MISSOURI PUBLIC SERVICE COMMISSION

REVENUE REQUIREMENT

COST OF SERVICE REPORT

LACLEDE GAS COMPANY

CASE NO. GR-2010-0171

Jefferson City, Missouri
May 10, 2010

**** Denotes Highly Confidential Information ****

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LACLEDE GAS COMPANY

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REVENUE REQUIREMENT

COST OF SERVICE REPORT OF

LACLEDE GAS COMPANY

CASE NO. GR-2010-0171

I. EXECUTIVE SUMMARY

A. Staff's Revenue Requirement Recommendation

The Staff has conducted a review of all cost of service components (capital structure and return on rate base, rate base, depreciation expense and operating revenues and expenses) which comprise Laclede Gas Company's (Laclede Gas or Company) revenue requirement. This audit was in response to the Company's December 4, 2009 filing seeking to increase rates to recover approximately an additional $60.7 million annually. The ordered test year for this case is the twelve months ending September 30, 2009, which also represents Company's most recent fiscal year. The test year update period ordered for this case is the six months ending March 31, 2010. The Staff also recommends at this time that a true-up audit be performed through June 30, 2010, to address all significant known and measurable changes that occur with regard to the Company's revenues, expenses and investment levels. The Staff's recommended revenue requirement for Laclede Gas, based upon updated results through March 31, 2010, as well as an inclusion of an estimate of certain true-up items, is approximately $12,014,510 at the Staff's recommended midpoint rate of return.

B. Impact of Staff's Revenue Requirement on Retail Rate Revenue

The Staff's recommended revenue requirement of $12,014,510 would represent an approximate 4.3% increase in Laclede Gas' total non-gas retail rate revenues. This increase

pertains to Company's margin revenues only, and does not include gas cost revenues. The impact of the Staff's recommended revenue requirement on each of Laclede Gas' rate classes will be discussed in the Staff's rate design and class cost of service report that is to be filed on May 24, 2010. It is important to note, that a portion of the Staff's general rate increase recommendation has already been passed on to Laclede Gas' customers through periodic Infrastructure System Repair Surcharge (ISRS) rate filings made by the Company. Since the Company's last general rate increase in 2007, and at the time of the Company's direct testimony filing in December 2009, rate increases totaling $8,093,710 annually had been approved by the Missouri Public Service Commission (Commission or MoPSC) and charged to Laclede Gas' customers through the ISRS rate mechanism. During March 2010, a new ISRS surcharge was approved by the Commission to reflect an additional $2,818,150 of revenue requirement related to ISRS eligible investment installed during the period covering June 1, 2009 through January 31, 2010. The revenue requirement associated with this additional investment increased Laclede Gas' annual collection of revenues to $10,911,860 through the ISRS rate mechanism. Once rates ordered by the Commission in this proceeding become effective, the current ISRS rate surcharge will be reset to zero and the amounts formerly collected through the ISRS surcharge will then be part of Laclede Gas' general retail rates. When the rate increases associated with past Laclede Gas ISRS filings are taken into account, the amount of the Staff's recommended incremental rate increase in this case would equal $1,102,650 (the revenue requirement determined in this case at midpoint of $12,014,510 less $10,911,860 of ISRS revenue).

II. BACKGROUND

Laclede Gas Company is the largest natural gas distribution utility in Missouri, serving approximately 630,000 residential, commercial and industrial customers in the City of St. Louis and parts of ten counties in eastern Missouri. Laclede Gas is a subsidiary of The Laclede Group, Inc., a public utility holding company that also acts as a parent company to various non-regulated entities that are affiliates of Laclede Gas.

The Commission last authorized a general rate increase for Laclede Gas in a July 19, 2007 Report and Order in Case No. GR-2007-0208 with new rates effective on August 1, 2007. In that case the Commission approved a stipulation and agreement granting Laclede Gas an annual rate increase of $38,600,000.

III. TRUE-UP RECOMMENDATION

In its December 4, 2009 direct testimony filing, Laclede Gas requested that a true-up audit be performed to measure significant events that will occur between the proposed update period of March 31, 2010 and July 31, 2010. In its January 11, 2010 filing entitled "Staff Response to Commission Order Regarding Test Year and True up," the Staff stated that it would make its recommendation to the Commission concerning the need for a true-up audit in this proceeding as part of its direct filing.

A test year update period reflects material changes to the Staff's case through a date near the conclusion of the Staff's audit. In contrast, true-ups are re-audits and updates of major elements of a utility's revenue requirement beyond the end of an ordered test year and test year update period. True-ups are not required for every rate proceeding, and typically are only ordered when a utility can demonstrate that it expects to incur material changes to its revenue

requirement after the end of the ordered test year update period but prior to the operation-of-law date in the case.

In this case, Laclede Gas has asserted that it expects to incur a material increase to its revenue requirement past the March 31, 2010 test year update period through July 31, 2010. Company witness James A. Fallert indicates on page 5, on lines 1 through 12 of his direct testimony that:

> Laclede requests a true-up through a date no earlier than July 31, 2010. It is essential that the most recent available information be included in the calculation of rates. Additionally, there are several significant events that will occur between the proposed update period of March 31, 2010 and July 31, 2010. These include, but are not limited to, changes in labor rates paid under the Company's union labor contracts, a possible change in the annual assessment paid to the Commission, changes in the annual contracts with health plan providers, and changes in insurance premiums. Depending on the Commission's disposition of the Company's tariff filing in Case No. GT-2009-0056, it may also be necessary to [sic] make adjustments relating to revenues and expenses associated with the Company's performance of service work on customer's premises.

The Staff believes it would be nearly impossible to conduct a true-up of all significant items through July 31, 2010 in time for the true-up hearings that are scheduled on September 1-2, 2010 for this case. The Staff bases this concern from its experience on the recent AmerenUE rate case, (Case No. ER-2010-0036), in which true-up information for a true-up period ending January 31, 2010, was not made available until March 5, 2010. The established date for true-up direct testimony in that case was April 1, 2010, with true-up rebuttal due on April 8, 2010 and true-up hearings scheduled for April 12-13, 2010. The Staff believes the earliest it would receive from Laclede all of the known and measurable supporting evidence it would need to conduct a true-up audit of all of these items is August 20th. This would not leave sufficient time to audit all

of the information and then file true-up direct testimony before true-up hearings scheduled for September 1-2, 2010.

As an alternative, the Staff recommends that a true-up audit be performed through June 30, 2010, to allow sufficient time for the Staff to properly review all significant known and measurable changes to the Company's revenues, expenses and investment levels. As such the Staff recommends that the following items be considered during a true-up audit in this case:

Rate Base

1. Plant in Service
2. Depreciation and Amortization Reserve
3. Prepaid Pension and OPEB Assets
4. Customer Deposits
5. Customer advances
6. Special Deposits
7. Insulation Finance and Energy Wise Program Loan Balances
8. Deferred Income Taxes
9. Materials and Supplies/Prepayments
10. Related Cash Working Capital effects
11. Natural Gas Stored Underground – Non-Current

Capital Structure

1. Rate of Return
2. Capital Structure

Income Statement

1. Revenues for Customer Growth
2. Payroll and Related Payroll Costs as a result of changes in employee levels and wage rates
3. Pension and OPEB Expense
4. Rate Case Expense
5. Depreciation and Amortization Expense
6. Healthcare Costs
7. Insurance Costs
8. MoPSC Assessment
9. Propane Revenue and Expenses
10. Uncollectibles
11. Related Income Tax effects

The Staff will consider changes on or near June 30, 2010 during the true-up audit. Items will only be considered if the Company timely provides sufficient supporting documentation and the items are known and measurable and auditable. In order to be included in the proposed true-up audit, all costs and the events giving rise to them must be known and measurable, and fully supported by documentary evidence (i.e., inspections, invoices, contracts, company ledgers, etc.). In addition, consideration of any item in true-up must be viewed in the context of maintaining an appropriate relationship between revenues, expenses and investment.

IV. MAJOR ISSUES

Laclede Gas filed its case based upon a test year ending September 30, 2009. The Staff updated the major components of the Company's revenue requirement through March 31, 2010. The major known and methodological or conceptual differences between the Staff and the

Company as reflected in their respective direct testimony filings include the following issues along with their approximate dollar value:

Rate of Return – Issue Value – ($10.8 million) The Company's case reflects an 11.125% return on equity (ROE) based upon a proposed range of 10.75% to 11.50%, while the Staff is recommending an ROE range from 9.00% to 10.00%, with a 9.50 midpoint ROE.

Pension Expense – Issue Value ($16.2 million) The primary issue between the Company and Staff involves the Company's proposal to increase pension expense based on estimates of possible increases in pension funding that the Company would not experience until January 2011. The Staff has not recognized these estimates and instead calculated pension expense based on contributions that were made by the Company during the test year ending September 30, 2009, plus an amortization of the Company's prepaid pension asset that is included in rate base.

Propane Revenues - Issue Value ($6 million) ** _____

_____

_____

_____

_____ **

Uncollectibles – Issue Value ($3.7 million) The difference in the Staff's determination of uncollectibles is attributable to its use of the actual net write-offs for the 12 months ending March 31, 2010, in contrast to the Company's method of applying a "percentage loss factor" to its normalized revenues. The Staff also made an additional adjustment to address the uncollectible portion of Gross Receipts Taxes in the test year, which the Company has not recognized.

Depreciation Expense - Issue Value ($3.4 million) The Company proposes to increase depreciation expense by $3.3 million based on its proposed depreciation rates. The Staff's proposed depreciation rates increase depreciation expense by $2.5 million. In addition the Company proposes to increase depreciation expense by an additional $2.6 million in connection with its proposed adjustment for theoretical reserve amortization.

Payroll - Issue Value ($3.0 million) The Staff made adjustments to test year payroll expense to reflect reductions in employee levels that were not recognized by Laclede Gas. In addition, the Staff has not recognized a majority of the Company's adjustments to increase payroll expense associated with proposed overtime levels.

Cost Allocations to Affiliates – Issue Value ($1.5 million) The Company allocates costs for services it provides to its unregulated affiliates. The Staff believes the amount allocated to affiliates is understated. Also the Staff makes recommendations for improvements in reporting with regard to the Company's current Cost Allocation Manual Report that is filed with the Commission annually. These recommended reporting improvements are intended to provide greater transparency with regard to the transactions engaged in by Laclede Gas Company with its affiliates.

Staff Expert Witness: (Section I, II, III and IV) John P. Cassidy

V. RATE OF RETURN

A. Summary

The Financial Analysis Department Staff recommends that the Commission authorize an overall rate of return (ROR) of 7.94 percent to 8.51 percent for Laclede Gas. The Staff's rate of return recommendation is based on a recommended return on common equity (ROE) of 9.00 percent to 10.00 percent, midpoint 9.50 percent, applied to The Laclede Group Inc's

("Laclede Group") September 30, 2009, common equity ratio of 57.41 percent. The Staff's recommended ROE is driven by the results of its single-stage, constant-growth, discounted cash flow (DCF) analysis of a group of comparable companies. The Staff continues to believe that the DCF methodology is the most reliable method available for estimating a utility company's cost of common equity.

Staff also employed a Capital Asset Pricing Model (CAPM) analysis using historical earned risk premiums and current U.S. Treasury bond yields as a test of reasonableness of its DCF result. Although its CAPM analysis resulted in lower estimated costs of common equity than the DCF analysis, Staff did not adjust its ROE recommendation downward due to Staff's continued concerns about the reliability of its CAPM results when using historical earned return spreads as an estimate of the current equity risk premium. However, Staff notes its CAPM estimate using an equity risk premium of 6 percent is within reasonable limits after considering lower long-term utility bond yields and stabilization of these yields. Staff will provide other information that corroborates these lower estimates and, therefore, supports the reasonableness and conservativeness of Staff's estimated cost of common equity for Laclede Gas.

Laclede Gas's credit rating is based on the credit quality of Laclede Group. Because Standard and Poor (S&P) does not rate Laclede Gas based on its stand-alone risk profile, Staff decided to use Laclede Group's actual consolidated capital structure, as of September 30, 2009, as the basis for its rate of return (ROR) recommendation. The use of Laclede Group's consolidated capital structure is also consistent with Staff's past capital structure recommendations in Laclede Gas rate cases. Although Staff is recommending the use of Laclede Group's consolidated capital structure in this case, Staff notes that this

capital structure is less leveraged than that of Laclede Gas. The Staff's resulting capital structure consists of 57.41 percent common equity and 42.59 percent long-term debt.

Staff did not include short-term debt and associated costs in its ROR recommendation due to the fact that these costs are recovered through Laclede Gas' purchased gas adjustment (PGA) clause. If Staff included short-term debt and associated costs in its ratemaking capital structure, this would result in double counting of such costs. Schedule 7 presents Laclede Group's capital structure and associated capital ratios. Staff's embedded cost of long-term debt of 6.51 percent is based on information provided by Laclede Gas in response to Staff Data Request No. 107. The Staff has prepared two attachments and 19 schedules that support its findings and recommendations in the cost-of-capital area. The attachments contain explanations of the DCF method and the CAPM. These attachments are denoted as Attachments A and B, respectively, to this Report. The schedules present numerical support for the Staff's ROR recommendation and are numbered as Schedules 1 through 19. The attachments and schedules can be found in Appendix 2 to this Report, with the attachments appearing first.

B. Legal Principles of Rate of Return

Rate of return witnesses are mindful of the constitutional parameters that guide the determination of a fair and reasonable rate of return. These parameters were announced by the United States Supreme Court in two seminal cases, *Bluefield Water Works and Improvement Company v. Public Service Commission of West Virginia* (1923) (*Bluefield*) and *Federal Power Commission v. Hope Natural Gas Company* (1944) (*Hope*).[1] The Court in *Bluefield* specifically stated:

[1] *Bluefield Water Works & Improv. Co. v. Pub. Serv. Comm'n of West Virginia*, 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923); *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943).

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.[2]

Similarly, the Court in *Hope* stated:

> The rate-making process, i.e., the fixing of "just and reasonable" rates, involves a balancing of the investor and the consumer interests. Thus we stated . . . that "regulation does not insure that the business shall produce net revenues." But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.[3]

From these Court decisions, the following principles can be discerned:

(1) A fair return is consistent with that realized from an investment in comparable companies, that is, an investment of comparable risk.

(2) A fair return is sufficient to assure confidence in the utility's financial integrity.

(3) A fair return is one that allows the utility to attract capital.

(4) A fair return is consistent with the current opportunity costs of investment.

[2] *Bluefield, supra,* 262 U.S. at 692-93, 43 S.Ct. at 679, 67 L.Ed. at 1182-1183.
[3] *Hope, supra,* at 603 (citations omitted).

While the legal requirements announced in the *Hope* and *Bluefield* cases have not changed, it is important to recognize that the methodology used to estimate a reasonable rate of return has evolved considerably since these cases were decided over 60 years ago. In fact, two of the most commonly used models in making rate of return recommendations, the DCF model (as used in utility regulatory ratemaking proceedings) and the CAPM, did not even become a part of mainstream finance until the 1960s. Likewise, capital markets are not confined to regional boundaries when determining the most efficient use of capital.

In mainstream finance literature, the DCF model, as used in utility ratemaking, is variously referred to as the dividend growth, Gordon growth or dividend discount model (DDM). This model was introduced by Myron J. Gordon for cost of common-equity determinations in 1962.[4] The use of this model for stock valuation purposes had been introduced before this time.

The basis for the CAPM was provided in 1964 by William F. Sharpe, who received the Nobel Prize in 1990 for much of his work in producing this model.[5] The CAPM is frequently used by investment bankers to estimate the cost of capital for purposes of discounting future cash flows to determine an estimated present value of an enterprise.

It is generally recognized that authorizing an allowed return on common equity based on a utility's cost of common equity is consistent with a fair rate of return. It is for this very reason that the DCF model is widely recognized as an appropriate model to use in arriving at a reasonable recommended ROE for a utility. The concept underlying the DCF model is to determine the cost-of-common-equity capital to the utility, which reflects the current economic and capital market environment. For example, a company may achieve an earned return on common equity that is higher than its cost of common equity. This situation will tend to increase

[4] Frank K. Reilly and Keith C. Brown, *Investment Analysis and Portfolio Management*, Fifth Edition, The Dryden Press, 1997, p. 438.
[5] Zvie Bodie, Alex Kane and Alan J. Marcus, *Essentials of Investments*, Richard D. Irwin, Inc. 1992, p. 11.

the share price. However, this does not mean that this past achieved return is the barometer for what would be a fair authorized return in the context of a rate case. It is the lower cost of capital that should be recognized as a fair authorized return.

The authorized return should provide a fair and reasonable return to the investors of the company, while ensuring that ratepayers do not support excessive earnings that could result from the utility's monopolistic powers. However, this fair and reasonable rate does not guarantee any particular level of return to the utility's shareholders.

Although neither the DCF model nor the CAPM were used for making rate-of-return-recommendations during the period in which the *Hope* and *Bluefield* decisions were made, state commissions (including the Missouri Commission) throughout the country have accepted these methodologies for purposes of estimating rates of return for utility ratemaking.

C. Overview of Laclede Group Inc.'s Operations, Financing and Staff's Proposed Approach for Estimating Laclede Gas Company's Cost of Capital

The following excerpt from Laclede Gas' Form 10-K filing with the SEC for the 2009 calendar year provides a good description of Laclede Group's and Laclede Gas' current business operations:

Overview:

> The Laclede Group, Inc. (Laclede Group or the Company) is a public utility holding company formed through a corporate restructuring that became effective October 1, 2001. Laclede Group is committed to providing reliable natural gas service through its regulated core utility operations while engaging in non-regulated activities that provide sustainable growth. All of Laclede Group's subsidiaries are wholly owned. The Regulated Gas Distribution segment includes Laclede Gas Company (Laclede Gas or the Utility), Laclede Group's largest subsidiary and core business unit. Laclede Gas is a public utility engaged in the retail distribution and sale of natural gas. Laclede Gas is the largest natural gas distribution utility in Missouri, serving approximately 630,000 residential, commercial, and industrial customers in the City of St.

