MEMORANDUM

TO: Missouri Public Service Commission Official Case File,
Case No. GR-2003-0224, Laclede Gas Company

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/s/ Dave Sommerer 12/29/04	/s/ Thomas R. Schwarz 12/29/04
Project Coordinator / Date	General Counsel's Office / Date

SUBJECT: Staff's Recommendation in Case No. GR-2003-0224, Laclede Gas Company's 2002-2003 Actual Cost Adjustment Filing

DATE: December 29, 2004

The Procurement Analysis Department (Staff) has reviewed Laclede Gas Company's (Company or Laclede) 2002-2003 Actual Cost Adjustment (ACA) filing. This filing was made on October 31, 2003, and is docketed as Case No. GR-2003-0224. The filing contains the Company's calculations of the ACA and Refund balances. The Staff's review included an analysis of billed revenues and actual gas costs for the period October 1, 2002 through September 30, 2003.

Laclede Gas Company serves approximately 630,000 residential, commercial and industrial customers in the St. Louis metropolitan area and the surrounding southeastern counties.

Staff conducted a reliability analysis for Laclede including a review of estimated peak day requirements and the capacity levels to meet those requirements, peak day reserve margin and the rationale for this reserve margin, and a review of normal and cold weather requirements. The Staff also reviewed Laclede's gas purchasing practices to determine the prudence of the Company's purchasing and operating decisions.

RELIABILITY ANALYSIS

To assure that sufficient capacity, but not excess capacity, is available to meet firm customer peak day capacity and natural gas supply requirements, Staff conducts a reliability analysis. The objective is to assure that a company has adequate capacity to provide natural gas to its firm customers on even the coldest days without maintaining excess capacity because when a company maintains excess capacity it costs consumers money without any related benefit.

Staff has the following comments and concerns regarding the Company's reliability information:

1. Laclede states that it conducted a regression analysis of actual distribution data for the winter of 2000-2001 to develop its estimate of peak cold day requirements.

However, the Company used only the daily data for the month of December, not for the entire winter. Laclede states that it did so because this was a recent period with sustained cold weather. Weekend and holiday data were included in the analysis.

Laclede excludes volumes for interruptible customers by estimating interruptible customer values from customer usage data for the 2000-2001 period; daily meter reads were not available at that time (Data Request No. 111). Electronic metering is now installed for all interruptible customers, but Laclede states that the equipment only stores up to 45 days of usage history and the Meter Department must go out to the meter and perform a download in order to obtain the data and the only time this is done is during periods of interruption just to verify the customer discontinued taking gas (Data Request No. 111).

Staff is concerned that the regression analysis only considers 31 days of data for estimating peak day capacity requirements. Because actual distribution data for other winter months was not evaluated in the peak day estimate, Staff cannot determine whether these would have resulted in the same or different estimates of peak day. Staff recommends that Laclede at least consider January and February actual distribution data in its review of peak day estimate.

Additionally, Staff is concerned that the interruptible customer daily volumes cannot be verified. For subsequent ACA periods, the 2003-2004 ACA and forward, Staff recommends that Laclede submit interruptible customer daily volumes for the winter months of December through February.

2. Laclede states that it did not include the one-degree slope addition in its estimate of peak day requirements that it had used in prior years. In a prior ACA review Staff had expressed concerns regarding addition of this factor unless additional justification was provided. Since Laclede is not using the one-degree slope addition, it is no longer an issue.

3. Laclede states that the normal adjustment factor (NAF), previously used to account for greater fuel usage for water heaters in the winter months, is not being used in this regression equation. In a prior ACA review Staff had expressed concerns regarding the use of the NAF. Since NAF is not being used in the Laclede peak day estimate for 2002-2003, it is no longer an issue.

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6. The reserve margin for early to mid-winter is high, but as storage is drawn down, the Laclede withdrawal capacity decreases and thus the reserve margin reduces. Staff disagrees with the pipeline capacity value used by Laclede in the reserve margin calculation and uses a higher pipeline capacity. However, even with this revision the late winter reserve margin estimate is reasonable at this time.

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HEDGING

The Staff reviewed the Company's Risk Management Strategy and its hedging transactions applicable to the 2002-2003 ACA period. In particular, the Staff found that the Company had significant hedging in place, on average when viewed over the entire winter period during November 2002 through March 2003, based on actually delivered gas. This hedged coverage comes not only from financial instruments but from storage withdrawals as well. The Staff also reviewed monthly hedged coverages. Although the Company provided a copy of its risk management strategy along with some explanations of how each financial transaction fit into the Company's risk management strategies, it did not provide critical supporting calculations for various matrices used to support price driven futures market activity. For example, its risk management strategy calls for the purchase of fixed price forward contracts in accordance with a specified price schedule, but how the price schedule was actually generated in terms of its specific calculations, was not provided to the Staff. The Company tariffs allow the pass-through of prudently incurred hedging costs, therefore it should be required to provide support for the reasonableness of those hedging expenditures. The Staff recommends that supporting documentation for the Company's pricing matrices, including cell formulas that are electronically readable, be provided to Staff for the 2003-2004 ACA review.

Although the Company provided the Staff documentation of its hedging transactions, the Staff did not find sufficient details regarding the rationale for each of its hedging transactions. For example, the Company evaluation of the market conditions that either support initiating the hedge or liquidating the hedge position. Additional detail regarding coding of the general types of hedging was provided in February of 2004 which the Staff views as a positive step but does not provide enough detail to show the specific explanation for the actions taken. Therefore, the Staff recommends that for the 2004-2005 ACA period forward, the Company provide for each hedging transaction a brief narrative of the interplay between the hedging purchase or liquidation and the Risk Management Strategy. The Staff further recommends this documentation should be maintained and be made available to the Staff during each ACA review.

RECOMMENDATIONS

The Staff recommends the Commission issue an order requiring Laclede to:

1. Establish the following account balances in its next ACA filing to reflect the (over)/under recovery of ACA and Refund balances to be (refunded)/collected from the ratepayers as of September 30, 2003:

	(Over)/Under Recovery per Laclede Filing	Staff Adjustments	Ending Balances
Firm Sales non-LVTSS	$ (3,823,401)		$ (3,823,401)
Firm Sales LVTSS	$ 1,135,186		$ 1,135,186
Interruptible Sales	$ 62,628		$ 62,628
LP Sales	$ 27,119		$ 27,119
Firm Transportation	$ (104,512)		$ (104,512)
Vehicular Fuel	$ 893		$ 893
Refund	$ 342,035		$ 342,035

2. Address the concerns in the Reliability Analysis Section regarding data used to estimate Laclede's peak day capacity requirements, utilization of Laclede's Lange underground storage resource in the winter months, and information regarding Laclede's propane facilities. Submit information addressing these concerns by March 31, 2005.

3. Document, for each hedging transaction executed, its rationale supporting its decision at the time of transaction for the 2004-2005 ACA period, as noted in Staff's comments in the Hedging section of this Memorandum. The Company will submit a copy of this documentation to Staff by November 1, 2005.

4. Respond to the recommendations herein within 30 days.