999

Jefferson City, Missouri

Volume 4

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

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NANCY DIPPELL, Presiding,
REGULATORY LAW JUDGE.
SHEILA LUMPE, Chair
HAROLD CRUMPTON,
CONNIE MURRAY,
ROBERT G. SCHEMENAUER,
M. DIANNE DRAINER, Vice-Chair
COMMISSIONERS.

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(EXHIBIT NOS. 1 THROUGH 109 WERE MARKED FOR IDENTIFICATION.)

JUDGE DIPPELL: This is Case No. GR-99-315 in the matter of Laclede Gas Company's tariff sheets to revise natural gas rate schedules. My name is Nancy Dippell, and I'm a Regulatory Law Judge for the Public Service Commission.

The attorneys have made written entries of appearance, but I'd like to go ahead and state if you're present and who you represent. If we could begin with Laclede Gas.

MR. PENDERGAST: Thank you, your Honor. Gerald T. McNeive, Jr., Michael C. Pendergast, Thomas M. Byrne, and Ellen L. Thereof of appearing on behalf of Laclede Gas Company. Our business address is 720 Olive Street, St. Louis, Missouri, 63101.

JUDGE DIPPELL: Okay. Staff?

MR. POSTON: Marc Poston, Cliff Snodgrass, Tim Schwartz, Nathan Williams, and David Stueven appearing for the Staff of the Missouri Public Service Commission, P.O. Box 360, Jefferson City, Missouri, 65102.

JUDGE DIPPELL: Office of Public Counsel?

MR. MICHEEL: Douglas E. Micheel appearing on behalf of the Office of Public Counsel and the public, P.O. Box 7800, Jefferson City, Missouri, 65102-7800.

JUDGE DIPPELL: Missouri Industrial Energy Consumers?

MS. SCHMIDT: Diana M. Schmidt appearing on behalf of the Missouri Industrial Energy Consumers, Bryan Cave, LLP, 211 North Broadway, Suite 3600, St. Louis, Missouri, 63102.

JUDGE DIPPELL: Union Electric Company?

MS. KNOWLES: Susan B. Knowles for Union Electric Company, 1901 Chouteau Avenue, P.O. Box 66149, St. Louis, Missouri, 63166.

JUDGE DIPPELL: MRT Energy Marketing Company?

MR. LANDWEHR: John Landwehr, Cook, Vetter, Doerhoff and Landwehr, 231 Madison Street, Jefferson City, Missouri, 65101.

JUDGE DIPPELL: Mid-Missouri Energy Group?

MR. JOHNSON: Robert C. Johnson appearing on behalf of the Missouri Energy Group, Emerson Electric Company, et al., 720 Olive Street, Suite 2700, St. Louis, Missouri, 63101.

JUDGE DIPPELL: Oil Chemical Atomic Workers Local 56?

There's no one present today representing the union.

Is there anyone else that needed to make an entry of appearance?

We have some motions pending that I wanted to go through. First, Staff had filed a motion to request an extension of time to file its order of witnesses and order of cross-examination and to amend the general list of issues. I haven't ruled on that motion yet so I'll go ahead and grant that at this time.

There was also a proposed order of witnesses and order of cross-examination filed by Staff and we will attempt to follow that. That's granted.

OPC asked to supplement the witness list by adding Mr. Kind into the advertising section, and I will grant that as well.

There were no objections received to any of these orders -- or requests, I'm sorry. I guess I should ask, was there an objection to the proposed order of witnesses that Staff had filed?

MR. PENDERGAST: Your Honor, no objection to the proposed order of witnesses, just a few practical adjustments as we talked about that may need to be made in accommodating some witnesses.

JUDGE DIPPELL: Okay. We did discuss off the record some accommodation of witnesses' schedules. And, again, I'm happy to do that where we can, where it's not disruptive to the hearing. We're going to attempt to get this hearing done on time, and I have reserved a room for

Tuesday should the hearing run later than its scheduled five days.

Mr. Micheel, is Mr. Kind going to appear in the witness list after Ms. Bolin?

MR. MICHEEL: Yes, your Honor. That would be the appropriate place to place Mr. Kind for the advertising issue.

JUDGE DIPPELL: Okay. There were also some motions to strike that had been filed. Laclede had had a chance to respond to Public Counsel's motion. And I understand from our discussions off the record that there's been some last-minute settlements of some issues and that a Stipulation and Agreement is going to be filed probably tomorrow.

So what we're going to do is -- and I understand that Stipulation and Agreement will affect some of these motions to strike. So what I'm going to do is wait and rule on those motions as necessary when that witness is ready to testify. So if you have not had an opportunity to respond to the motion to strike, you need to be prepared to respond to that here at the hearing when that witness is called.

There was also still pending a joint motion to establish a true-up audit and hearing. Is it necessary for me to rule on that before the hearing begins? Does it affect the --

MR. PENDERGAST: Your Honor, I'm not sure it's necessary to rule upon that before the hearing begins, but we've also recommended a true-up hearing be established in late September, and given what I know is a busy Commission schedule, obviously the sooner that is scheduled, probably the better from our perspective.

JUDGE DIPPELL: All right. I'll hold off on ruling on that for right now, but I will rule on that during the course of this hearing.

Are there any other pending motions that -- or preliminary motions? I believe there was also an entry of appearance for Mr. Snodgrass by Staff that I didn't rule on earlier, and that's also granted. And also for Mr. Schwartz.

During the course of this hearing I will be identifying parties by abbreviated names. And those of you that represent a consumer group or an energy group please know that the abbreviation I give your group, that you're responding on behalf of all of those parties.

I believe there was maybe some request to be excused from part of the hearing. Would you like to go ahead and make those?

MS. SCHMIDT: Yes. On behalf of the Missouri Industrial Energy Consumers, we do not have any cross-examination for revenue witnesses, so we would request to be excused, if no party objects, from the revenue portion of the hearing and then return for the rate design and cost of service portion of the hearing.

JUDGE DIPPELL: Is there any objection to that? Okay. Ms. Schmidt, you may be excused from the portion of hearing, but you will give up any rights to object to that testimony as it is presented if you're not present at the time.

MS. SCHMIDT: I understand.

MR. JOHNSON: Judge Dippell, yes, the Missouri Energy Group also has a similar request. We have no cross-examination for the witnesses on the revenue issues and ask to be excused with respect to that portion of the case.

JUDGE DIPPELL: Is there any objection to that?

Okay. Again, you may be excused from participating in the hearing in full and return. You will give up your right to make those objections if you're not present when the issue is raised.

Mr. Landwehr?

MR. LANDWEHR: Your Honor, MRT has a similar request as portions of the hearing arise we're not interested in. We'll monitor the hearing, and if we are allowed to be excused, it can be presumed that our right to cross-examine is waived.

JUDGE DIPPELL: All right. You may also be excused. And, therefore, when I'm reading the list of cross-examination, if I do not see counsel for that party in the group, I may not call on them to make cross-examination. If you are present and I skip you, then you need to speak up. If I forget something, you need to speak up so that you're not waiving your right to cross at that time.

Are there any other questions? Are there any other preliminary matters? Okay. We've pre-marked the exhibits. Basically, we're going to proceed with opening statements. And if you all are prepared for that, I'll take about a five-minute recess and go and get the Commissioners. Let's go off the record.

(Off the record.)

JUDGE DIPPELL: We're ready to begin with opening statements. Laclede Gas Company?

MR. PENDERGAST: Thank you, your Honor. We have a few exhibits, visual aides and we do have copies of them for the Commission, if we could be allowed to pass those out.

JUDGE DIPPELL: Did you want to mark those?

MR. PENDERGAST: No. I don't believe we want to make them official exhibits, but we did want to go ahead and make sure the Commission had a copy of them and the parties had a copy of them as well. But if your preference is to mark them --

JUDGE DIPPELL: I would prefer to mark them and then they can be kept track of in the record since you're not going to offer them. So let's go ahead and mark those beginning with Exhibit 110.

MR. PENDERGAST: Okay. Exhibit 110 would be a -- it says Analysis of the Effect of Staff Return on Equity Recommendations.

JUDGE DIPPELL: I also didn't mention earlier that I expect you all to keep your opening statements brief.

(EXHIBIT NO. 110 WAS MARKED FOR IDENTIFICATION.)

MR. PENDERGAST: Exhibit 111 would be Degree Day Deviation from NOAA Normal.

(EXHIBIT NO. 111 WAS MARKED FOR IDENTIFICATION.)

MR. PENDERGAST: Exhibit 112 would be -- the top of it says Returns on Market Value. I guess we could call it that.

(EXHIBIT NO. 112 WAS MARKED FOR IDENTIFICATION.)

JUDGE DIPPELL: Thank you. Go ahead.

MR. PENDERGAST: Thank you. If it pleases the

Commission.

I will try and keep my remarks as brief as possible; however, I would note that it's been more than 20 years since Laclede last took a general rate case proceeding to hearing with this Commission so we do have a few comments to make.

By anyone's measure, 20 years is a long time. And there have been tremendous changes over that period of time in the way Laclede operates its business, the way the natural gas industry is structured, the way we're regulated and the economic environment that affects all of us.

All of these changes have presented both challenges and opportunities for both the Company and the Commission. There were the nationwide natural gas shortages in the mid-to-late '70s during which Laclede, with the Commission's approval, actually went out in the producing fields and drilled for the gas required to meet our customers' needs.

There were the subsequent federal efforts to deregulate natural gas prices at the well head and to provide LDCs like Laclede with the ability and eventually the obligation to buy their own gas supplies and procure the myriad of transportation and storage services necessary to transport those gas supplies to the LDC cities' gates.

And then there were the innovative actions the

Commission has taken to ensure that LDCs procure their gas supplies and services as efficiently as possible and to ensure that smaller customers would be protected from the volatility in gas prices brought about by these changes.

Closer to home, the last 20-years-plus have seen some 200,000 customers and nearly a third of the Company's customer base leave the City of St. Louis and relocate elsewhere in our service territory or leave the area all together; a customer migration that its relative magnitude is probably unmatched by any other city in America.

As Mr. Yaeger, our president and chief executive officer, explains in his direct testimony and will be happy to talk about today if you like when he takes the stand, this extreme incidence of urban sprawl has had a profound impact on our financial situation as the Company has had to invest in facilities to serve hundreds of thousands of customers who aren't really producing any new revenues. They've simply moved those revenues from one part of the Company's service territory to another.

All of which I think helps to explain why the Company's only been able to manage 1 to 1 1/2 percent growth over this period, an amount that does not begin to offset the continuing, although in more recent years, more modest impact of inflation on all of our costs.

The last 20 years have also seen the Company's finances buffeted by an almost unbroken stream of warmer than normal weather culminating in the most recent decade in which we have actually experienced five of the top ten of the warmest winters since the government started keeping track of that information nearly a century ago.

Conservatively, we've estimated that the difference between the revenues produced by this warmer than normal weather and what was assumed for rate-making purposes has cost the Company some $20 million in lost earnings over the past 15 years.

At the same time that these factors have been exerting additional financial pressure on Laclede, we have also seen a fundamental change in the financial markets. You've witnessed this phenomena yourself, and I don't have to dwell on it other than to note how tremendously large the gap has grown between returns that are being recommended for Laclede and what investors are earning and what they expect to earn in today's seemingly endless pool market.

Even with all of these changes, and in many cases despite them, at least one thing I think has remained constant over the past 20 years. We've been there to serve our customers. Whether it be exploring for gas in shortage or meeting the new procurement challenges associated with Order 636, we've never faltered in our obligations to serve our customers and obtain the gas services they need to heat their homes and fuel their businesses.

Moreover, we've delivered those services at a cost that compares favorably with other utilities in Missouri and throughout the country. Indeed, the independent reviews of our operations, which your own Staff has submitted in support of the rate of return recommendations, notes that our business performance has been characterized by, and I quote, competitive residential rates, efficient operations and a conservative financial management.

Reliability and value of our services has also not been lost on our customers. In single-family homes, well over 95 percent of our residential customers have shown their clear preference for natural gas as a heating source, even though we face a very able, relatively low cost and much larger electric competitor that's constantly trying to convince them otherwise.

That may be the best indication that you have that we've met and continue to meets the needs of our customers. And if we weren't, I think you know from your own experience, that our customers would tell you so, as they have in the past with other utilities that have provided less than adequate service. They'll make a point of it to come to local public hearings or telephone the

Commission's consumer hotline to express their dissatisfaction.

As indicated by the small handful of customers who have to come to testify at our public hearings over the past decade and our low rate of customer complaints, it's clear that ours haven't found it necessary to do so.

The fact that this is Laclede's first litigated case in 20 years I think is also a pretty good indication of our ability and willingness to work with other parties and compromise and settle difficult issues in this complex and sometimes frustrating business of adjusting rates so that we'll continue to have the financial resources necessary to meet our public service obligations.

Unfortunately, that era of conciliation and compromise of differences seems to have waned somewhat over the last couple of years. Despite our continuing obligation to invest in new facilities and repair our existing ones, the ongoing pressure of cost increases, the continuing impact of abnormally warm weather and the lack of any real growth to offset these financial pressures, the Staff has effectively taken the position that we can go along indefinitely without any meaningful rate relief.

Even though it's now almost three years since we last increased our base rate, Staff remains relentless in denying us meaningful rate relief for the foreseeable future. And quite frankly, maybe we've been part of the problem. To avoid increasing rates in our last case, we agreed to offset real cost increases with decreases in our depreciation rates to the point where those rates are now among the lowest in the nation.

We also agreed to offset real cost increases with accelerated rate recognition of the gains made in our pension fund as a result of the booming stock market. And we continued to defer potentially extraordinary costs for later recognition in rates through Accounting Authority Orders.

These approaches recognized available expense reductions provided by -- proposed by Staff and at the time provided our customers with another year of unchanged rates. However, they were never long-term solutions to our true financial needs.

For the most part, Staff and Public Counsel have agreed, at least on paper, that the Company should be permitted to recover most of its increases in wages and salaries in rate base additions and other items.

Why then haven't they recommended rate increase in this case? Because I think what they've recognized on the one hand, it's equally clear that they've denied on the other through a series of adjustments which we strongly believe, and which we hope you'll conclude, are inappropriate, unfair and unjustified.

I'll only address the two that have the largest impact in this case; namely, return on equity, which has a dollar value of approximately $16.6 million and weather normalization, which is worth approximately $10 million.

As the Staff and Public Counsels return on equity recommends, I don't think you have to be an expert in growth rates or dividend yields or in the intricacies of the discounted cash flow analysis to realize how unreasonable and inadequate they are.

Staff and Public Counsel have said in their testimony that our investors require a return on equity of 9.5 and 9.7 percent respectively. We think that's a little low, but that's not the worst of it. Because while they say our investors require a return on equity between 9.5 and 9.7 percent, they've only included enough revenue requirement in their case in connection with these specific return recommendations to yield an effective return of approximately 6 to 6 1/2 percent. And you don't have to take our word for it. You can take Staff's word for it.

The chart to my right over here, which is also a schedule contained in Laclede Witness Fallert's testimony, shows a series of calculations we had the Staff return witness do during his deposition that we held in this case.

We started with his recommended returns, which you see at the top, and revenue requirement amounts that he has included in connection with them. We then had him apply that revenue requirement amount to what he verified was the value of Laclede's outstanding stock as of March 31st, 1999. And then we had him tell us what return his revenue requirement recommendation would really yield our investors based on the actual market value of our stock.

And as you can see in the calculated -- as you can see, calculated returns of 6 percent at Staff's low point, 6.3 percent at the mid-point and 6.6 percent at the high. Effective returns that are more than 300 basis points below the returns that Staff and Public Counsel say our investors really require.

And I just want to emphasize to you nobody has disputed these calculations in the record. Nobody has filed surrebuttal testimony and said that they're inaccurate or they don't reflect reality. These are the undisputed and uncontested facts about what kind of effective return the Staff and Public Counsel's recommendations make.

I should also tell you that when we asked the Staff witness where the revenue requirement was going to come from to make up for this more than 300 basis point difference between Staff's recommended return and its effective return, he simply answered, I don't know.

As shown on the next chart, the 6 1/2 -- or 6 to 6 1/2 percent recommended return for Laclede is nearly -- and we're in the blue right there -- 2,000 basis points below the average returns that have been earned over the last five years by the Standard and Poor 500, 400 basis points below what utility stocks have done over the same period of time, and incredibly, almost 100 basis point below the performance levels achieved by utility bond funds. In fact, it's very near the equivalent to the return for what Staff has classified as risk-free investments, and that's the black line that you see running across all four of the bars.

Moreover, even if you ignore everything I just said, the unreasonableness of this recommendation is still evident from a simple comparison of the return -- of these returns to what other utilities in Missouri and elsewhere have been authorized to earn.

As the bottom segment of the chart shows, the phenomenal return that's been recommended for Laclede, once again we're in the blue, is about 300 basis points below what our primary competitor, Ameren UE, is permitted to earn before it even has to start sharing. Moreover, it's nearly 200 basis points below the average returns granted other LDCs. Indeed, it's even 150 basis points below the return you granted the second largest LDC in this state in the not to distant past.

There's one more very critical component that you need to know about this particular issue. As Staff's witness indicated in his deposition, these returns are so low that they would also produce interest coverages consistent with a triple B credit rating, a rating that's at least two levels below our current double A-minus rating.

In fact, the Staff witness even admitted that Laclede Witness McShane, who you'll have an opportunity to hopefully listen to this afternoon and ask questions of, with her nominal return recommendations of 12.75 and effective return recommendation of approximately 10 percent was the only witness in this proceeding who had proposed a rate of return that was consistent with avoiding such a downgrade.

As part of its conservative financial management, which Staff has stressed in its rate of return testimony, Laclede has maintained, often at the Staff's urging, an A or better credit rating for at least the last 4 1/2 decades. This rating has allowed the Company to procure both debt and equity at a substantially lower cost. Lower costs that have benefited our customers both in the past and are benefiting them today in this case.

And yet without a single word of explanation as to why such a result would be appropriate and without even mentioning it, in fact, Staff and Public Counsel propose that you send the Company down the path to a reduction in its credit rating.

It simply wouldn't be fair to our shareholders, the majority of whom are also Missouri residents and many of whom are customers, to accept a recommendation that would have those kind of consequences, nor do we believe would it be fair to our customers who depend on the Company being financially healthy enough that it can continue to provide them with reliable service. And that's one of the main reasons why we're litigating our first rate case in 20 years.

The second major reason concerns weather. As I previously indicated to you, and as the chart to my right will show in just a second, the difference between so-called normal weather and the weather actually experienced by the Company over the past 15 years has been profound to say the least.

The red bars show how many times and by how many degree days the weather has been warmer than normal, while the far fewer and, unfortunately, far smaller blue bars show how often it's been colder than the NOAA published normal.

Unfortunately, the warming trend this chart reflects has been about $23 million in red ink for the

Company over this period of time as our actual revenues have failed again and again to reach the weather normalized levels assumed in rate cases.

In an effort to address this problem and in recognition of what we have seen as an ongoing warming trend in our weather, we have proposed a normal consisting of the most recent 10 years of observed data. And I should note, as the evidence shows in this proceeding, even with this shorter time period of weather data, we still have incurred this huge shortfall, but at least it helps.

Unfortunately, Staff has been moving in the opposite direction. It has consistently insisted on using a 30-year normal of weather experienced during 1961 to 1990, which is a reflection of history now long past. If that wasn't bad enough, however, the Staff is now seeking to adjust that 10 year -- or 30-year historical normal even higher despite the obvious warming trend to the contrary because of a change in weather station locations at Lambert Airport in 1996.

Staff's position of clinging to an outdated 30-year normal and adjusting that normal even higher has a double-whammy effect on setting weather normalized rates for Laclede in this proceeding.

We believe the evidence will show, and show in a very compelling fashion, that the analysis relied upon by

Staff to support an increase in the Lambert weather normal is unreliable as illustrated by the numerous changes that have been made in the method and the approach Staff has taken in that analysis over the last year, the constantly changing results of the various approaches that Staff has taken and the degree to which the analysis contains numerous errors, and its complete failure to account for the fact that meteorological conditions vary from season to season.

So what might be perhaps at some point an overall adjustment if you were doing things on an annual basis might be appropriate, and we don't believe Staff's is, you would still have to determine whether those things hold constant in both the summer and the winter. Their approach completely fails to go ahead and do that.

We are willing, of course, to cooperate going forward in a working group to find a thoughtful and legitimate resolution to the 1996 station location change at Lambert. Quite frankly, we just don't believe that what Staff has proposed in this proceeding, however, is a correct and well-thought through solution. And we just can't accept an analysis which is so obviously wrong.

Since at this time no such solution has been reached, we will leave it to you, the Commission, to judge what the just and reasonable weather normal for Laclede should be.

There are other issues remaining and they're all important in their own right. They include the appropriate capital structure to be employed in this case. They include what proper revenue collection lag to be used for purposes of cash working capital, the treatment of advertising expenses and heating ventilation and air conditioning service revenues and cost depreciation.

I mentioned to you before that we now have among the lowest in the nation and we're trying to propose a gradual move back to a more reasonable level. Regulatory treatment of off-system sales and capacity release revenues, which you may have recalled hearing something about in our recently completed GSIP proceeding. Of course, class cost of service allocations, how the rate increase in this case should be allocated, rate design and tariff issues.

Finally, it would be unfair to Staff and Office of Public Counsel not to mention that we have, with their assistance, reached a reasonable settlement of some important issues, most particularly, an agreement after lengthy and hard bargaining which eliminates going forward all Accounting Authority Orders the Commission has authorized for Laclede except for the gas safety replacement order.

I can remember several Commissioners last year in our last case questioning the number of Accounting

Authority Orders that Laclede had and whether it was wise to put off the day of reckoning. We've done our best in cooperation with the other parties to work on that, and I think we've reached a solution that obviously substantially reduces our reliance on those.

Perhaps this is a positive indication that some paramount settlements can still be reached on difficult issues. For all of these reasons, we respectively request that you find for the company on the issues that will be presented for your consideration, and we certainly appreciate your time. Thank you.

JUDGE DIPPELL: Thank you.

Missouri Energy Group, do you want to make an opening statement?

MR. JOHNSON: Yes. Missouri Energy Group has a group of three major hospital systems in the St. Louis area, Barnes Jewish entity and SSM, plus some large industrial companies that include Emerson Electric and Chrysler. We are customers of the utility. We have a strong interest in this case. We support -- we're interested primarily in the rate design. That's how any increase is to be allocated or how the revenues are to be treated with respect to the different customer groups and within each customer group.

Our position is in support of the testimony of

MIC Witness Johnstone. And we will be participating in that portion of the hearing that relates to those issues. Thank you.

JUDGE DIPPELL: MRT Energy Marketing Company?

MR. LANDWEHR: MRT waives opening statement.

JUDGE DIPPELL: Missouri Industrial Energy Consumers?