Louis and parts of ten counties in eastern Missouri. The Non-Regulated Gas Marketing segment includes Laclede Energy Resources, Inc. (LER), a wholly-owned subsidiary engaged in the marketing of natural gas and related activities on a non-regulated basis. LER markets natural gas to both on-system Utility transportation customers and customers outside of Laclede Gas' traditional service territory, including large retail and wholesale customers. As such, LER's operations and customer base are subject to fluctuations in market conditions. Other subsidiaries provide less than 10% of consolidated revenues. As of September 30, 2009, Laclede Group had 1,762 employees, including 13 part-time employees.

On March 31, 2008, the Company completed the sale of 100% of its interest in its wholly-owned subsidiary SM&P Utility Resources, Inc. (SM&P) to Stripe Acquisition, Inc. (an affiliate of Kohlberg Management VI, LLC) for $85 million in cash, subject to certain closing and post-closing adjustments. SM&P was an underground facilities locating and marking business that formerly comprised Laclede Group's Non-Regulated Services operating segment. The sales agreement included representations, warranties, and indemnification provisions customary for such transactions and was filed as an exhibit to the March 31, 2008 Form 10-Q. In accordance with generally accepted accounting principles, the results of operations for SM&P are reported as discontinued operations in the Statements of Consolidated Income.

Other Pertinent Matters:

The business of Laclede Gas has monopoly characteristics in that it is the only distributor of natural gas within its franchised service area. The principal competition is the local electric company. Other competitors in Laclede Gas' service area include suppliers of fuel oil, coal, propane in outlying areas, natural gas pipelines which can directly connect to large volume customers, and in a portion of downtown St. Louis, a district steam system.

Laclede Gas' residential, commercial, and small industrial markets represent approximately 85% of the Utility's revenue. Given the current adequate level of natural gas supply and market conditions, Laclede believes that the relative comparison of natural gas equipment and operating costs with those of competitive fuels will not change significantly in the foreseeable future, and that these markets will continue to be supplied by natural gas. In the new multi-family and commercial rental market, Laclede Gas' competitive exposure is presently limited to space and water heating applications. Certain alternative heating systems can be cost competitive in traditional markets, but the performance and reliability of natural gas systems have contained the growth of these alternatives.

Coal is price competitive as a fuel source for very large boiler plant loads, but environmental requirements for coal have shifted the economic advantage to

natural gas. Oil and propane can be used to fuel boiler loads and certain direct-fired process applications, but these fuels require onsite storage, thus limiting their competitiveness. In certain cases, district steam has been competitive with gas for downtown St. Louis area heating users. Laclede Gas offers gas transportation service to its large user industrial and commercial customers. The tariff approved for that type of service produces a margin similar to that which Laclede Gas would have received under its regular sales rates.

Laclede Group has a current S&P corporate credit rating of "A" (Attachment C); and the following is an excerpt from an October 30, 2009, S&P credit-rating report on Laclede Group:

> LG's [Laclede Group] excellent business risk profile reflects reasonably supportive regulation by the Missouri Public Service Commission (MoPSC), a stable, largely residential customer base, diverse gas supply sources, significant gas storage capacity, and low operating risks characterize LG and Laclede Gas' excellent business profile. These strengths are moderated by below-average customer growth and higher risks associated with LG's unregulated activities. High leverage and somewhat weak cash flow measures characterize the companies' intermediate financial profile.
>
> The MoPSC provides favorable cost-recovery mechanisms, including recovery of capital expenditures and adjustments related to weather conditions. Effective Aug. 1, 2007, the MoPSC granted a $38.6 million rate and an allowed ROE of 10%. The MoPSC also granted provisions which allow the company to retain a portion of profits generated by off-system sales. Continued, favorable regulatory treatment related to increasing costs and infrastructure investments is critical to achieve financial metrics appropriate for current ratings.
>
> LG's unregulated businesses have higher risks than the regulated operations due to greater variability in cash flow generation. Laclede Energy Resources Inc. (LER) provides gas marketing services to large industrial and wholesale clients. LER's financial performance can vary dramatically with changes in commodity prices and price volatility, effectiveness of the company's hedge program, and competition. Financial performance at LER has improved primarily from a combination of additional firm transportation capacity, lower natural gas prices, and higher sales volumes. As a result of these factors, LG's unregulated businesses generated FFO of about $38 million for the 12 months ended June 30, 2009, compared with $24 million in fiscal 2008 and $21 million in fiscal 2007.
>
> Because the majority of debt is issued by Laclede Gas, the utility's stand-alone financial metrics are materially weaker than those of LG. As a result, Laclede Gas' stand-alone credit metrics remain slightly weak for the rating. At June 30, 2009, Laclede Gas generated FFO interest coverage of 3.7x, FFO to total debt of 18%, and total debt to capital of 57%. At June 30, 2009, LG's credit metrics

were appropriate for the rating with FFO interest coverage of 5x FFO to total debt of 25%, and total debt to capital of 51%.

The credit metrics of Laclede Gas are invariably weaker than those of Laclede Group because the long-term debt is issued by Laclede Gas. However, Laclede Gas's credit rating is based on Laclede Group's credit profile. In recent reports S&P has not explicitly stated its reason for rating Laclede Gas based on the consolidated profile of Laclede Group. However, in past reports, S&P stated that there aren't sufficient regulatory or structural barriers to restrict the payment of dividends to Laclede Group to warrant such consideration. As a result, Staff used the consolidated capital structure of Laclede Group to determine the recommended ROE and ROR for Laclede Gas.

Although Laclede Group's business risk profile is higher due its non-regulated operations, Staff considers Laclede Group's consolidated capital structure to be reasonable at this time for purposes of ratemaking. However, to the extent that Laclede Energy Resources, Inc.'s operations continue to require additional common equity than Laclede Gas, Staff will evaluate these circumstances in future rate cases.

Laclede Group's capital structure used for rate making comprises 57.41 percent common stock equity and 42.59 percent long-term debt. If short-term debt had been included, the ratios would have been 49.9 percent common stock equity, 37.57 percent long-term debt and 12.53 percent short-term debt. Short-term debt related costs, including reasonable line of credit fees, should be included with the recovery of short-term debt interest in the Purchased Adjustment (PGA) clause, construction work in progress and elsewhere as applicable.

Schedules 5 and 6 present historical capital structures and selected financial ratios, from 2005 through 2009, for Laclede Group. Laclede Group's consolidated common equity ratio has ranged from a high of 57.78 percent to a low of 50.40 percent from 2005 through 2009.

Laclede Group's consolidated earned ROE for the last five years has ranged from a low of 10.90 percent to a high of 12.50 percent from 2005 through 2009. Laclede Group's consolidated 2009 earned ROE was 12.40 percent. In a March 12, 2010, report in *The Value Line Investment Survey: Ratings & Reports*, Value Line estimates that Laclede Group's consolidated 2010 projected ROE will be 10.00 percent.

Laclede Group's historical-funds-from-operations (FFO) to interest coverage ratio for the previous five years has ranged from a low of 2.40 times in 2006, to a high of 4.49 times in 2009. Laclede Group's FFO to average total debt ratio for the previous five years has ranged from a low of 14.2 percent in 2007, to a high of 22.3 percent in 2008. Laclede Group's 2009 FFO to average total debt ratio was 21.50 percent.

D. Determination of the Cost of Capital

A utility's cost of capital is usually determined by evaluating the total dollars of capital for the utility company at a specific point in time, generally the end of the test year or update period. This total dollar amount is then apportioned into each specific capital component: common equity, long-term debt, preferred stock, and short-term debt. A weighted cost for each capital component is determined by multiplying each capital component ratio by the appropriate embedded cost or by the estimated cost of common equity component. The individual weighted costs are summed to arrive at a total weighted cost of capital. This total weighted average cost of capital (WACC) is synonymous with the fair rate of return for the utility company.

A company's authorized WACC is considered a just and reasonable rate of return under normal circumstances. From a financial viewpoint, a company employs different forms of capital to support, or fund, the assets of the company. Each different form of capital has a cost, and these costs are weighted proportionately to fund each dollar invested in the assets.

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

E. Capital Structure and Embedded Costs

As explained earlier in the report, the capital structure Staff used for this case is Laclede Group's capital structure on a consolidated basis as of September 30, 2009. Schedule 7 presents Laclede Group's capital structure and associated capital ratios. The resulting capital structure consists of 57.41 percent common stock equity and 42.59 percent long-term debt. The amount of long-term debt outstanding as of September 30, 2009 was $383,612,550 (See Schedule 8). The embedded cost of long-term debt for Laclede Group (and Laclede Gas since all long-term debt is issued by Laclede Gas) as of September 30, 2009, was 6.51 percent. Please see Schedules 8.

F. Cost of Common Equity

In order to calculate the cost of common equity for Laclede Gas, the Staff performed a comparable company analysis of seven companies because these companies have similar natural gas operations that are comparable to Laclede Gas. The Staff selected the DCF model (explained in detail in Attachment A) as the primary tool to determine the cost of common equity for Laclede Gas. The Staff also selected the CAPM (explained in detail in Attachment B) to check the reasonableness of the DCF results.

Staff started with a list of eleven market-traded companies classified as natural gas distribution utility companies by Edward Jones in its March 31, 2010, "Natural Gas

Industry Summary" report (See Schedule 9). This list was reviewed for the following criteria to develop a proxy group comparable in risk to Laclede Gas:

1. Classified as a natural gas distribution company by Edward Jones;

2. Stock publicly traded: this criterion did not eliminate any companies;

3. Information printed in Value Line: this criterion did not eliminate any companies;

4. Ten years of Value Line historical data available: this criterion did not eliminate any companies;

5. No reduced dividend since 2007: this criterion eliminated one company;

6. Projected growth available from Value Line and Reuters: this criterion eliminated three additional companies;

7. At least investment grade credit rating: this criterion did not eliminate any additional companies.

This final group of seven publicly-traded, natural gas distribution utility companies (the comparables) was used as a proxy group to estimate the cost of capital for Laclede Gas. The comparables are listed on Schedule 10.

It is debatable how much of an impact economic and business cycles have on the long-term growth rates of natural gas distribution companies. Because Laclede Gas's rate design is largely decoupled due to a relatively large amount of the revenue requirement being recovered in the first block, growth in earnings should largely be driven by customer growth. Therefore, at least for the residential class, if the contraction in the economy caused vacant housing, then this will cause a reduction in earnings from residential customers. Staff is not aware of any specific studies performed on the natural gas distribution industry that address the potential impacts of a low-growth economy on expected growth for natural gas distribution companies. The reason utility companies in general are considered to be safe investments is because the demand for

utility services is not expected to be as sensitive to economic cycles as other less essential goods and services. However, it is only logical to conclude that the growth, or lack thereof, of the real estate market would be a primary driver of earnings growth for a utility company. While some may argue that this is a risk factor which would require a higher rate of return, it also means that investors would expect very low growth or even negative growth in cash flows from this investment. It is important to understand these fundamental concepts when judging the reasonableness of an estimated cost of common equity.

The first step Staff performed in its constant-growth DCF analysis was to estimate a growth rate. The Staff reviewed the actual dividends per share (DPS), earnings per share (EPS), and book values per share (BVPS), as well as projected DPS, EPS and BVPS growth rates for the comparables. Schedule 11-1 lists the annual compound growth rates for DPS, EPS, and BVPS for the past ten years. Schedule 11-2 lists the annual compound growth rates for DPS, EPS, and BVPS for the past five years. Schedule 11-3 presents the averages of the growth rates shown in Schedules 11-1 and 11-2.

Staff also analyzed the projected DPS, EPS and BVPS as estimated by the Value Line analyst over the next five years for each company (See Schedule 12). The average of these projected growth rates was lower than the average of the five and ten-year historical averages. When comparing the EPS estimates from Value Line to equity analysts' EPS estimates from Reuters, Staff discovered a difference of over 100 basis points, with the Reuters estimates being higher (See Schedule 13). If there does not appear to be a consensus in expected growth among analysts, then this should cause investors to become more skeptical about projections. However, because the historical growth rates in this case support a growth rate range in between the

average projected growth rates, Staff believes it is reasonable for investors to expect growth rates in between these projected growth rates.

The next step was to calculate an expected yield for each of the comparables. The yield term of the constant-growth DCF was calculated by dividing the amount of DPS expected to be paid over the next 12 months by the market price per share of the firm's stock.

Staff decided to use a weighted average of the 2009 and 2010 projected DPS from Value Line to approximate investors' expected dividends over the next 12 months. Staff applied 75 percent weight to the projected 2010 DPS and 25 percent weight to the 2011 projected DPS. This is a reasonable proxy because if investors purchase any one of these stocks, this would be the amount of dividends they could reasonably expect to receive over the next 12 months.

It is important to ensure the selection of stock prices that reflect investors' current expectations of the business and economic climate. Staff believes the use of stock prices for the three months through the end of March 2010 is reasonable as this reflects investors' analysis of the current economic conditions over the most recent quarter and the impact it is having on their expectations of future returns and the risk of these returns. It should be noted that Staff's use of three months of average stock prices for the comparable group is different from its past practice of using four months of stock prices. Staff decided to make this change because most financial data is reported at least on a quarterly basis.

The monthly high/low averaging technique minimizes the effects on the dividend yield which can occur due to short-term volatility in the stock market. Schedule 14 presents the average high/low stock price for the period of January 1, 2010, through March 31, 2010, for each comparable.

Column 1 of Schedule 15 indicates the expected dividend for each comparable over the next 12 months as derived from the most recent Value Line report. Column 3 of Schedule 15 shows the projected dividend yield for each of the comparables. The dividend yield for each comparable was averaged to estimate the projected-average-dividend yield for the comparables of 4.25 percent. Considering the Commission's position regarding the quarterly-compounding of dividends expressed in its Report and Order in the most recent Union Electric rate case, Case No. ER-2008-0318, it is important to note that this dividend yield has not been adjusted for quarterly compounding. Staff is attempting to estimate investors' expectations and, because the Value Line quoted dividend yield does not reflect quarterly compounding, Staff is not convinced that investors' analyze the expected dividend yield on a quarterly-compounded basis.

As shown on Schedule 15, Staff's estimate of the proxy group's cost of common equity based on the projected dividend yield and a growth rate range of 4.75 to 5.75 percent is 9.00 percent to 10.00 percent.

To verify the reasonableness of the Staff's DCF cost of common equity, the Staff performed a CAPM cost of common equity analysis on the comparables. The CAPM requires estimates of three main inputs, the risk-free rate, the beta and the market risk premium. For purposes of this analysis, the risk-free rate Staff used was the yield on thirty-year U.S. Treasury bonds. The Staff determined the appropriate rate to be the average yield for March 2010. The average yield of 4.64 percent was obtained from the St. Louis Federal Reserve Bank website.

For the second variable, beta, the Staff used Value Line's betas for the comparable group of companies. Schedule 16 contains the appropriate betas for the comparables.

The final term of the CAPM is the market risk premium (R_m - R_f). The market risk premium represents the expected return from holding the entire market portfolio, less the

expected return from holding a risk-free investment. The Staff relied on risk premium estimates based on historical differences between earned returns on stocks and earned returns on bonds.

The first risk premium the Staff used was based on the long-term, arithmetic average of historical return differences from 1926 to 2009, which was 6.00 percent. The second risk premium used was based on the long-term, geometric average of historical return differences from 1926 to 2009, which was 4.40 percent. These risk premiums were taken from Ibbotson Associates, Inc.'s *Stocks, Bonds, Bills, and Inflation: 2010 Yearbook.*

Schedule 17 presents the CAPM analysis of the comparables using historical actual return spreads to estimate the required equity risk premium. The CAPM analysis using the long-term arithmetic average risk premium and the long-term geometric average risk premium produces estimated costs of common equity of 8.54 percent and 7.50 percent respectively.

Although Staff recommends that the Commission rely primarily on the Staff's cost-of-common-equity recommendation using its constant-growth DCF analysis in this case when authorizing a fair rate of return, the Staff recognizes that the Commission has expressed a preference in past cases to at least consider the average authorized returns as published by the Regulatory Research Associates (RRA).

According to RRA, the average authorized ROE for gas utility companies for the first quarter of 2010 was 10.24 percent based on nine decisions.

The average authorized ROE for gas utility companies for 2009 was 10.19 percent based on 29 decisions (first quarter – 10.24 percent based on four decisions; second quarter – 10.11 percent based on eight decisions; third quarter – 9.88 percent based on two decisions; fourth quarter – 10.27 percent based on fifteen decisions).

Although average authorized ROEs tend to garner the most attention in rate cases, it is also important to consider average authorized rates of return (RORs) to provide some context for average authorized ROEs. Some companies' costs of debt may cause their ultimate authorized return to be somewhat higher than the average. Although the cost of debt is only adjusted in extraordinary circumstances (for instance, in past Aquila rate cases, the cost of debt was adjusted to make it consistent with investment grade costs), there may be concerns about the reasonableness of these costs. Because it is the overall ROR (not the quoted average authorized ROE) that is applied to rate base to determine the revenue requirement, it would appear that this average would also be important in testing the reasonableness of the total cost of capital.