MS. SCHMIDT: Thank you. The Missouri Industrial Energy Consumers are also large customers of Laclede, large transportation customers. Our evidence in this case shows that transportation rates are subsidizing other customer class rates.

We believe that rates should be based on cost of service, and that that's an important consideration for the Commission in setting rates. We believe this case represents an opportunity for the Commission to move Laclede's rates toward cost of service. That's what our evidence shows.

And Judge Dippell has granted our request earlier on the record to be excused from the revenue portion of this hearing. It is not to say that we're not interested in the revenue issues, but we simply don't have any cross-examination for those witnesses, but we do plan to actively participate in the rate design portion of this hearing. Thank you.

JUDGE DIPPELL: Ameren UE?

MS. KNOWLES: My name is Susan Knowles and I represent Union Electric Company during this week's proceedings. Union Electric Company's intervention is discreet in nature and is limited to finite issues relating to the class cost of service or rate design areas.

Those issues are as follows: Number one, gas supply costs should be removed from base rates; number two, Laclede's demand charge understates peak usage and does not reflect appropriate seasonal differentials; and number three, the structure of Laclede's seasonal air conditioning rates contain an improper subsidy.

Union Electric and Laclede compete for customers in providing certain energy services such as cooking, air conditioning, space and water heating. Accordingly, UE has a keen and appropriate interest in ensuring that Laclede's rates for seasonal services such as space heating and air conditioning are set at or near the actual cost of providing such services and are not set arbitrarily low.

In fact, one of the cardinal tenets of rate design is that rates should mirror cost of service. As part of its direct case, Laclede has prepared a class cost of service study which in many critical respects is flawed.

Union Electric will present testimony from two witness in this proceeding, Mr. Richard Kovach and Mr. Phil Difani, who will offer an alternative rate design and cost allocation approach for the general service and seasonal air conditioning classes. Mr. Kovach will testify as to the necessity of designing on a seasonally differentiated basis rates which reflect the cost of providing such services.

Laclede recovers certain expenses which are attributed to gas supply such as stored services, reservation fees, transportation charges and the like through a combination of two mechanisms. Part of these charges are recovered through a purchase gas adjustment, or PGA, and are part are recovered through base rates.

The failure of Laclede to properly segregate all of these gas supply costs under the PGA mechanism unduly complicates the rate design. At the conclusion of this matter, Union Electric Company will ask the Commission to order Laclede to convert all of its gas supply costs to a zero-based PGA cost recovery mechanism.

In addition, Laclede has introduced the concept of a demand charge to be incorporated into the rate structure for its general service class customers. UE has no objection to this philosophical concept. However, as the testimony of Mr. Phil Difani makes clear, UE objects to the matter in which Laclede has structured its demand charge. Laclede has over allocated its demand-related cost to the summer billing season and under allocated such costs to the winter billing season.

Lastly, Laclede offers consumers who operate gas air conditioners a seasonal gas air conditioning service rate. Laclede has not extended its concept of a demand charge to the seasonal air conditioning service class. As a result, general service rate consumers subsidize certain costs in favor of consumers on the air conditioning rates. Such a subsidy is improper and inequitable.

At the conclusion of this case we will ask the Commission to order Laclede to discontinue this inequitable practice.

JUDGE DIPPELL: Office of the Public Counsel?

MR. MICHEEL: May it please the Commission.

The Office of the Public Counsel has filed testimony on six of the issues that remain contested in this proceeding. Those issues are the rate of return/capital structure issue, advertising, capacity release revenues, off-system sales revenues, rate design, class cost of service, and the sunset period for the Accounting Authority Orders. I'd like to comment briefly on all of those issues.

The first and apparently most important issue in terms of dollars is the rate of return capital structure issue. The evidence will indicate that the Office of Public Counsel via its witness, Mr. Burdette, utilized the traditional discount cash flow method.

And despite the rhetoric of Laclede, that's the traditional method that this Commission has used for a number of years. That method has indicated that the adequate and proper return on equity for Laclede Gas Company is 9.7 percent. I would remind you to ask my witness why he believes that's appropriate and that's not going to cause problems alluded to by Laclede in their opening statement.

I think when the evidence is all heard, you will come to the conclusion that utilization of the traditional discounted cash flow method that this Commission has utilized throughout the years is the appropriate method to set the Company's return on equity.

With respect to the capital structure issue, the Office of the Public Counsel has utilized the Company's actual capital structure with one exception. There's a dispute with respect to the appropriate level of short-term debt that should be built into the capital structure.

Laclede has proposed, the evidence will show, $29 million be built into capital structure, but such number is not representative of the historical or the proforma levels. Public Counsel recommends that the Commission utilize approximately $79 million of short-term debt to be built into the capital structure.

I think it's important on this issue that the

Commission recognize that what Laclede has requested, and I think the evidence will show, that the Commission abandon the methods it set for return on equity in the past and accept a new method. And I don't think the evidence is going to indicate that accepting that new method is going to result in just and reasonable and equitable rates for both the shareholders and ratepayers.

The next issue is advertising. The Office of the Public Counsel once again has utilized their traditional method of allocating advertising costs by looking at each advertisement and setting them in specific categories per this Commission's decision years ago in a Kansas City Power and Light case. That's resulted in adjustments to the cost of service of about $475,000.

The Company, the evidence will show, wants the Commission, once again, to abandon its traditional method and build in just a certain level of advertising revenues in rates. I think the evidence is going to show that there's too much discretion involved in that and it's unworkable.

The evidence will show you may have ratepayers paying, for example, for political advertising. Something I don't think -- I think we can all agree the Company shouldn't do. I guess with respect to the advertising issue what the evidence is going to show is that the traditional method is appropriate and should be utilized on a going-forward basis.

The next level -- issue, excuse me, is the off-system sales capacity release revenue. I'm sure you're all familiar with this issue from GT-99-303 so I won't belabor the point, but we filed testimony of Mr. Shaw indicating and recommending that we build a certain level of revenue into this case's cost of service recognizing the inherent level of revenues built into Laclede's mix of pipeline supply services for off-system sales and capacity release. With respect to the capacity release, we've recommended the level of $3.3 million. For off-system sales we've recommended a level of $2.4 million.

The next issue is with respect to the Accounting Authority Order issues. And as Mr. Pendergast indicated, we have for the most part been able to settle the lion's share of the Accounting Authority issues, but there's one very important issue that is outstanding.

And that issue is the sunset provisions that should be included with the Accounting Authority Orders. As we're all familiar with, currently Accounting Authority Orders, pursuant to this Commission's decision in a Missouri Public Service case EO-91-358 and EO-91-360 include a set cut-off date of two years.

If a utility has not come in and requested rate relief for two years, it's assumed that the AAOs are not needed and they are extinguished by the utilities in action. In this case, once again, Laclede has proposed something new, that we go away from the traditional method and they want to elongate out that sunset provision.

First of all, I think the evidence is going to show that there's no reason for this Commission to change its policies with respect to these extraordinary accounting methods that we've granted the Company. The two-year method is clean, it's understandable and it's easy. It says, Company, if you don't need to recover these deferred costs within two years, it's extinguished.

I think it's fair both to the shareholders and the ratepayers. It gives administrative ease and everybody knows when the cut-off date is.

I think the evidence will show under the Company's proposal, all we're going to get into is another moras of litigation. We're going to be arguing over how we define terms, whether or not it's necessary. And it's just going to equal more litigation, more uncertainty, and I don't think it's going to be fair either to the shareholders or the ratepayers.

Finally, the final issues that we have are the rate design issues. There are a lot of sub-issues under this. I just want to talk about a few. The first of them is whether or not -- or how we're going to allocate any rate increase that may or may not result from this proceeding.

The Office of Public Counsel, if indeed there is some rate increase to be had in this rate proceeding, recommends that an equal percentage go to all classes and that it be subject to the principal that no class should receive a net class decrease if other classes receive a net increase in revenue requirements. And that's Ms. Hu's testimony.

With respect to the class cost of service shifts, Public Counsel recommends the Commission order a revenue neutral shift that only goes at most halfway to the Office of Public Counsel's class cost of service study results.

Another important issue for the residential customers is the residential customer charge issue. Currently the evidence will show that Laclede Gas Company has a residential customer service charge of $12. That is the highest residential customer service charge in the state and one of the highest in the nation. Public Counsel's cost of service study indicates that the residential customer charge should be lowered from the $12 level to $10.

Finally, I want to talk about -- well, not finally -- but the issue of recovery of the fixed non-gas costs through the rate design. Laclede, the evidence will show, has a proposal to recover some of the fixed costs through the rate design, and Public Counsel opposes this essential for five reasons.

First, we believe that it is an inprecise method to estimate customer demand, and the evidence will show that there is no way accurately to estimate residential customers' demands.

Secondly, it will lead to bill comprehensibility problems and confuse customers, and it could lead to a lot of problems there.

Third, the evidence will show that utilizing this fixed demand charge will result in diluted price signals for increased usage and it may indeed spur on increased use of gas at times when the gas -- increased gas usage should not be encouraged.

Fourth, the evidence will show that the Company, if indeed the Commission does grant this proposal, has failed to acknowledge the need to adjust the return on equity due to the reduced revenue volatility of extending or placing in a demand charge recovery in the rate design.

And, finally, inclusion of any costs -- as the UE individual indicated, there are the inclusion of many costs that should not be classified as demand related in this proposal. And Mr. Kind is our witness on this.

Finally, two final issues. It's the separation of the general service rate class. Currently under Laclede's rate design, the general service rate class includes both residential and commercial industrial customers.

The Office of the Public Counsel supports separating those rate classes. They have discreet cost of service inputs and discreet costs to serve those customers, and we recommend that the Commission disaggregate the GS rate class and residential and commercial industrial class.

And, finally, we also support Staff's recommendations to separate the gas and non-gas costs and put all of the gas costs over to the PGA side so we're not recovering any gas costs here in the non-traditional side. Thank you very much.

JUDGE DIPPELL: Staff?

MR. POSTON: Thank you. May it please the Commission.

It was not long ago that Laclede Gas Company came to this Commission seeking a $28.5 million increase and settled for a zero increase. Less than four months later, Laclede filed with this Commission again, claiming this time that its current revenues are insufficient by as much as 30.5 million.

I should point out that this number, which is found in the direct testimony of Laclede Witness Douglas Yaeger, is actually $7 million less than the $37.1 million increase that is supported by Laclede's case pursuant to Section E of the schedules attached to Laclede's direct testimony.

The Staff asks that the Commission deny Laclede this increase and instead accept Staff's recommendations for the following reasons. On the issue of rate of return, the standard use across the nation today on what constitutes a fair rate of return was established in the 1923 U.S. Supreme Court case of Bluefield Water Works and Improvement Company versus PSC of West Virginia. That case established the key elements of what constitutes a fair rate of return.

The testimony before the Commission of Staff Witness David Broadwater follows these standards precisely, while the testimony of Laclede's six rate of return witnesses departs from the Supreme Court's decision.

Laclede named three tests that it used in its recommendation of 12.75 return for Laclede. The obvious defect with Laclede's analysis is that the Company apparently felt that these recognized tests were all three producing inaccurate results.

Accordingly, Laclede found it necessary to adjust each test result to reach what it found to be an accurate number. On two of the tests Laclede raised the return on equity results that the test produced from 10.75

to 11.25 and from 10.5 to 15.6. Each adjustment that Laclede used to change the numbers produces -- the numbers it produced when it ran the test represents a significant flaw in the analysis.

Laclede adjusted its discount cash flow or DCF analysis output by 310 basis points by use of a market to book adjustment. As Mr. Broadwater pointed out in his rebuttal testimony, this Commission in the past rejected this very adjustment.

For more than 20 years the DCF model has been used as the primary tool to determine Laclede's return on common equity without a market to book adjustment. And during this time, the expectations of Laclede's stockholders were met, yet Laclede suddenly finds it necessary to make this adjustment today to support a return of 12.75.

The Company also believed that it's equity risk premium analysis needed an upward adjustment to account for floatation costs. There are two deficiencies in this adjustment. One, floatation costs are already built into the case on a dollar-for-dollar basis. And, two, floatation costs would exist under the DCF test. Laclede chose to adjust floatation costs in the equity risk premium test alone.

The last test that Laclede performed was the comparable earnings test. Following the Bluefield decision, a public utility is allowed a return consistent with the returns achieved by other companies corresponding risks and uncertainties. Laclede's testimony on the corresponding risks and uncertainties of comparable companies, however, tries to convince us that companies such as Hershey Foods, Briggs and Stratton and Pepsi-Co are companies that have risks and uncertainties comparable to those of a regulated public utility such as Laclede.

If we look at the testimony of Laclede's consultant, Kathleen McShane, the Company admits that the industrials it shows in its comparable earnings test have a higher risk than Laclede. Instead of using comparable companies, Laclede used these more risky industrials to justify an adjustment to account for the differences between Laclede and the companies it used. Had Laclede used comparable companies in its analysis, it would have not needed to use this downward adjustment.

Staff, on the other hand, used the test according to accepted practice and the test producing 9 to 10 percent return rates that do not need adjusting to account for some inherent inaccuracy in the test itself or inaccuracy in the manner in which the test was used.

Laclede's requested return on equity is a departure from accepted practice. And return on equity anywhere outside the Staff's range for Laclede would also be a departure from the financial theories that are the underlying basis for the return on equity tests used by the parties in this case and those that have been historically accepted by this Commission.

The Supreme Court in Bluefield also held that a return should be sufficient to assure confidence in the financial soundness of the utility. A proper application of the DCF model does exactly that. It calculates an investors required return on equity from the Company.

Staff asks that the Commission not allow itself to be led into believing that calculating an appropriate return on equity is as confusing and always in need of adjustment as Laclede would like the Commission to believe. The Staff used a DCF methodology in support of its 9 to 10 percent return on equity, and the Staff further performed a risk premium cost of equity analysis and a capital asset pricing model or cap end to check the reasonableness of Staff's DCF model derived return on equity for Laclede.

The results of those both tests support Staff's return of 9 to 10 percent for Laclede. This rate of return is fair for both the Company's stockholders and the ratepayers.

The Staff takes a very reasonable approach respecting Laclede's capital structure, and in particular, the contested issue regarding Laclede's short-term debt. The Staff simply averaged the short-term debt experienced during the last 12 months, less a monthly construction work in progress balance.

Laclede is arguing that the level of short-term debt should be adjusted downward. A downward adjustment is contrary to the obvious upward trend that has occurred over the past 3 1/2 years, as shown in Mr. Broadwater's testimony. In addition, Laclede's projected cash flow analysis indicates that this upward trend will continue into the future.

On the issue of weather, Laclede's customers have two major uses for natural gas, space heating for residential and small businesses, and water heating, both of which are weather sensitive. The Staff has normalized test year temperatures against a 30-year normal.

The first weather issue concerns a calculation for normal heating degree days. Laclede's position is simple. It does not want to recognize adjustments that need to be made to the temperature data from NOAA due to the resulting effect those adjustments have on the normal heating degree day calculation.

Laclede accuses the Staff of being inconsistent with the Staff's position in previous rate cases. However, the Staff presented this very position in

Laclede's last late case. This argument by Laclede appears to be an attempt to ignore the additional information that is now available regarding the differences in weather measurements resulting from the relocation of the weather station.

In fact, Laclede offers no explanation of how it accounted for the significant changes that have occurred in the measurement of temperatures at Lambert Field. Since the Company has not recognized the inconsistent measurements between the actual and historical temperature readings at Lambert, it did not make any adjustments to account for the change.

Staff Witness Michael Proctor in his surrebuttal testimony explains the sound reasoning behind the differences in Staff's position starting with the 1992 case and leading up to the present case. The most important consistency in Staff's position on normal heating degree days is its use of the best information available at the time. The Staff asks that the Commission do the same, consider the best information available today.

The Staff supports the use of the NOAA normal weather period, which is the 30 years from 1961 through 1990. This is the internationally recognized period used for the calculation of normal weather. Accordingly, the Staff's use of a 30-year normal weather period adjusted for the changes in the weather station location support the Staff's calculation of 5100.8 heating degree days.

On the issue of Accounting Authority Orders, the remaining issue regarding AAOs the period of time the authority granted by the safety AAO should be in effect. Staff's position is that the Company must file a rate case within two years following the effective date of the rates to qualify for recovery of the amounts deferred.

This provision has been included and accepted by the Commission in this AAO in the past. If after two years the deferral is not significant enough to require the company to file a rate case, then the AAO is no longer necessary. The Staff's position does not suggest that Laclede is prohibited from requesting an extension of the AAO. In fact, the Company is free to do so at any time prior to the end of two years.

Laclede has submitted a proposal that it wishes to implement in place of the two-year requirement. The Staff has reviewed that proposal, and contrary to Laclede's claim, finds that it lacks a definite time frame in which the Company must file a rate case.

Additional flaws exist in the Company's proposal as explained in the surrebuttal testimony of Stephen Rackers. Accordingly, the Staff continues to support the provision that Laclede must file a rate case within two years in order to do recovery the amounts deferred.

On the issue of advertising, as this Commission knows, it has divided allowable advertising expenses into five categories and provides separate rate treatment for each category. The Staff's position is consistent with the Commission's adoption of these categories in the 1985 KCPL cases.

The Staff places a significant advertisement into a category based on the primary message the ad was designed to communicate. Laclede is suggesting in this case that the Commission abandon these categories for a total dollar spent standard. In their argument for the standard Laclede suggests that the current practice is expensive and time consuming.

The Staff has been categorizing advertising expenses into the Commission's five categories since 1985 and is in the best position to testify that the current method is neither expensive nor time consuming. In fact, the current standards are a manageable method by which this Commission can be assured that the Company is not requiring its ratepayers to pick up the cost for institutional, political or unjustified promotional ads.

On the issue of HVAC, under the laws of this state utilities are prohibited from engaging in services regarding heating, ventilating and air conditioning services accept by an affiliate or unless, like Laclede, it offered these services prior to 1998.

The HVAC service revenue of Laclede is unverifiable and it is not known if Laclede is covering its cost or if the ratepayers are subsidizing the services of appliances. The Company has not provided sufficient detail in the books and records to allow the Staff to determine all the costs associated with appliance service work. Therefore, the Staff and this Commission do not know if Laclede is in violation of Section 386.756 of the Missouri statutes.

Until Laclede produces books and records showing that their ratepaying customers are not subsiding its HVAC services, the Staff and the Commission will never know. The intent of Section 386.756 is to prevent utility-regulated operations from subsidizing HVAC services. Until Laclede calculates the appliance service work costs on a fully distributed cost basis, the Commission will not know whether such a subsidy is occurring.

The depreciation rates proposed by Staff are rates that will with reasonable accuracy charge Laclede's customers annually for an amount equal to or nearly equal to the amount Laclede is spending annually for net salvage.

Net salvage is the gross salvage minus cost of removal. The whole life formula proposed by Laclede would result in the Company collecting $2.3 million more from their customers for net salvage than Staff's proposal.

In addition, Staff's proposal -- proposed depreciation rates recognize that Laclede has fully recovered their capital investment in the four gas holders, that there is no material net salvage and that the current customers should not pay for final removal until Laclede takes a non-reversal action toward the removal of any of the four gas holders.

Laclede wants to continue to depreciate the gas holders for approximately $200,000 a year, even though they are fully depreciated. Laclede does this under the guise that they are going to remove them from service and need to begin recovering $200,000 per year for final removal and remediation of the four gas holders. And yet Laclede has not made any firm commitment to remove the gas holders.

Until Laclede makes a firm commitment to move the gas holders, Staff requests that Laclede not be allowed any depreciation from the gas holders. When Laclede takes irreversible steps towards removal, Staff will support an amortization for recovery of those costs.

On the issue of off-system sales and capacity release revenues, the Staff requests that the Commission approve the Staff's proposed off-system sales PGA tariff language regardless of whether or not the Commission allows Laclede to operate under a GSIP in the future.

Under the current underlying tariffs, there is no GSIP that the Company retains -- the Company retains all the profits generated by off-system sales; however, the reservation and demand charges for the firm transportation contracts and gas supply contracts that Laclede uses to enter into off-system sales transactions are funded by the ratepayers through the ACA PGA process.

Laclede opposes any change to the tariff that would appropriately credit the ratepayers for these charges. If the Commission does not approve the off-system sales PGA tariff language, Staff's alternate proposal is to impute the rate case revenue requirement, additional revenues for off-system sales. This amount is approximately $2.5 million. Staff's proposed off-system sales net revenue amount is based on a three-year average of the off-system sales profits, which Laclede experienced in its three most recent ACA periods.

If the tariff language is not approved and the profits from off-system sales are not included in Laclede's revenue, than absent a GSIP, Laclede will retain 100 percent of the profits from off-system sales even though the transactions are funded by the ratepayers through the reservation and demand charges which the customers pay through the PGA ACA process.

On the cost of service rate design issue, parties have broken down the cost of service and rate design component of this rate case into several remaining issues. For the sake of time, I'll briefly touch upon each issue.

First is the allocation of the rate increase. The Staff does not propose a change in the percentage of non-gas revenues contributed by each class since the revenue requirement may not be significantly different from the current revenue requirement. Any increase in revenue requirement should be spread among all classes based upon the current percentage allocated to that class.

The only change that the Staff is recommending is an increase in the customer charge for the small commercial and industrial class. The Staff's position on the general service rate class is that the class should be separated into a residential class, and a commercial and industrial class. These are essentially two separate rate classes since they currently have two different customer charges.

On the issue of residential customer charge, the Company proposed to increase the customer from $12 to 12.50, while the Office of Public Counsel has proposed a reduction. The Staff maintains that neither change is warranted and that the residential customer charge should stay at $12. Laclede has the highest residential customer charge of any gas company in this state and one of the highest of any gas company in the nation.

The next rate design position of the Staff is that rates should be separated into gas and non-gas rates. Laclede is the only gas company in the state that has not moved its gas costs from the base rates to the PGA ACA mechanism. To stay consistent, the Staff recommended that gas costs be removed from base rates and be included only in the PGA ACA. The OPC concurs with the Staff's position on this issue.

On the issue of miscellaneous tariff issues, regarding off-system sales, the Staff proposed clarifying PGA tariff language that defines how off-system sales revenues are to be treated. Staff recommends that the Commission approve these changes to clarify Laclede's tariffs. In addition, the Staff supports Laclede's proposed increased in the re-connection charge from $43 to $54.

Finally, the Staff did not concur with the Company's belief that the service territory descriptions are adequate. Accordingly, the Staff asks that the service territory descriptions be revised to add more detail and avoid future problems.

The final issue is cash working capital collection -- and collection lag. The collection lag is a period of time between the day the bill's placed in the mail by the Company and the day the Company receives payment from the ratepayers for services rendered. Staff utilized the sample from GR-98-374. The sample was computed by waiting the number of days that amounts billed for services were outstanding for each individual customer in the sample. Based on this -- on this, Staff calculated the proper collection lag at 25.4 days.

The Staff asks that the Commission accept its recommendations. Thank you.

JUDGE DIPPELL: We discussed earlier that the witnesses were going to be called in the order as proposed by Staff with the addition of Mr. Kind in the advertising section. We'll go ahead then and proceed with our first witness.

MR. MCNEIVE: That's Mr. Yaeger. If it would please the Commission, we'd like to call as our first witness, Douglas Yaeger to the stand.

JUDGE DIPPELL: Mr. Yaeger, could you please spell your name for the court reporter.

THE WITNESS: Y-a-e-g-e-r, Yaeger, Douglas, D-o-u-g-l-a-s.

(Witness sworn.)

JUDGE DIPPELL: You may proceed.

MR. MCNEIVE: Thank you, Judge.

DOUGLAS YAEGER, having been sworn, testified as follows:
DIRECT EXAMINATION BY MR. MCNEIVE:
Q. Would you please state your name for the record, sir.
A. My name is Douglas H. Yaeger.
Q. Are you the same Douglas H. Yaeger who had caused to be filed direct testimony in this proceeding under an affidavit dated March 11, 1999, consisting of 23 pages?
A. I am.
Q. I hand you what's been marked for identification as Exhibit 1 to this proceeding and ask if you can identify that?
A. That is my direct testimony.
Q. Do you have any changes or corrections, sir, to make to your direct testimony today as filed?
A. I do not, all though there are several issues raised in that testimony that I think are covered in a proposed stipulation that is to be filed tomorrow for your consideration, your Honor.
Q. You're speaking specifically about the Accounting Authority Orders?
A. Yes, I am.
MR. MCNEIVE: At this time, I would offer into evidence Exhibit No. 1 and tender the witness for cross-examination.

JUDGE DIPPELL: Are there any objections to Exhibit No. 1?

Then that will be received into evidence.

(EXHIBIT NO. 1 WAS RECEIVED INTO EVIDENCE.)

JUDGE DIPPELL: We'll also begin with cross in the order as set out in Staff's proposed order. If we could begin with Missouri Energy Group. I'm sorry. You've waived your cross-examination.

MR. JOHNSON: We have waived our cross.

JUDGE DIPPELL: MRT Marketing?

MR. LANDWEHR: No cross.

JUDGE DIPPELL: Ameren UE?

MS. KNOWLES: No questions.

JUDGE DIPPELL: Office of Public Counsel?

MR. MICHEEL: I have questions, your Honor.

CROSS-EXAMINATION BY MR. MICHEEL:

Q. Mr. Yaeger, do you have a copy of your direct testimony in front of you, which has been marked for purposes of identification as Exhibit 1?

A. I do.

Q. Could you, sir, turn to page 10 of that testimony? And I'm focusing on your answer to the question there beginning on line 13. Let me know when you're there.

A. I have it.

Q. And you're discussing in that Q and A the

Commission's historical use of a historic test year, is that correct, sir?

A. That is correct.

Q. And you say that the Commission has recognized problems in the recent past with the historical test year; is that correct?

A. That is correct.

Q. And what utility decision would that be, Mr. Yaeger, that the Commission discussed problems with the historical test year?

A. It was in the St. Louis County water rate case. I think it was 1996 or so. I don't have the exact case, but I think we can provide that for you.

Q. Okay. And what was the specific problem there?

A. I think the problem was -- or the issue was one of non-reflection of additional cost beyond the establishment of traditional test year.

Q. Has your company recommended a historical test year for use in this proceeding?

A. The Company has a historical test year that it filed its initial case on, yes.

Q. And your company hasn't recommended, for example, a projected test year or anything like that; is that correct?

A. Not to my knowledge.
Q. Okay.
A. Although I think there was discussion of a true-up mechanism that would effectively have the same impact that I was referring to.
Q. And you would agree with me that the true-up, when we utilize a historic test year, does indeed capture some expenses that go beyond the historical test year; is that correct?
A. If the true-up is applied in the manner that I believe we've -- I think have a tentative agreement on, it will have the impact of recovering some of those costs, that's correct.
Q. And so that visciates a lot of the concerns you're talking about there on page 10?
A. I think I stated earlier on that the testimony covered some of the issues that may well be covered in the settlement document to be filed tomorrow, and I think as well as the true-up that has yet to be considered.
Q. Okay. I just wanted to be clear that the true-up was a separate document?
A. It is a separate document.
Q. Okay. So that concern's pretty much been visciated; is that correct?
A. On the assumption that the true-up mechanism

is approved as we've agreed.

Q. Okay. And Public Counsel and Staff have agreed to that; is that correct?

A. That's my understanding.

Q. I want to talk to you a little bit about a statement you have at page 17 of your direct testimony. And I'm focusing on the question there, sir, that begins at line 6 where you're talking about increase risk, the gas supply function and other risks?

A. Yes.

Q. Specifically, I'm looking at the part of the answer there on line 12 that says, The Missouri General Assembly has passed certain legislation regarding HVAC services; is that correct?

A. That is correct.

Q. Is it correct that pursuant to 386, I guess, 756.7, that utilities engaging in HVAC services in the State of Missouri prior to August 28th, 1988, may continue providing to existing as well as new customers those type of HVAC services; is that correct?

MR. MCNEIVE: I'm going to interpose an objection. The witnesses isn't a lawyer, if he knows the answer. But I think the Commission should know that he is not a lawyer, so I think it's asking for a legal conclusion.

JUDGE DIPPELL: Okay. I'll let the witness answer if he knows.

THE WITNESS: I don't have that document in front of me, but my recollection is generally it does have that exemption feature to it.

BY MR. MICHEEL:

Q. And so Laclede essentially has been excluded from that legislation -- or your HVAC services have been excluded from that legislation; is that correct?

A. That's my understanding.

Q. Okay. Because you've been engaging in that type of activity well prior to August of 1998; isn't that correct?

A. I'm not sure exactly when we started. It's been so long ago that nobody around the company can even recall. It's been that long.

Q. So that's not a risk that your company faces specifically; isn't that correct?

A. I think the issue that's raised in the rate case -- and I'm not sure which witness in our direct case is going to address this -- really has to do with the allocation of the costs and how that's treated. It's not the fact that indeed we were doing HVAC-type service work prior to that time. Indeed we are.

Q. So any mention that you have in your direct testimony is really about the cost allocation issue. Is

that what you're saying, sir?
A. Yeah. That's one of the risks -- that is a risk that I'm referring to.
Q. And, if you know, I recognize you're not a lawyer, but does that legislation require that the HVAC services provided not subsidize the regulated utility operations?
A. You might restate that. I'm not sure I understood the question.
Q. I'll just leave it alone.
On page 18 and 19 of your direct testimony, sir, you talk about Laclede's responses to the changing environment and regulatory recommendations; is that correct?
A. That is correct.
Q. And you indicate there on page 19 that the Company has focused its efforts and attention on making certain that all routine activities and tasks required to provide quality service are not only done, but done well; is that correct?
A. That's correct.
Q. And one of those routine services that you talk about is arranging service with new pipeline suppliers so that the Company will be able to meet current and future changing demands of the customers; is that correct?
A. I think I state that on page 19, that's

correct.

Q. And would you agree with me that arranging pipeline service for new pipeline suppliers is something -- a routine activity and task required by a local distribution company?

A. I'm not sure I would call that routine. I think when I was referring to routine, maybe 10 lines above that where we talk about sweating the details, I think is the term I utilize, was really the day-to-day activities that we perform for our customers and provide the service that our customers have come to expect from us.

MR. MICHEEL: Okay. That's all I have for Mr. Yaeger. Thank you very much.

JUDGE DIPPELL: Staff?

MR. POSTON: Thank you.

CROSS-EXAMINATION BY MR. POSTON:

Q. Mr. Yaeger, would you please turn to page 5 of your direct testimony?

A. I have it.

Q. On line 8 -- let me get this right.

Okay. On line 8 you start a sentence that says, As discussed in the direct testimony of Laclede's Witness McShane, it is simply unreasonable to expect LDCs, which are riskier than ever before, will be able to continue to attract capital. And the sentence continues.

Can you please tell me what is the basis for your comments that LDCs are risky than ever before?

A. Oh, well, certainly there's a lot of -- there's a lot of risks in running today -- a local distribution company in today's environment then there was, say, even five or ten years ago. Most notably, as I think I go on to say, is the fact that the entire responsibility of the acquisition of natural gas supplies and having those supplies differed on a timely basis, as required by our customers, has now been shifted from the pipeline function pursuant to Order 636 directly to the local distribution company. That's a huge risk.

Before, it was a certificated obligation of the interstate pipelines to provide all natural gas pursuant to their contract with the LDC on demand 365 days a year under all conditions. And that obligation is no longer there. That obligation is now -- rests solely on the part of the distribution company to provide that. It's a huge shift in risk.

Q. When did that obligation shift take place?

A. November 1st, 1993, in the case of Laclede Gas Company with the implementation of Order 636 on MRT, Mississippi River Transmission Corporation's Pipeline.

Q. So five years ago the LDCs wouldn't be any riskier than they are today?

A. I wouldn't say that. I don't think we've ever had a test yet in those five-plus years that the 636 has been in effect of just how well that system actually works. We really hadn't -- we haven't had a winter that would be deemed cold as you saw from one of the earlier charts that would test that entire system.

And I guess the case in point would be what we saw occurring on the electric -- in the electric industry a year ago in June when it was -- the demand in the Midwest was such that people were going out on the open market and paying $7,000 plus for kilowatts in order to keep that system from cascading. There's a system that was -- that was absolutely tested and hadn't -- has not gone under any fundamental change of obligation to serve like the gas industry has.

So I don't think -- I don't think we've seen a true test of just how well the -- the obligation shift pursuant to 636 is actually going to operate in the marketplace. That's yet to be determined. I don't think those risks have been fully identified nor have they been tested.

Q. Doesn't Laclede flow through those purchase gas costs to the ratepayers?

A. Yes, we do. We have a purchase gas cost adjustment. But that's not what I'm talking about in terms of the -- of the cost being flowed through. I'm talking about the physical delivery of the molecules on demand. The cost recovery is certainly a portion of that, but I'm talking about the operational considerations to make that happen.

Q. Would you please turn to page 4 of your testimony?

A. I have it.

Q. You have a graph there.

A. Yes.

Q. And would you please explain to me what this index is measuring?

A. It really shows the difference beginning from March 1994 of the returns, the S and P 500 and how that has grown over roughly a five-year period compared to the value of Laclede common stock.

Q. What does the index portion of this graph represent? Does that represent stock price?

A. I think it's -- I think it's the price of the S and P 500.

Q. Isn't it true that most of the companies in the S and P 500 are industrial?

A. I think over that period of time the -- the mix of the S and P 500 has changed dramatically. There's technologically driven stocks that are shown in the

March 1999 period that weren't even in existence in March of 1994. I don't know exactly the make up. We may have a witness that has the exact make up of the S and P 500, but it's undergone a tremendous amount of change.

Q. Would you have any reason to doubt that most of the companies in S and P 500 are industrials?

A. No. I would say overall they're industrial in nature.

Q. Isn't it true --

A. But that make up has changed very much so. And many of them who were there in 1994 are not there in March of 1990.

Q. Isn't it true that most of the companies in the S and P 500 do not have the luxury of asking for a rate increase like Laclede has done in this case?

A. Oh, no. They -- again, I don't know specifically who's in the S and P 500. It's an industrial index, so I doubt if there's anybody in a utility nature that's in there. But certainly they have the freedom to move in and out of markets and in and out of products that -- that a utility does not. They also have the ability to move their prices up to the extent the market will bear that or downward on a real-time basis.

Q. Isn't it true that most of the companies in the S and P 500 are not monopolies?

A. I have no reason to believe that's untrue.

Q. Mr. Yaeger, do you know what the dividend yield percentage has been on Laclede's common stock has compared to the dividend yield percentage for the S and P companies over the past five years?

A. Not off the top of my head, no, I don't. But I'm sure if we don't have it in the myriad of testimony that we have, we can certainly have it for you shortly if you would like us to produce that.

Q. Would you have any reason to doubt that the dividend yield for utilities is higher than the dividend yield for an S and P industrial on a percentage basis?

A. Would I have any -- restate that. I'm sorry. I -- I didn't hear you.

Q. If I were to tell you that an S and P industrial -- that a dividend for an S and P industrial is, on a percentage basis, lower than a dividend yield for an S and P utility, would you have any reason to doubt that statement?

A. That would not be my sense, no.

Q. That would not be your sense?

A. That would not be my sense that the dividend yield for a utility would be higher than an S and P industrial.

Q. You think that -- it's your position that a

S and P utility would have a --

A. A utility or industrial?

Q. S and P utility would have a lower --

A. I'm sorry. I thought your question had to do with S and P industrial.

Q. I'm asking both. Which do you think is higher?

A. They're two completely different industries.

MR. MCNEIVE: Could I just ask counsel to rephrase so our witness can understand the question. I think there's some confusion right now.

BY MR. POSTON:

Q. Okay. Would you have any reason to doubt if I were to tell you that over the past 10 years Laclede Gas Company has had a dividend yield of 6.3 percent while S and P industrials have had a dividend yield of 2.28 percent?

A. I -- I'd have to take that subject to check. My sense of that is if you're going in a directional situation, certainly the value of Laclede Gas Company common stock, as I think we showed in my direct testimony, has remained relatively flat while the value of the common stock for the S and P 500, as well as the other S and P utilities, have probably gone up.

To the extent that the math would work that --

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and everybody maintain the same level of dividend, certainly the math would work where the -- that percentage, that dividend yield would go down in the case of the escalating stock value and remain roughly the same for the -- for the flatter valued stock. That's just the math.

Q.   Is there more --

A.   The investor may be much better off under the one situation. Had he bought stock or she bought stock for $5 five years ago that's now worth $100 and maybe only got a 25 cent dividend over that period, I'm not so sure that would be such an unhappy investor. Depends if that investor's looking for yield or looking for appreciation of his investment.

Q.   Mr. Yaeger, are stock prices alone the best measure to judge an investment's performance?

A.   Stock prices are one way to measure an investment's performance. Dividends are another. And I think it depends on what the investor's looking for.

MR. POSTON: That's all the questions I have.

JUDGE DIPPELL: Thank you. Are there questions from the Bench for Mr. Yaeger? Chair Lumpe?

QUESTIONS BY CHAIR LUMPE:

Q.   Mr. Yaeger, you, I believe in your testimony, allude to the issue of global warming. Does Laclede have a public position on global warming?

A. I don't believe we've got a public position, per se. Our position is really driven largely by what you've seen in this earlier on and in what has gone on in this last 10- to 15-year period, and particularly in the last 9 years in this decade where we've experienced 5 of the 10 warmest winters since 1900, I think. Certainly there's a trend there. As you can see over the 15-year period, there's a trend toward much warmer winters as opposed to certainly colder or even normal.

Q. You haven't taken a public position in this debate. Based on what you're proposing to us, do you have a position there?

A. Not that I'm aware of, but I'm not a meteorologist. Certainly I think things like global warming are issues you have to look at over a long, long period of -- of time. And the short answer to your question is, no, not to my knowledge, we haven't taken a public position.

Q. The reason I pose that was because if you're going to address the issue of global warming and then use a 10-year period, surely one wouldn't suggest global warming could be detected over a 10-year period, could they?

A. No. But I think the advocates for global warming have looked at it for much longer than the 10-year period. And I think that's -- again, I'm not a meteorologist. I think that is their basis for a trend in global warming that covers decades, if not centuries of information.

All we've chopped down is the last 15 years to see that if indeed there is a trend to global warming, the last 15 years sure haven't shown anything to make you think that there's anything different going on.

Q. Let me go to page 5 where you were earlier. And there's, on line 16, the phrase "a comparable earnings approach." In using that phrase, is this where you're suggesting that you shouldn't be compared to utilities, but you should be compared to other non-regulated industries or companies?

A. Well, I -- I think a specific answer is probably better directed toward Witness McShane, but my understanding of that -- of that approach is really that the investor, in a large part, doesn't really -- is looking for either the return or the appreciation of his investment and not necessarily limited to investing into a utility or a non-utility.

So you -- as one -- as one way of evaluating a utility's attractiveness in the competitive investor market, in a market that has a lot of opportunities, would be to compare it to not just utilities, but other investments that individuals are free to make. And I think the comparable earnings does that in a large part.

That's not to say that -- that that's the model by itself that should be followed, but it is a consideration and I think a real world consideration.

Q. So it would be the investor -- was it the investors of the past that looked at a company that was a monopoly company which was less riskier, but today the investor wishes to take more risk? Do you have that knowledge?

A. Well, I think as the chart earlier showed, that we're -- where Laclede would be given the Staff recommendation on rate of return would basically be absolutely comparable to a risk-free treasury note. I don't think that's -- I mean, the investor in the equity market isn't looking for a T-bill.

He's looking for or she is looking for an equity investment that I think has inherent with that the opportunity for the stock itself to appreciate, not just the yield. If you're looking just for yield, there's other investment opportunities that are out there that I don't think you'd necessarily look in the equity markets to get.

Q. So the investor today is looking more for --

A. The equity investor.

Q. The equity investor is looking more towards -- or a great risk-taker today --

A. I think certainly, again, going back to the chart, you can see that you don't have to -- you can go to the S and P utilities as an equity investment and certainly get a better return than what Laclede Gas by itself would be -- would be developing under the -- under the Staff's proposal. So we're at the low end of that curve.

Q. I forget what page it was, but you talk about other reasons that might exist for the -- I guess the lack of growth of the company, and one is that people are conserving. Does this penalize them for conserving?

A. No. Not necessarily. I think that was -- I don't remember exactly where that was either, but I think it was part of my testimony that dealt with the impact of urban sprawl and the lack of growth within our traditional service area, where basically we're getting -- we're getting impacted in several fronts by the current Laclede Gas customer or long-term Laclede Gas customer who has decided to move out -- within our service area, but further out where we have to build infrastructure to support him or her, and in doing that, generally builds a new home because the housing stock is not existent out there with higher technological and higher -- more efficient equipment and more insulation.

And, therefore, we expend a lot of capital to provide the same service, lesser usage for that same customer. At the same time we still have the obligation, as we should, and the O and M responsibility to maintain and keep up that existing infrastructure that he or she is moving away from. So it is a -- our costs raise and the revenues don't follow basically is the point I was trying to make, if that helps to clarify that.

Q. Well, it does. And it leads me to probably my last question. And I think you mentioned the -- someone mentioned the urban sprawl, it might have been your attorney or you, I'm not sure which, issue. And there's a lot of discussion and activity trying to address that in the metropolitan area. Is Laclede involved in that effort to address this whole issue of sprawl?

A. Absolutely. I personally sit on the executive council of the Regional Commerce of Growth Association that has an infra-- standing infrastructure committee. That infrastructure committee overwhelmingly is focused not on the utility infrastructure. They view that to be our responsibility as a company. But primarily as to whether we have adequate roads, bus routes, things of that nature to accommodate the dramatic change and the shift in the population within the metropolitan area. So, yes, we are a part of it in that regard.

Q. Wouldn't it be a value to be involved in that in order to use the current infrastructure in a more efficient way --

A. Absolutely.

Q. -- other than continuing to have to develop infrastructure out where the sprawl is?

A. It is a difficult -- it is a difficult situation that -- that, I guess, fundamentally has the potential of not allowing people to move where they want to move. So it's -- it's a -- it is complex.

Q. To the extent that there are efforts to utilize the infrastructure that is there and assist in that rejuvenation, those are activities you --

A. We are very active in that.

Q. -- are supportive of?

A. Absolutely. Absolutely.

CHAIR LUMPE: Thank you, Mr. Yaeger

JUDGE DIPPELL: Vice Chair Drainer?

QUESTIONS BY COMMISSIONER DRAINER:

Q. Good morning.

A. Good morning.

Q. I just have a few questions. With respect to your testimony on the urban sprawl, you mentioned customers leaving the St. Louis City area and possibly the county. But overall since 1990 has Laclede's customer base decreased or increased?

A. It has increased at a very modest level. I think the -- 1 to 1 1/2 percent in terms of customer number.

Q. Okay. Then --

A. But, again, those customers, by and large, are using less so it doesn't necessarily equate to an increase in throughput.

Q. Do you have any information to what the average customer of Laclede uses today compared to what they used in 1990?

A. I don't have it with me, but I'm sure we have it.

MR. MCNEIVE: We can provide that to the Vice Chair, if you'd like.

BY COMMISSIONER DRAINER:

Q. Well, does support whether or not on average the customers are using less? If I take --

A. Oh, I --

Q. If I take, you know, your average customer usage in 1990 and even with the modest increase, the average customer usage, has it decreased?

A. Certainly. That's the basis of --

Q. You know that it has decreased? Your average customer usage has decreased since 1990?

A. I -- I -- yes.

Q. Okay. You believe that?

A. I totally believe that.

Q. All right. I would like to have that

information.

MR. MCNEIVE: We'll provide it.

THE WITNESS: Surely.

BY COMMISSIONER DRAINER:

Q. And I would like that to be on residential customers.

A. Yes. And where you have to be careful is the heating requirement. You know, that's been -- that's been affected by the lack of degree days where you're really looking at -- and certainly we can show it, I think in the non-heating core. I don't think there's any problem with that.

Q. I just want usage. I want the average usage of your customers, what they used in 1990 and what the average customer uses currently.

A. That won't show your conservation impact, because --

Q. Sir -- excuse me, sir. I'm asking you the questions and you answer my questions. And this is going to be a long hearing. This isn't just for us to have a dialogue. And I wasn't talking to you about conservation. All I was asking was I wanted to know how many customers you had, how many you have now. You have had an increase.

I then wanted to know if your average customer usage has increased for your residential customers or not since 1990. That's what I asked you. That's what I'd like to receive, period.

Now, having asked that, when you get to conservation, you mentioned that your customers are moving from less efficient houses to more efficient houses. Have you any evidence or surveys that Laclede has done that shows that the customers have moved to more energy-efficient homes?

A. I don't have that with me, but I'm sure we can provide that to you.

Q. You have done surveys that show that for Laclede specifically -- Laclede?

A. Yes.

Q. Could you tell me what those studies are?

A. I don't have them in front of me nor do I have them with me.

Q. But tell me about them. What have you done?

A. We look at -- we look at the usage of our residential customers on an ongoing basis. And we can certainly look at certain locations within the city versus what the usage would be in a new home -- new housing stock in St. Charles. That's what I'm talking about. When you move from an older housing stock that may have a furnace that's 25 years or 20 years old, to a new home that has a highly efficient furnace and is much better insulated.

Q. And you have studies that show that? You wouldn't have to go and push the pen on this? You could give me a study that already shows you've looked at this?