The average authorized ROR for gas utilities for the first quarter of 2010 was 8.20 percent based on ten decisions.

The average authorized ROR for gas utilities in 2009 was 8.15 percent based on 28 decisions (first quarter – 8.11 percent based on five decisions; second quarter – 8.05 percent based on seven decisions; third quarter – 8.30 percent based on two decisions; fourth quarter – 8.19 percent based on fourteen decisions).

It is important to note that Staff has not researched the specifics of the cases cited in the RRA reports.

G. Conclusion

Under the cost of service ratemaking approach, a WACC in the range of 7.94 percent to 8.51 percent was developed for Laclede Gas (See Schedule 19). This rate was calculated by applying an embedded cost of long-term debt of 6.51 percent and a cost of common equity range of 9.00 percent to 10.00 percent to a capital structure consisting of 57.41 percent common equity and 42.59 percent long-term debt. Therefore, from a financial risk/return prospective, as Staff

suggested earlier, Staff recommends that Laclede Gas be allowed to earn a return on its rate base in the range of 7.94 percent to 8.51 percent.

Through Staff's analysis, it believes that it has developed a fair and reasonable return, which, when applied to Laclede Gas' jurisdictional rate base, will allow Laclede Gas the opportunity to earn the revenue requirement developed in this rate case.

Staff Expert/Witness: Zephania Marevangepo

VI. RATE BASE

A. Plant in Service - Accounting Schedule 3

This Schedule reflects, by account, the Staff's rate base value of Laclede Gas' plant in service through March 31, 2010. The Staff's Adjustments to the September 30, 2009 test year balances are reflected in Adjustments to Plant – Accounting Schedule 4.

Staff Expert/Witness: Erin M. Carle

B. Depreciation Reserve - Accounting Schedule 5

Accounting Schedule 5, Depreciation Reserve, reflects, by account, the Staff's rate base value of Laclede Gas' depreciation reserve through March 31, 2010.

The Staff's Adjustments to the September 30, 2009 test year balances are reflected in Adjustments to Depreciation Reserve - Accounting Schedule 6.

Staff Expert/Witness: Erin M. Carle

C. Cash Working Capital (CWC)

1. Calculation of Revenue and Expense Lags

As part of Laclede Gas Company's Case Nos. GR-94-220, GR-96-193, GR-98-374, GR-99-315, GR-2001-629 and GR-2002-356, the Staff conducted a lead/lag study to determine

appropriate revenue and expense lags for its CWC analysis. Over the years, each of the Staff's lead/lag studies produced similar results for its revenue lag, as the following chart reflects:

Revenue Lag	GR-94-220	GR-96-193	GR-98-374	GR-99-315	GR-2001-629	GR-2002-356	GR-2005-0284	**GR-2010-0171**
Usage	15.21	15.21	15.30	15.21	15.21	15.21	15.21	**15.21**
Billing	2.90	2.92	3.30	2.93	2.98	3.17	3.17	**2.17**
Collection	21.30	20.43	21.07	25.40	25.40	25.18	25.18	**25.18**
Total	39.41	38.56	39.67	43.54	43.59	43.56	43.56	**42.56**

The lead/lag study developed as part of Case No. GR-2002-356 was relied upon by the Staff as part of Case No. GR-2005-0284. With exception to the billing portion of the revenue lag, the Staff used the lags that it developed as part of Case No. GR-2002-356 in the current rate proceeding. In past cases, the revenue billing lag utilized by the Staff was 3.17 days. However, in this case the Staff reduced the revenue billing lag by one (1) day to 2.17 days, in order to reflect the change in the Company's meter reading time attributable to the Automated Meter Read (AMR) program, which was fully implemented since the time of Laclede Gas' last rate case. The Staff recommends that all revenue and expense lags should be reviewed as part of the Company's next rate case.

Staff Expert/Witness: Lisa K. Hanneken

D. Natural Gas Underground Storage

Laclede Gas owns a natural gas underground storage field located in the St. Louis area. The Company generally fills storage in the summer and uses gas from this storage to serve its customers on cold days during the heating season.

The storage field and the natural gas in the storage field is a Laclede Gas investment. The natural gas in this storage field is recorded in one of three accounts as required by the

Federal Energy Regulatory Commission (FERC) Uniform System of Accounts (USOA). The natural gas included in FERC account 164.1 Gas Stored-Current, represents attainable natural gas that is used to meet seasonal demand increases. The balance in this account is addressed as part of the PGA/ACA process and therefore was not included in rate base in the cost of service calculation as part of this rate case. The natural gas in this storage field that is included in rate base is recorded in FERC accounts 117.10 and 352.30. The balance of inventory contained in FERC account 117.10 Gas Stored-base gas, also known as "cushion gas," represents the volume of gas that must remain in the storage facility to provide the required pressurization to extract current gas from the storage facility. The balance reflected in FERC account 352.30 is non-recoverable natural gas that is permanently embedded in the storage field and may never be extracted. Including this gas in rate base gives the Company the opportunity to earn a return on its investment for these items.

In June 2009, the Company made two adjustments to reclassify the amount of natural gas stored in its storage field and accordingly decreased the amounts recorded in account 164.1 and increased the amount of gas recorded in FERC accounts 117.10 and 352.30.

In its response to Data Request No. 158.1, the Company provided, as support for its natural gas storage reclassification adjustments, an undated Lange Storage Field Power Point presentation by NITEC LLC (NITEC). The Staff was given a hard copy of the Power Point presentation but not the presentation's underlying support, explanation, report or analysis.

Due to this lack of information Staff does not have a sufficient basis to accept the Company's storage reclassifications. Therefore, the Staff proposes an adjustment to plant in service in the amount of $3,981,224 to reduce the test year balance of natural gas recorded in

FERC account 352.30. This adjustment recognizes the amount of natural gas in this storage account prior to the Company's June 2009 reclassification.

Similarly, the Staff has included $5,884,285 in rate base for natural gas in storage recorded in FERC account 117.10. This is the amount of natural gas in this account prior to the Company's June 2009 reclassification of natural gas in storage.

In its response to Data Request No. 158.1, the Company also explains the cost of on-going storage losses from its Lange storage field were included in its PGA/ACA filings beginning in November 2009. The Staff will review the Company's proposed ratemaking treatment and claimed storage losses within the context of the Company's ACA case. Given the information provided at this time, the Staff does not agree with the Company's proposal to recover storage losses through the PGA/ACA process.

Staff Expert/Witness: Anne M. Allee

E. Laclede Gas Company Reliance on On-System Storage

Laclede Gas continues to rely on both of its on-system storage resources, propane supplies from its propane storage facility and natural gas from its St. Louis underground aquifer natural gas storage facility (Lange UGS), for its supply resources for a winter peak day and for cold winter requirements. The Staff recommends, therefore, Laclede Gas continue to maintain its propane and Lange UGS facilities as part of the regulated cost of service.

As a regulated gas corporation and a Local Distribution Company (LDC) providing natural gas service to Missouri customers, assuring reliability of supply is an essential function. The Company must make long-range supply plans and be responsible for implementation of those plans. The Company documents some if its plans in its Reliability Reports.

As outlined in the Mississippi River Transmission (MRT) pipeline tariff, as the MRT storage (a pipeline storage system) is drawn down during the winter months, gas deliverability decreases. Because of restrictions on storage withdrawals on the MRT storage and the Laclede Gas on-system resources (Propane and Lange UGS), Laclede Gas must consider the supply available to serve late winter cold weather. In its Reliability Reports, Laclede Gas includes a cold day in February as a crucial part of its late winter analysis.

1. Peak Day Requirements

The peak day for early and late winter in Laclede Gas' most recent 2009-2010 Reliability Report and the prior 10-years Reliability Reports are shown in Tables 1 and 2. Except for two earlier Reliability Reports, which noted that ** _____ _____ _____ ** The Reliability Reports do not provide estimates of future peak day requirements or Laclede Gas' supply plans for future years. The eleven Reliability Reports summarized here have stated ** _____ _____ _____ **

The largest changes in the past estimates of peak day requirements are highlighted in the tables below. The peak day estimate ** _____ _____ _____ _____ **

NP

Table 1 is Highly Confidential in its entirety.

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**

Table 2 is Highly Confidential in its entirety.

**

**

NP

2. Reliance on Laclede Gas Propane and Lange UGS, Early Winter Peak Day

Laclede Gas plans to use a ** _____

_____

_____

_____

_____

_____ ** For the early winter peak day, the Laclede Gas supply plans are to use ** _____ **.

3. Reliance on Laclede Gas Propane and Lange UGS, Late Winter Peak Day

Laclede Gas plans to use a ** _____

_____

_____

_____

_____

_____ ** For the late winter peak day, the Laclede Gas plans range from ** _____

_____ **.

NP

4. Possible Revisions to Reliance on Lange UGS, Early and Late Winter Peak Day Supply

The Company has undertaken an evaluation of the Lange field to assess the field's current and future capabilities, as reported for the fiscal year ending September 30, 2008.[6] The recent Reliability Reports do not include any discussion of the evaluation of the Lange field or address how the plans for a peak day may change based on the Lange UGS current or future capabilities. Laclede Gas contracted with ** _____

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_____

_____

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** _____

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_____

[6] The Laclede Group, Inc., Securities and Exchange Commission, Form 10-K, Annual Report for the Fiscal Year Ended September 30, 2009; page 23.

_____

_____

_____

_____

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_____

_____ **

A row is included in Tables 1 and 2 for ** _____

_____

_____

_____

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_____

_____

_____ **

5. Cold Winter Requirements and Reliance on Lange UGS and Propane

In addition to consideration of capacity and supply for peak cold day requirements, an LDC must consider its natural gas supply plans for various weather conditions. In its Reliability Reports, Laclede Gas summarizes its planning process to meet a ** _____

_____

_____

NP

_____ ** Review of thirty three years of weather data shows that the coldest winter was 1977-1978 with 5,039 HDD (123% of Normal) compared to 1935-1936 with 4,814 HDD (118% of Normal).

** _____

_____

_____

_____ **

The Reliability Reports do not provide estimates of requirements or supply plans for cold winters in future years.

** _____

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_____

_____

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_____ **

Prior to the plan for 2009-2010, Laclede Gas propane provided ** _____ _____ ** For 2009-2010, the Laclede Gas plan reduces this to ** ____ ** . The change in the propane plan is more clearly illustrated in Chart 1, attached to this report as Appendix 3.

Staff Expert/Witness: Lesa Jenkins

F. Prepayments

The amount Staff included for prepayments in rate base reflects a 13-month average ending March 31, 2009. The level of prepayments will be re-examined as part of the Staff's proposed true-up audit through June 30, 2010.

Staff Expert/Witness: Lisa K. Hanneken

G. Materials and Supplies

The Company maintains a variety of materials and supplies in inventory to meet its day-to-day needs in performing its utility operations. The Staff has included Laclede Gas' average balance of materials and supplies inventory that was maintained during the 13 months ending March 31, 2010. The level of materials and supplies will be re-examined as part of the Staff's proposed true-up.

Staff Expert/Witness: Erin M. Carle

H. Prepaid Pension Asset

The Staff has consistently included a prepaid pension asset in rate base in all Laclede Gas rate cases dating back to 2001 through the present case, GR-2010-0171. The prepaid pension asset represents the accumulated difference between the pension expense included in rates and Company's contributions to the pension fund as of March 31, 2010.

Staff Expert/Witness: Doyle L. Gibbs

I. Other Post-Employment Employee Benefits Asset

In Company's last rate case, GR-2007-0208, the Commission authorized the rate base inclusion of the difference between the amount of Other Post-Employment Employee Benefit (OPEB) expense included in rates established in Case No. GR-2007-0208 and the

amount funded during the period those rates were in effect. The OPEB asset included in rate base represents the accumulation of that difference as of March 31, 2010.

Staff Expert/Witness: Doyle L. Gibbs

J. Special Deposits

The amount of this item in Staff's Accounting Schedule 2, Rate Base, represents the 12-month average of the Company's special deposits at March 31, 2010. Special deposits include the cash deposited by the Company with federal, state or municipal authorities as a guaranty for the fulfillment of obligations.

Staff Expert/Witness: Lisa K. Hanneken

K. Customer Deposits

The amount of Staff's inclusion for customer deposits in rate base represents the balance at March 31, 2010. The Staff utilized this number as the appropriate level of customer deposits given the declining trend of this item. Customer deposits are funds received from the utility company's customers as security against potential loss arising from failure to pay for utility service. Until refunded, customer deposits represent a source of funds available to the company, and are included as an offset to the rate base investment. Generally, interest is calculated on customer deposits and paid to customers for the use of their money. The Staff adjusted expenses to include interest that the Company is required to pay based upon the balance of customer deposits that existed at March 31, 2010. The Staff will re-examine these balances as part of its proposed true-up audit through June 30, 2010.

Staff Expert/Witness: Lisa K. Hanneken

L. Customer Advances

Customer advances are funds provided to the Company by individual customers to assist in the costs of providing their service. Since these funds represent interest-free money to the Company, it is appropriate to include these funds as a reduction or offset to rate base. Unlike customer deposits, no interest is paid to customers for the use of their money. The amount of customer advances reflected on Staff's Accounting Schedule 2, Rate Base, represents the balance of the account at March 31, 2010.

Staff Expert/Witness: Lisa K. Hanneken

M. Deferred Income Tax Balance

Laclede Gas' deferred tax reserve represents, in effect, a prepayment of income taxes by Company's customers prior to payment by the Company. As an example, because Laclede Gas is allowed to deduct depreciation expense on an accelerated basis for income tax purposes, depreciation expense used for income taxes paid by the Company is considerably higher than depreciation expense used for rate making purposes. This results in what is referred to as a "book-tax timing difference," and creates a deferral of income taxes to the future. The net credit balance in the deferred tax reserve represents a source of cost-free funds to the Company. Therefore, Company's rate base is reduced by the deferred tax reserve balance to avoid having customers pay a return on funds that are provided cost-free to the Company. The balance reflects the deferred tax reserve as of March 31, 2010, the ordered update period for the direct filing in this case.

Staff Expert/Witness: Doyle L. Gibbs

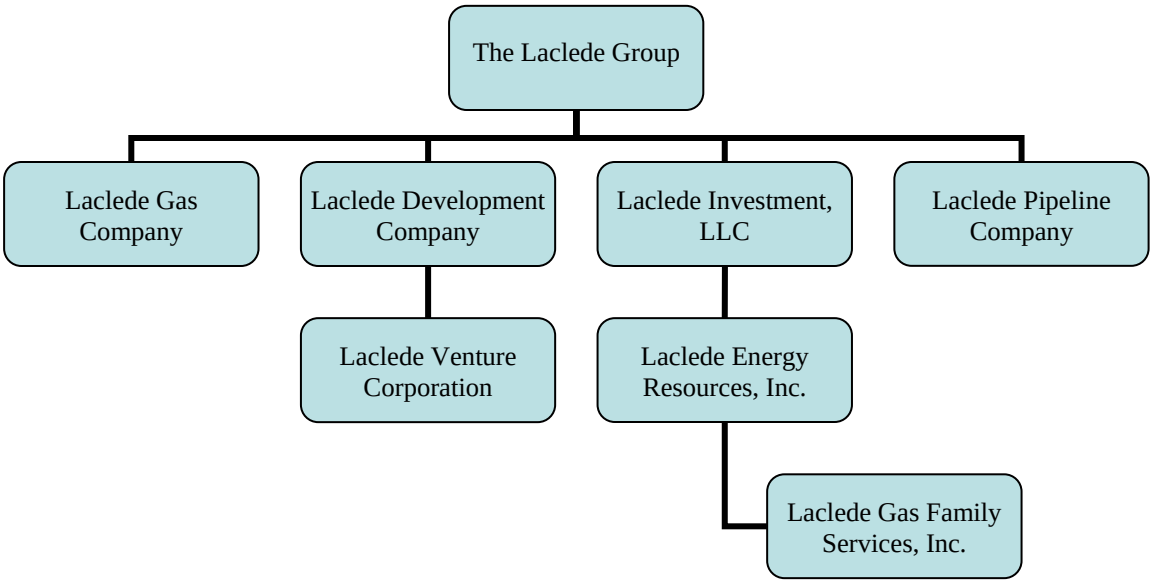
VII. ALLOCATIONS OF COSTS TO AND FROM AFFILIATED ENTITIES

A Allocations

This section discusses the Staff's recommendations concerning the reasonable allocation of expenses among the Laclede entities.

1. Corporate Relationships

Laclede Gas Company is a wholly owned subsidiary of The Laclede Group. The following chart shows the relationships between The Laclede Group and its subsidiaries.



Laclede Venture Corporation (Venture) offers services for the compression of natural gas to third parties who desire to use or to sell compressed natural gas for use in vehicles.

Laclede Pipeline Company (Pipeline) operates a propane pipeline that connects the propane storage facilities of Laclede Gas to propane supply terminal facilities located in Illinois.

Laclede Investment, LLC (Investment) invests in other enterprises and has made loans to several joint ventures engaged in real estate development.

Laclede Gas Family Services, Inc (Family Services) is a registered insurance agency in the State of Missouri and promotes the sale of insurance-related products.

Laclede Development Company (Development) participates in real estate development.

Laclede Energy Resources, Inc (LER) is engaged in non-regulated efforts to market natural gas and related activities.

Laclede Gas Company (Laclede Gas) is the largest natural gas distribution company in Missouri and is a regulated public utility.

The Laclede Group, Inc. (Group) is a public utility holding company that provides natural gas service through its regulated utility (Laclede Gas) while engaging in non-regulated activities. Laclede Group's main subsidiaries are Laclede Gas and LER.

2. Directors and Officers

Below is a chart showing the directors and officers of the above entities. Notably most of the individuals who are listed hold positions in several, if not all of the entities.

Assoc GC - Associate General Counsel
Asst Sec - Assistant Secretary
Asst VP - Assistant Vice President

CEO - Chief Executive Officer
CFO - Chief Financial Officer
CGO - Chief Governance Officer

Exc. VP - Executive Vice President
GC - General Counsel
VP - Vice President

	DEV	LER	FAM	GAS	GRP	INV	PIPE	VEN
Yaeger	Director President	Director President	Director President	Chairman President CEO	Director President CEO	Director President	Director President	Director President
Neises	Director	Director VP	Director	Director Exc. VP		Director	Director VP	Director
Waltermire	Director VP	Director VP	Director VP	Director Sr. VP CFO	 CFO	Director VP	Director VP	Director VP
Darrell				Sr. VP GC	 GC			
Rawlings	Director Treasurer Asst Sec.	Director Treasurer Asst Sec.	Director Treasurer Asst Sec.	 Treasurer Asst Sec.	 Treasurer Asst Sec.	Director Treasurer Asst Sec.	Director Treasurer Asst Sec.	Director Treasurer Asst Sec.
Kullman	Secretary	Secretary	Secretary	Secretary CGO	Secretary CGO	Secretary	Secretary	Secretary
Spotanski				Director Sr. VP			 VP	
Abernathy				VP				
Fallert				Controller				
Geiselhart				VP	VP			
Godat		VP						
Hoeferlin				Asst VP				
Jaskowiak		VP						
Mathews				VP				
McReynolds				VP				
Pendergast				VP				
Rasche				VP				
Skau				Sr. VP				
Theroff			VP	Asst VP Assoc GC				

3. Services Provided

Each of the subsidiaries of Group, as well as Group itself, have an agreement with Laclede Gas which allows them to request ** _____ _____ _____ _____ **

In addition, the affiliates may also be provided with services performed by Laclede Gas employee. While the opportunity to share certain administrative and other functions may introduce efficiencies, it may also lead to inappropriate cross-subsidization. Laclede Gas maintains a Cost Allocation Manual (CAM) which contains general information concerning the relationships between affiliates. Staff was able to determine through data requests that Laclede Gas employees perform many duties for LER including:

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Staff believes there are many more tasks performed by Gas employees than listed above that Staff is not aware of due to minimal CAM details.

4. CAM Discussion

There are several types of allocations made to the various subsidiaries for the variety of services provided by Laclede Gas. The Company chooses the method it utilizes to allocate each of it expense categories. In some cases, Laclede Gas chose a three factor methodology for making its allocations, in other cases it choose to use different criteria.

The Company's CAM lists the following twelve sections of allocated costs:

Annual Reporting – all costs for this category are included in the Laclede Group Miscellaneous section and allocated to all affiliates based on the Company's three-factor method which is a composite percentage including plant, payroll and revenues.

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Directors and Officers - this category contains life insurance, directors and officers insurance and group insurance for the directors and officers. This category is allocated based on the three-factor allocation.

Corporate Costs - includes pension expense for the directors, director's fees and expenses, dividend notices, and stockholder's meeting costs. This category is also allocated on the three-factor allocation method.

Laclede Group Miscellaneous - includes all Laclede Group costs. This would include all allocated labor costs and benefits, depreciation, etc. As well as costs incurred directly by Group, including items such as dues, and other miscellaneous expenses. This category is allocated based on the three-factor allocation.

Outside Audit - includes costs for external audits. This category is allocated based on the three-factor method.

Depreciation – Furniture and Fixtures - includes the amount of depreciation on the equipment and furniture used by Laclede Gas employees during the provision of service to the affiliates. Therefore, this is allocated based on the percentage of wages allocated to each affiliate.

General and Administrative Expense - includes all expenses under FERC 921. The account 921 description shows this account consists of:

The cost of office supplies used and expenses incurred by the Accounting, Financial Services, Tax and Payroll Departments in the general administration of their departmental functions. The following is illustrative of the type of items which should be charged to this account when the cost is incurred by or for the Accounting, Financial Services, Tax or Payroll Departments.

1. Local transportation expenses.
2. Books, periodicals, bulletins, subscriptions to newspapers, etc.
3. Communications service expense.
4. Rental of office equipment and purchase of minor items of office equipment properly chargeable to expense.
5. Membership fees and dues in trade, technical and professional associations for personnel described above and coincidental expenses of membership and attendance.
6. Office supplies, postage and expenses.
7. Travel expenses, as paid by the Company in accordance with existing policy.
8. Printing and stationery expense (including clearing account distribution).

This category is also allocated based on the percentage of wages allocated to each affiliate.

However, the CAM notes that this category does not include costs specifically attributable to an affiliate and therefore directly charged to the books of the affiliate using standard voucher account distribution procedures. By not including these direct costs in the Company's CAM, it is not possible for Staff to determine the allocation between the affiliates and Laclede Gas.

Property and Liability Insurance - includes costs for property, excess liability and workers compensation insurance for those affiliates that the Company believes benefit from the insurance; which are Laclede Pipeline Co. and Laclede Venture, Corp. This allocation is based on net assets. The other affiliates do not carry large enough property balances on their books to warrant an allocation of insurance since Laclede Gas provides most of the assets required as a service to the affiliates

Rent - includes an allocation of physical office space and storage of primary location based on the number of employees and square footage at the General Office building at 720 Olive Street, St. Louis Missouri. Rent is allocated based on the percentage of payroll allocated to each affiliate.

Personnel Costs - includes the amount of labor, benefits and taxes related to employees providing services to affiliates and allocated based on two methods. The first method is by utilizing Form 68, which allows each individual allocating employee to record his or her time based on hours worked for each entity. The second method is generally used by managers and officers and is based on a fixed allocation rate.

EDP System Expense - includes the expenses and labor costs related to Information Systems including Laclede Gas' mainframe and network. These costs are allocated based on two methods. The first allocates based on general ledger transactions. The second utilizes the amount of network nodes (stations) utilized by each affiliate.

Energy Related Goods and Services - is the sale or release of natural gas supplies and transportation/storage capacity. This category is allocated based on fair market value.

Given the nature of this category, Staff did not include this allocation in its allocation review. All numbers and data represented below also do not include this category.

Laclede Gas' annual CAM report is not clear as to the exact charges to affiliates. This is problematic in that Staff is unable to clearly determine the amount and type of services received by each affiliate and whether the allocation of costs is reasonable or whether cross-subsidization

is occurring. In contrast, in their annual CAM reporting other large Missouri utility companies, such as AmerenUE and Missouri American Water Company, provide a breakdown of the amounts of direct and indirect costs charged to affiliate entities receiving service. The Staff is able to trace transactions more easily, providing Staff with the transparency to determine the reasonableness of allocations of costs and expenses to their affiliates.

Identification of charges is an important part of the Staff's allocation analysis because the Staff must be able to see the entire universe of costs Laclede Gas allocates to its affiliates to ensure that all related overhead costs are being properly allocated and to ensure that cross-subsidization is not occurring.

5. Amount of Fiscal Year 2009 CAM Allocations

During the test year, Laclede Gas allocated a total of ** _____ ** for expenses (exclusive of the Energy Related Goods and Services category). This amount represents ** _____ ** of Laclede Gas' total allocated expense. Attached as Appendix 4, to this report is a schedule showing the breakdown of all the categories and amounts allocated by Laclede Gas. In addition, the schedule shows the details of the allocation of expenses from Laclede Group to its subsidiaries for the category 'Laclede Group Miscellaneous Expenses'. During the test year, the amount of expenses incurred by Laclede Group was ** _____ **, of which Group allocated ** _____ **, leaving ** _____ ** on its books. The bulk of the allocation was to Laclede Gas in the amount of ** _____ ** which represents ** _____ ** of total Group cost.

6. Findings and Adjustments

In this case the Staff reviewed and analyzed Laclede Gas' CAM and allocation policies and procedures as well as the books and records related to its allocations. The Staff has found

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several items it believes should be corrected or modified based on its research. The Staff is not advocating the formation of a service corporation to provide services to Laclede Gas and its affiliates, rather Staff is recommending certain changes to the current processes, policies and procedures related to the proper allocation of costs to the affiliates, as well as modifications to the Company's CAM reporting. The Staff is addressing these items either through adjustments to its revenue requirement calculations or through recommendations for changes to Laclede Gas' policies, procedures or future CAM submissions.

7. EDP System Expense Allocation

As discussed above, the Laclede Gas' information systems (IS) allocations rely on two factors. One uses the relationship of general ledger transaction to allocate that system cost, and the other uses network nodes to allocate other IS costs. Laclede Gas looks at the prior year's level of transactions or network nodes in order to calculate the allocation percentage for the current year. According to the Company's response to Staff's Data Request No. 229, the IS node report for the actual 2009 time period, there were eight nodes show for ** ____ **, however according to the Company's response to Staff's Data Request No. 195, in October 1, 2008, there were ** __ ** Laclede Gas employees allocating ** _____ ** of their time to ** _____ _____ ** At the end of FY 2009 ** _____ _____ ** It does not seem feasible that ** __ ** employees share 8 network nodes, therefore, Staff questions the allocations for IS costs to ** _____ **

The Staff also questions how Laclede Gas allocates costs related to those employees who allocate a portion of their time to an affiliate. For example, if an employee were to allocate 5% of their labor costs, then benefits, payroll tax, office supplies, miscellaneous expense, furniture depreciation and rent related to that employee would all be allocated to the appropriate affiliate

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at that 5%. However, Staff is not aware of any procedures to allocate this cast based on an employee's partial time allocation.

Staff recommends Laclede Gas adjust its apportionment of costs to properly allocate IS expenses.

8. The Laclede Group Sign Expense

During the spring of 2008, Laclede Group installed a huge lighted sign at the top of the building located at 720 Olive Street, St. Louis, Missouri. The sign consists of the words "Laclede Group" and its logo. During its audit Staff discovered that the costs of this sign were charged entirely to Laclede Gas. The Staff removed both the capital and maintenance costs of the Laclede Group sign from Laclede Gas' cost of service. The sign is unnecessary for the provision of safe and adequate service and ratepayers should not bear any of the costs in rates. Attached as Appendix 4, is Company's response to Staff's Data Request No. 205 which details this cost.

9. Miscellaneous Expense

Travel expenses are included as part of the General and Administration Expense category and based on the percentage of wages being allocated to the affiliates. While this methodology may appear equitable, the Staff believes that it actually highlights the cross-subsidization issue. First, incorrect time reporting by employees skews the amount of the travel expenses allocated to the affiliates. The larger issue, however, is that some of the entities do not require travel. The Staff recommends this expenses be allocated on a direct charge basis, be clearly shown on the Company's CAM annual report along with all other direct charges

10. CAM allocation factors

The Staff adjusted the Corporate Cost category of the Company's CAM to reflect allocations based on a revenue factor. In its workpapers Staff included the adjusted level of Director's fees, which were annualized by Staff Witness Erin M. Carle, in addition to the other costs in this category. The Staff also used the revenue factor to adjust the Directors and Officers, and Laclede Group Miscellaneous Expense categories.

11. Time Allocations

In its review the Staff found several areas of time allocation that require corrections or additions to Laclede Gas' policies, procedures, and/or future CAM annual reporting in order to accurately record and reflect these items.

For example, the Staff found that employees receive minimal informal training regarding proper allocation of their time and the proper method of recording their time allocation. In addition, the Company relies on it employees to follow its Code of Business Conduct to ensure proper allocation. It is up to each employee to decide whether an allocation is necessary and to determine the amount of any allocation. The Staff recommends the Company review its training, policies, and internal audit procedures to make certain that proper allocations are made by its employees.

As explained above employees that allocate time to the affiliates do so either through the fixed method or the variable method.

12. Fixed Time Allocation Method Review

Laclede Gas' fixed allocation method is flawed for several reasons. First, this method lets each employee set the fixed allocation percentages, used to allocate their time, based on their own determination of the amount of time spent on each affiliate. It is the Staff's understanding

that each employee may use whatever method they choose to determine these percentages. The allocation may be based on previous time period's agendas and schedules or simply an "idea" of what they believe to be the correct percentage. While employees may adhere to the Company's Code of Business Conduct, and are diligent about correctly determining and updating their percentages, the lack of policies, procedures, formal training and guidance makes it impossible for Laclede Gas to assure its customers are paying only for employee time devoted to providing safe and adequate service. It is also impossible for the Staff to assure the Commission that proper allocations are being made.

Examples of this can be found with several of the Company's employees. For example, as revealed in response to Staff's Data Request No. 214, ** _____ _____ _____ _____ ** Attached as Appendix 4, is Company's response to Staff's Data Request No. 214 which details his duties. In order to address the deficiency ** _____ _____ **.

The Staff also made an adjustment to correct ** _____ _____ _____ _____ **. In order to make this adjustment, Staff utilized the percentage of time allocated by other employees as an indication of proper allocation.

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In addition, the Staff made adjustments to other employees which had similar issues with their time reporting.

The Staff also reviewed the time allocation records for ** _____ _____ _____ _____ _____ _____ _____ _____ _____ _____ _____ ** The Staff's review revealed that five of these individuals failed to allocate any time to affiliates for which they are officers.

Another flaw found by the Staff is the fact that the fixed allocation percentages are only revised every one to two years, or when a major event occurs, such as the sale of a large business segment. While employees may change their percentages whenever warranted, such as when they receive a promotion or assume different duties, it was represented to the Staff that most fixed allocation employees only assess their percentages when prompted to do so by the person responsible for the CAM recordkeeping during the revision period.

In order to correct these obvious faults in the Company's time allocation process, the Staff has made adjustments to appropriately attribute officers' work hours to affiliated companies.

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13. Variable Time Allocation Method

During its review, the Staff noted that most of the variable employees seem to allocate their time with some degree of diligence; however the Staff cannot conclusively state that these allocations are correct given that each employee assigns their time based on their personal timekeeping methods. The Staff also found that there is no formal training provided to employees regarding the proper procedures to use, other than the reliance on the employee's adherence to the Company's Code of Business Conduct. The Staff is not aware of any oversight of individual time records by supervisors.

In addition, during the Staff's review it was observed that some variable employee's allocate their time exactly the same way every month. While some employee's duties may entitle the same tasks with the same about of time, the Staff has concerns as to whether this is always the case, given the lack of formal training, guidance, procedures and supervision of employee's time allocations. The Staff's concern is heightened by the lack of ability to verify the allocation.

The Staff also encountered an entire department that seemed to incorrectly allocate their time to affiliated companies. **

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** Attached as Appendix 4, is Company's response to the Staff's Data Request No. 219 which provides more details on this issue.

14. Separation of Entities

As stated previously, the Staff believes Gas employees perform numerous tasks for its affiliates and in some cases the Staff is concerned that there is not proper separation of the entities.

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One example of the lack of separation is noted in response to Data Request No. 212 which states that Mary Kullman and Lynn Rawlings and their respective administrative assistants have keys to the vault where all corporate and affiliate documents are kept. Ms. Kullman is the Secretary of all Laclede companies and Chief Governance Officer for both Gas and Group. Ms. Rawlings is the Treasurer and assistant secretary of Laclede Group and all affiliated companies. In addition, as noted above ** _____ _____ **.

Another area of concern is that Mr. Neises is an operational Vice President of Laclede Gas Company, Pipeline and LER, and therefore has access to all of Gas', pipeline's and LER's confidential gas purchasing and marketing information and strategies.

15. Summary and Reporting Recommendations

The Staff has serious concerns that the Company's policies, procedures and methods for its allocation of costs to its various affiliates is inadequate to prevent Laclede Gas' customers from paying expenses that are related to affiliates. The Staff's concerns are based on the lack of information detail provided by the Company with regard to allocation record keeping and reporting. Therefore, the Staff reserves the right to make further adjustments and recommendations regarding the Company's allocation procedures throughout this rate case based on any additional data it may obtain.

In addition to the above recommendations, the Staff recommends the Commission require modifications be made to the Company's annual CAM report to include data that would clarify the Company's allocations and methods, as well as provide the transparency required for the Staff to properly analyze the Company's allocations. These modifications at a minimum would include:

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- Inclusion of all supporting documentation, including the data provided in response to Staff's Data Request No. 198. Staff would recommend this data be segregated by month.
- Inclusion the data provided in response to Staff's Data Request No. 121, regarding employee time allocation
- Separation of direct and non-direct costs

Staff Expert/Witness: Lisa K. Hanneken

VIII. INCOME STATEMENT

A. Rate Revenues

1. Introduction

Since the largest component of operating revenues result from rates charged to Laclede Gas' retail customers, a comparison of operating revenues with cost of service is fundamentally a test of the adequacy of the currently effective retail gas rates. If the overall cost of providing service to retail customers exceeds operating revenues, an increase in the current rates Laclede Gas charges its retail customers for gas is required. One of the major tasks in a rate case is to determine to what degree a deficiency (or excess) between cost of service and operating revenues exists. Once determined, the deficiency (or excess) can only be made up (or otherwise addressed) by adjusting retail rates (i.e., rate revenues) prospectively.

2. Definitions

Operating Revenues are composed of three components: (1) Rate Revenue; (2) Late Fees; and (3) Other Operating Revenue. The definitions of these components are as follows:

Rate Revenue: Test year rate revenues consist solely of the revenues derived from Laclede Gas' authorized Commission charges for providing natural gas service to its retail customers. Laclede Gas' variable charges are determined by the amount of each customer's usage and the (per unit) rates that are applied to that usage. Each customer also pays a flat monthly customer charge depending on each customer's rate class. These rate classes include

residential, commercial, industrial, large volume, transportation, interruptible, unmetered street lighting, and vehicular fuel customer classifications.