A. I -- I'm sure we have that. I don't -- I can't tell you off the top of my head, but I'm sure we have that.

Q. If there is --

MR. MCNEIVE: If I may --

COMMISSIONER DRAINER: Yes.

MR. MCNEIVE: The witness is obviously telling you what he thinks, but we'll have to find that out and provide it. I don't want to suggest that we absolutely sitting here today have what you're asking for. But I will find out.

COMMISSIONER DRAINER: If you do not have it, I don't want something put together.

MR. MCNEIVE: I understand.

BY COMMISSIONER DRAINER:

Q. I'm just trying to figure out what the basis for these generalized summary statements that you made on page 8 and 9 are -- you know, what data backs them up. Okay? And if there is data that back up those statement, I'd like to see that.

A. I hate to raise this again, but simply dividing the usage by the number of customers is not going to give you -- in the years that were warmer that you saw, you're going to see significantly less usage than the years that are colder. You know, that we have certainly, but I don't know if that's what --

Q. Well, that might be make you believe that you need to look at a 30-year average to look at --

A. Well --

Q. -- all the information.

A. -- a 30-year average or a 10-year average won't change the actual throughput that we experienced over that period.

Q. With respect to the increase that Laclede is asking for in this case, you discuss that one of the problems Laclede is having is the cost in having to put in more outside plant. What percent of the increase that Laclede is asking for in this case is a result of the urban sprawl into the Chesterfield/St. Charles areas?

A. I don't have that number off the top of my head, but I'm sure we can get that for you.

Q. Is it a very significant piece of the increase that's being asked for in this case?

A. Our -- our capital expenditures over the last five years or so have gone up primarily -- well, in large part -- I should say in large part due to increased installation of mains in the St. Charles/St. Peters area.

And we can get that information.

Q. And the service connection charges and the charges that are currently attributed to new customers don't cover that expense?

A. No. I think that's one of the reasons we've asked for an increase in those service connection costs in this case.

COMMISSIONER DRAINER: Okay. Thank you. No other questions.

JUDGE DIPPELL: Let me go ahead and state that I'll reserve Exhibit No. 113 for information, if it's available, on residential customer average usage in 1999 [sic] versus the customer average usage currently, and for Laclede to file that as a late-filed exhibit.

And I'll reserve Exhibit No. 114 as a late-filed exhibit for support or studies, if they exist, that the customers are moving into more efficient homes.

COMMISSIONER DRAINER: When could we have that information? Could we have it by the end of the day Wednesday, the 1st?

MR. MCNEIVE: Certainly, I would think so. If there's a problem with that, we'll advise the law judge. By the end of Wednesday, yes, ma'am.

COMMISSIONER DRAINER: Thank you.

CHAIR LUMPE: What were the dates you were using in the Exhibit 113?

JUDGE DIPPELL: 1990 versus the current period.

CHAIR LUMPE: I thought I heard you 1999 versus the current year. Thank you.

JUDGE DIPPELL: Commissioner Murray, did you have questions?

COMMISSIONER MURRAY: I pass. Thank you.

JUDGE DIPPELL: Commissioner Schemenauer?

COMMISSIONER SCHEMENAUER: Just a few. Thank you.

QUESTIONS BY COMMISSIONER SCHEMENAUER:

Q. Good morning, sir.

A. Good morning.

Q. On page 6 of your direct testimony could you tell me, the degree date deviation from NOAA -- I'm looking at 1995, and there's a red number 728.

A. Yes.

Q. What does that tell me, or what is it supposed to tell me?

A. That would tell you that the NOAA average normal for 1995 was 728 degree days higher than what we actually experienced in our service area.

Q. In 1995 there's 365 days. So when you tell me 728 degree days, what are you talking about?

A. Hold on. I may have -- I don't think I have those. There's -- the -- could we go off the record for a second?

JUDGE DIPPELL: Do you need to retrieve something?

THE WITNESS: Yes.

JUDGE DIPPELL: We can go off the record.

(Off the record.)

JUDGE DIPPELL: Let's go back on the record then. I believe the Commissioner's question can actually be answered by another witness's testimony. Is that what you're saying, Mr. McNeive?

MR. MCNEIVE: Yes. If I may speak on the subject, the question from Commissioner Schemenauer, I believe, was with respect to the charts shown here earlier, which also appears in the testimony -- direct testimony of Witness Krieger, which is page 12.

And in addition to the visual chart there were also numbers, sir, that were reflected there. And I'm looking at that now on page 12 of her testimony. And if you look for the year 1995 numerically, it will show that we had 400 and -- pardon me -- 4,030 actual degree days that year, and the normal that was used by NOAA at the time was 4,758. So you subtract 4,030 from 4,758 and you come up with that negative 728, sir. That's what this --

COMMISSIONER SCHEMENAUER: You're telling me a degree day isn't a calendar day. It's some other period?

THE WITNESS: I now understand your question.

MR. MCNEIVE: I do too. And I'm sorry for not understanding it earlier.

JUDGE DIPPELL: Let's let the --

THE WITNESS: A heating degree day is a term of art that basically is calculated as follows. You assume at an average temperature of 65 degrees over a 12 -- 24-hour period. If the actual temperature -- that's a comfort -- that's a level of comfort.

To the extent that the average temperature for that day actually was 40 degrees, all right, that means you've created 25, or the difference between 65 and 40 heating degree days, indicating that if it's 40 degrees, the average consumer would turn their furnace on and use so much natural gas or whatever they're using for that point -- that point in time to generate a level of comfort to take them back to 65.

So over -- over a winter period, there are -- and NOAA calculates this over 30 years on average -- so many expected heating degree days between -- it's actually over more than a winter period, basically it runs October through May, I believe. And the -- I don't recall the number, but the anticipated normal for that year was 728 heating degree days, significantly colder than what we actually experienced, or the actual experience of the company was a much warmer than anticipated normal.

And either that normal or some other normal expected heating degree day level which generates usage of our product is what our rates are based on. So that's basically showing you -- that entire chart shows you that there's been a consistent and significant deficiency of those heating degree days because it's been so much warmer than anticipated or warmer than normal over that 15-year period that has negatively impacted our throughput an our opportunity to recover our costs.

BY COMMISSIONER SCHEMENAUER:

Q. Wouldn't it have been simpler to give us a chart that showed your throughput cubic feet of gas per year and the differences? I mean, I understand the red means it's warmer and blue means it's been colder. I assume when it's -- the red means you're selling less gas; when it's blue, you're selling more gas. I -- this just seems like an unnecessary exercise to me.

A. Well, a heating degree day is just a term of art in the industry --

Q. Yeah, I know.

A. -- as a cooling degree day is in the electric industry. And it's just used as a universal unit that is a basis upon rates and throughput.

Q. Your testimony translated this to a loss of $22 million over the past 15 years, which is about one and a half million dollars per year. And it would be much easier for a -- for me to understand if one and a half million dollars per year loss was the result of how much less fuel you were selling during that period. But that's all right.

Next question, when was your last rate case filed?

A. It was filed in -- if I remember -- December of 1997.

Q. Okay.

A. Is that correct?

Q. And you were granted, I think, in opening statements I understood a zero dollar increase?

A. We had no increase in our rates.

Q. And then the rate case before that, when was it filed?

A. '95 or so.

Q. Okay.

A. I think that resulted in a $9 1/2 million increase, if memory serves.

Q. The '95 and '97 rate case, did they take into consideration these degree day deviations from normal from 1985 up and through at least '91 or '2?

A. Certainly in both those cases and -- at least in our initial case we -- we had the warmer than normal weather as a consideration in those cases, absolutely.

Q. Then why would that be relevant in this rate case if it's already been --

A. It wasn't.

Q. -- addressed in the other?

A. It wasn't. We -- well, clearly in the most recent case, the last case, we didn't get any increase.

Q. But it was addressed, was it not?

A. Well, it was a settled case. It was never -- it was never --

Q. Certainly you must have --

A. -- agreed to.

Q. -- brought this -- I mean, if this affected your rates and you didn't bring this to the attention --

A. We did bring it -- we did bring it to the Commission's attention.

Q. So it was addressed in the last --

A. No, it wasn't addressed. It was -- what we ended up agreeing to is -- in a stipulation among the parties was not to address this issue, but instead to -- to come to an agreement on how some accounting features of the way we booked some of our expenses should be reflected.

Q. Let me rephrase. It wasn't a secret from the

Commission that these degree days from 1985 through 1990 -- it was not a secret from the Commission that these degree days were in red from 1984 through 1992?

A. It was part of our -- it was part of our direct case, that is correct.

Q. Okay. Okay.

A. We just didn't get any rate recovery to reflect that, at least in the most recent case.

Q. Did you appeal that case -- or either of those cases?

A. I'm sorry? I didn't hear you.

Q. Did you file an appeal on either of those two cases?

A. No. We agreed to the settlement in the last case and the case before.

COMMISSIONER SCHEMENAUER: Okay. Thank you. That's all I have.

JUDGE DIPPELL: Yes. Vice Chair Drainer, do you have another question?

FURTHER QUESTIONS BY COMMISSIONER DRAINER:

Q. I just wanted to get a clarification for the record. In the last two cases all the parties did a Stipulation and Agreement for those two cases so that the direct -- any direct rebuttal or surrebuttal testimony filed was never presented in a hearing to the Commission; is that

correct?

A. Thank you. You're absolutely correct.

JUDGE DIPPELL: Is there anything further from the Commission?

Is there recross based on questions from the Bench, Ameren?

MS. KNOWLES: No. No questions.

JUDGE DIPPELL: Public Counsel?

MR. MICHEEL: Yes. I have a couple, your Honor.

RECROSS-EXAMINATION BY MR. MICHEEL:

Q. Both Chair Lumpe and Vice Chair Drainer asked you some questions about urban sprawl. Do you recall those questions, Mr. Yaeger?

A. I do.

Q. Does Laclede contend that when one of its customers leaves the City of St. Louis to move to, for example, St. Louis County, then it leaves behind a house or apartment which no longer has a customer that Laclede provides service to?

A. I think in my testimony I indicated the City of St. Louis has lost something in the magnitude of 350,000 residents, so indeed that housing stock is either sitting vacant or has been torn down.

Q. And did you provide any studies that indicate that indeed people aren't moving into those houses that are vacated and not being sold?

A. Well, I think there's some influx back into the city. What we're talking about here are general overall trends and impacts on our overall marketplace.

Q. You also got a question, I believe from Vice Chair Drainer, with regard to the number of mains and different items you're having to put in St. Charles County and out in St. Peters. Do you recall those questions?

A. Uh-huh.

Q. Is it correct that when you place the plant in ground, eventually that plant is reflected in the Company's rate base and the Company's allowed to earn a return on that?

A. That is eventually correct. To the extent we've had kind of a dialogue here about the impact of settling out rate cases over a period of time, which we've done for the last 20 years, you know, I'm not sure it's dollar for dollar, but theoretically that's absolutely correct.

Q. So, in other words, the more plant you put on the ground -- in the ground, your rate base gets bigger and you're allowed to earn more return?

A. To the extent we get recovery of those costs, that's absolutely correct. And that's part of our issue.

We haven't had that opportunity.

MR. MICHEEL: Thank you very much, Mr. Yaeger.

JUDGE DIPPELL: Mr. Landwehr, I'm sorry. I --

MR. LANDER: No questions.

JUDGE DIPPELL: MRT? Staff?

MR. POSTON: Yes. I have a question.

RECROSS-EXAMINATION BY MR. POSTON:

Q. Following up on a question asked to you by Chair Lumpe concerning risk, isn't it true, Mr. Yaeger, that a dollar dividend today is less risky than a potential dollar that might or might not be earned in the future through capital gain?

MR. MCNEIVE: I'm going to object to the question as being something that's totally beyond what Chair Lumpe asked about. I think this is just another earlier question dressed up in that respect. So I object as opening up a whole new area that he had an opportunity to cross about earlier.

MR. POSTON: She asked a question concerning risk, and he responded and brought in the issue of capital gains regarding that risk.

JUDGE DIPPELL: I'll overrule the objection. You may answer the question.

THE WITNESS: Please restate it. I'm sorry.

BY MR. POSTON:

Q. Isn't it true, Mr. Yaeger, that a dollar dividend today is less risky than a potential dollar that might or might not be earned in the future through capital gain?

A. I don't believe I can answer that question. There's no guarantee from one year to the next the company can make its dividend. There are situations, particularly in the -- well, we have a situation, I think, in the 1990s where earnings did not cover our dividends. We maintained our dividend payout at that point in time, but over a period of time I don't know if we could continue to do that.

So, I'm sorry. I can't answer your question. If you give me a specific company -- a specific company, I can give you my opinion.

MR. POSTON: I have no further questions.

JUDGE DIPPELL: Is there redirect?

MR. MCNEIVE: We have no redirect. Thank you.

JUDGE DIPPELL: Okay. Is there anything further of this witness?

Mr. Yaeger, you may be excused. Thank you.

THE WITNESS: Thank you.

JUDGE DIPPELL: Since it's noon, let's go ahead and take a lunch break. Let's return and be prepared to start at 20 after 1:00. Off the record.

(Off the record.)

JUDGE DIPPELL: Mr. Pendergast, do you want to call your next witness?

MR. PENDERGAST: Yes. At this time, your Honor, we'd call Kathleen McShane to the stand.

JUDGE DIPPELL: Ms. McShane, could you spell your name for the court reporter.

THE WITNESS: McShane, M-c-S-h-a-n-e, Kathleen, K-a-t-h-l-e-e-n.

(Witness sworn.)

JUDGE DIPPELL: You may go ahead, Mr. Pendergast.

MR. PENDERGAST: Thank you.

KATHLEEN MCSHANE, having been sworn, testified as follows:

DIRECT EXAMINATION BY MR. PENDERGAST:

Q. Ms. McShane, would you please state your name and business address for the record, please.

A. My name is Kathleen C. McShane. My business address is 4550 Montgomery Avenue, Suite 350 North, Bethesda, Maryland, 20814.

Q. And are you the same Kathleen C. McShane who has previously caused to be filed in this proceeding direct, rebuttal and surrebuttal testimony that has previously been marked as Exhibits 2, 3 and 4?

A. Yes, I am.

Q. Do you have any corrections or additions to make either in your direct, rebuttal or surrebuttal testimony?

A. I have one correction to make for my direct evidence.

Q. Please do.

A. It's on page 3. It's at line 28 where it says, for the S and P 500. And that should state, For the S and P 400. And that's the only correction that I have.

Q. Thank you. With that correction, if I were to ask you the same questions that appear in your pre-filed direct, rebuttal and surrebuttal testimony today, would your answers be the same?

A. Yes, they would.

Q. And are those answers and the information contained in your schedules true and correct to the best of your knowledge and belief?

A. Yes.

MR. PENDERGAST: At this time I would offer Exhibits 2, 3 and 4 into evidence and I would tender Ms. McShane for cross-examination.

JUDGE DIPPELL: Are there any objections to Exhibits 2, 3 and 4, after that amendment to Exhibit 2?

Then those will be received into evidence.

(EXHIBIT NOS. 2, 3 AND 4 WERE RECEIVED INTO

EVIDENCE.)

JUDGE DIPPELL: We'll go ahead and proceed with cross-examination. Ameren UE?

MS. KNOWLES: No questions.

JUDGE DIPPELL: Office of the Public Counsel?

MR. MICHEEL: Yes, your Honor.

CROSS-EXAMINATION BY MR. MICHEEL:

Q. Is it correct, Ms. McShane, that the companies that you selected for your comparable earnings test were, as a group, more risky than Laclede Gas Company?

A. Yes.

Q. Is it correct that you attempted to rectify this difference by making subjective adjustment to your results?

A. No. It was not a subjective adjustment. It was an objective adjustment.

Q. And what did you do to adjust your results?

A. I reduced the returns for the sample by the difference in the beta coefficient, which is the measure of relative risk, as between the sample of local gas distribution companies and the sample of -- of industrials.

Q. When you picked the companies that you picked for your comparable earnings analysis, would it have been possible for you to select a group of companies that had similar beta coefficients as Laclede Gas Company?

A. I may have been able to do that, yes.

Q. Okay.

A. I chose to screen the companies at the outset by looking at factors other than simply the beta, the safety factor, for example. And I used the -- the beta as a means afterwards to make sure that the returns for the sample of industrials were indeed returns that would be achievable by companies of commensurate risk with utilities.

Q. Do you have a copy of your surrebuttal testimony with you? I believe that's been marked for purposes of identification as Exhibit 4.

A. Yes, I do.

Q. And focusing on the question and answer that appears at the top of page 4 there, Ms. McShane, and there you're generally talking about the whole concept of interest coverage and bond ratings; is that correct?

A. Yes.

Q. Would you agree with me, Ms. McShane, that it's speculation on your part that Laclede's bond rating would be reduced assuming the Commission accepted either the Staff or Public Counsel's return on equity in this proceeding?

A. I think speculation is a term that I would not use in that regard. I do not know what the rating agencies will do. I know what the standards that the rating agencies have are, and I have looked at what the results would be. And, therefore, if the rating agencies do what -- what they say they'll do, then there is a possibility that that rating would be reduced.

Q. Let's chat about those standards. Is it correct that interest coverage ratio is just one standard that, for example, Standard and Poors uses in rating a bond; is that correct?

A. Interest -- pre-tax interest coverage is one. Free cash flow to total debt is another. Cash flow coverage is another. The debt ratio is another. There are, I think, five total that are quantitative standards that they use.

Q. And then they also have some subjective standards; isn't that correct?

A. Yes.

Q. Such as management of the company and those items?

A. Yes. That's correct.

Q. And so you would agree with me that the interest -- pre-tax interest coverage ratio is only one of the objective categories looked at by S and P; is that correct?

A. Yes.

Q. Okay. And is it correct, Ms. McShane, that you do not have to meet all of the specific coverage standards in order to have a specific bond rating?

A. I think that's -- that's correct, that you don't have to at every point in time meet them. The Standard and Poors and Moodys certainly will look at trends. And I think if you talk to Mr. Fallert, he can give you some more specific information on some of the other standards. This is the one that I looked at here, but there are other measures, given the recommended return on equity, that would also be reduced to levels below the double A rating level.

Q. And it's correct currently that Laclede's bonds are rated double A; is that correct?

A. Today, yes.

Q. Okay.

A. We're not talking about today. We're talking about what the impact of a decision to allow a return of 9 1/2 percent would have for the future.

Q. And is it correct that you show on page 8 of your direct testimony the current S and P guidelines for a double A rated bond and where Laclede is at, vis-a-vis those guidelines?

A. Yes.

Q. And is it correct that for the funds from total operations to total debt, Laclede is currently below a double A rating; is that correct?

A. Yes.

Q. And the same for funds for operations interest coverage; is that correct?
A. Yes. They have been weak according to the category.
Q. Okay.
A. Standard and Poors has noted that. Standard and Poors has also noted that it expects those measures to increase. If Standard and Poors instead sees that that trend -- that it anticipates would be reversed, then -- then I would expect that we might well see a credit warning in the future.
Q. Okay. We haven't yet, have we?
A. No. Because this decision hasn't been made.
Q. When the Company took a zero rate increase in its last rate case, was there a credit warning issued then?
A. Not to my knowledge.
Q. Okay. You also talk on page 4 --
A. But Pitch did lower their ratings within the last 18 months that -- as I recall.
MR. MICHEEL: I'll just move to strike that. I asked her about Standard and Poors. There was no question remaining. I mean, if Mr. Pendergast wants to ask her on redirect, that's fine.
MR. PENDERGAST: Your Honor, I think that was entirely responsive in the ambient of the question that was

asked.

JUDGE DIPPELL: I'm going to strike that testimony. She'd already answered the question and the counselor had moved onto his next issue.

BY MR. MICHEEL:

Q. Again, Ms. McShane, focusing on page 4 of your surrebuttal testimony, I think it's the answer beginning there on line 10. Is it correct there that you claim that the cost of equity for a triple B rated utility can be 11 percent higher than that for a double A?

A. It could be, yes.

Q. Okay. And if I understand your testimony correctly, you base that on an article in Public Utilities Fortnightly entitled Utility Bond Ratings and the Cost of Capital; is that correct?

A. That was a study that -- that those authors did that showed those differentials and the cost of equity.

Q. And do you know whether that was a study looking at all utilities; is that correct?

A. I believe it focused on electric utilities.

Q. And, indeed, it didn't focus on gas utilities; is that correct?

A. No. But there are only, let's say, 17 gas utilities in the entire country that would be considered comparable enough to make that kind of analysis; whereas, there are approximately 100 electric utilities. And, therefore, if you're trying to make a study that would allow you to draw some statistically accurate conclusions, you need a larger sample than 17 companies.

MR. MICHEEL: May I approach the witness, your Honor?

JUDGE DIPPELL: Yes.

BY MR. MICHEEL:

Q. I have a copy of that October 27th, 1988, Public Utilities Fortnightly Utility Bond Ratings and the Cost of Capital. Is that the article that you cite there at page 4 of your testimony?

A. Yes.

Q. Could you read the paragraph starting with Telecommunications into the record for me?

A. It says, Telecommunications and natural gas stocks are not included in the study because of the differing business risks in these industries. And because relatively few -- can I take my glasses off?

Q. Whatever you need to do to read.

A. -- telecommunications or natural gas companies are publicly traded common stock or pure plays, in quotation marks.

Q. Thank you very much.

A. I think that's what I said about the natural gas industry.

Q. And so the study that those individuals conducted was only for the electric industry; is that correct?

A. Yes.

Q. And indeed they admit that the telecommunications industry and the gas industry are somewhat different than the electric industry; is that correct?

A. Yes.

Q. Okay.

A. That's why I wouldn't put them in the same sample together, but that doesn't change the point that you would expect different risks between different-rated companies within the same industry.

Q. Have you conducted any study that indicates that with respect to the natural gas industry?

A. No. I -- in fact, I pointed out in my response to one of my data requests that at the present time, if you look at the betas of natural gas companies, there is no indication that an LDC with a lower beta is riskier than an LDC with a higher beta. But these are -- over the longer term you would anticipate that a triple B company would have higher equity risk than a double A company.

Q. Isn't the beta coefficient itself considered a measure of risk, Ms. McShane?
A. Yes, it is.
Q. Is it correct, Ms. McShane, that non-regulated companies, unlike Laclede, do not have a monopoly service territory?
A. Typically, no.
Q. And is it correct that unregulated companies, unlike Laclede, are going to have competitors selling the same products in the same service territory; is that correct?
A. Typically, yes. Some more than others.
Q. Okay. Are you aware of whether or not unregulated companies can get a rate increase within 11 months or at least try a rate increase within 11 months if they have a statutory deadline?
A. I'm sorry. Can you repeat that?
Q. Are you aware in Missouri that utilities, for getting a rate increase, there's a 11-month statutory deadline on any rate increase?
A. They can apply for one.
Q. Yes.
A. There's no guarantee that they're going to get one.
Q. Are you aware that Missouri is an original

cost book value state?