Late Fees: Includes charges for fees related to late payments by customers.

Other Operating Revenue: Other operating revenue includes incidental oil sales, rental of gas property and capacity release and off-system sales.

Each of these charges are also established by the Commission, and all of these revenue items are taken into account in setting retail rates for Laclede Gas' gas service to customers.

3. The Development of Revenue in this Case

To determine the level of Laclede Gas' revenue, the Staff has applied standard ratemaking adjustments to test year (historical) sales (Ccf) and revenue data. The Staff makes these adjustments to test year rate revenues in order to determine the level of revenue that the Company would collect on an annual basis, under normal weather or climatic conditions, based on information that is "known and measurable" as of the end of the update period. In this particular case, the test year is the 12 months ending September 30, 2009, and the update period ends March 31, 2010. Revenue has been developed and summarized by the Staff in two different ways: (1) by type of regulatory adjustment; and (2) by total revenue by rate class. The Staff workpapers provide the source numbers and analysis, as well as a more detail. This Report describes the five major regulatory adjustments the Staff made to test year billed rate revenues:

a. weather normalization
b. 365-day adjustment
c. customer growth
d. large customer annualization
e. removal of gas costs
f. removal of off-system sales and capacity
g. removal of Gross Receipts Tax amounts
h. removal of Infrastructure System Replacement Surcharge (ISRS) amounts

Not all of these adjustments affect both sales and rate revenue, and not all rate classes require all five adjustments.

Other revenue adjustments proposed by the Staff in this proceeding are also briefly described in the following COS Report sections.

Staff Expert/Witness: Lisa K. Hanneken

4. Regulatory Adjustments to Test Year Revenue

a. Adjustment for Unbilled Revenues

The Staff eliminated unbilled revenue from its determination of revenue requirement. The recording of unbilled revenue on the books of the Company is an attempt to recognize the sales of gas that have occurred, but have not been billed to the customer. Since the Staff has adjusted revenues to assure that it includes only 365 days of revenue, and since the revenues have been restated to a billed basis, it is unnecessary to recognize unbilled revenue.

Staff Expert/Witness: Lisa K. Hanneken

b. Adjustment to remove Gas Costs

All revenue adjustments in the Staff's cost of service were priced on the margin rate (the total rate excluding gas cost) included in the Company's tariffs. Therefore, revenues and expenses related to gas costs were removed from the Staff's revenue requirement calculation. The cost of gas will be addressed as part of the Staff's review of the Company's Purchase Gas Adjustment (PGA) and Actual Cost Adjustment (ACA) filings.

Staff Expert/Witness: Lisa K. Hanneken

5. Adjustment to remove Off-System Sales and Capacity

Revenue and expenses from off-system sales and capacity have been removed from the Staff's determination of the Company's revenue requirement, since these items are also addressed through the PGA/ACA process.

Staff Expert/Witness: Lisa K. Hanneken

6. Adjustment to Remove Gross Receipts Tax (GRT)

The Company acts as a collector for taxes imposed on utility service revenues by municipalities and other taxing jurisdictions. The GRT included on a customer's bill is collected by the Company and remitted to the appropriate taxing jurisdiction. The GRT included on a customer's bill is recorded as revenue on the books of the Company with a corresponding charge to GRT expense. Theoretically, the revenue and expense offset one another and therefore, have no effect on net income. However, the expense accrual for GRT does not always match perfectly with the GRT included in revenue due to timing differences in the collection and payment of the GRT. Eliminating the GRT recorded in revenue and expense through companion adjustments assures that GRT will have no impact on the calculation of net income or revenue requirement. In addition, the Staff adjusted the Company's level of Uncollectible expense to account for GRT taxes not paid by those customers whose bill amounts are written off.

Staff Expert/Witness: Lisa K. Hanneken

7. Adjustment to Remove Infrastructure System Replacement Surcharge (ISRS) Amounts

During the test year, the Company collected revenues from the surcharges approved by the Commission through the ISRS mechanism. These revenues must be removed from the test year in order to reflect the current on-going level of permanent rate revenues. These surcharges

will expire, in other words, will be reset to zero and included in rate base at the time new rates are established by the Commission in this rate proceeding.

Staff Expert/Witness: Lisa K. Hanneken

8. Regulatory Adjustments to Test year Sales and Rate Revenue

a. Weather Normal Variables Used for Weather Normalization

This Commission uses a "test year" to determine revenues and set appropriate rates. Natural gas usage and revenue vary from year to year based on weather conditions. Since each year's weather is unique, test-year sales need to be adjusted to "normal" weather. Climatological normal weather is characterized as an average daily temperature for each day, calculated over a 30-year period. Currently, the time period used by the Staff in determining the normal values of weather variables is the 30-year period (January 1, 1971 to December 30, 2000), which is used by the U. S. National Oceanic and Atmospheric Administration (NOAA) and the World Meteorological Organization (WMO) to calculate normal weather variables.

Natural gas sales are predominantly influenced by ambient air temperature, so daily average temperature and the derivative measure, heating degree days (HDD), are the measures of weather used in adjusting natural gas revenues. Degree days are weather measures that were originally devised to evaluate the relationship between temperature and energy demand and consumption. Degree days are based on how far the daily average temperature (average of daily maximum and daily minimum) departs from a comfort level of 65 °F. HDDs are calculated as the number of degrees the daily average temperature is below 65 °F, and is equal to zero when the daily average temperature is above 65 °F.

To develop "normal" average temperatures and HDDs Staff used weather records from the weather station at St Louis Lambert International Airport, MO (STL). The STL weather

station is designated by the NOAA as a "First Order Weather Station". These First Order Weather Stations are usually located at regional or municipal airports, where professional observers continuously monitor the weather instruments. The NOAA-certified instruments at STL record daily maximum and minimum temperatures, with hourly observations of precipitation, temperature, dew point, wind and other weather elements.

NOAA initially calculates *monthly normal* temperature variables (such as maximum, minimum, average temperatures, HDDs) over the 30-year normals period, these monthly normals are not directly usable for Staff's purposes because NOAA's daily normals are derived by statistically fitting smooth curves through these monthly values. As a result, the published values reflect smooth transitions between seasons. However, for weather normalization Staff needs to examine seasonal variability, as this variability affects usage through the year. Consequently, Staff develops *daily normal* temperature variables by adjusting actual daily temperature data such that the average of the adjusted daily temperature variables corresponds with NOAA's normal monthly average.

Using these temperature variables Staff calculates Normal and Actual heating degree days (HDDs) to weather normalize gas usage. To determine daily normal HDDs Staff averages the adjusted daily actual HDDs for each calendar date. For example, the 30 observations of actual HDDs for January 1, of each year for the years 1971 through 2000, were averaged to determine the normal HDDs for January 1. The normal peak-day HDDs for each of the 12 months were calculated as the average of the HDDs of the coldest day in each of the 12 months.

Schedule ML-1, attached to this report as Appendix 5, presents calendar month summaries of the adjusted daily actual and normal HDDs during the test year for Laclede Gas.

The weather data shows that the test year (October 1, 2008- September 30, 2009) was approximately 3% warmer than "normal" for Laclede Gas's service area. This information was made available to Staff witnesses Kim Cox to use in calculating weather normalization adjustment factor.

Staff Expert/Witness: Manisha Lakhanpal

b. Weather Normalization of Sales

This analysis addresses the Staff's weather-normalization of natural gas sales for Laclede Gas' customers in the Residential Class (Res), the Commercial and Industrial (C&I I, II and III) classes, and the Propane (LP) class for the test year ending September 30, 2009. Natural gas is predominately used for space heating in Missouri and, therefore, sales are dependent upon weather conditions. Since rates are based on natural gas usage it is important to remove the influence of abnormal weather from the test year.

The Staff's weather-normalized adjustments of natural gas sales correct for deviations from normal weather conditions that have occurred during the test year. The Staff adjusted monthly natural gas volumes to normal by first equalizing each billing cycle's annual total normal heating degree days (HDDs). The Staff then added or subtracted a number of days to make each billing cycle's annual total days equal to 365. This adjustment for days sets each billing cycle to the same total number of days and normal HDDs. Once each billing cycle has the proper normal HDD, the second step is to calculate each billing cycle's difference between normal and actual HDDs. The third step is to multiply these differences times the appropriate estimate from the regression results. The fourth step is to sum each billing cycle's adjustment volumes by billing month. The fifth step is to add the monthly adjustments in Therms to the total monthly natural gas sales to calculate normalized volumes.

The Staff completed these calculations by first subdividing Laclede Gas' billing records into five geographic regions – St. Charles Division, Laclede Division, Midwest Division, Missouri Natural Division, and Franklin Division. Staff witness Manisha Lakhanpal provided the daily actual and daily normal HDDs for the St. Louis Lambert International Airport, MO (STL). Ms. Lakhanpal addresses the calculation of HDDs as part of her section included in this cost of service report.

Laclede Gas provided the Staff with monthly natural gas sales in Therms (one hundred thousand British Thermal Units, or BTUs) and the corresponding number of customers for each billing cycle by customer class and geographic region for each month of the test year. (Note that in data furnished by the Company, the Company uses the term Bills rather than Customers when referring to monthly Therm usage.) The Company groups natural gas accounts into billing cycles whose meters are to be billed throughout a month. The Company bills the accounts based on the meter reading. Since there are approximately twenty-one (21) working days in a month, customers' accounts are usually grouped into one of the approximately twenty-one (21) billing cycles. Staggering the billing of customers' accounts over the billing month spreads the amount of work necessary to bill Laclede Gas' customers. The Staff calculated two sets of twelve billing month averages by customer class for the Residential, C&I I, II and III, and Propane classes in the five geographic regions specified above. One set of these averages was the daily average natural gas usage in Therms and another set was the daily average HDD.

These billing month averages were calculated from the data on numbers of customers, natural gas usage in Therms, and summed HDD from approximately twenty–one (21) billing cycles for each billing month by customer class. Each billing month's daily average HDD in each billing cycle was weighted by the percentage of customers in that billing cycle. Thus, the

billing cycles with the most customers are given more weight in computing the billing-month daily average HDD. The Staff calculated twelve monthly average-usage-per-customer amounts across the billing cycles to calculate one month's daily average usage in Therms. The Staff's studies estimate the change in usage in Therms related to a change in HDD based on the two sets of twelve monthly billing month averages of average daily usage in Therms per customer and the customer-weighted average daily HDD. These two sets of billing month averages (usage and weather) were used to study the relationship between space-heating natural gas usage in Therms and colder weather.

The Staff used regression analyses to estimate the relationship for each of the Residential, C&I I, II and III, and Propane customers in the five geographic regions listed above. The regression equation develops quantitative measures that describe the relationship between daily space-heating sales per customer in Therms to the daily HDD. The regression equation estimates a change in the daily natural gas usage per customer whenever the daily average weather changes one HDD.

The Staff's analyses resulted in increases to natural gas sales because the weather during the test year was warmer than normal. The Staff's analyses resulted in an approximate 2.62 percent increase from natural gas sales for the residential customer class and for the C&I general service class I, II and III increases of 2.78 percent, 2.25 percent and 2.07 percent respectively and 1.64 percent for the propane customer. (Appendix 6, Schedules K-1 through K-14). These results include an increase of 139,958.8 Therms for class C&I II and an increase of 2,874,602.2 Therms for class C&I III for the customers that switched rate classes. The increases to natural gas sales do not include the Staff's customer growth annualization.

After calculating the adjustment to natural gas sales, the Staff then applied the adjustment to Laclede Gas' current General Service (GS) blocks. Laclede Gas' rates are differentiated according to a commodity charge that is divided into two blocks. The first block differs according to the rate class and the season of the year. The summer billing months are May through October and the winter billing months are November through April. For the residential customers, the *first block, or initial block,* is defined as the first thirty (30) Therms of natural gas used in the month and the *second block, or tail block,* is defined as all volumes over thirty (30) Therms per month. For the C&I Class I customers, the *first block* is defined as the first fifty (50) Therms of natural gas used in the month and the *second* block is defined as all volumes over fifty (50) Therms per month. For the C&I Class II customers, the *first* block is defined as the first five-hundred (500) Therms of natural gas used in the month and the *second* block is defined as all volumes over five-hundred (500) Therms per month. For the C&I Class III customers, the *first* block is defined as the first three-thousand (3,000) Therms of natural gas used in the month and the *second* block is defined as all volumes over three-thousand (3,000) per month. In order for Staff witness, Lisa K. Hanneken, to compute the revenues associated with the normal volumes, the normal volumes must be properly allocated monthly to each block to determine the rate at which the volumes are to be computed.

The Company provided the Staff with test year (October 2008 – September 2009) monthly active meters and monthly Therms per customer (Therms/Cust) for the first block and total Therms/Cust for the GS rate codes and customer classes served on the GS tariff. The Staff used the Company's test year first block Therms/Cust and total Therms/Cust to determine the normal usage falling into each rate block and the total usage for each month for each GS rate

class in the Laclede Division, St. Charles Division, Midwest Division and the Missouri Natural Division.

For each GS customer class in each division monthly normal usage was estimated using regression analysis to compute a statistical relationship between cold weather and the Therms/Cust. The Staff observed that in the lower heating months of May through October the percent in the first block is nearly constant. The Staff used a simple average of the percent in the first block in the test year months May-October to estimate the normal percent in the first block for the months of May-October. For the remaining months, November-April, which have more heating use, the Staff used regression analysis to estimate normal billing units in each month. Using the Company's test year monthly customer counts and bill frequencies for the GS classes, the Staff used the monthly Therms per customer per day in the test year months of October 2008 – September 2009 to estimate an equation that related it to the monthly percent use in the first block. The Staff used normal monthly usage per customer in the regression equation to estimate the normal monthly percent in the first block. If the normal adjustments to the first and second blocks in a season were in opposite directions, the adjustment to the first block was set to zero and the total adjustment was assigned to the second block.

To compute the adjustment to test year volumes to yield the estimated normal volumes, the Staff set the adjustment in the second block equal to the total minus the first block adjustment. The difference between the predicted normal usage volumes and test year volumes gives an estimated monthly adjustment for the first block.

Schedules K-15 through K-24, of Appendix 6, contains the actual, normal and adjustment volumes for each billing month during the test year. The total adjustment for the Residential customer class is 13,311,634 Therms, and for the C&I general service class I, II and III is

1,303,477 Therms, 2,616,777 Therms and 1,134,100. The total of these adjustments accounts for 100% of the adjustments made to both the first and second blocks. These adjustments were supplied to Staff witness Lisa K. Hanneken for use in the customer growth revenue adjustment.

Staff Expert/Witness: Kim Cox

9. Customer Growth Annualization

For customer classes that exhibited a trend in customer levels, the Staff made adjustments to the test year to reflect the addition or reduction in rate revenue that would have occurred if the number of customers taking service at the end of the update period (March 31, 2010), had existed throughout the entire test year. For customer classes that exhibited seasonality in customer levels, the Staff also made adjustments to reflect the current ongoing level of customers. The customer annualization adjustments for both trends and seasonality take into account weather and usage normalizations, as well as the adjustments for 365 days and rate changes that occurred during the test year.

Staff Expert/Witness: Lisa K. Hanneken

10. Large Customer Adjustments

Laclede Gas provided monthly billing units and information for every customer who took service on the Large Volume Sales, Interruptible Sales, Basic Transport, or Firm Transport rates during the test year. Staff used these units as the basis of its analyses and adjustments.

The following adjustments were made:

a. Rate Switching Adjustment

If a customer was in a rate class at the beginning of the test year, then transferred to a different rate class during the test year, the customer's billing determinants and associated

revenues in the original class were removed from that class' totals. The customer's billing determinants were then "priced" out using the tariffs of the class to which the customer switched, and those determinants and revenues were added to the totals in the second class. This resulted in a full year of history for the customer in the rate class they were in at the end of the test year. This analysis was performed using information supplied by the Company for the test year, updated through February 1, 2010.

Staff Expert/Witness: Thomas M. Imhoff

b. Customers Gains/Losses Adjustment

I performed a similar procedure for customers who began taking service or who discontinued service during the test year, updated through February 1, 2010.

If a customer began taking service on the Laclede Gas system during the test year, the customer would not have 12 months of usage in the test year. The usage for the "missing" months was estimated using either Company projections on the amount that the customer was expected to use, or by looking at actual usage in the months following the test year. Staff put the double billing usage in the prior month that reflected no usage. Usage, and the associated revenue, then was imputed for the missing months. This resulted in a full year of history for the customer.

If a customer ceased operations, the usage and revenues were removed from the rate class in which they occurred. This analysis was performed for events occurring during the test year, and updated through February 1, 2010.

Staff Expert/Witness: Thomas M. Imhoff

c. Weather Normalization Adjustment

The large volume sales customers were weather normalized due to their sensitivity to weather. I used the weather normal usage per customer as computed by Staff witness Kim Cox. All weather adjustments were computed in the first block, due to the test year usage of these customers.

Staff Adjustments Rev-7.5, Rev-8.5 and Rev-9.4 reflect the total impact from Staff's computations of these individual adjustments to the large volume, interruptible and transportation classes respectively.