A. I'm aware that that's the way the return is applied. I'm also aware that it's required to do the fair value estimates.

Q. Okay. So you're not aware of -- and so I guess it's your testimony that you're aware traditionally that's what Missouri has done; is that correct?

A. Yes.

MR. MICHEEL: Thank you very much, Ms. McShane. That's all I have.

JUDGE DIPPELL: Are there questions from Staff?

MR. POSTON: Yes. Thank you.

CROSS-EXAMINATION BY MR. POSTON:

Q. Ms. McShane, would you please turn to Appendix D, page D-2, line 4 of your direct testimony?

JUDGE DIPPELL: Which schedule were you referring the witness to?

MR. POSTON: Appendix D to Ms. McShane's direct testimony.

THE WITNESS: I have that.

BY MR. POSTON:

Q. Okay. What is the formula that appears on line 4?

A. It's a DCF formula.

Q. Is this DCF formula slightly different than the DCF formula that Staff used?

A. It could be. I -- the only difference would be, I think, in the treatment of the dividend and the -- but I'm not positive whether it's identical or not.

Q. Could you now please turn to page D-7 of Appendix D to your testimony? And you have a formula on line 5?

A. Yes.

Q. And what does this formula represent?

A. It's a form of the discounted cash flow model which assumes that the growth expectation is equal to the sustainable growth rate, which is itself equal to the rate of earnings retention, times the return on equity.

Q. Did the Staff use this formula in its analysis using the DCF model? Are you aware?

A. Not in this context, no.

Q. Looking at this formula, can you please just walk through the elements of this formula and tell me what each letter in here represents? It can be brief.

A. Okay. ROE stands for return on equity. M/B is equal to the market-to-book ratio. K is equal to the cost of equity. And the R is the earnings retention rate, which is equal to one minus the dividend pay ratio.

Q. And where did you get this formula,

Ms. McShane?

A. It is a discounted cash flow model formula whose elements are, I guess I'd say, turned around in such a way that you're solving for the return on equity, as opposed to when you use the DCF model, as we looked at on the earlier page, where you're solving for the market derived cost of equity.

Q. My question was, where did you get this formula?

A. From what source?

Q. Yes.

A. I -- I mean, I've been using this for a long time, and I don't know what the specific source of it is. I don't have a specific source.

Q. You stated the M/B is the market-to-book ratio; is that correct?

A. Yes.

Q. What number did you use in your calculations for the market-to-book ratio?

A. 155 percent.

Q. And that's 1.55; is that correct?

A. Correct.

Q. Ms. McShane, do you recall citing a book authored by Dr. Roger Morin on page 16 of your direct testimony?

A. Yes.

Q. Would you recognize Dr. Morin's book if I showed it to you?

A. Yes, I would.

MR. POSTON: Your Honor, can I approach the witness?

JUDGE DIPPELL: You may.

BY MR. POSTON:

Q. I'm handing you a book. Can you please read the name of the book and the name of the author for me, please?

A. The name of the book is Regulatory Finance: Utilities' Cost of Capital by Roger A. Morin.

Q. And is this the same book that you cited on page 16 of your direct testimony?

A. Yes, it is.

Q. Would you please turn to page 252 where it's been tabbed? I ask that you please read out loud from here -- down here, read this paragraph, please (indicating). You can end before --

A. Before the formula?

Q. -- before the formula.

A. The allowed return on book equity must be revised to account for any sanctioned difference between market price and book value. This adjustment to the cost of equity capital can be obtained using the annual DCF model.

Q. Thank you. Ms. McShane, has this Commission sanctioned a market-to-book ratio for Laclede of 1.55?

A. No.

Q. Turning now to your use of floatation costs, are you familiar with the way the Commission Staff has done floatation costs?

A. Yes.

Q. And how do they handle floatation costs?

A. My understanding is that whenever there is an equity issue, the Commission Staff would propose to amortize those out-of-pocket costs on a five-year basis.

Q. And that would be above the line adjustment to the income statement; is that correct?

A. That's what Staff would propose to do. That's not what the Company's case is.

Q. I'm going to turn now to your comparable earnings test. Ms. McShane, why did you adjust the output of the comparable earnings test?

A. Because the companies that were selected were not of equivalent risk to the LDCs.

Q. And in this test could you please explain to me what beta is measuring?

A. It's measuring systematic -- what's called systematic risk. It's the total of the business and financial risk or investment risk. And in principle it would be those risks that are systemic to the industry, to the capital market, those risks that cannot be eliminated through diversifying among various stocks through a portfolio.

Q. Is it correct to say, Ms. McShane, that beta is calculated as a measure of risk based upon the total return of security as compared to the market as a whole?

A. It's -- it is a measure of the co-variability of the individual -- an individual stocks return or portfolios return relative to the market. That is to say it -- it measures both the relative absolute volatility, how -- how much does -- does a particular stock move relative to how much the entire market moves as -- at the same time to what extent do the market as a whole and the individual stock or the portfolio move together.

Q. Isn't it true that returns for utility shareholders are achieved largely through dividends?

A. I don't think that's right. I guess it would depend on what you mean by "largely." But I think you -- you might have used a number for average yield over the past number of years of 6 percent and the total return to shareholders has been 11. So it would be about, you know, 6 percent dividend yield a bit more than 5 percent on capital appreciation.

Q. Is it true then that more than half of return for utility shareholder would be achieved through dividends?

A. It has been for -- for natural gas stocks, for electric. I think that's right.

Q. Isn't it true that returns for industrial shareholders are achieved largely through capital gains when the stock is sold?

A. If you look at the returns that have been achieved over the past 15 years, the breakdown between dividend and capital gains has been largely capital gains.

Q. Isn't it more of a risk to potentially receive a dollar in the future through capital gains than it is to receive a dollar today through dividends?

A. It really depends on the company. There are some companies whose capital gains are going to be a lot more sure than others. I mean, you can't just make a blanket statement. I agree with you that if you have an assurance that you're going to get a dollar today because you're holding a bond, then that's going to be less risky than a stock from which you would get some of your return through capital gains.

Q. Ms. McShane, are you aware of the industrial yield on S and P industrials, S and P utilities and Laclede Gas Company?

A. Generally, yes.

Q. And could you please give me those figures?

A. Let me see. The yield on Laclede's stock is in the range of 575 to 5 -- about 59. I don't know specifically what the yield on the S and P utilities is if you're talking about the 100 utilities that make up -- that are included in the S and P 500. The yield on the value line LDCs is probably about 4.75 percent, and the yield on the S and P 500 is about 1.3 percent.

Q. And one last question. Wouldn't the risk differential between local distribution companies and industrial companies be greater than what is reflected in the differences in their betas?

A. No. I don't think so. I think we have to recall that what we've talked about here this afternoon so far in terms of risks are primarily business risks. And we haven't talked at all about the fact that typically industrials are significantly less leveraged than the typical utility.

And you have to take into account the fact that industrials have lower financial risk than utilities. And that lower financial risk will be reflected in the betas because the beta is a combination of the business risk and the financial risk.

So if you have similar betas or adjustments that create similar betas, then you've taken account of the fact that, yes, industrials will tend to have higher business risks, but you can offset those higher business risks by capitalizing them much more conservatively.

MR. POSTON: I have no more questions. Thank you.

JUDGE DIPPELL: Are there questions from the Bench? Chair Lumpe?

QUESTIONS BY CHAIR LUMPE:

Q. Ms. McShane, in your direct testimony starting on page 17, if you'll help me understand some of this. When you -- tell me where I'm wrong here. When you did the standard DCF formula, is the 10.5 percent what you came up with?

A. Yes.

Q. Okay. What you're suggesting is that in today's conditions, whatever they may be, that this test is perhaps no longer relevant?

A. I wouldn't say that it's not relevant. What I would say is that you cannot simply use the results without recognizing that the validity of the test results when applied to an original cost book value, which is what happens in the regulatory arena, is only when the market and the book value are approximately equal to one.

In today's market, where we see for utility stocks that the market-to-book ratios are well above one and the discounted cash flow test is being conducted with a market value of -- for Laclede it's about 1.5, for other utilities it's as high as two plus times -- you can't just take a number that's calculated in relation to a value of 1.5 times book and apply it back to an original cost rate base or an original cost equity component and come up with a dollar amount of earnings that will provide to the investor the return that he required when the number was being calculated on market value.

Q. Is your term "market value" the same -- you use the word "replacement cost." Are you using market value and replacement cost the same?

A. No. What I'm -- what I'm saying is that there is a market price out there that you can observe. I mean, that's where the stock is trading. Replacement cost is the amount that it would cost to replace the assets that are being used using today's best technology.

Q. Which is the book value of today?

A. No. The -- it would be what it would cost today if I were going to replace the system. If I were to come in and say, okay, I need to replace the Laclede system, how much would it cost.

Q. But isn't that the book value?

A. No. That's what's -- I mean, the system has been --

Q. When you originally built it, that book value --
A. That's what I'm talking about.
Q. That's the book value originally?
A. Correct.
Q. Replacement is if you were to replace the whole system --
A. Exactly.
Q. -- today?
A. Exactly.
Q. Okay. You're talking about market value?
A. Right.
Q. What is that?
A. Okay. Market value is what investors think the stock is worth. And in the -- the economic theory is that under competition, which is what regulation is intended to simulate, the market value should equate approximately in equilibrium to the replacement cost. Because if it would cost me more to go out and build the system then --
Q. So you are telling me there's a relationship between --
A. Yes.
Q. -- replacement cost and market value?
A. And market value. And the relationship is that in -- in the long term under competition if competition

works, they should be approximately the same for any kind of company.

Now, you know, there are going to be times when that's not true, that you can't always expect that investors out there will be operating, you know, knowing what replacement cost is. I mean, they are sometimes going to be operating on speculation, they're going to be overly optimistic, they may be overly pessimistic, but in the long term, the market value should approximately equate to the replacement cost. And it is the replacement cost to book value ratio that I've used to make this adjustment to the -- what I call the traditional DCF cost.

Q. Replacement cost use is not new. Right? It was used some time in the past and discarded?

A. You mean for purposes of --

Q. Of coming up with --

A. I think what my -- my recollection is that what was used in the past was something -- something akin to replacement cost. It may have been reproduction cost new. I'm not sure of the exact term.

And -- and my understanding is that what -- what happened was that it became a circular exercise, because what you were trying to do was to determine the fair value of the property and the rate of return at the same time and you couldn't do both. So rather than continue with what was a circular exercise, it was determined that the original cost rate base would give you an objective point of departure, because you could measure that in accounting terms. And then you could apply your return to that original cost so that you'd come up with the fair value of the investment.

So -- so I'm saying, okay, let's stay with the original cost, that's okay. But let's apply to it a return that will provide the investor -- the company, and then the investor with sufficient earnings so that the market value that results is a measure of the fair value.

Q. And these adjustments that you've made is what you're calling them return on fair value rate base as opposed to return on equity?

A. No. It's -- I would call it a return on original cost rate base that will provide a sufficient return that we will have a fair return to the investors so that his investment is fair value.

Q. Okay. Well, I guess what I'm reading is on page 20, return on fair value rate base, and that's why I was asking you that question.

A. Oh, sorry. Well, that is -- when you're looking at page 20, that's a totally different exercise.

Q. Is it another formula or --

A. Well, I was at -- well, I was told by the

Company that it is a requirement in the State of Missouri to do this exercise.

Q. By statute?

A. By statute.

Q. Okay. You're not aware of that statute yourself?

A. Not specifically. I just did what I was told.

Q. Okay.

A. And this was the result of that, but this -- this particular estimate that is in that section starting on page 20 does not enter in any fashion into the determination of the 12.75 percent return that I recommended.

Q. All right. Now, from your formula exercise that you did do, you came up with something in excess of 13 percent?

A. Correct.

Q. Why did you adjust it downward?

A. Because I wasn't using just that test. I was using a combination --

Q. You looked at --

A. -- of tests.

Q. So based on the three tests you used, the comparable --

A. Comparable earnings test as well as the --

Q. Risk --

A. -- risk premium test which itself was a number of ways of looking at the equity risk premium. I came up with a number of 12.75 percent.

Q. Did you make adjustments to the risk premium test?

A. I made a floatation cost adjustment to the risk premium test.

Q. So that one is a little different than just a straight --

A. Yes.

Q. And the comparability test, where did you get that?

A. The comparable earnings test?

Q. Comparable earnings test. Did you make adjustments to some formula that does that?

A. With the comparable earnings test what I did was I selected a sample of competitive industrials who's -- who -- which were in industries that have relatively stable demand characteristics, consumer-oriented industries, to try to start with a universe that was as similar in business risks as I could.

Q. Did you use any gas companies in that set?

A. No. These are entirely competitive companies. The idea being that if you -- when you're looking at regulated companies and you're looking at the returns of regulated companies, what you're doing is looking at what the regulatory process itself has resulted in. And by looking at unregulated companies with appropriate adjustments for risk differentials, what I'm trying to do is say this is directly what the competitive market has produced.

Q. Can you cite me any other regulated gas company in the last six months that was given a 12.7 return on equity?

A. That was given a -- no. The closest one I know of was a double A company in Wisconsin, which was allowed 12.2 percent.

CHAIR LUMPE: Thank you. I have no further questions.

JUDGE DIPPELL: Commissioner Drainer?

QUESTIONS BY COMMISSIONER DRAINER:

Q. Good afternoon.

A. Good afternoon.

Q. In your rebuttal testimony, page 13, your answer on about line 8, you state that any single beta estimate is subject to considerable company-specific noise. Please define for me what company-specific noise is.

A. Noise means that there can be reasons that the stock price would move differently than what the risk itself might lead you to believe it would do. One of the elements that I think I mentioned in here was the fact that if you've got a stock that doesn't trade very often, then it might normally move, you know, 75 percent of what the rest of the market moved except that nobody might have been interested in trading it that day. And so it doesn't move anywhere. And, therefore, you get less co-variability with the market than you might otherwise get simply because it's not a particularly liquid stock. Another --

Q. Well, then let's stop a second. What you're really trying to talk about is why the beta estimate would be different for Laclede than some sample --

A. Sure.

Q. -- data?

A. Yes.

Q. And that there might be some things that are specific to the characteristics for Laclede that make its beta different than a sample beta?

A. Yes.

Q. All right. So then let's talk about Laclede. What company-specific noise does Laclede have that you thought moved it from a sample beta of -- I forget what it was, 6 -- .63, and you said it should have been like .55. What was that noise that caused that adjustment?

A. Well, my view is that in large part it's because it doesn't trade. It's not very liquid. It's relatively small stock and not very many shares trade relative to the average of the whole sample.

Q. So it was because Laclede's stock doesn't trade that it caused it to have a lower beta and, therefore, would have caused it to translate into being more risky than the sample beta?

A. No, no, no. It wouldn't be more risky. I'm just saying that I don't think there's any reason to conclude it's less risky. That's all.

Q. But is .63 or .55 factor, that measurement, for a higher risk or lower risk, more volatile or less volatile?

A. A .63 is more volatile than a .55.

Q. So because it doesn't trade, then you're saying that --

A. It's less --

Q. -- .55 is less volatile?

A. Yes.

Q. Okay. So then with respect to using the discounted cash flow model, Mr. Broadwater's, I believe, rebuttal testimony stated that your calculation came up with Laclede being 10.5. Do you dispute that? Was 10.5 percent what your return on equity would have been for the discounted cash flow?

A. My discounted cash flow number prior to the adjustment that I made was 10.5. But it was not a Laclede-specific number. It was a number for my sample of LDCs.

Q. Okay. So that would have been for your sample of LDCs?

A. Yes.

Q. Not just the sample of non-regulated companies?

A. No. I didn't do -- I didn't do a DCF test for non-regulated companies.

Q. So the DCF test you did only on regulated companies?

A. Correct.

Q. And how many were in there? Does that --

A. I think 13. Let me just double check before -- 13, yes.

Q. Is that one of the schedules?

A. There would be a schedule, yes. Schedule 13 would have the names of all of the LDCs on it.

Q. And you have no LDCs -- are any of the LDCs practicing in Missouri?

A. Yes.

Q. ATMOS?

A. Yes.

COMMISSIONER DRAINER: Thank you. I have no other questions.

JUDGE DIPPELL: Commissioner Crumpton?

QUESTIONS BY COMMISSIONER CRUMPTON:

Q. Yes. The market price that you're using, is it similar to the price per share in the marketplace?

A. Yes.

Q. Okay. So it's the same thing?

A. Yes.

Q. Okay. And how does an investor go about assigning an estimated value to a stock?

A. That's a good question. The -- I guess I would say that probably the market is being -- the market prices generally are being set by large institutional investors. And the valuation is basically set by what they think the cash flows from those shares are going to be in the future through earnings growth, through cost cutting, through acquisitions, any -- any myriad of actions that the Company might take.

Q. So what you're saying is the institutional investors generally set the price and they generally use a model like the net present value of the future stream of incomes, plus some expected growth factor adjusted for risk?

A. Well, that's -- that's an interesting question. Because Mr. Olson, who operates on Wall Street, and I do not -- and you can obviously talk to him more about this -- says that most big investors really don't look at sophisticated models. They look at relative valuations of other -- other companies.

So, for example, if I'm looking at a drug company and I'm comparing it to the drug industry, and its price earnings ratio is significantly below the price earnings ratio of other drug companies and I think this is a good drug company with good prospects, than I'm probably going to buy it and drive the price up to where the price earnings ratio is closer to that of the industry.

Q. But isn't that an assessment of the expected growth?

A. Yes, it is. And -- and implicitly, yes, I guess you're -- you are looking at the growth prospects. Whether it's as sophisticated an analysis as is undertaken I think in perhaps in my testimony, I don't know. I think that perhaps it's -- it's a bit more judgmental than that.

Q. Is there any circularity in what we're doing here?

A. Oh, sure. There's --

Q. Can you identify some --

A. There's no doubt about it.

Q. Can you identify the circularity that is implied in what you're doing?

A. Well, I think the biggest circularity problem, that is to a large extent unavoidable if you're going to do a discounted cash flow test and apply it to utilities, is to determine what the growth expectations are. Because if you're looking at pure play utilities whose returns are largely a function of regulation, then you can't really get around the fact that either you or the analyst whose growth expectations you're using are trying to assess what the regulator is going to allow as a return and how closely the utilities are going to come to that allowed return or if they have, you know, enough flexibility in their operations to earn something in excess of that return.

Q. Another question that I'm interested in is, where did you obtain your beta value? Did you calculate it, or did you go to some publication and retrieve it?

A. I went to a publication. I got the betas from Value Line.

Q. Okay.

A. I also did calculate some of my own to do some analysis of the -- of the statistical significance of them, and they were very close to the --

Q. In your beta analysis -- the analysis where you use beta, I guess it was your comparable earnings test is where you used the beta. Right?

A. I used it in the comparable earnings test to make the relative risk adjustment. I also used it in the capital asset pricing model.

Q. You developed a beta based on the experience of other companies in your -- that met your criteria; is that right?

A. The betas were taken from Value Line for a sample of relatively low-risk industrial companies.

Q. And that beta is sensitive to the sample that you chose?

A. Yes.

Q. Okay. Much of the difference between the parties on these financial issues is related to differences in the sample that they use; is that not true?

A. No. I think that probably very little of the difference between --

Q. Excuse me. Plus the risk. But let's eliminate the risk factor -- or risk adjustment.

A. Well, I -- I think that there are two -- probably what I would characterize as two major differences between my position and the position of Misters Broadwater and Burdette. The first would be whether or not one can simply take the -- the unadjusted DCF result and apply it directly to book value without adjustment. I mean, that makes a significance difference in our results.

And the second major difference is that I believe quite strongly that one should, because of the way returns are set, be looking at comparable earnings in relation or with reference to low-risk competitive industrial companies to -- you need a reference point away from simply regulated conditions. So those are the two big differences in our results.

Q.   Yeah. Have the courts approved the method that you use in making the -- using the comparable earnings test?

A.   Have the courts approved it? You mean in the sense of have they --

Q.   Have any of the courts ever ruled upon applicability of your model?

A.   Making that kind of adjustment?

Q.   Yes.

A.   To my knowledge, yes. There is a court case from the DC Circuit Court of Appeals, 1968, in which the court said that it recognized that it was virtually impossible to come up with a sample of companies that would be of identical risk to utilities, and that it was reasonable to make adjustments to the results for a sample of companies of somewhat different risks to come up with returns that were comparable.

Q.   But were the adjustments similar to the ones that you made?

A.   Oh, I doubt it very much, because it was 1968.

Q. So you haven't --

A. And the capital asset pricing model probably didn't have much currency at that point. My recollection is that the -- they talked in the -- in that particular decision about judgemental adjustments. And those were -- were acceptable. And what I think I've done here is -- is gone beyond simply making something that -- an adjustment that's judgemental and gone to an adjustment that's based on an accepted financial model.

COMMISSIONER CRUMPTON: Thank you. That's all the questions I have.

JUDGE DIPPELL: Commissioner Murray, do you have questions?

COMMISSIONER MURRAY: Yes.

QUESTIONS BY COMMISSIONER MURRAY:

Q. Good afternoon.

A. Good afternoon.

Q. In calculating your recommended 12 1/2 -- or 12.75 percent return, correct me if I'm wrong, but I understand that you used a combination of risk premium, DCF, capital asset pricing modeling and comparable earnings?

A. That's correct.

Q. Okay. And then with the comparable earnings you took relatively low-risk industrials and compared a group of relatively low-risk industrials; is that correct?

A. To -- to LDCs, yes.
Q. And what was the average beta of those low-risk industrials you used?
A. 83.
Q. And Laclede's beta?
A. Laclede's own beta is 50, I believe. The beta for the sample of LDCs is 59, and that was the comparison that I made between the 83 and the 59.
Q. Okay. Now, a beta of 83 would -- again, correct me if my understanding of this is wrong, but would that represent that a company with a beta of 83 would be approximately 83 percent as risky or as volatile as the S and P 500 index --
A. Yes.
Q. -- companies put together?
A. That's correct.
Q. Okay. And a beta of 59 would represent that that company was 59 percent as risky or as volatile?
A. Based on the beta, correct.
Q. Okay. And the company that would be 59 percent as risky as the S and P 500 index, an investor would be willing to take a little bit lower return for that company than they would for a company that was 83 percent --
A. That's right.
Q. -- as risky?

A. Correct.
Q. That's correct?
A. Uh-huh.
Q. And in your comparable earnings test you made that adjustment --
A. Yes, I did.
Q. -- for investors being willing to accept a lower return?
A. Yes.
Q. And in terms of risk premium, did you also make that adjustment in that calculation?
A. Yes. In the -- in the -- in the capital asset pricing model, which is one of the risk premiums, that's what I did. You start out with a risk premiums of the market at a whole, whose beta is one by definition. And then you -- so from that risk premium, you adjust it for the relatively lower risk of the utilities.
So if -- in my case, my market risk premium was 8 1/2 percent. And so for the purpose of the capital asset pricing model, I took 59 percent of that and added that to the risk-free rate. My other risk premium test was conducted directly on utilities, so there wasn't any need for any relative risk adjustment.
Q. And is there any precedent that we could look to where a combination of those methodologies is used to

arrive at a recommended return that you're aware of?

A. Well, I can't tell you offhand any specific def-- decisions, but there are clearly any number of Commissions who state that they look at all of the evidence and all of the tests in front of them and don't necessarily look at solely one test or one result. I mean, they recognize that the fair return is not simply a number, that -- that you have to look at various tests and all of the circumstances that are relevant to the determination of the fair return.

Q. We heard some testimony earlier about the DCF model being used and that this Commission has used the DCF model and applied it to book value in the past is that --

A. That's --

Q. Do you recall that?

A. Yes. I recall that.

Q. And on page 3 of your direct testimony at line 28 -- or 29, rather, you say, Regulatory convention applies that return to the book value. Do you agree that your testimony says that?

A. Could you tell me again what page you're looking at?

Q. Page 3.

A. Page 3. I agree -- I agree that's what's typically been done, yes.

Q. And the reason for your recommendation that that is no longer appropriate to apply the DCF test to book value is that the market has changed significantly and that market values are no longer close to book values; is that true?

A. Yes. I'm not -- I'm not saying we shouldn't apply a return to book value. That's -- that's not my testimony. My testimony is that the return that we do apply to book value should recognize that there is this significant deviation between market and book and that needs to be taken into account in determining the number that's applied to book value.

Q. Okay. And if we took Staff's number, the calculations that Staff made using a DCF test and applied it to book value, how would that affect the dividend yield of the Company, if at all, and how would it affect the growth factor?

A. If you took 9 1/2 percent return and applied it to book value, in principle what would happen is that the market value would decline to book value. So if we're sitting with a market value of about 155 percent right now, let's say, then you're talking about, you know, potential of 35 percent decline in the market value of the shares.

If you get a decline in the market value of the shares, obviously your dividend yield is going to go up.

You're providing a return in dollars that is about 95 percent of the current dividend. So you're -- you're pushing your dividend payout ratio up to about 95 percent. That's without any earnings that are less than what you'd anticipate because of warmer than normal weather.

So, you know, you're running very close to the inability to even cover the dividend. And the fact is that your growth, which, you know, the analysts say is -- is expected to be 4 percent, can't possibly be 4 percent. So your dividend yield goes up and your growth expectations go to virtually nil.

Q. And then if you have something unforeseen such as unusually warm weather, you're saying that would drive your -- that percentage that you have beyond the dividend yield?

A. The -- the earnings that you have available to cover your dividend if you have warmer than normal weather, are basically not there.

Q. I have just one more question. Would you explain the floatation adjustment that was made to the risk premium test? I'm still not quite sure I understand that.

A. The floatation cost adjustment is to recognize that when a company issues shares, that it needs to be able to do so at greater than book value. The risk premium test in principle is a test that is a market-derived test just like the DCF test.

And in order to assure that the company can be in a position to issue shares at more than book value, you need to add something to that minimal cost of equity to assure that the company can issue shares without dilution of the existing investment to below book value.

So those -- that amount is intended to provide for past and future recovery of out-of-pocket costs and the fact that when you issue shares into the market, there tends to be a downward pressure on stock. That's been measured at typically 2 to 3 percent. So there's some element for the market pressure as well as the out-of-pocket cost included in that increment for floatation cost.

COMMISSIONER MURRAY: Okay. Thank you. That's all my questions.

JUDGE DIPPELL: Commissioner Schemenauer?

COMMISSIONER SCHEMENAUER: Thank you.

QUESTIONS BY COMMISSIONER SCHEMENAUER:

Q. Good afternoon.

A. Good afternoon.

Q. I have a few questions on the stock, and I assume you've studied Laclede's stock quite well?

A. Some.

Q. Do you have any idea how many outstanding shares there are, approximately?

A. Yes. I don't -- can't think it have right off the top of my head.

Q. I mean, if you don't know, that's fine.

A. I have it written down and it's just -- the number has escaped me.

Q. You had mentioned that there wasn't a whole lot of shares out there. And also --

A. Oh, no. There are a fair number of shares out there.

Q. Okay. You mentioned the volume of trading.

A. They're not that many that have traded, but there are a fair number out there.

Q. Do you know how many are traded on average?

A. 4.8 million, I think was the number that I was looking at.

Q. Is that on a monthly --

A. Annual basis.

Q. Annual basis. Do you know what the high and low of the stock has been in the past 12 months?

A. No.

Q. You don't know?

A. Not off the top of my head, no.

Q. Could you find that out for me?

A. Yes, I could.

Q. Do you know the current value of the stock?

A. Not today. I know that on average over the past three months it was approximately $23.

Q. Okay. And book value as of today, I guess, is $14.57?

A. That sounds approximately correct.

Q. I see the basic difference between the Company's position and the Staff's is whether or not to base that return on market value or book value. Is that fundamentally the big difference? Market value, of course, would be -- 10 percent return would give you a better rate of return on the market value than it would on book value. Right?

A. Well --

Q. If market value is 23.25 now?

A. The market value right now is 23, let's say.

Q. Okay.

A. And, as you pointed out, the book value is approximately $14.50, which gives you a market-to-book ratio of about one -- let's say 150. So as an investor in Laclede, I'm sitting there with stock that's 1.5 times book value. And I determine that I require on that market value a return of 10 percent. But if I -- but if the company is only allowed a return on the book value of that 10 percent, I'm not going to earn 10 percent on that market value.

Q. Okay. I understand that fully. I guess what

I'm trying to get at is, if -- I mean, the stock market is mature, wouldn't you say?

A. The stock market just as an entity?

Q. Just as an institution. I mean, it's full of savvy investors who know what stocks are worth and they either discount them or bid them up based on usually reliable information before the average person buys them?

A. I would say that is generally true. I would also say that there are a lot of investors out there who are speculating that they can just get a little bit more, a little bit more and sort of -- you know, it will be the next guy who's the sucker, not me.

Q. I mean --

A. But -- but as a general proposition the people who are operating in the market, the large --

Q. Investors --

A. -- investors are generally savvy people.

Q. Do you know whether Laclede's market prices fluctuated wildly, you know, 50, 60 percent in the past 12 to 24 months?

A. No, it hasn't.

Q. It's been pretty stable?

A. Really sort of flat and declining.

Q. And 1.55 to 1 PE ratio or priced equity ratio is probably lower than most stocks?

A. Lower than most stocks, including most other utility stocks.

Q. Okay. If Value Line forecasts -- and I'm looking at page 4 of your rebuttal, I guess, yeah. Value Line's forecast for this year is earn earnings per share of $1.43, those current owners of that stock at twenty-three, twenty-five or whatever the market price is now. And evidently they're not all dumping it and running, are they?

A. No, they're not. But they are looking at -- if you look at Value Line's projections further out, they're looking at 13 percent returns. That's what the Value Line forecast for the ROE for, let's say, the 2001, the 2003 period is.

Q. Okay. On page 4 of your rebuttal you were asked this question: Is it your view that it is the function of the Commission, meaning this Commission, to set a return that will either sustain the Company's market value at recent levels or ensure that the relative market valuation improves.

And you replied, Simply put, it's the role of the Commission to set a fair return.

That question seems to be far reaching as far as the power that this Commission would have to determine the value of anybody's stock. I mean, I -- are you saying we could affect -- or it's our duty to set a return that would keep the value of that stock?

A. No. I'm saying exactly the opposite. You can't do that.

Q. I didn't think we could.

A. Okay. Then you were right.

Q. I was kind of under the impression we had a lot more power than --

A. No. I just wanted to make sure that you didn't think that I was coming in hear saying, well, it doesn't matter what the price of the stock is, it's -- you know, you have to set a return that -- that would assure that the value of that stock stayed there irrespective of why it was there. That's not what I'm saying.

Q. I would love my investments to be required to do that. So then when you say it's the role of the Commission to set a fair return and -- a fair return to who? I know you're the Company witness, so I assume the Company, but anybody else who would need a fair return?

A. Does anybody else need a fair return? Well, the Company and the investors. The fair return is for them. Indirectly it's for customers.

Q. The non-equity --

A. The company that has, you know, the opportunity to achieve a fair return has the financial resources to provide the service to customers the customers demand.

COMMISSIONER SCHEMENAUER: Okay. I think that's all my questions, but I would like to know what the high and low of the stock has been --

THE WITNESS: I would be very happy to provide that for you.

COMMISSIONER SCHEMENAUER: -- over the past 12 to 24 months.

JUDGE DIPPELL: Commissioner, would you like me to reserve an exhibit for that information or would you like --

COMMISSIONER SCHEMENAUER: Whatever you'd like. If that would be the proper thing to do --

JUDGE DIPPELL: Okay. Why don't we do that, just so we make sure we account for it. So I'll reserve as Exhibit No. 115 the information that Commissioner Schemenauer requested, which was the value of the stock --

COMMISSIONER SCHEMENAUER: The high and the low market price of the stock in the past 12 to 24 months. And, yeah, the total number outstanding shares. And I imagine that's on the financial statements. Does that include rights and options too?

MR. PENDERGAST: Yes. We have approximately 17 1/2 million right now, but that doesn't include our latest issuance. We will get that and add them all together.

COMMISSIONER SCHEMENAUER: That's close enough. That's in the record.

MR. PENDERGAST: Eighteen eight, I think with the latest issuance.

JUDGE DIPPELL: Mr. Pendergast, are you getting that information from your Company's financial statement? Is that something that's on file with the Commission?

MR. PENDERGAST: Well, I was getting the first number from our annual report, and the second I was getting from the folks back in the room, including Mr. Yaeger. And we will go ahead and get something that we can put into the record and identify the source of it too.

JUDGE DIPPELL: Thank you.

Commissioner Murray, you had an additional question?

FURTHER QUESTIONS BY COMMISSIONER MURRAY:

Q. I just have one more question. I just wanted to clarify for sure here. With your 12.5 percent that you recommended on book value, correct, that would be a return to the investor of something like 10 percent?

A. That's right.

COMMISSIONER MURRAY: Thank you.

JUDGE DIPPELL: Is there recross based on

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questions from the Bench, Ameren UE?

MS. KNOWLES: No questions.

JUDGE DIPPELL: Public Counsel?

MR. MICHEEL: Yes, your Honor.

RECROSS-EXAMINATION BY MR. MICHEEL:

Q. Chair Lumpe asked you about whether or not you were aware of any utility that had been granted a return of 12.75 percent. Do you recall that question?

A. Yes.

Q. And you said that you're aware of a Wisconsin utility that got 12.2 percent; is that correct?

A. Yes.

Q. What utility was that?

A. Wisconsin Electric.

JUDGE DIPPELL: I'm sorry?

THE WITNESS: Wisconsin electric.

BY MR. MICHEEL:

Q. Wisconsin Electric. And does Wisconsin Electric have any gas operations?

A. Not to my knowledge.

Q. Okay. And when was that decision made?

A. I'd have to check it and get back to you. It was within the last eight months.

Q. So that was not an LDC; is that correct?

A. No.

Q. I believe it was Commissioner Crumpton who asked you and you discussed a District Court of Appeals case in 1968 with respect to the comparable earnings test. Do you recall those questions?

A. Yes.

Q. What's the name of that case, if you know?

A. It's DC Transit System, Inc., versus Washington Metropolitan Area Transit Commission.

Q. Okay. Let me go back to that question that Chair Lumpe asked you about the Wisconsin Electric utility. Do you have an opinion whether or not electric utilities are more risky or less risky than local distribution companies?

A. It depends. I cannot give you a blanket statement. It's entirely dependent on the company.

Q. Okay. So, in other words, when we're determining a company's risk, we should just look at the company? We shouldn't look at the industry as a whole; is that correct?

A. No.

Q. No, we shouldn't look at the industry as a whole?

A. Yes. You should look at the industry as a whole. And you need to decide whether the company you're dealing with is more or less risky than the industry.

Q. Okay. Do you have an opinion whether the electric industry, as a whole, is more risky than the local distribution company industry?

A. Well, I would say that it's -- it's a very difficult question to answer because what you're seeing happen is that a lot of electric utilities are getting rid of their generation. All they've got left is their distribution and transmission.

And electric utilities that are distribution and transmission may well be less risky than your typical LDC. And companies that still have -- have generation, it really depends on where they are and to what extent they're being affected by competition.

Q. Chair Lumpe asked you a line of questions with respect to investors' expectations. Do you recall those questions?

A. No. Could you be more specific?

Q. Well, Chair Lumpe started out with a line of questions about the DCF analysis, your original DCF analysis and the 10.5 percent?

A. Yes.

Q. And then you talked about what investors look at, the market-to-book value and things like that. Do you recall those questions?

A. Yes.

Q. I guess my question is, are investors guaranteed any type of return when they invest in an equity issue?

A. No.

Q. Okay.

A. That's why it's an equity issue because there's risk.

Q. I believe that Commissioner Murray talked to you a little bit about the dividend yield and growth factors. Do you remember those questions?

A. Yes, I do.

Q. Is it correct that it's a Laclede Gas Company company decision on what dividend it should pay out to its investors?

A. Of course it's their decision what -- what should be paid out, but the decisions that the Company makes are within the context of what it can reasonably expect to earn as a fair return and what it can reasonably expect to sustain on an ongoing basis as a dividend.

MR. MICHEEL: Thank you very much, Ms. McShane.

JUDGE DIPPELL: Staff?

MR. POSTON: Thank you.

RECROSS-EXAMINATION BY MR. POSTON:

Q. Following up on questions that Chair Lumpe asked you regarding replacement costs --

A. Yes.

Q. -- do you know the replacement costs of Laclede's systems?

A. Not specifically, no.

Q. Do you know the book value of Laclede's systems?

A. Yes. Approximately. I mean, I don't have the numbers sitting right in front of me, but it's -- I mean, I know what the rate -- original cost rate base is.

Q. What is that?

A. It's about -- I'd say it's between 500 and 550 million dollars.

Q. And in response to a question from Chair Lumpe, you said your competitive low-risk industrials had stable demand characteristics. Do you recall that?

A. Sorry. Can you repeat that?

Q. In response to a question from Chair Lumpe you said that your competitive low-risk industrials that you used in your analysis had stable demand characteristics?

A. What I said was -- I think was that I tried to select industries from the outset that are consumer product oriented so that they would have relatively stable -- everything's relative, but, you know, they would have relatively stable demand characteristics.

Q. And how did you perform the analysis to determine what was relatively stable?

A. I simply eliminated from the analysis at the outset industries that I knew were commodity based such as mining, oil and gas production, agriculture, that kind of thing. So that the industries that were left were your retail stores, food, manufacturing, there's a list of them in my testimony.

MR. POSTON: I have no more questions.

JUDGE DIPPELL: Is there redirect by Laclede?

MR. PENDERGAST: Yes. I've got a few questions. Thank you.

REDIRECT EXAMINATION BY MR. PENDERGAST:

Q. Ms. McShane, you indicated that in doing your comparable earnings analysis in order to adjust for risk differences you used beta coefficients. To your knowledge, is that a methodology that Staff and Public Counsel have also used for various risk analysis purposes?

A. The use of the beta?

Q. Yes.

A. Yes. They've used beta to do capital pricing alone.

Q. You were asked a question by Mr. Micheel on whether or not Laclede received any downgrade in its rating following the last rate case. And I think you had mentioned that you were aware of some downgrading that had happened in the not too distant past. Could you please elaborate?

A. My understanding is that Pitch downgraded Laclede's bonds to A plus in mid-1998.

Q. And can you tell me -- I think Mr. Micheel also asked you some questions about Laclede not meeting certain standards for a double A rating already. Do you recall those questions?

A. Yes.

Q. And as someone who is making the recommendation on a fair return in trying to determine what its potential impact would be on credit rating, is the fact that Laclede may already be under some of those standards and criteria give you more concern about a lower return rather than less?

A. Yes, it would.

Q. You were also asked some questions about the comparison for Laclede and unregulated firms, including whether or not unregulated firms had monopoly service territories. Do you recall those questions?

A. Yes.

Q. And do you have any views as to whether or not having a monopoly service territory, if you will, also brings certain obligations?

A. Yes, it does. It brings the obligation to raise capital on demand to serve customers.

Q. Does it also have burdensome -- particularly in a regulated environment -- limitations on pricing flexibility?

A. Yes. The company can only raise prices when it gets permission from the Commission to do so; whereas, unregulated companies can raise their prices overnight if they want if -- if market conditions so permit.

Q. And do you know whether unregulated firms have less or more flexibility to negotiate the pricing terms under which they will provide service to customers than generally regulated companies?

A. Unregulated companies negotiate prices all the time. Regulated companies typically are limited to negotiating prices when the Commission has specifically allowed them to negotiate prices.

Q. Do you know whether unregulated companies can negotiate pricing arrangements with customers in terms and conditions of service that shift the risk for weather deviations from assumptions that may be used in setting the price?

A. Sorry. You'll have to repeat that for me.

Q. I apologize. I'm not sure I understood it myself. Do you know whether or not unregulated companies have the flexibility, for example, to include in their pricing and service arrangements with customers provisions that protect them from changes in weather and the impact on their financial performance?

A. Not specifically, no, I don't.

Q. Okay. Do you know whether or not the growth prospects for unregulated firms and growth experience for unregulated firms recently have been below, about the same or greater than Laclede's 1 1/2 percent per year?

A. Considerably above.

Q. Can you --

A. The average expected growth rate for the S and P 500 is about -- earnings growth is about 15 percent.

Q. Okay. Okay. Can you tell me -- you were asked a number of questions about what an investor looks at when he's making a determination. I believe this was perhaps Commissioner Crumpton. And you were asked a number of questions about market value. When you say market value and what an investor looks at, what do you mean in terms of the company's stock?

A. It's the price per share of -- of the stock trading in the marketplace.

Q. And for Laclede, I think you said that averaged around $23 of late?

A. Yes.

Q. Okay. You also indicated in response to a question about whether you believed -- and I think this may have been from Chair Lumpe -- whether the DCF model was irrelevant, that that wasn't the point of your testimony; is that correct?

A. Yes.

Q. And was it your testimony that in light of current market conditions you have to take the results of the DCF analysis with some degree of caution?

A. Yes. And I specifically provided a methodology for adjusting them that is -- that takes into account what competitive markets would suggest the price should be.

Q. Okay. Are you aware of whether or not the Staff has also expressed in recent times some cautionary note about accepting the results of the DCF analysis?

A. My reading of Mr. Broadwater's testimony last year was that he felt uncomfortable recommending the results of the DCF test at that time.

Q. And in your view has there been any change in economic circumstances or in anything having to do with Laclede and its financial situation that should change that view?

A. Not in my view, no. I would have had the same concerns this year as I did last year.

Q. You were also asked a number of questions, I think it was by Commissioner Crumpton, about circularity and as well questions about comparable earnings. Can you tell me what the relationship is of the circularity concern to the obligation to look at comparable companies in determining risk?

A. Sorry. You'll have to repeat that.

Q. Yes. You were asked some questions about circularity --

A. Yes.

Q. -- and whether or not that's a concern?

A. Yes.

Q. Would you explain what circularity is as that issue has sort of developed in this proceeding, your understanding of it?

A. Circularity arises when one is using a test that requires that one basically make a guesstimate of what the Commission is going to allow as a return. And that's exactly what happens when you do a DCF test that is applied specifically to the company whose return you're trying to set. I mean, that's -- to my mind, is the most egregious form of circularity.

I think everything test has -- you could probably find some degree of circularity in it, but when -- when you're -- when you're focusing on the company whose return you're trying to set, you can't avoid a huge degree of circularity except by not doing the test applied to that company alone, but rather looking at either comparable utilities or -- and a set of unregulated companies.

Q. And were you in the room today when counsel for the Staff in his opening statement quoted some passages from decisions that I know you're familiar with relating to how you go about setting a fair return and the need to look at comparable companies with comparable risks?

A. Yes.

MR. MICHEEL: I'm going to object to any further questions. It's beyond the scope. I don't think Commissioner Crumpton asked anything about the Commission Staff's opening statements.

BY MR. PENDERGAST:

Q. Well, were you here a few moments ago when you were asked questions about your comparable analysis?

A. I think I was, yes.

Q. Fine. And you're familiar with the standards that apply to the obligation to do that kind of comparable analysis?

A. I'm familiar with the -- the standards that have come out of the basic decisions, landmark decisions, yes.

Q. Okay. And in your review, is that comparable analysis performed by comparing a utility to itself?

A. I would think that would be, as I suggested, an egregious circularity and no one needs to go well beyond that. In fact, I'm comfortable with not doing a DCF test for Laclede, period, but rather looking at other regulated companies, in addition looking beyond regulated companies to unregulated companies to get an independent view of what the returns are for companies that are not determined within regulation.

Q. And is it your understanding that Staff has, in fact, performed a DCF analysis that looks at Laclede only?

A. Yes, they have done so.

Q. And that's the basis for its primary recommendation in this case?

A. I believe that's -- they call that their primary test.

Q. You were also asked a number of questions about what would happen if Staff's recommendation were adopted in this case. And I think you responded that it might raise the Company's pay out ratio to some 95 percent and make it difficult for the Company to achieve the 3 to 4 percent growth it's been projected. Do you recall that?

A. Yes.

Q. Can you tell me who's projecting that 3 to 4 percent growth as part of their DCF recommendations in this case?

A. Mr. Broadwater's growth forecasts for Laclede are in the range of 3 1/4 to 4 percent.
Q. Okay. And you, I think, indicated earlier in response to another question of Laclede perhaps by Commissioner Schemenauer, I believe it was, had a market value of approximately $23; is that correct?
A. Yes.
Q. What would 3 1/4 to 4 percent growth on $23 market value of stock suggest by way of growth?
A. Do you want me to do the math?
Q. Would you like a calculator? Sorry.
A. I'm sure this is probably something I ought to be able to do in my head, but it's late in the afternoon -- let's see. 3 1/2 percent growth in the -- in the stock price would get you from $23 to 23.80, so --
Q. So about 80 cents?
A. Yes.
Q. And I think you also indicated that Laclede's book value had been hovering around 14.57 in response to a question --
A. Correct.
Q. -- by Commissioner Schemenauer?
And can you tell me what Staff's return recommendation of 9.5 percent if applied to that book value would produce?

A. A dollar 38.

Q. A dollar 38. And if, in the example you gave, you assumed a 95 percent payout ratio for dividends, how much of that 1.38 would be left over for growth?

A. Seven cents.

Q. Seven cents. So is it fair to say that Staff expects Laclede to achieve 80 cents worth of growth with 7 cents worth of earnings that would be left over after Laclede pays out its dividends?