Staff Expert/Witness: Thomas M. Imhoff

11. Other Revenue Adjustments

a. Revenues Associated with Propane Sales Transactions

In the Company's direct testimony filing, it has proposed to remove the propane peaking inventories and cavern from the regulated cost of service. Based on this proposal, Company made adjustments to remove all propane revenues and expenses that occurred during the test year ending September 30, 2009. Laclede states that the current and reasonably foreseeable peak demands of their customers could be satisfied in the future with something less than the full level of peak-shaving resources. Staff witness Lesa Jenkins addresses Laclede's reliance on these propane resources and the need to maintain all of its propane resources as part of the regulated cost of service. Accordingly, the Staff made no adjustment to remove any propane revenues collected or propane expenses incurred during the test year from its cost of service calculation. Similarly, the Staff made no adjustment to remove the propane cavern related investment, net of the depreciation reserve, from its determination of rate base.

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_____ ** The Staff made an adjustment to increase test year revenues to reflect this sale as part of its calculation of revenue requirement.

Staff Expert/Witness: John P. Cassidy

b. Insulation Financing Program and EnergyWise Program

Laclede Gas offers an Insulation Financing Program that permits qualifying residential customers to borrow funds for the purpose of insulating their homes and adding storm windows and storm doors. The EnergyWise program is similar to the insulation financing program except that its focus is offering financing for high-efficiency natural gas furnaces, high-efficiency gas air conditioners as well as certain energy efficient appliances. This program is available to credit-qualified residential and commercial customers. Since the loan balances associated with each of these programs are included in rate base, the Staff made adjustments to increase revenues that are included in the cost of service calculation associated with the interest income that the Company collects in relation to both of these programs.

Staff Expert/Witness: John P. Cassidy

B. Payroll and Benefits

1. Payroll and Payroll Taxes

The Staff's annualized payroll was based upon the actual payroll expense during the test year ending September 30, 2009, adjusted for the following: a) inclusion of the lump sum payments applicable to union contract employees; b) increases in wage rates that have occurred between October 1, 2008 through March 31, 2010, which represents the beginning of the test year established in the rate proceeding through the update period cutoff date; c) adjustment for reduced ongoing levels of contract employees in the Laclede Gas and Missouri Natural (MoNat) divisions; and d) an adjustment to normalize overtime associated with MoNat division union clerical employees. The Staff's adjustment for payroll expense was distributed by account based on the actual payroll distribution experienced by the Company during the test year ending September 30, 2009.

The Federal Insurance Contributions Act (FICA) Old Age Survivors and Disability Insurance (OASDI) Social Security and Medicare payroll taxes were annualized by applying the respective payroll tax rates to the Staff's annualized payroll adjustment. Based on these calculations the Staff developed an adjustment that reduced the test year level of FICA by $174,000. The Staff also made adjustments that reduced test year levels of expense that related to the Federal Unemployment Tax Act (FUTA) by $2,000, and the Payroll Expense Tax (PET) that is administered by the City of St. Louis by $6,000 consistent with its payroll annualization. The Staff will examine both payroll and payroll taxes as part of the Staff's proposed true-up audit.

Staff Expert/Witness: Erin M. Carle

2. Other Employee Benefits

The Company currently offers employees medical, dental, vision and life insurance, long term disability and 401k benefits. The Staff has reflected in the cost of service calculation 401k benefits based on its annualized payroll through March 31, 2010. Medical, dental, vision, life insurance and long term disability employee benefit costs were also adjusted for premium changes that occurred through March 31, 2010. The Staff has also made an adjustment to remove benefit costs associated with contract employees that are no longer with the Company. The Staff will continue to analyze actual benefit cost information as it becomes available through the proposed June 30, 2010 true-up/cutoff date proposed by the Staff in this rate proceeding. As a result of this continuing analysis, the Staff may propose further adjustments to employee benefits as part of the Staff's proposed true-up audit in this case.

Staff Expert/Witness: Erin M. Carle

3. Incentive Compensation/Bonus/Equity Plan

Laclede Gas has removed all Incentive Compensation, bonuses, and equity plan costs from their expenses. Consistent with the Company's treatment for these items, the Staff has also removed all of these costs from expense as part of its revenue requirement calculation. In addition, the Staff made adjustments to plant and the related depreciation reserve and deferred income tax reserve, to remove the rate base amounts associated with the Company's capitalization of incentive compensation, bonuses and equity plan costs during the test year and update periods established in this rate proceeding, as well as in previous years to the extent this information was available. The Staff will continue to examine capitalized incentive compensation, bonuses and equity plan costs as part of the true-up audit.

Staff Expert/Witness: Erin M. Carle

4. Pension Expense

Laclede Gas and the Staff are both proposing to continue the use of the methodology that was used in the previous rate case, GR-2007-0208. Pension expense for the Company's qualified pension plans has been determined based the required minimum ERISA contribution for the year ending September 30, 2009, as determined by an actuary, plus an amortization of the prepaid pension asset that is included in rate base. See the discussion in the Rate Base Section of this Report for an explanation of the prepaid pension asset. Additionally, pension expense includes the cost related to non-qualified pension plans for the Directors Retirement Program and the Supplemental Employee Retirement Program (SERP). The actual payments made during the test year were used as expense for the Directors Retirement Program. The expense for SERP is a five-year average of the actual payments for the period October 1, 2004 through September 30, 2009.

Staff Expert/Witness: Doyle L. Gibbs

5. Other Post-Employment Benefits (OPEBs)

Laclede Gas' OPEB expense is actuarially calculated for financial and regulatory purposes. In past cases, a difference existed in actuarial methods between the OPEB expense calculated for financial reporting purposes and the OPEB expense calculated for regulatory and funding purposes. The difference in methodologies reflect the shorter amortization period for actuarial gains and losses using the regulatory methodology, which currently produces an increase in expense, relative to the longer amortization of gains and losses using the financial reporting methodology. In this case, the Staff proposes to continue calculating the expense and funding levels for OPEBs based on the regulatory method

Staff Expert/Witness: Doyle L. Gibbs

C. Other Non-Labor Expenses

1. Rate Case Expenses

The Staff included a three year amortization of the estimated amount of rate case expense, exclusive of the cost of the depreciation study. The Company's depreciation study, which was submitted as part of this rate case, fulfills the requirement to perform a study every five years. Therefore, this cost is being amortized over a five-year period. This adjustment resulted in an overall decrease to the Company's annual level of rate case expense. The level of rate case expense will be re-examined as part of the Staff's proposed true-up audit through June 30, 2010.

Staff Expert/Witness: Lisa K. Hanneken

2. MoPSC Assessment

The MoPSC Assessment is an amount billed to all regulated utilities operating under the jurisdiction of the Commission as an allocation of the Commission's operating costs for regulating those utilities. The MoPSC Assessment is charged to regulated utilities operating in Missouri, who in turn include this expense in rates charged to customers.

The Staff's MoPSC Assessment adjustment represents the difference between MoPSC assessment expense recorded by the Company during the test year and the most recent MoPSC Assessment that was in effect for fiscal year 2010, for the period covering July 1, 2008 to June 30, 2009. The Staff will reflect the fiscal year 2011 assessment, effective July 1, 2010, as part of the proposed true-up audit in this case.

Staff Expert/Witness: Erin M. Carle

3. Property Tax Expense

For property assessment purposes, each utility company is required to file with its respective taxing authority a valuation of utility property at the beginning of each assessment year, which is January 1st. Several months later, based on the information provided by the utility, the taxing authority will in turn send the company what is known as "assessed values" for every category of the company's property. The taxing authority will issue to the utility company a property tax rate later in the year. The final step in the process is when the taxing authority issues a property tax bill to the company late in each calendar year with a due date of December 31st. The billed amount of property taxes is based on the property tax rate applied to the previously determined assessed values of the utility's plant in service balances as of January 1st of the same year. The Staff developed its property tax rate based on the Company's actual taxes paid and assessments for 2009.

Staff Expert/Witness: Erin M. Carle

4. Uncollectible Expense

Uncollectible expense is the portion of revenues that Laclede Gas is unable to collect from its customers by reason of bill non-payment. After a certain amount of time has passed, delinquent customer accounts are written off. The Staff has included the balance of net write-offs for the 12-months ending March 31, 2010, as its uncollectible expense level. The Staff adjusted this level of write-offs to eliminate the amount associated with customers who received service under the emergency and new cold weather rule. The write-offs associated with these customers have been specifically identified and is included in the cost of service through an amortization to expense. The Staff will reexamine the level of net write-off as part of the Staff's

proposed true-up audit through June 30, 2010. The Staff is not recommending any alternative rate treatment for uncollectibles/bad debt expense such as a tracking mechanism.

Staff Expert/Witness: Lisa K. Hanneken

5. Proposal to allow recovery of Uncollectible Expense in the Purchased Gas Adjustment (PGA) and Actual Cost Adjustment (ACA) process

The Staff opposes Laclede Gas' proposal to modify its recovery of what it describes as the "gas cost portion" of its uncollectible expense or "bad debt" expense through the PGA clause.

Laclede, like other utility companies currently recovers bad debt through rates set by the Commission in a general rate case, where the Commission may consider all factors relevant to establishing a utility's rates. The Staff proposes Laclede continue to recover bad debt through rates rather than through an addition to the PGA for the following reasons:

The PGA is designed to recover only the actual cost of gas which may be verified through invoices and is audited after customers have already been charged. The concept of a "gas cost portion" of bad debts, moves away from the requirement that only actual costs are passed through the Actual Cost Adjustment (ACA) process. Bad debt is a constantly changing expense that may only be estimated. Bad debt is an expense over which Laclede has considerable control.

The Company's proposal adds an estimated cost, approaching $8 to $10 million annually, to customers' gas costs. Unlike actual gas costs the continual ebbs and flows of partial debt recoveries and account reinstatements makes it nearly impossible to track the amount specifically related to gas costs. Perhaps to resolve the problem of an estimate flowing directly through to customers, Laclede proposes to "deem" its estimate to be the "actual" cost bad debt, with no prudence review by the Staff or the Commission, either before or after the charge flows to customers. This approach places the vast majority of the costs in an automatic recovery

mechanism (surcharge) where recovery is quick and prudence reviews are time-consuming and difficult.

Further complicating the issue is the fact that the ACA process is already laborious with the review of numerous contracts, affiliate transactions, hedging losses, reserve margins, and allocations of purchases between off-system and on-system markets. Further burdening this process with additional reviews simply hampers Commission's ability to establish just and reasonable utility rates.

Staff Expert/Witness: David M. Sommerer

6. Franchise Taxes

The Staff annualized the Company's corporate franchise taxes to reflect the current level of expense paid by Laclede Gas. During the past three years, the Company has been able to take advantage of credits to minimize the amount of tax it is required pay. The Staff has reflected these credits in its annualized expense level for corporate franchise taxes.

Staff Expert/Witness: Lisa K. Hanneken

7. Injuries and Damages

The Staff used a three-year average of actual injuries and damages payments to determine the normalized level for this expense item. A three-year average of payments, for the thirty-six month period ending September 30, 2009 was used as representative of ongoing injuries and damages costs, because a historical analysis shows a considerable amount of fluctuation in the level of payments from year to year.

Staff Expert/Witness: Doyle L. Gibbs

8. Insurance Expense

Insurance expense is the cost of protection obtained from third parties against the risk of financial loss associated with unanticipated events or occurrences. Utilities, like non-regulated entities, routinely incur insurance expense in order to minimize their liability associated with unanticipated losses. The Staff adjusted Laclede Gas' insurance expense based on the current property and liability premiums in effect as of March 31, 2010.

Staff Expert/Witness: Doyle L. Gibbs

9. Postage Expenses

The Staff has annualized the level of postage expense to reflect the postage rate increase that took place during the test year.

Staff Expert/Witness: Lisa K. Hanneken

10. Customer Deposit Interest Expense

See the discussion in Section VI. K., Rate Base-Customer Deposits.

Staff Expert/Witness: Lisa K. Hanneken

11. Advertising Expense

In forming its recommendation of the allowable level of Laclede Gas' advertising expense, the Staff relied on the principles it has consistently applied by adhering to the Commission's decision in: In *re: Kansas City Power and Light Company*, Case Nos. EO-85-185, et al., 28 Mo. P.S.C. (N.S.) 228, 269-71 (1986). In that case, the Commission adopted an approach that classifies advertisements into five categories and provides rate treatment of recovery or disallowance based upon a specific rationale. The five categories of advertisements recognized by the Commission are as follows:

1. General: informational advertising that is useful in the provision of adequate service;

2. Safety: advertising which conveys the ways to safely use electricity and to avoid accidents;

3. Promotional: advertising used to encourage or promote the use of electricity;

4. Institutional: advertising used to improve the company's public image; and

5. Political: advertising associated with political issues.

The Commission adopted these categories of advertisements explaining that a utility's revenue requirement should: 1) always include the reasonable and necessary cost of general and safety advertisements; 2) never include the cost of institutional or political advertisements; and 3) include the cost of promotional advertisements only to the extent that the utility can provide cost-justification for the advertisement (Report and Order in KCPL Case Nos. EO-85-185, et al., 28 Mo. P.S.C. (N.S.) 228, 269-271 (April 23, 1986)).

Accordingly, in the current rate case, the Staff has proposed an adjustment to exclude the costs of institutional and promotional advertising, including advertising pertaining to energy efficiency outside the test year, from recovery in rates (refer to examples contained in Appendix 7). The Staff found no evidence that Laclede Gas engaged in any political advertising. Costs for safety advertising and general advertising directed towards the benefit of existing customers were unadjusted by the Staff.

The Staff has examined all advertising pertaining to Energy Efficiency that occurred subsequent to the test year, but was proposed for inclusion in rates in the direct testimony of Company Witness, Glenn W. Buck. The Staff classified all of this advertising as being either

promotional or institutional and does not propose to include these post test year costs in the cost of service calculation.

Staff Expert/Witness: Erin M. Carle

12. Governmental Affairs/Lobbying

As part of its analysis of dues, the Staff determined that some of the organizations use a percentage of member payments to fund government affairs or lobbying activities. The Staff traditionally disallows the cost of these activities and therefore has removed the associated amounts from the Company's test year expense level. The Staff's disallowance of these amounts is consistent with the Staff's treatment in previous rate cases.

Staff Expert/Witness: Lisa K. Hanneken

13. Dues and Donations

The Staff reviewed all membership dues paid, and donations made, to various organizations that Laclede Gas charged to expense during the test year ending September 30, 2009. The Staff recommends adjustments to disallow various dues and donations that were incurred by Laclede Gas during the test year. Such dues and donations were disallowed by the Staff because they were not necessary for the provision of safe and adequate service, and thus do not have any direct benefit to ratepayers. Allowing the Company to recover these expenses through rates causes the ratepayer to involuntarily contribute to these organizations. Examples of items disallowed by the Staff are amounts that Laclede Gas paid to The United Way and Habitat for Humanity. In *Re: Missouri Public Service, a Division of UtiliCorp United, Inc.*, Case Nos. ER-97-394, et al., Report and Order, 7 Mo.P.S.C.3d 178, 212 (1998), the Commission stated:

The Commission has traditionally disallowed donations such as these. The Commission finds nothing in the record to indicate any discernible ratepayer benefit results from the payment of these donations. The Commission agrees with the Staff in that membership in the various organizations involved in this issue is not necessary for the provision of safe and adequate service to the MPS ratepayers.

The Staff also made an adjustment to remove the costs associated with items such as: luxury suites to sporting events, tournament sponsorships, and various other organizations that are not necessary in the provision of safe and adequate service and therefore should not be funded by ratepayers.

Staff Expert/Witness: Erin M. Carle

14. Treasury Account Special (TAS)

During Staff's review, it was revealed that the Company utilizes a TAS to book its officer's expenses. These expenses are therefore booked to the general ledger through TAS entries which prevent unauthorized employees from seeing the original entries. Staff reviewed the original entries and has made an adjustment to remove the amounts related to dues, donations and other miscellaneous expenses that provide no ratepayer benefit. Staff is awaiting further information from the Company and will continue to review this area as the data becomes available.

Staff Expert/Witness: Lisa K. Hanneken

15. Legal Expenses

The Staff has removed the legal related fees charged to the Company during the test year for a non-recurring event. These charges are not an on-going expense for the Company and therefore the Staff has adjusted test year legal expenses to a normalized level.

Staff Expert/Witness: Lisa K. Hanneken

16. NITEC Study

Laclede Gas maintains a large scale underground natural gas storage reservoir, referred to as the Lange storage facility, which was developed over 50 years ago and that extends over an area covering approximately 13,000 acres located in parts of North St. Louis County and St. Charles County. Laclede Gas recently engaged NITEC LLC, an oil and gas consultant, to evaluate its Lange natural gas storage facility in order to assess the field's current and future capabilities. During the test year period ending September 30, 2009, Laclede Gas incurred ** _____ ** related to the conduct of this study. The Company paid an additional ** _____ ** to NITEC for services that were performed through the six month update period ending March 31, 2010. In total, the Company has incurred ** _____ ** related to the NITEC study. The Staff made an adjustment to reduce test year expenses by $430,307 in order to normalize the costs that the Company has incurred associated with this study over a period of ten years.

Staff Expert/Witness: John P. Cassidy

17. Home Sale Reinspections Fees

The Company collects revenues related to home sales appliance reinspections on an annual basis. During the test year ending September 30, 2009, the Company reported revenues totaling $164,577 based upon fees that were in effect during that twelve month time period.

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During the test year and subsequent to the test year, differing components of the fees increased. The Staff made an annualization adjustment to restate the reported test year revenues associated with these fees to reflect the impact of all changes that have occurred for each component.

Staff Expert/Witness: John P. Cassidy

18. Gain on Sale of Property

During the test year ending September 30, 2009, Laclede Gas sold its Shrewsbury gas holder station which was no longer a used and useful component of plant in service and the land at the site represented a non-depreciating asset. During April 2009, the Company experienced a gain as a result of the sale of this property. The Staff has not reflected this gain as part of its cost of service calculation. This treatment is consistent with the Staff's long standing practice of excluding gains and losses associated with the sale of utility property from the cost of service calculation.

Staff Expert/Witness: John P. Cassidy

19. Lease and Rent Expense

During the test year, Laclede Gas incurred lease and rent expense on various buildings and pieces of equipment that it uses in the provision of utility service to its customers. The Staff reviewed Laclede Gas' leases and rent expense during the test year ending September 30, 2009, and also through the update period ending March 31, 2010. The Staff made an annualization adjustment to the Company's expense levels in its cost of service calculation to include an amount of expense related to two properties that Laclede Gas has started renting subsequent to the test year, but before the update period ending March 31, 2010. The Staff also included an

ongoing decrease in vehicle lease expense as part of this adjustment. Overall, the Staff's annualization adjustment increases expense for these items at the annual on-going level.

Staff Expert/Witness: Erin M. Carle

20. Director's Fees

The Staff normalized the retainer fees and meeting fees to the current levels paid to the Board of Directors consistent with the Company's adjustments.

Staff Expert/Witness: Erin M. Carle

21. Communication Equipment Expense

The Staff's adjustment represents the net lease cost increase for a new phone system installed by Laclede Gas. The adjustment was determined by comparing the annualized lease cost of the new system to the lease cost charged to expense during the test of the system that was replaced.

Staff Expert/Witness: Doyle L. Gibbs

22. Fuel Expenses

The Staff annualized the level of fuel (gasoline and diesel) expense to reflect current fuel prices. The Staff's adjustment increased expense by $351,583.

Staff Expert/Witness: Lisa K. Hanneken

23. Energy Efficiency Programs and Collaborative

a. Low-Income Weatherization Assistance Program Funding:

As a result of the July 19, 2007 Commission Order Approving Unanimous Stipulation and Agreement and Authorizing Tariff Filing (Order) in Case No. GR-2007-0208, Laclede Gas was authorized to continue its existing low-income weatherization program with revised funding

levels of $950,000 per year, which Laclede Gas collects in rates. Each year Laclede Gas makes the funds available to the Missouri Department of Natural Resources (DNR) as supplemental funds to the U.S. Department of Energy (DOE) funds for Low-Income Weatherization Assistance Program (LIWAP or Weatherization), administered through DNR. Staff recommends Laclede continue to contribute $950,000 per year for Weatherization, funded through rates, to supplement LIWAP DOE funds.

For Program Year 2008, which DNR lists as November 2008 through October 2009, 443 homes were weatherized with funds from Laclede Gas, funded by ratepayers. This is an average of 36.9 homes per month. For the 5 months reported for Program Year 2009, only 52 homes have been weatherized which is an average of 10.4 homes per month. All five months in Program Year 2009 had lower number of homes weatherized than any of the months in Program Year 2008. The expenses and number of homes receiving Weatherization are summarized in the Tables 1 and 2 below.

Table 1: Utility/Ratepayer Funded LIWAP, Program Year 2008

Month	Expenses	Homes Weatherized
Nov-08	$23,944	26
Dec-08	90,600	29
Jan-09	74,604	33
Feb-09	91,382	55
Mar-09	78,537	47
Apr-09	103,446	47
May-09	111,668	30
Jun-09	99,425	42
Jul-09	84,422	43
Aug-09	73,588	24
Sep-09	86,969	29
Oct-09	105,076	38
Total	$1,023,661	443
Total Grant	$1,031,343	Includes carryover funds from prior program year all associated with one community action agency
Balance	$7,682	
Average	$85,305	36.9

Table 2: Utility/Ratepayer Funded LIWAP, Program Year 2009		
Month	Expenses	Homes Weatherized
Nov-09	$22,761	19
Dec-09	12,202	0
Jan-10	32,171	1
Feb-10	37,812	21
Mar-10	46,437	11
Total	$151,383	52
Total Grant	$995,686	Includes carryover funds from prior program year
Balance	$844,303	
Average	$30,277	10.4

In an attempt to understand the difference in levels of Weatherization being performed in Program Year 2009, Staff has requested information from DNR regarding its policies and procedures for when and how it uses funds from the utilities for home weatherization and any plans it has to include the Commission, Office of the Public Counsel (OPC), Laclede Gas, or the Laclede Energy Efficiency Collaborative in discussions regarding these policies and procedures. A summary of the local distribution companies (LDC) Weatherization funding is included in Table 3.

Table 3: Low-Income Weatherization Assistance Program (LIWAP)					
LDC	Annual Funding	Customer Number	Avg. Funding per Customer	Tariff Sheet No.	Comments
AmerenUE	$263,000	125,600	$ 2.09	75, 76, 77	
Atmos	$102,410	56,400	$ 1.82	112.1, 112.2, 112.3, 115	The funding listed is for Year 3.
Empire District Gas	$ 71,500	44,700	$ 1.60	R-51d, R-51e, R-51f	
Laclede Gas	$950,000	629,400	$ 1.51	R-44	
Missouri Gas Energy	$750,000	514,700	$ 1.46	96, 97, 97a	
Missouri Gas Utility		1,700	$ -		Annual $9,000 contribution but not specifically for LIWAP.
Southern Missouri Natural Gas		8,000	$ -		

b. Energy Efficiency Collaborative

As a result of the Order, an Energy Efficiency Collaborative (EEC) was established to identify a portfolio of cost-effective energy efficiency programs. The EEC charter members include Laclede Gas, DNR, Staff and OPC. In addition to the charter members, others allowed to participate in the EEC process were USW Local 11-6, AmerenUE, and other parties that are accepted by the EEC charter members. The Order required that any new or modified energy efficiency and conservation programs were to be developed as a result of the EEC process. The Unanimous Stipulation and Agreement further states if a consensus of the charter members cannot be reached, two or more of the charter members may petition the Commission to resolve in accordance with its normal procedural rules any differences over the selection of specific programs for implementation or other aspects of the energy efficiency program development process.

The EEC worked with Applied Energy Group, Inc. (AEG), a consultant selected through a Laclede Gas RFP process to assist in the design, pre-implementation evaluation, and planning for a post-implementation evaluation of the programs. The EEC worked with AEG on an Energy Efficiency Program Portfolio report, dated September 18, 2008, which was attached to Staff's November 19, 2008 recommendation in Case No. GR-2007-0208.

Five of the seven Missouri natural gas LDCs work with an EEC in a process to evaluate and select cost effective energy efficiency programs, and discuss and monitor implementation. The Laclede Gas EEC has conference calls every one or two months to discuss the existing energy efficiency programs and potential new programs or changes to existing programs, including any potential for building on programs offered by AmerenUE, the major electric utility in the Laclede Gas service area. To make the meetings as productive as possible, Laclede Gas's representative for the EEC has recently committed to sending an agenda prior to each EEC

conference call and, after the call, to sending minutes listing the attendees, a summary of items discussed, and any decision or follow-up items noted.

c. Energy Efficiency Programs

Summaries of the Laclede Gas energy efficiency programs and those of other Missouri LDCs are included in Table 4, Utility/Ratepayer Funded Energy Efficiency Programs (non-LIWAP), Funding and Non-Rebate Programs and Table 5, Utility/Ratepayer Funded Energy Efficiency Programs (non-LIWAP), Rebates are attached to this report as Appendix 8.

Additionally, existing Laclede Gas energy efficiency programs are described in more detail in its tariff.

Some of the programs identified in the Laclede Gas September 18, 2008 Energy Efficiency Program Portfolio report, have not moved forward. For example, the portfolio addresses programs for low to limited income customers that the EEC decided not to pursue because the expansion of the federal LIWAP program allows greater expenditure of dollars and expanded eligibility. Other programs such as Home Performance with Energy Star require coordination with the electric utility and this has not been advancing.

d. Existing Energy Efficiency Program Funding

The funding level for the Laclede Gas energy efficiency programs is accomplished through three means:

(1) Funding for the two financing programs is included in rates

(2) $150,000 per year, which Laclede Gas collects in rates

(3) Up to $3,500,000 over a three-year period with investments tracked through a regulatory asset account at the time such investments are made

The EEC could have requested the Commission approve a greater expenditure during that time period. (Unanimous Stipulation and Agreement, GR-2007-0208, page 19)

Laclede Gas reports the balance in its energy efficiency and conservation fund as of December 31, 2009 is $382,461.93, which is only 11% of the $3.5 million allowed in a regulatory asset account. Thus, the EEC did not have any need to seek increased funding. However, because the Unanimous Stipulation & Agreement in GR-2007-0208, only addressed funding over a three-year period, the funding on a moving forward basis must be clarified. Funding for the low-income weatherization assistance program (LIWAP) is addressed separately.

A summary of the existing Missouri LDC energy efficiency funding is shown in Table 4, Utility/Ratepayer Funded Energy Efficiency Programs (non-LIWAP), Funding and Non-Rebate Programs attached to this report as Appendix 8.

e. Staff Recommendation for Laclede Gas, Energy Efficiency Program Funding

The Staff is not opposed to Laclede Gas continuing the funding in rates for the two finance programs and $150,000 per year for energy efficiency program development, implementation, and evaluation including consulting services that will be employed in the process. The Staff recommends any annual funding amounts included in rates, which are not expended in a given year, be carried over to the subsequent year. In addition to these funds, the Staff recommends the Commission authorize Laclede Gas to invest up to $1,700,000 per year to fund conservation and energy efficiency programs that are developed as a result of the EEC process, subject to a review in future rate cases by any party, including charter members of the EEC, for prudence of program implementation and evaluation implementation. Such investments for the development, implementation and evaluation of energy efficiency programs

that are not funded through rates may be accumulated in a regulatory asset account at the time such investments are made, and may be reflected in Laclede Gas rate base in its next general rate case in the same manner as other rate base items, provided that a ten-year service life be presumed for such investments.

Such funding is consistent with the funding level of Missouri Gas Energy and Atmos Energy Corporation. The Commission has approved a greater funding level for Empire District Gas. However, there is no indication, based on the level of Laclede Gas customer participation to-date, that a higher funding level is needed at this time. Consistent with the Unanimous Stipulation and Agreement in GR-2007-0208, the Staff is not opposed to allowing, upon unanimous agreement of the parties, a Laclede Gas request for Commission approval of a greater expenditure, should this funding level prove insufficient on an annual basis.

Laclede Gas reports the balance in its energy efficiency and conservation fund as of December 31, 2009, is $382,461.93. Laclede Gas has not yet reported the balance through the March 31, 2010 update period. The Staff will examine the Laclede Gas investments through June 30, 2010 as part of the Staff's proposed true-up audit. Pending review of the investments, the Staff will recommend a balance for expenditures for energy efficiency and conservation in rate base, to be amortized over 10-years. As noted in the Order in Case No. GR-2007-0208:

> Subject to a review by any party, including charter members of the EEC, for program implementation and evaluation implementation prudence in future rate cases, such investments for the development, implementation and evaluation of energy efficiency programs that are not funded through the $150,000 annual funding amount shall be accumulated in a regulatory asset account at the time such investments are made. Such investments will then be reflected in Laclede's rate base in its next general rate case in the same manner as other rate base items, provided that a ten year service life shall be presumed for such investments. Any monies advanced in rates or by Laclede in connection with these programs

shall accumulate interest at an annual rate equal to Laclede's average short-term debt cost as of March 31, 2007.

f. The Staff's Rationale for Not Recommending Higher Funding at this Time

Funding for energy efficiency programs reviewed in the National Action Plan for Energy Efficiency ranged from 0.5% to 1% of natural gas utility revenue.[7] It is not clear whether this is total operating revenue, total operating revenue for only residential, commercial, and industrial customers, or whether it is net revenue, which would be reduced for items such as cost of natural gas.

The Fiscal Year 2009 10-K listed Laclede Gas Operating Revenue of $1,053,993,000. Funding at 0.5% of gross operating revenues would be $5,269,965 per year, which is approximately $8.37 per customer. A review of the Laclede Gas Operating Revenues over the past five years shows that a goal of 0.5% of gross operating revenues for energy efficiency would have been a range of $4.9 million to $5.7 million annually. If one considers only the operating revenue for residential, commercial, and industrial customers, a funding goal of 0.5% would be $4,702,225 per year, based on Laclede Gas Operating Revenue for Fiscal Year 2009.

Reports such as the February 2007 American Council for an Energy Efficient Economy (ACEEE)[8] and the National Action Plan for Energy Efficiency consider policies and measures including rating and labeling, efficiency standards for appliances and other equipment, building energy codes, incentive programs, and technical assistance and consumer information. Laclede Gas's energy efficiency programs to-date have included LIWAP, education, and rebates and financing for energy efficiency measures for residential, commercial and industrial customers. Efficiency standards for appliances and other equipment would require national or regional

[7] "National Action Plan for Energy Efficiency," *U.S. Environmental Protection Agency*, July 2006, pp. 6-5.
[8] "Quantifying the Effects of Market Failures in the End-Use of Energy," *American Council for an Energy-Efficient Economy (ACEEE)*, Prepared for International Energy Agency, February 2007, pp. vii.

coordination. Changes to state and local energy efficiency building codes would require more than the involvement of Laclede Gas, the Staff, OPC, and DNR.

Thus, to approach the 0.5% to 1% of natural gas utility revenue funding for energy efficiency.

g. Energy Efficiency Program Evaluation

The Energy Efficiency Program Portfolio report, dated September 18, 2008, indicated two types of evaluations will be completed on the energy efficiency programs as appropriate: (1) a process evaluation to identify improvements to delivery processes that will make the implementation of the program more effective, and (2) for direct impact programs, an impact evaluation. The report indicates evaluations will be conducted during the second year of program implementation.

In some conference call, the EEC has discussed improvements to the programs. Laclede Gas indicates it plans to hire an outside contractor for the impact evaluation, but because of the timing of these programs, that evaluation will occur at a future time.

Staff Expert/Witness: Lesa Jenkins

24. Capitalized Depreciation Expense

The Staff made an adjustment to remove a portion of the annualized depreciation expense calculated on transportation and power operated equipment. This equipment is used by the Company to perform both maintenance and construction activities. Therefore, a portion of the depreciation calculated on this equipment is capitalized and charged to construction projects. As a result, the depreciation must be removed from the annualized depreciation expense included in the calculation of net operating income to prevent a double recovery.

Staff Expert/Witness: Erin M. Carle

25. Amortization of Non-Depreciated Accounts

The Staff made an adjustment to annualize the September 30, 2009 test year expense to reflect all changes to the non-depreciable accounts that have occurred through the update period ending March 31, 2010.

Staff Expert/Witness: Erin M. Carle

26. Accounting Authority Order (AAO) Adjustments

a. Gas Safety Related Service Line Replacement AAOs

As part of Case Nos. GR-99-315, GR-2001-0629, GR-2002-0356 and GR-2005-0284, the Commission authorized the Company to defer depreciation, property taxes and carrying costs associated with its gas safety related service line replacement projects. The Staff is amortizing all deferred costs associated with these AAOs that were previously ordered by the Commission as part of these cases, with the exception of those costs authorized in Case No. GR-99-315 because the ten year amortization of the deferred costs authorized in that case ended in December 2009, within the updated period ending March 31, 2010, as established in this current rate case proceeding.

b. Emergency Cold Weather Rule (ECWR) AAO

As part of Case Nos. GU-2007-0137 and GR-2007-0208, the Company was authorized to defer and then amortize costs associated with the emergency cold weather rule. A five year amortization related to these costs began on August 1, 2007, which corresponds to the effective date of rates established as part of Laclede's last rate case, Case No. GR-2007-0208 and will continue through July 31, 2012. The Staff included a full year of amortization for these costs as part of this rate proceeding.

In Case No. GU-2007-0138, the Commission authorized the Company to defer approximately $2.49 million related to the ECWR, with interest. As part of that case, the Commission also ordered the Company to track payments and additional arrearages related to the 8,440 customers after a September 30, 2007 cutoff date for consideration in Laclede's next rate case. As part of the current rate proceeding, Laclede provided this information to the Staff for the period covering November 1, 2006 through March 31, 2010. This information identified a decline in the outstanding balance for the ECWR customers therefore the Staff reduced the balance being amortized. The Staff proposes to amortize the costs associated with this ECWR AAO over a period of five years.

Staff Expert/Witness: John P. Cassidy

c. Laclede's Request for Accounting Authority Order (AAO) to Address Potential International Financial Reporting Standards (IFRS)

IFRS represents a single set of globally accepted accounting standards that are being considered by the Securities and Exchange Commission (SEC) for possible implementation in the United States. As of February, 2010, the SEC has indicated that it will not make a decision until sometime during 2011 on whether to move forward on incorporating IFRS into the U.S. financial reporting system and that if it does decide to move forward, such a transition would not occur until 2015 at the earliest. That being the case, the Staff believes that it would be premature to consider authorization of an AAO for any such IFRS related costs and that this request should not be granted at this time.

Staff Expert/Witness: John P. Cassidy

D. Income Tax Expense

The Staff's calculation of income tax expense reflects its determination of net operating income. This amount is adjusted to reflect the different treatment afforded various income and deductible items in determining taxable income for calculating income taxes. To this taxable income, the Staff applied the federal and state income tax and St. Louis City Earnings tax rates in the calculation of income tax expense.

Staff Expert/Witness: Doyle L. Gibbs

IX. DEPRECIATION

A. Summary

The Staff conducted a depreciation study of the capital assets of Laclede Gas, including an analysis of the accumulated reserve for depreciation. Based on its study, the Staff recommends depreciation rates for Laclede Gas as indicated in Appendix 9, Schedule DCW-1 of this testimony.