A. That would be the implication, yes.

MR. PENDERGAST: Thank you. I have no further questions.

JUDGE DIPPELL: Thank you. Is there anything further from this witness?

Ms. McShane, you may be excused.

THE WITNESS: Thank you.

JUDGE DIPPELL: Let's take a 15-minute break and come back at 20 after. Off the record.

(Off the record.)

JUDGE DIPPELL: I believe we're ready for your next witness.

MR. PENDERGAST: Yes, your Honor. Before we begin, I just wanted to alert you that we have a slight correction to make to Mrs. McShane's testimony. I think she had recalled that we had a Pitch downgrade in '98 and I think it was probably the end of '97. And Mr. Micheel, I think, is going to ask our next witness a question to verify that. Thank you.

JUDGE DIPPELL: Okay.

MR. PENDERGAST: At this time we would call John Olson to the stand.

JUDGE DIPPELL: Mr. Olson, could you please spell your name for the court reporter?

THE WITNESS: Olson, O-l-s-o-n, John E.

(Witness sworn.)

JUDGE DIPPELL: You can go ahead and proceed, Mr. Pendergast.

MR. PENDERGAST: Thank you.

JOHN OLSON, having been sworn, testified as follows:

DIRECT EXAMINATION BY MR. PENDERGAST:

Q. Mr. Olson, would you please state your name and business address for the record.

A. My name is John Olson. My business address is Sanders Morris Mundy, Chase Tower, Houston, Texas.

Q. And are you the same John Olson who's previously caused to be filed in this proceeding direct and surrebuttal testimony which have been previously marked as Exhibits 5 and 6?

A. I am.

Q. Do you have any corrections or additions to make to either your direct or surrebuttal testimony or any of the schedules contained therein?

A. I had one addition -- or one correction rather to make. That was on Schedule 2 of my direct testimony where a table was mislabeled. In the center of that table where it said 30-year gas yields, that should have been 30-year bonds or 30-year government bonds, however you prefer.

Q. Okay. And that would be the fourth column over on --

A. Yes, it is.

Q. Okay. With that one correction, if I were to ask you the same questions that appear in your pre-filed direct and surrebuttal testimony today, would your answers be the same?

A. They would.

Q. And are those answers and the information contained in your schedules true and correct to the best of your knowledge?

A. Yes, they are.

MR. PENDERGAST: With that, I would offer Exhibits 5 and 6 into evidence and I would tender Mr. Olson for cross-examination.

JUDGE DIPPELL: Are there any objections to Exhibits No. 5 and 6 with the correction that the witness has noted?

Since there are no objections, I will receive Exhibits Nos. 5 and 6 into evidence.

(EXHIBIT NOS. 5 AND 6 WERE RECEIVED INTO EVIDENCE.)

JUDGE DIPPELL: Is there cross-examination from Ameren?

MS. KNOWLES: No.

JUDGE DIPPELL: Public Counsel?

MR. MICHEEL: Yes, your Honor. May I approach the witness?

JUDGE DIPPELL: Yes.

CROSS-EXAMINATION BY MR. MICHEEL:

Q. Mr. Olson, I hand you a partial response to a Public Counsel Data Request that sought the bond ratings for Laclede Gas Company. And I just wish you to read into the record the Pitch first mortgage bond rating there?

A. A plus.

Q. And behind the paren it says what?

A. Downgraded from double A minus, October 9th, 1997.

Q. Okay. Thank you very much. I note in your direct testimony, Mr. Olson, that you cover about 20 natural gas stocks; is that correct?

A. Yes, I do.

Q. And what 20 natural gas stocks do you cover?

A. They would include everything from big energy conglomerates like Enron Corporation or Williams Companies or Duke Energy, all the way down to local distribution companies like One Oak or MCN, which is the former Michigan Consolidated Gas Sempra Energy, which is out in California, the largest local distribution company in the country.

Q. Of the 20 stocks that you cover, how many of them are just stand-alone LDCs?

A. Very few. One right now.

Q. And what one would that be?

A. One Oak Oklahoma Natural Gas.

Q. And so you do not cover Laclede Gas; is that correct?

A. I do not.

Q. Okay. Is it your testimony, Mr. Olson, that this Commission should set a return on equity of 18 percent for Laclede Gas Company?

A. I would love to see that return personally, but that is not the direction from Laclede. Laclede is looking for a 12 and 3/4 percent return on equity with, I gather, about a 55 or 51 percent equity ratio.

Q. And if I understand what your testimony is saying, is that investors right now in the unregulated market are seeing returns of 18 to 20 percent; is that

correct?

A. That is correct. In fact, they've improved a little bit.

Q. And so if I understand the tenor of your testimony, it seems to be if the Commission doesn't grant Laclede a level of return commensurate with what an individual could get in the unregulated world, no one will invest in Laclede; is that correct?

A. This Commission will set a return at whatever it feels like, but the point I'm trying to make is -- and the gist of my testimony is that returns should be indexed to a rolling or moving average of competitive returns on equity out there in the real world.

And if they aren't, we're going to continue to lose market share or shelf space, if you will, for local distribution companies much like we have in the last six months. We've lost about six or seven companies. Several of which are -- those are local distribution companies, two of which were in the sample that the Staff had been using.

Q. When you say we're going to lose those companies, what do you mean?

A. They're going to be merged out of existence into bigger companies, much like what happened with Missouri Gas Energy.

Q. And in your opinion that's bad?

A. For stockholders the average premium has been about 2 1/2 times book to 3 times book value. Typically 25 percent over the last trade before the announcement. In some cases and with the North Carolina local distribution companies it's been about 46 to 50 percent over the last trade. I would tell you out of one side of my mouth at least that it is very good for stockholders. I'm not so sure down the road whether it's -- it works out that way -- that well.

Q. I'm just trying to understand your testimony. So the reason that this Commission should grant Laclede a 12.75 percent return is to prevent a merger from happening or to avoid shelf life problems or --

A. I would say this Commission should do that, because I think it's much better advice than perhaps you're getting from the Staff simply because the -- I think it's in the Commission's best interest and the State's best interest to remain -- to sustain a company like Laclede with good or competitive investing credentials.

Q. Let me ask you, what's the authorized return currently for One Oak, the LDC that you --

A. About a 12.15 percent return. Usually they do overearn that.

Q. Is that their authorized return?

A. Yes. It's a black box settlement, but that's

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the number.

Q. Okay. So the last rate case that One Oak had was a settled rate case; is that correct?

A. Yes.

Q. And it was a black box settlement?

A. It was a public litigated rate case, the likes of which I hope you-all never see. It look four years and million pages of testimony. They called it the five-ton rate case, which I wouldn't want to inflict on anybody.

Q. And ultimately the five-ton rate case was settled; is that correct?

A. Yes.

Q. And there was no explicit ROE number; is that correct?

A. That is right.

Q. Okay. So are you aware of any LDCs that you follow that currently have had a litigated return on equity of 18 percent?

A. I have seen a number of them realize those kind of returns often. And -- in the case of Michigan Consolidated Gas they are 19 percent a year for 10 years.

Q. That wasn't my question, sir. I wasn't talking about the realized returns. And you understand the difference between --

A. Yes, I do.

Q. -- an authorized return and realized return.
And my question to you was, authorized returns of 18 percent. Have you seen any?
A. No.
Q. How about authorized returns for LDCs of 12.75 percent?
A. I'm -- no. I'd have to say realized is the case.
Q. Okay. So you have not seen, in your experience reviewing LDCs, an authorized return of 12.75; is that correct?
A. Not for a number of years.
Q. Okay.
A. I have seen often in the past in the early '80s and the late '70s.
Q. In the early '80s and late '70s. So that was 15 years ago?
A. That's right.
Q. And would you agree with me that the economic conditions have changed since then?
A. They have changed considerably.
Q. On page 5 of your direct testimony you're asking a question about utility ROEs and they should be more in line with Corporate America. And you make the statement, While there is perhaps some residual economic argument that

utilities still enjoy some natural monopoly and should not earn monopoly returns -- let me ask you, is it your contention that currently Laclede does not enjoy a natural monopoly in its service territory?

A. I'm saying if the state of Missouri -- if the good state of Missouri ever decides to unbundle, it will become a much more competitive market, and Wall Street tends to discount the future accordingly.

Q. And that would be a competitive market only as it relates to supplying gas; isn't that correct?

A. Yes.

Q. In other words, we're not going to have five companies knocking on my door if I lived in St. Louis saying, we want to string pipe to your house, Mr. Micheel; is that correct?

A. That is correct.

Q. So in terms of the pipes business and what I'll call the distribution business, Laclede is always going to retain that natural monopoly identity; is that correct?

A. It may become the default supplier of record, but on the other hand, it will be conceivably out of the merchant business.

Q. Indeed, in states where we've seen what we'll call unbundling, the local distribution company is still the pipe supplier of gas; isn't that correct?

A. We're very high on the -- on the learning curve right now. I would tell that you in some of the states like Ohio and Georgia, for instance, nobody's making any money doing it.

Q. Well, that wasn't my question. My question was, for example, Atlanta Gas Light still owns the distribution system; isn't that correct?

A. Yes.

Q. And nobody else is coming in there and putting in a new distribution center; isn't that correct?

A. Not as of this moment.

Q. And so they still retain, as it relates to distribution, a natural monopoly; isn't that correct?

A. Yes. Uh-huh.

Q. Are you aware of whether or not we've had any movement here on unbundling in the state of Missouri?

A. I have not seen anything recently.

Q. Are you aware whether or not Missouri has any pilot unbundling programs?

A. I am not.

Q. Do you know what Laclede Gas Company's position is with respect to unbundling?

A. That was not what I was brought in to testify on.

Q. Are you aware of their position?

A. I am not aware of it.

Q. Okay. On page 6 of your direct testimony, I believe it's still answering that question starting on page 5, you say, In the case of regulated LDCs, however, investors' perceptions about ROEs have become particularly polarized because of their legitimacy and the evident lack of offsetting profit opportunities available; is that correct?

A. That's correct.

Q. Are you aware that currently Laclede Gas Company is operating under a gas supply incentive plan that gives the company incentive to profit in their gas supply area?

A. I am.

Q. Are you aware that the company --

A. I would hardly call that an offsetting of profit opportunity away from the basic local distribution function.

Q. Okay. So is it your testimony that historically Laclede has been able to earn revenues on its gas supply costs recovered through the purchase gas adjustment clause?

A. I believe this is a three-year program -- correct me if I'm wrong somebody -- which is up about right now -- from my viewpoint on Wall Street the front lines of

Wall Street, effectively, I'm looking at a company which certainly needs help somewhere, because they're earning in 1998 what they earned in 1988, ten years earlier. And I hope that more opportunities like this come along.

Q. Let me ask you this: Are you aware that the Commission just recently authorized Laclede's price stabilization fund which allows Laclede to trade in and out of certain risk management instruments and gives them the opportunity to profit?

A. No, I'm not.

Q. Okay. So you're not aware of that proposal -- or that Commission decision; is that correct?

A. No. I'm -- again, from a Wall Street point of view I hope they make money, but the experience with a number of these companies is they've lost money.

Q. So the experience with a lot of these type of financial instrument programs has been that companies have lost money. Is that your testimony?

A. All you have to do is look at what's happened to Synergy just in the last several weeks, taking another $75 million or so hit on that.

Q. So those programs can be risky?

A. Yes.

Q. On page 9 of your direct testimony you say that a number of states already set ROEs based on external indexes; is that correct? Page 9, I'm looking at line 2 through 3 there.

A. Yes.

Q. What external indexes are those and what states set those?

A. The following part of the sentence would explain it, albeit with the wrong connection on namely interest rates. What they're doing is old fashioned risk premium methodologies which have caused us a world of pain on Wall Street.

Q. What states utilized the external indexes?

A. Oregon, Washington in particular.

Q. Any other states?

A. They use -- they're very strong advocates of the risk premium methodology.

Q. Can you think of any other states?

A. Most will tend to use a -- Canada is very strong that way, all provinces in Canada, but most states will tend to use, like Missouri, a combination of methodologies.

Q. Would you agree with me that generally most states currently use the discounted cash flow method or some form of that?

A. Yes. Yes.

Q. So that's a widely accepted method; isn't that

correct?

A. It is. It's not necessarily the best method, but it is --

Q. On page 18 of your testimony you talk about Order No. 636 and the substantial risk that that's brought about for LDCs; is that correct?

A. Yes.

Q. Can you tell me when Order 636 was implemented for Laclede?

A. I'm not sure about Laclede, but I imagine it was implemented with the -- whenever MRT implemented its case, probably 1993 or early 1994.

Q. And as a Wall Street observer, do you believe that Wall Street is aware of the risks and rewards offered up by the implementation of Order 636?

A. On which front are you talking about? From the pipeline point of view or local distribution point of view?

Q. From all points of view.

A. The imple-- the implementation of Order 636 was voted in -- it was voted in on July 31st of 1991, became law of the land on April 2nd -- April 8th, 1992. The -- it ended up as a net positive for just about every pipeline out there.

For local distribution companies, which had high-load factors, it wasn't necessarily that good. For low-load factor -- it wasn't necessarily that good for low-load factor systems either. What it did was to introduce a much higher level of fixed costs for the local distribution companies, which was then passed onto the customers.

Q. And so those fixed costs that resulted from Order 636 were passed onto customers via the purchase gas adjustment clause; is that correct?

A. Yes.

Q. So that was pretty much a straight pass through to the customers; is that right?

A. That is correct.

Q. So Wall Street is aware of those risks; isn't that correct?

A. Generally, yes.

Q. And they've been aware since 1993; isn't that correct?

A. If -- it was a learning process, but I'd say by 1995, '96, yes.

Q. So the market price of any LDC stock, including Laclede's, would have already taken those risk factors into account; isn't that correct?

A. Yes. Uh-huh.

Q. Okay. In your surrebuttal testimony you talk about the fact that Laclede has to compete for capital with all companies in the universe of investors; is that correct?

A. Precisely.

Q. Are you aware that as recently as May '99 that Laclede Gas Company just issued $25 million of common equity?

A. Yes.

Q. And are you aware of whether or not there were investors out there that were willing to step up to the plate and purchase that equity?

A. On Wall Street nowadays I can sell anything. Even the New York Stock Exchange may be sold and brought public. This is a happy window of opportunity. On the other hand, if we had different interest rate conditions or a market down 500 points, you might have a different set of circumstances.

Q. Okay. But right now under these market conditions Laclede was able to sell $25 million worth of common equity --

A. That's right.

Q. -- isn't that correct?

A. Uh-huh.

Q. And those investors knew what they were buying, did they not?

A. I hope so.

Q. And they made an investment decision based on all the relevant factors that they think need to be taken into account, didn't they?

A. If you recall that about 50 percent of Laclede's stock is held by your fellow Missourians out there, and it's mostly held by retail clients out there, I'm not sure if most of them really know what they own. I think their brokers get a very nice credit in the process, but hopefully they are going to be able to do better in the future than they have in the last five years, because the stocks have not done well -- as well as a government bond.

Q. You mean does someone's stockbroker -- for example, if I have a stockbroker, do they owe a fiduciary duty to me to steer me to a good stock?

A. I am afraid that Wall Street will go to the highest medvac, shall we say. And there's a lot of incen-- financial incentive to sell a deal as opposed to trade securities. The commissions are much higher.

Q. Are you aware that Laclede recently issued $25 million worth of debt in June of '99?

A. Yes, I am.

Q. And do you know whether or not there were buyers out there for that debt?

A. I presume there were because it's a good credit and a good company.

Q. And so despite the pendency of this rate proceeding, there were people out there willing to buy Laclede's debt; isn't that correct?
A. Yes. But I don't know that they are as fully informed as you'd like to suggest they are, because the rate proceeding is not anywhere close -- was not anywhere close to being settled.
Q. In your analysis for Mundy, Moody -- Sander, Morris and Mundy --
A. Yes.
Q. -- are current pending rate proceedings factors that you look into when you're making recommendations to your stockbrokers?
A. Yes, I do. Yes.
Q. And I know in the last case you filed strikingly similar testimony when you were working, I believe, for -- I think it was Merill-Lynch --
A. Yes.
Q. -- is that correct?
A. Right.
Q. And when you worked for Merill-Lynch, was a company's pending rate case something that you took into account when you were making your recommendations to the brokers?
A. Generally speaking.

Q. And would you agree with me that pending rate cases is something that all stock -- reputable stock analysts take into account in making their recommendations?

A. I would hope so. On the other hand, if you don't have some sufficient information as to how this thing is -- how the rate case is going to work out, I think you're putting the cart before the horse.

Q. Okay. Would you agree with me that different investors have different risk-tolerance levels?

A. Very much so.

Q. And would you agree with me that --

A. They also have much different profit seeking levels too.

Q. Certainly. And would you agree with me that, in general, investors in local distribution -- or local distribution companies have been viewed by investors as low risk?

A. I can cite you chapter and verse of institutional investors who will loan up to 35 local distribution companies on the premises that they're going to be taken over at 2 1/2 to 3 times book value.

For Laclede, again, there's a categorical difference. With most of the shares being held by retail investors, they probably are -- are lower risk, but there are many investors out there institutionally who are owning these stocks purely and simply because of take-over possibilities.

Q. And you didn't do any studies or any formal analysis to arrive at your opinion that LDCs should be given an 18 percent return on equity, did you?

A. I'm not proposing they be given an 18 percent return on equity. I'm proposing that they be indexed to a -- a good, stand-alone kind of composite measure of profitability like the S and P 500. I'm not saying 18 percent. It may be 14, 13, whatever a good sense or judgment that the Commission -- a Commission would exercise.

Q. Are you aware of any Commissions that have set returns on equity based on your index proposal?

A. No. But hope springs eternal. In order to keep all these companies competitive -- again, it's a shelf space issue. Because if I -- if I may answer Ms. McShane's earlier thought of Commissioner Crumpton's question about what makes a good investment, you have growth, you have profitability and you have income. Very simple.

And in the case of Laclede I don't have any growth. I have good income, but in terms of profitability which is return on equity and related capital structure, I have reasonable capital structure, but I don't have an ROE because I have -- I've got 1 or 2 percent a year or 3 percent a year of growth.

One thing has to compensate for another effectively. I can buy Laclede Gas any day of the week or I can sell it any day of the week, but I can also buy Microsoft Dell computer or anything else I want to. I have infinite choices. It's not just limited to Indiana Energy or Northwest Natural Gas or something of that sort.

Q. Why do you think that Laclede Gas Company's trading over book value?

A. Because of take-over possibilities.

Q. And that's the only reason?

A. There's probably an interest rate differential too that will affect a relative valuation in that regard.

MR. MICHEEL: Thank you very much for your time, Mr. Olson.

THE WITNESS: Thank you.

JUDGE DIPPELL: Staff?

MR. POSTON: Staff has no questions. Thank you.

JUDGE DIPPELL: Are there questions from the Bench? Chair Lumpe?

QUESTIONS BY CHAIR LUMPE:

Q. You've answered a lot of it, Mr. Olson, but on page 19 of your direct where you talk about they would steadily fall by the wayside, am I to interpret that statement to mean they will be merged or bought out? Is that what you're talking about?

A. There are -- the alternatives right now, Commissioner, are not very happy in this industry because of the low growth prospect or low growth profile that's being presented in states like Missouri or Arkansas or wherever. And the -- this is what's been happening. We've lost six or seven local distribution companies just in the last eight months.

Q. You're not anticipating bankruptcy, you're anticipating they will be bought or they would merge?

A. I am anticipating opportunistic mergers to the extent that they can come in and streamline an LDC acquisition and take costs out and put them in -- carry them up to the holding company, for instance. I don't see any concern here of bankruptcy at all. I do see a 94 percent payout ratio this year, which is way, way above normal.

Q. You do, I think, take a stronger position on the relevance of the current discounted cash flow risk premium, CAPM, it appeared to me. Am I correct? Are you, in effect, recommending or agreeing with Ms. McShane that if a DCF is used, it should have the adjustments she made and you should use this comparability thing as opposed to either of the other two; is that correct?

A. I am very much in agreement with Ms. McShane as regards adjusting the DCF methodology. She is giving a very kosher, very orthodox approach to valuation as followed by the Commission.

I am outside the box. I am from Wall Street. I'm right on the front lines. And I can tell you that nobody on Wall Street uses these methods, nobody. Nobody. I have not been asked about price to book value or discounted cash-flow methodologies or risk premium or whatever in years effectively.

Q. So the methods the states have been using for however long, is it because of market conditions? Is it --

A. I think it's --

Q. Why are they now no longer relevant?

A. I think that the market has just left these methodologies in the dust. They don't work is the basic problem. They flat out do not work. And from a Wall Street point of view in terms of coming up with a five-year earnings forecast, I'm lucky to get 1999 close. I'm one of maybe 14 or so natural gas analysts in the country who do these forecasts that you all put into these discounted cash flow projections. And I have trouble with 1999 much less 19-- year 2000 or 2003 or 2004.

Q. Would you not even recommend the discounted cash flow as adjusted? Is that irrelevant also?

A. I would say that you, as a Commission, have to look at all these nice things about profitability return equity and related capital structure. And if you feel duty-bound, either out of inertia, out of comfort, or whatever, to continue with the discounted cash flow and all other methodologies that you like because the Staff has been weaned on these methods, you clearly would need to adjust it so as to get this company, business reason to exist. There has to be some sort of incentivization in there.

To give you an example, Michigan -- again, they're allowed a 11 1/2 percent return on equity and the companies earn 15 to 16 percent. Whether it's a pure allowed return plus something -- but that's where all the money goes on Wall Street. That's where the fiduciary interest are driving us, into those areas where you can make the greatest returns.

Q. Your new method then, if one were to discard all of these three, is the index approach?

A. It's actually an old method. It's been around well before these methods were used. And if anybody has any history on the Commission, they would perhaps remember back in the '60s and early '70s comparable earnings was a methodology that was used extensively with Corporate America and by the FERC.

And what happened was that the pipelines decided that -- made a great argument that they should be using -- or excuse me -- academics made a strong case to the

FERC that they should be using discounted cash flow methodology. This happened around 1972.

The trouble with discounted cash flow methodology is I can justify just about any kind of return and any kind of capital structure. It's entirely subjective.

Comparable earnings is something where you use your best judgment. You can take five companies, you can take 30, whatever you want or -- and use it to, you know, index against the S and P 500 or 400 Corporate America or Industrial America, or any group that you feel more comfortable with, like Ms. McShane's group.

Q. So your comparable companies would not necessarily just be gas companies?

A. Not at all.

Q. They would be whatever group you wanted to pick?

A. I have choices. I have thousands and millions of choices literally. And I can trade Laclede Gas in one nanosecond. I can do a program trade by pushing a button on my computer and I'm done. And that's the harsh reality that Commissions nationwide are facing, is that if they're not competitive, then -- in the capital markets, then their companies are probably going to get taken over.