The Staff's proposed depreciation rates for Laclede Gas would increase the currently ordered annual depreciation expense from approximately $34,697,448 to $37,148,816, as indicated in Appendix 9, Schedule DCW-2, which is a total increase of $2,451,368.

Schedule DCW-3 of Appendix 9, lists, by plant account, the Staff's proposed depreciation rates. This schedule also provides a comparison of the Staff's recommended new depreciation rates to the current rates, which the Commission ordered in Case No. GR-2005-0284, effective October 6, 2005, and amended for two accounts (391.2 and 391.4) on in Case No. GR-2007-0208 on July 9, 2007.

Schedule DCW-4 of Appendix 9, lists, by plant account, the accumulated reserve for depreciation and the theoretical reserve amount. The Staff's study indicates an under-accrual of the accumulated reserve for depreciation of approximately $29,559,744.

B. Depreciation

"Depreciation," as applied to depreciable utility plant means:

(a) the loss in service value not restored by current maintenance,

(b) incurred in connection with the consumption or prospective retirement of utility plant in the course of service,

(c) from causes which are known to be in current operation and

(d) against which the utility is not protected by insurance.

Among the causes to be given consideration are: wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand and requirements of public authorities.

The purpose of depreciation in a regulatory setting is to recover the cost of capital assets over the useful lives of the assets. The depreciation rate for each plant account is designed to recover, over the average service life of the assets in that account, the original cost of the assets plus an estimate for any cost of removal less scrap value. Annual depreciation expense for a plant account is the depreciation rate for that plant account multiplied by the balance of plant in that account. The annual depreciation expense returns to the Company's shareholders a portion of the costs of the capital assets. In a regulatory setting, this return is commonly referred to as a return of equity. The remaining portion of the costs of the capital assets of the Company, known as net plant-in-service, is returned to the Company's shareholders in the future. The Company is permitted during this period to earn a return on the capital assets in rate base, commonly referred

to as a return on net plant-in-service, a component of rate base. In a regulatory setting this return is also commonly referred to as a return on equity.

C. Depreciation Study

The Staff used the straight-line method, broad group-average life procedure, and whole-life technique depreciation system for its depreciation study of the Company's capital assets. The Staff has consistently used the whole-life technique in developing depreciation rates that reflect expected average service lives. The whole life technique does not include an adjustment factor to address over- or under-accruals in the accumulated reserve for depreciation. The Staff does not recommend any amortization of the excess accrual at this time, but will continue to monitor the balance. The Staff uses the following formula to calculate a depreciation rate for each plant account:

Depreciation Rate = (100 % - Net Salvage %) ÷ (Average Service Life).

This is consistent with the Commission's Depreciation Rate Formula from its Report and Order in The Empire District Electric Company Case No. ER-2004-0570. As shown in the formula, the average service life and net salvage percentage are the depreciation parameters used to determine the depreciation rate. The Staff calculated depreciation rates for each plant account based on the average service life and net salvage percentage determined applicable to each account, as shown in Appendix 9, Schedule DCW-1. That determination is addressed in detail below.

D. Average Service Life

For each plant account, the average service life (ASL) is the expected period, in years, of the useful service of each unit of property in that account, (e.g., meters) regardless of when that

unit was first put into service (its placement date). An account's ASL is developed in four steps. The first step is to review historical mortality data and historical salvage and cost of removal data. The data is checked for reasonableness, and to determine whether or not sufficient data exists to perform a statistically significant analysis. In addition, the Staff reviews the data to determine if retirements recorded in one historical database are also recorded in another historical database.

The second step is to gain familiarity with the Company's facilities and to discuss current trends and developments that may influence the useful life of plant-in-service with Company operations' personnel, engineers, accountants, and other depreciation experts. Current developments such as technological changes, environmental regulations, regulatory requirements, or accounting changes can all affect the average service life of property in an account. Different vintages of plant being manufactured from different materials, changes in installation practices, or the development of a life extending maintenance procedure are some examples of factors contributing to changes in average service lives.

The third step is to perform a statistical analysis of the retirement experience of each utility plant account, followed with analysis of the results for reasonableness for the type of plant in question. To evaluate the retirement experience of the Company's plant accounts, the Staff uses depreciation software to analyze historical plant data by calculating the ratio of retirements to exposures by age, and solve for the percent surviving by age to develop a survivor curve for an account. Data regarding plant additions in dollars by year, or vintage, and retirements from each vintage, in dollars by year, are necessary for this analysis. The exposures at a given age are the dollars remaining from the various vintages that have lived to that age. The retirement ratio is the dollars retired during an age interval divided by the exposures at the beginning of that

interval. The survivor ratio is then calculated by subtracting the retirement ratio from "1". Multiplying each successive survivor ratio by the percent surviving of the previous age will generate a survivor curve. This original survivor curve can then be smoothed and fitted to an empirically developed statistical model known as an Iowa curve.[9] Smoothing the original survivor curve by fitting it to an Iowa curve eliminates irregularities and extrapolates stub curves to zero percent. The average service life of an account's original survivor curve is estimated as the area under the selected Iowa curve.

The fourth step is to apply the Staff's engineering experience and informed judgment to the aggregate of the first three steps in the process to assign an appropriate ASL for each plant account. The Staff recommends the Average Service Lives, by account, identified in Appendix 9, Schedule DCW-1, attached to this report.

As noted earlier the average service life is just one of two factors determining a given depreciation rate.

E. Net Salvage Percentage

The second factor in determining a given depreciation rate is the net salvage percentage. Consideration is given to the future net salvage (or cost of removal) that property in an account may experience.

Net Salvage = Gross Salvage - Cost of Removal

Gross salvage is the recovered marketable value of retired plant. Cost of Removal is the cost associated with the retirement and disposition of plant from service. Negative net salvage

[9] The Iowa curves are widely accepted models of the life characteristics of utility property. The system of Iowa curves is a family of 176 types of utility and industrial property. The curves were developed at the Iowa Engineering Experiment Station at what is presently known as Iowa State University. The Iowa curves were first published in 1935 and reconfirmed in 1980. The original survivor curve is mathematically and visually matched with various Iowa curves to determine which has the most appropriate fit, either for a significant portion of the curve or just a specified portion of the curve.

occurs when the cost of removal exceeds gross salvage. A negative net salvage is commonly referred to as an expense or net cost of removal and a negative net salvage percentage is called a net cost of removal percentage. Today, many utility accounts experience a net cost of removal; therefore the net salvage percentage in the depreciation calculation is negative, which results in an increase to overall depreciation expense.

Net salvage percentages were developed by dividing the experienced net cost of removal by the original cost of plant retired during the same time period to calculate the net cost of removal percentage realized by the Company. This is consistent with the Commission's policy for net salvage from its Report and Order in The Empire District Electric Case No. ER-2004-0570.

Depreciation software uses the selection of a specific Iowa curve and net salvage percentage for each plant account to calculate the account's theoretical accumulated reserve for depreciation.

F. Analysis of Accumulated Reserve for Depreciation

Another analysis performed with a depreciation study is an examination of the adequacy of the accumulated reserve for depreciation and identification of any reserve over- or under-recovery. This analysis illustrates whether prior depreciation estimates have differed significantly from actual experience. An analysis of the accumulated reserve for depreciation reserve is performed by comparing the existing accumulated reserve for depreciation as of a certain date, in this case, September 30, 2009.

A depreciation reserve account is the amount for plant investment and net cost of removal that has been recovered in depreciation rates over the life of the capital assets, reduced by retirement amounts, costs of removal experienced, and transfers out, and increased by actual

salvage proceeds collected, and transfers in. The aggregate of the depreciation reserve accounts is known as the accumulated reserve for depreciation. The theoretical accumulated reserve for depreciation amount can be viewed as the level of accumulated depreciation reserve that would exist today if the selected depreciation parameters had been used since the inception of placing plant in service. If the amount of the actual accumulated reserve for depreciation is more than the theoretical amount, an over-accrual is noted. Conversely, if the actual accumulated reserve for depreciation is less than the theoretical amount, an under-accrual is noted.

The need for, the magnitude of, and the timing of an adjustment should be based upon consideration of several factors: the characteristics of the account, the causes of the difference, and the year-to-year volatility of the accumulated provision for depreciation and the magnitude of the imbalance. Future service life cannot be estimated to a degree of certainty that guarantees that the actual life will not be different. In fact, the depreciation estimation process is dynamic and it is possible that the currently determined ASL recommended by the Staff will differ from the ASL that occurs.

G. Recommendations

The Staff recommends that the Commission order the depreciation rates proposed in Appendix 9, Schedule DCW-1.

The Staff also recommends that Laclede Gas be ordered to follow the policy and guidance sought and received in Case No. ER-2004-0570, that a separate accounting be kept of the amounts accrued for recovery of its initial investment in plant from the amounts accrued for the cost of removal. The Staff's recommendation addresses the Commission's policy as stated in Case No. ER-2004-0570. Under the traditional accrual method, the depreciation rate for a particular asset or group of assets is calculated as follows:

$$\textit{Depreciation Rate} = \frac{\textit{100\% – \% Net Salvage}}{\textit{Average Service Life (years)}}$$

In this formula, net salvage equals the gross salvage value of the asset minus the cost of removing the asset from service. The net salvage percentage is determined by dividing the net salvage experienced for a period of time by the original cost of the property retired during that same period of time. This is the accrual method used by the Staff to determine the depreciation rate.

Staff Expert/Witness: David Williams

APPENDICES

Appendix 1 - Staff Credentials

Appendix 2 - Support for Staff Cost of Capital Recommendation - Zephania Marevangepo

Appendix 3 - Cold Winter Requirements and Reliance on Lange UGS and Propane - Lesa Jenkins

Appendix 4 - Supporting documents for Allocations - Lisa K. Hanneken

Appendix 5 - Weather Normal Variables Used for Weather Normalization - Manisha Lakhanpal

Appendix 6 - Weather Normalization of Sales - Kim Cox

Appendix 7 - Supporting documents for Advertising Expense - Erin M. Carle

Appendix 8 - Utility/Ratepayer Funded Energy Efficiency Programs (non-LIWAP) - Lesa Jenkins

Appendix 9 - Depreciation - David Williams

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Tariff to Increase Its Annual Revenues for Natural Gas Service	))))	Case No. GR-2010-0171

AFFIDAVIT OF ANNE M. ALLEE

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Anne M. Allee, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Staff Report in pages 21o - 28; that she has knowledge of the matters set forth in such Report; and that such matters are true to the best of her knowledge and belief.

Anne M. Allee

Subscribed and sworn to before me this 10th day of May, 2010.

Notary Public

NIKKI SENN
Notary Public - Notary Seal
State of Missouri
Commissioned for Osage County
My Commission Expires: October 01, 2011
Commission Number: 07287016

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Tariff to Increase Its Annual Revenues for Natural Gas Service	)))	Case No. GR-2010-0171

AFFIDAVIT OF ERIN M. CARLE

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Erin M. Carle, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Staff Report in pages 35,69-70,72-73,76-78,78-79,81-82,90-91; that she has knowledge of the matters set forth in such Report; and that such matters are true to the best of her knowledge and belief.

Erin M. Carle
Erin M. Carle

Subscribed and sworn to before me this 10th day of May, 2010.

NIKKI SENN
Notary Public - Notary Seal
State of Missouri
Commissioned for Osage County
My Commission Expires: October 01, 2011
Commission Number: 07287016

Nikki Senn
Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Tariff to Increase Its Annual Revenues for Natural Gas Service	)))	Case No. GR-2010-0171

AFFIDAVIT OF JOHN P. CASSIDY

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

John P. Cassidy, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Staff Report in pages 1-8, 67-68, 80-81, 91-92; that he has knowledge of the matters set forth in such Report; and that such matters are true to the best of his knowledge and belief.

John P. Cassidy

Subscribed and sworn to before me this 10th day of May, 2010.

Notary Public

NIKKI SENN
Notary Public - Notary Seal
State of Missouri
Commissioned for Osage County
My Commission Expires: October 01, 2011
Commission Number: 07287016

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Tariff to Increase Its Annual Revenues for Natural Gas Service	))))	Case No. GR-2010-0171

AFFIDAVIT OF KIM COX

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Kim Cox, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Staff Report in pages 100-105; that she has knowledge of the matters set forth in such Report; and that such matters are true to the best of her knowledge and belief.

Kim Cox
Kim Cox

Subscribed and sworn to before me this 3rd day of May, 2010.

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

SUSAN L. SUNDERMEYER
My Commission Expires
September 21, 2010
Callaway County
Commission #06942086

Susan L. Sundermeyer
Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Tariff to Increase Its Annual Revenues for Natural Gas Service	)))	Case No. GR-2010-0171

AFFIDAVIT OF DOYLE L. GIBBS

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Doyle L. Gibbs, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Staff Report in pages 35-36, 37, 71, 75-76, 82, 92 ; that he has knowledge of the matters set forth in such Report; and that such matters are true to the best of his knowledge and belief.

Doyle L. Gibbs

Subscribed and sworn to before me this 10th day of May, 2010.

Notary Public

NIKKI SENN
Notary Public - Notary Seal
State of Missouri
Commissioned for Osage County
My Commission Expires: October 01, 2011
Commission Number: 07287016

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Tariff to Increase Its Annual Revenues for Natural Gas Service	)))	Case No. GR-2010-0171

AFFIDAVIT OF LISA K. HANNEKEN

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Lisa K. Hanneken, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Staff Report in pages 25, 35, 36-37, 38-58, 65, 72, 73-74 75, 76, 78, 79-80, 83; that she has knowledge of the matters set forth in such Report; and that such matters are true to the best of her knowledge and belief.

Lisa K. Hanneken

Subscribed and sworn to before me this 10th day of May, 2010.

NIKKI SENN
Notary Public - Notary Seal
State of Missouri
Commissioned for Osage County
My Commission Expires: October 01, 2011
Commission Number: 07287016

Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Tariff to Increase Its Annual Revenues for Natural Gas Service	)))	Case No. GR-2010-0171

AFFIDAVIT OF THOMAS M. IMHOFF

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Thomas M. Imhoff, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Staff Report in pages 05-07; that he has knowledge of the matters set forth in such Report; and that such matters are true to the best of his knowledge and belief.

Thomas M. Imhoff

Subscribed and sworn to before me this 4th day of May, 2010.

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

SUSAN L. SUNDERMEYER
My Commission Expires
September 21, 2010
Callaway County
Commission #06942086

Susan L. Sundermeyer
Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Tariff to Increase Its Annual Revenues for Natural Gas Service	))))	Case No. GR-2010-0171

AFFIDAVIT OF LESA JENKINS

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Lesa Jenkins, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Staff Report in pages 28-34, 82-90; that she has knowledge of the matters set forth in such Report; and that such matters are true to the best of her knowledge and belief.

Lesa A. Jenkins
Lesa Jenkins

Subscribed and sworn to before me this 10th day of May, 2010.

NIKKI SENN
Notary Public - Notary Seal
State of Missouri
Commissioned for Osage County
My Commission Expires: October 01, 2011
Commission Number: 07287016

Nikki Senn
Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Tariff to Increase Its Annual Revenues for Natural Gas Service	)))	Case No. GR-2010-0171

AFFIDAVIT OF MANISHA LAKHANPAL

STATE OF MISSOURI	)	
	)	ss.
COUNTY OF COLE	)	

Manisha Lakhanpal, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Staff Report in pages 58-60; that she has knowledge of the matters set forth in such Report; and that such matters are true to the best of her knowledge and belief.

Manisha Lakhanpal

Manisha Lakhanpal

Subscribed and sworn to before me this 10th day of May, 2010.

NIKKI SENN
Notary Public - Notary Seal
State of Missouri
Commissioned for Osage County
My Commission Expires: October 01, 2011
Commission Number: 07287016

Nikki Senn

Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Tariff to Increase Its Annual Revenues for Natural Gas Service	)))	Case No. GR-2010-0171

AFFIDAVIT OF ZEPHANIA MAREVANGEPO

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Zephania Marevangepo, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Staff Report in pages 8-25; that he has knowledge of the matters set forth in such Report; and that such matters are true to the best of his knowledge and belief.

Zephania Marevangepo

Subscribed and sworn to before me this 10th day of May, 2010.

NIKKI SENN
Notary Public - Notary Seal
State of Missouri
Commissioned for Osage County
My Commission Expires: October 01, 2011
Commission Number: 07287016

Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Tariff to Increase Its Annual Revenues for Natural Gas Service	)))	Case No. GR-2010-0171

AFFIDAVIT OF DAVID M. SOMMERER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

David M. Sommerer, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Staff Report in pages 74-75; that he has knowledge of the matters set forth in such Report; and that such matters are true to the best of his knowledge and belief.

David M. Sommerer

Subscribed and sworn to before me this 10th day of May, 2010.

Notary Public

NIKKI SENN
Notary Public - Notary Seal
State of Missouri
Commissioned for Osage County
My Commission Expires: October 01, 2011
Commission Number: 07287016

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Tariff to Increase Its Annual Revenues for Natural Gas Service	)))	Case No. GR-2010-0171

AFFIDAVIT OF DAVID WILLIAMS

STATE OF MISSOURI	)	
	)	ss.
COUNTY OF COLE	)	

David Williams, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Staff Report in pages 93-100; that he has knowledge of the matters set forth in such Report; and that such matters are true to the best of his knowledge and belief.

David Williams
David Williams

Subscribed and sworn to before me this 10th day of May, 2010.

NIKKI SENN
Notary Public - Notary Seal
State of Missouri
Commissioned for Osage County
My Commission Expires: October 01, 2011
Commission Number: 07287016

Nikki Senn
Notary Public