Q. Let me ask you, on page 8 of your direct testimony, somewhere around lines -- I guess line 10, what do you mean by that under this approach?

A. What I am suggesting to you, Commissioner, is that there is a residual value for the monopoly that you need to discount away from what Corporate or Industrial America is making, whether it's 10 or 20 or whatever percentage point you want to determine, that is your call.

The problem with setting DCF methodology or derived ROEs over the last 15 years is that we've had this enormous upsurge in profitability of Corporate America and profits have virtually -- ROEs have doubled effectively.

The business cycle has gone way up, and what has happened to Laclede's ROE? It's gone down, down, down. Why should an investor who has infinite liquidity, can sell -- buy and sell shares 80 times a day or whatever, why should they stick around with Laclede Gas where the ROE's going down when they can buy something -- you know, Dell Computer, to use as an extreme, there's's an 80 or 90 percent return on equity. And the stock has delivered 102 percent a year for the last nine years.

Q. So where does the 10 percent come in? As an investor, am I saying, okay, the monopoly is worth 10 percent to me so I don't need an 18 percent return --

A. That's right. In other words --

Q. -- and it would be fine?
A. -- you'd take a -- take off 20 percent for the sake of argument, take off -- from 18 percent you take 20 -- or 3.6 percentage points below that. That would be 14 1/2 or so. Remember ROE's gone down as well and they were 10 percent -- 10.9 percent in 1991. 20 percent below that would give Laclede an ROE of probably 8 percent or so. That fits intuitively with the business cycle, with interest rates and everything else.
Q. All right. I think one last question here. From your vantage point as an investment analyst, do you support or do you think it would be wise for the state to move to further unbundling of the gas industry?
A. How many hours do you have?
Q. Yes or no will do.
A. I would think that as nature takes its course, I would strongly suggest you do it later rather than earlier, because you can go to school on everybody else's mistakes. But as nature does take its course, I think unbundling is going to be a state of nature in the next five years just about everywhere in the country.
CHAIR LUMPE: Thank you.
JUDGE DIPPELL: Commissioner Murray?
COMMISSIONER MURRAY: Thank you.
QUESTIONS BY COMMISSIONER MURRAY:

Q. Good afternoon. I'm a little bit intrigued by your alternative using the index. And as you know, the wheels of government grind slowly, so the likelihood of that being adopted is probably pretty remote, but I think it's still intriguing.

And I'd like to ask you, if we were using that approach and say we were indexing to the S and P 500 index, for example, what is the year-to-date return '99 for the S and P 500?

A. The year-to-date return is about -- I'm trying to say about 11.3 percent.

Q. And the --

A. Excuse me. It's 9.7 percent, plus a 1 1/4 percent yield currently gives you about 10.9 percent through the end of August. If you analyze that return at 9.7 percent, would be -- with four months to go, 3 1/2, so that would be about -- about 15 percent.

Q. That's including taking the dividend into consideration?

A. In rough numbers, yes, Commissioner.

Q. So when you're looking at a comparison, you're looking at comparing the return plus the dividend and coming up with a percentage; is that --

A. That's your old-fashioned DCF methodology. That's what you would come up with if you just simply used

this year as using -- say 15 percent and then take 20 percent off of that, you come up with about 12 percent.
Q. And if we're looking at -- all right.
If we said 12 percent, how would that be divided between a return and a dividend?
A. Well, it varies all over the place because -- in this case to -- the dividend would be or 5, 3 quarter percent or so that's currently going on right now. I'm extrapolating into Laclede's case from, say, the S and P 500 case.
Q. So if you're looking at Laclede's case and you're taking the S and P 500 index and you say -- I think you said 80 percent --
A. Yeah. 80.
Q. -- and came up with an annualized 15 percent?
A. Most always in all of the equivalent return equity would be derived from the capital appreciation or earnings growth portion of the -- of that indexing idea.
Q. So wouldn't that be a 9.25 percent?
A. Yes.
Q. Plus a 5.75 percent dividend?
A. That -- you can look at it that way.
Q. And is the last 12 months an unusual 12 months or can we --
A. It's unusually low for the last five years.

The average total return for the stock market has been 24.8 percent -- 25 percent a year. Laclede, by comparison, over that last five years, has been 8.6 percent. Thirty-year governments over that, bond is 9.3 percent. They've done worse than bonds effectively. The S and P, I mentioned to you, large local distribution companies run about 12 3/4 percent.

Q. And what if you looked at the last 10 years? How does the last year compare?

A. The last 10 years would show Laclede at about 10.42, 10.4 percent. 30-year governments were about 8.6 percent. The S and P 500 I don't have right here. I dare say it's going to be in the 20 percent area. And large local distribution companies -- I'd have to go back, but I'd dare say they were running a little bit better, about 13 or 14 percent.

Q. Now, when you give me 10.4 percent for Laclede, is that --

A. An average annual total return of the capital appreciation plus the dividend yield.

Q. Plus the dividend. And if you were to take the 20 percent of the S and P, 80 percent of that --

A. Yeah. You would come up with about 16 percent.

Q. Versus Laclede's 10.4 percent?

A. Yeah.

COMMISSIONER MURRAY: I think that's all the questions I have. Thank you.

JUDGE DIPPELL: Commissioner Schemenauer, did you have questions for Mr. Olson?

COMMISSIONER SCHEMENAUER: Just one.

QUESTIONS BY COMMISSIONER SCHEMENAUER:

Q. Good afternoon, Mr. Olson.

A. Good afternoon.

Q. On page 3 of your direct testimony, I guess you're asking a rhetorical question, on lines 17 through 21, Why should equity investors buy an 11 percent return on equity investment in an industry which is low growth, increasingly risky, yet still regulated when they can buy an 18 to 20 percent return on equity today in Corporate America? You're referring to Laclede?

A. Yes.

Q. Is everybody dumping Laclede stock right now?

A. The stock is down from 27 to 23 in round numbers. It's treated -- the range for the last year has been between 20 and 27 parenthetically. It is down around 8 or 11 percent in the year to date. It's down 11.3 percent in the year to date.

Q. Is everybody dumping the stock?

A. I think interest rates -- the fact that this company has been treated as a bond equivalent because of the rate-making mechanisms, that's where the corelation has coming. It's been almost a quasi-bond.

Q. So it's less risky than a stock because it's looked at as a bond?

A. Yes.

Q. And that's why people normally tend to purchase utility stocks, they look at the dividend payout and it's a safe investment; is that correct?

A. That is the case. Although before you came in, Commissioner, I mentioned the fact that many of these stocks have risen in the past year or two because of their take-over characteristics, that they're worth more dead on -- beef on the hoof then they are as a going concern.

Q. That's something beyond the control of --

A. Yes.

Q. -- customers or regulators? If the industry sees some things out there that they want to acquire, they're going to go after it. Correct? I mean --

A. Yes.

Q. -- nothing -- the rate of return that we set is going to affect whether or not it's a better price or --

A. Well, the returns that you set are very, very important because you would keep a lot of wolves from the door if you set a terribly low rate. Like in Canada no one will touch a Canadian utility because they are so far out of the box. I mean, it's --

COMMISSIONER SCHEMENAUER: That's all I have. Thank you.

COMMISSIONER MURRAY: I have some follow-up.

JUDGE DIPPELL: Go ahead, Commissioner Murray.

FURTHER QUESTIONS BY COMMISSIONER MURRAY:

Q. I was just looking at my notes here and I'm not sure I took this down right. When I asked you the annualized return on the S and P 500, was that 15 percent for the last --

A. Yes.

Q. -- annualized period?

A. Yes. The year to date 1999.

Q. So that really if you took 80 percent of that, you'd be talking about starting with 12 --

A. Yes.

Q. -- and subtracting the 575 from that?

A. Yeah. Okay.

COMMISSIONER MURRAY: Okay. Thank you.

QUESTIONS BY JUDGE DIPPELL:

Q. I wanted to ask you one question, Mr. Olson, and this is on behalf of Vice Chair Drainer. She couldn't be here this afternoon. But why do monopolies need to attract capital?

A. That's a good question, because there are hardly any monopolies left nowadays. In order for a monopoly to stay viable and finance the growth of its territory, you're going to need to have a -- some portion of outside capital. And you have to come to Wall Street for debt or equity.

Accordingly, if you do -- if you come to Wall Street with returns which are again clearly non-competitive, then it will become more troubling. Granted there are places like Canada where you have a captive -- you can't invest outside the country so they'll go after -- Canadian dollars will keep on being recycled inside the country. In the United States we can invest in single-park fuel in the future or pork bellies or anything we want, which is a great blessing, I presume.

But as long as monopolies have -- as long as there is a monopoly and with reasonably competitive returns to the owners, I suspect that -- I'm not sure I'm answering your question as well as I'd like, but the owners will demand a competitive return.

A monopoly, there's no -- I'd hardly call a -- a 9.7 percent return a monopoly return. Coca-Cola with 40 percent of the world market in carbonated beverages earns 55 percent on its equity. And, you know, there are others like Kellogg, Rice Krispies earns 40 percent and Johnson and

Johnson earns 37 percent, Microsoft earns 37 percent. Now, you could call those natural monopolies, but I don't think we're anywhere close to those kind of returns in the state of Missouri. Correct me if I'm wrong.

JUDGE DIPPELL: Thank you.

Is there recross based on questions from the Bench from Ameren UE?

MS. KNOWLES: No.

JUDGE DIPPELL: Public Counsel?

MR. MICHEEL: Yes. I have just a few.

RECROSS-EXAMINATION BY MR. MICHEEL:

Q. Commissioner Schemenauer asked you some questions about whether or not investors were dumping Laclede stock. Do you recall those questions?

A. Yes.

Q. Isn't it a fact that Laclede just placed approximately $25 million worth of equity and it was purchased by some investor?

A. Yes.

MR. PENDERGAST: I was going to object on asked and answered grounds, but I guess he can ask it again.

JUDGE DIPPELL: I take it you're withdrawing your objection?

MR. PENDERGAST: I'll withdraw it.

MR. MICHEEL: I think it was appropriate

anyway based on the questions from the Bench, your Honor.

That's all I have.

JUDGE DIPPELL: Staff?

MR. POSTON: I have no questions.

JUDGE DIPPELL: Is there redirect?

MR. PENDERGAST: A few redirect, if I could.

REDIRECT EXAMINATION BY MR. PENDERGAST:

Q. Mr. Olson, you were asked about LDC authorized returns and what returns you were familiar with. And you mentioned a One Oak 12.1 percent return that was the result of a black box settlement you said?

A. Yes.

Q. How are you familiar with the 12.1 percent then if it was a black box settlement?

A. I had to file testimony in the -- in that case.

Q. The five-year case?

A. The five-ton rate case.

Q. Five-ton. Sorry. And can you tell me -- you were also asked whether there were other LDCs that had been authorized 12.75 percent and you indicated you weren't familiar with any. Are there other firms that operate in the natural gas industry that have been authorized returns in the 12 percent rage?

A. Numerous. After opinion 414 and 414-A, which came out July 31st of 1998, in the various Williams Companies cases, pipelines are being authorized anywhere from 12 to the latest refiled number is 13.77 percent. And that's with a 45, 55 debt equity capital structure by Northwest Pipeline Company, about a billion dollar rate base company.

Q. When you say "pipelines," are you referring to interstate pipelines?

A. Interstate pipelines.

Q. And these are the same interstate pipelines that have been relieved of their merchant obligations as a result of 636?

A. Correct.

Q. You also were asked questions about 636 and the extent to which the shifting risks associated with it had been recognized in the market. And I think in a subsequent question you also mentioned Synergy as an example of a company that undertook some risk. Can you tell me what the nature of the Synergy experience was?

A. Synergy had a very bad time in the power markets when they tried to exercise force majeure clauses where they could not deliver to a variety of power traders, power marketers. And, as a consequence -- they decided to honor those contracts due to the very hot weather, peak day conditions that they had experienced. And as a consequence, they were market to market effectively and honored their contracts and were going to take a big bath in that area.

Q. So these were electric power contracts?

A. Yes.

Q. And as much as I appreciate Mr. Micheel's efforts to make Laclede appear riskier than it may be, are you familiar with -- I think you indicated you weren't familiar with our hedging incentive program?

A. Not really.

Q. And what type of financial instruments are used --

A. No.

Q. -- in that program?

A. No.

Q. Would you be surprised if I told you that they weren't financial instruments relating to electric power?

A. I would not be surprised at all.

Q. And the Synergy experience happened during a period you said of very, very hot weather?

A. Extreme conditions. They had not seen those -- I think it's a 1 percent probability.

Q. Was that an extended period of hot weather?

A. About three or four days.

Q. Okay. And was there a similar experience with some substantial losses the year before, if you're aware --

A. Yes.

Q. -- in the electric industry?

A. Yes.

Q. And was that during another period of extremely hot weather?

A. That is correct.

Q. From the standpoint of whether all the risks of 636 have been taken into account, do you know whether the natural gas industry has been tested to the same degree with an extended period of cold weather as -- and specifically here in our area, as the electricity has been?

A. I -- I have a recollection, but I -- the weather's been warm. I want to go back to winter -- the winter of 1993. If my memory serves me correctly, you were tested and not found wanting.

Q. Maybe back in '93?

A. Uh-huh.

Q. Do you know whether that was before or after?

A. 636?

Q. Yes.

A. I would presume that would be either the winter of '92 -- I can't tell you.

Q. Okay. Thank you. You were also asked some questions about whether -- both, I believe from Vice Chair Drainer and from Mr. Micheel about Laclede's status as a natural monopoly. In your view, to the extent somebody might say that Laclede has monopolistic characteristics as a natural monopoly, does that mean Laclede faces no competition?

A. No.

Q. Were you here in the room today when the counsel for Ameren UE talked about some competitive issues relating to rate design?

A. I was not.

Q. You were not. It's an interesting discussion. I'm sorry you missed it.

But you are aware that Laclede does compete with electric companies for customers?

A. Yes.

Q. Okay. Do you know if Laclede competes with other forms of energy for customers?

A. I don't.

Q. Okay. You also were asked a question by Mr. Micheel as to whether or not Laclede had been able to go ahead and sell its stock and whether it had been able to issue bonds over the last several months. Do you recall those questions?

A. Yes.

Q. Do you know whether or not the investment community generally accepts, in evaluating whether to purchase stock, that whatever recommendation a Staff person makes is ultimately going to be adopted by the Commission?

A. Could you rephrase that?

Q. Yes. These transactions happened obviously before the Commission issued a decision in this case; isn't that correct?

A. Yes.

Q. Okay. And do you know whether the investment community generally assumes that whatever a Commission Staff or an Office of Public Counsel has recommended, either with respect to return on equities or with regard to overall revenue requirement, that that will necessarily be adopted by the Commission?

A. The underwriters generally presume that a Commission will act rationally. I would say that it has happened before when I was at Merill-Lynch, there was a rate case in the state of Washington where equity was issued and they came out with a worse case set of circumstances. The stock went from 26 to 13, they busted the dividend, they had to sell off assets and was -- that was worst case situations. But, again, that's an extreme. But generally we hope the Commissions act rationally.

Q. And I will not ask you the follow-up question on what that means in terms of accepting Staff's and Public Counsel's recommendations, but are investors expecting the

Commission to set a fair return?

A. Very much so.

Q. And in determining whether the Commission is likely to do that, do you know whether investors would evaluate returns that the Commission has set in the not too distant past?

A. Yes.

Q. For example, would they evaluate a return of 10.93 that was set for Missouri Gas Energy?

A. They would certainly look at it.

Q. Okay. And would they look at the 12.61 that Ameren UE is permitted to earn before it has to start sharing with its customers?

A. Very much so.

Q. Okay. Okay. Earlier Commissioner Murray asked you a series of questions on your S and P index. And you stated that year to date the S and P index had a 15 percent annualized return. Is this a return on market value --

A. Yes, it is.

Q. -- or book value?

A. Market value.

Q. And what is the S and P 500 return on book value on an annualized basis year to date, do you know?

A. I don't know off the -- I can give you a --

the latest estimates, if you'd like. As of Friday, last Friday afternoon, we would be looking at 19.3 percent.

MR. PENDERGAST: No further questions. Thank you, Mr. Olson.

JUDGE DIPPELL: Thank you. Is there anything further for Mr. Olson?

You may be excused, sir. Thank you.

THE WITNESS: Thank you.

JUDGE DIPPELL: Should we go ahead and begin with Mr. Fallert?

MR. PENDERGAST: Mr. Byrne is going to handle that.

MR. BYRNE: Sure. Might as well.

JUDGE DIPPELL: Were the objections to Mr. Fallert's testimony strictly related to the AAO issue?

MR. MICHEEL: Yes, your Honor. My motion to strike was strictly related to the AAO issue. So to the extent that they're putting Mr. Fallert up right now, I would just say that we don't admit his testimony until we've dealt with those issues.

JUDGE DIPPELL: Okay. Would anybody have an objection to that?

MR. BYRNE: I guess I don't have an objection. I thought perhaps your -- oh, are you waiting until the stipulation gets filed? Is that what you're concerned about?

MR. MICHEEL: Filed and signed and sealed and delivered and all that stuff.

MR. BYRNE: And assuming all that gets done, you're not going to have an objection at that point. Right?

MR. MICHEEL: I don't believe so, Mr. Byrne.

MR. BYRNE: That's fine with me.

JUDGE DIPPELL: We can do it that way, we can hold off admitting it completely, or we can admit it with your objection, and I can wait to rule on the objection.

MR. BYRNE: I don't care. Either way.

JUDGE DIPPELL: Let's go ahead and get to the preliminary stuff, and then we'll see what happens.

MR. BYRNE: Okay. I would call to the stand James A. Fallert.

JUDGE DIPPELL: Mr. Fallert, could you please spell your name for the court reporter.

THE WITNESS: F-a-l-l-e-r-t, James A.

(Witness sworn.)

JUDGE DIPPELL: Go ahead and proceed, Mr. Byrne.

JAMES A. FALLERT having been sworn, testified as follows:

DIRECT EXAMINATION BY MR. BYRNE:

Q. Could you please state your name for the record.

A. James A. Fallert.

Q. And what is your business address, Mr. Fallert?

A. 720 Olive Street, St. Louis, Missouri, 63101.

Q. And by whom are you employed?

A. Laclede Gas Company.

Q. And are you the same James A. Fallert that caused to be filed in this proceeding direct testimony that's been marked as Exhibit No. 7, and rebuttal testimony that's been marked as Exhibit No. 8, and surrebuttal testimony that's been marked as Exhibit No. 9?

A. Yes.

Q. And do you have any corrections you'd like to make to that testimony?

A. Yes, I do. I have a correction to rebuttal testimony, page 24, line 7. After the words "revenue requirement," I would insert a parenthetical which would read "before transfers to construction."

Q. So then the sentence would read, This would result in revenue requirement, parenthesis, before transfers to construction, closed parenthesis, close to that proposed by Staff in this case?

A. Yes.

Q. Okay. Any other changes?

A. No.

Q. Okay. With that change, are the answers that you provided to the questions in your direct, rebuttal and surrebuttal testimony and the information provided on the schedules attached thereto true and correct to the best of your knowledge and belief?

A. Yes.

Q. If I were to ask you the questions contained in that testimony here today while you're under oath, would your answers be the same?

A. Yes.

MR. BYRNE: With that, I would offer Exhibits 7, 8 and 9 and tender Mr. Fallert for cross-examination.

JUDGE DIPPELL: Are there any objections to Exhibit 7?

I'll receive Exhibit 7 into evidence.

(EXHIBIT NO. 7 WAS RECEIVED INTO EVIDENCE.)

JUDGE DIPPELL: Are there any objections to Exhibit No. 8?

MR. MICHEEL: We have a motion to strike outstanding, your Honor.

JUDGE DIPPELL: All right. I'm going to go ahead then and hold off receiving this exhibit into evidence, but we're going to go ahead with the cross-examination pending a ruling tomorrow morning after the proposed Stipulation and Agreement has been filed.

Are there any exhibits to -- sorry -- are there any objections to Exhibit No. 9?

Okay. Then Mr. Byrne, I'd ask you to make sure that I do rule one way or the other receiving or not receiving that exhibit.

MR. BYRNE: I will, your Honor.

JUDGE DIPPELL: And Exhibit No. 9 is received.

(EXHIBIT NO. 9 WAS RECEIVED INTO EVIDENCE.)

JUDGE DIPPELL: Is there cross-examination from Ameren UE?

MS. KNOWLES: No. No questions.

JUDGE DIPPELL: Public Counsel?

MR. MICHEEL: I have no questions for Mr. Fallert.

JUDGE DIPPELL: Staff?

CROSS-EXAMINATION BY MR. POSTON:

Q. Mr. Fallert, what is the return on equity you are supporting in this case?

A. The Company's asked for 12.75 percent.

Q. And is that what you're supporting as well?

A. Witness McShane's the witness supporting that return on equity in this case.

Q. So it's true that you have not done any analysis to determine Laclede's return on equity?

A. No. Kathleen McShane did that analysis.

MR. POSTON: I have no more questions.

JUDGE DIPPELL: Are there questions from the bench, Commissioner Murray?

COMMISSIONER MURRAY: Just one or two.

QUESTIONS BY COMMISSIONER MURRAY:

Q. Good afternoon.

A. Hello.

Q. On page 2 of your rebuttal testimony you talk about the 12.61 percent for Ameren UE at which point it begins sharing with its customers. And can you give me the rationale for Laclede being compared to Ameren UE?

A. Well, we're both public utilities, we're both severing the same market, we're both regulated by the same Public Service Commission. I think that investors looking at what their expectations might be for returns on either company would expect that there would be some relationship there.

Q. Okay. But what your testimony is pointing out is that the recommendations by Staff and OPC are something like 300 basis points below what Ameren UE is able to earn prior to sharing?

A. That's right.

COMMISSIONER MURRAY: I don't have any other questions for this witness.

JUDGE DIPPELL: Thank you.

Is there any recross based on those questions from the Bench? I'm just going to ask in general.

MR. MICHEEL: I'll pass.

JUDGE DIPPELL: Seeing none, then is there any redirect?

MR. BYRNE: No, your Honor.

JUDGE DIPPELL: Okay. Then this witness will not be recalled for the Accounting Authority Order issue?

MR. BYRNE: I think he will be recalled for that, for the single issue that remains, which is the sunset data.

JUDGE DIPPELL: Then you may step down, Mr. Fallert, but you are not excused.

THE WITNESS: Thank you.

MR. BYRNE: Your Honor, our next witness is Zach Wagner, and my understanding is he's not going to be here until tomorrow.

JUDGE DIPPELL: Okay. Then since it's 4:30, let's go ahead and conclude for the day. Let's get an early start tomorrow though. Can we start at 8:15? Let's go ahead and go off the record.

(HEARING WAS ADJOURNED UNTIL AUGUST 31, 1999, AT 8:15 A.M.)

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