MEMORANDUM

TO: Missouri Public Service Commission Official Case File,
Case No. GR-2004-0273, Laclede Gas Company

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/s/ Dave Sommerer 12/29/05	/s/ Thomas R. Schwarz 12/29/05
Project Coordinator / Date	General Counsel's Office / Date

SUBJECT: Staff's Recommendation in Case No. GR-2004-0273, Laclede Gas Company's 2003-2004 Actual Cost Adjustment Filing

DATE: December 29, 2005

The Procurement Analysis Department (Staff) has reviewed Laclede Gas Company's (Company or Laclede) 2003-2004 Actual Cost Adjustment (ACA) filing. This filing was made on October 29, 2004, and is docketed as Case No. GR-2004-0273. 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, 2003 through September 30, 2004.

Laclede Gas Company serves approximately 632,000 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

The Company is responsible for conducting reasonable long range supply planning and the decisions resulting from that planning. One purpose of the ACA process is to examine the reliability of the Local Distribution Company's (LDC's) gas supply, transportation, and storage capabilities. For this analysis, Staff reviews the LDC's plans and decisions regarding estimated

peak day requirements and the capacity levels to meet those requirements, peak day reserve margin and the rationale for this reserve margin, and natural gas supply plans for various weather conditions.

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

1. Reserve Margin

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 decreases. Staff disagrees with the pipeline capacity value (MMBtu/day value) used by Laclede in the reserve margin calculation and uses a higher pipeline capacity figure/number. Laclede asserts that excess reserve is needed because of potential failure of a component in the propane facilities, but the deliverability calculated for these facilities already is reduced for startup problems and/or operational inefficiencies. However, even with the revision in pipeline capacity, the late winter reserve margin estimate is reasonable at this time.

2. Pipeline Capacity – Upstream

To support the quantity of upstream pipeline capacity needed, Laclede states that it considers: 1) geographic diversity of supply, 2) the availability of the firm flexible type supplies that it requires in its gas supply portfolio, 3) cost of supply in comparison to other options the Company may have from time to time, 4) access to supplies during late cold peak days when Mississippi River Transport (MRT) storage and on-system peak shaving resources are limited, and 5) transport availability in the long term (Data Request No. 107-HC).

Laclede states that certain supply areas are dominated by producers that only offer baseload-type services so it has to be careful not to rely too heavily on these areas when structuring its portfolio (Data Request No. 107-HC). Such a review should include a summary of the upstream pipelines that can provide the transportation for the firm flexible type supplies desired by Laclede, with a breakout for both the summer and winter months. However, Laclede provided no details to support which supply areas are dominated by producers with baseload only service.

Laclede indicates that it must consider how the supply basis varies in summer versus winter and where physical supply is needed to meet winter peak needs. It must also consider where supply is needed to fill MRT's storage in the summer months. The Company states that physical constraints require it to take large quantities of supply in certain areas of its system in the winter months but will only allow small quantities to be taken in the summer months when system requirements are low. Laclede further states that during the summer months, the Company needs large quantities in the field to maintain MRT storage injections. (Data Request No. 107-HC) However, Laclede provides no specific information explaining how the upstream pipelines were evaluated for 2003/2004 to assure that the stated conditions were met for the winter months and for

the summer months with acceptable cost. For example, between 2002/2003 and 2003/2004 Laclede dropped its capacity subscription from 100,000 MMBtu/day to 80,000 on Natural Gas Pipeline Company of America (NGPL) and increased its capacity from 60,000 MMBtu/day to 80,000 on Trunkline while maintaining the same capacity on Center Point Energy and Gulf South. Laclede provided no analysis supporting these changes.

Laclede states that it is the most vulnerable to daily peak sendout situations late in the winter season when on-system peak shaving resources and Laclede's storage in MRT's Unionville storage site are potentially depleted. Laclede asserts that it must have access to flowing supplies on upstream pipelines given the limited amount of supply that is directly connected to the MRT system. Laclede provides an Excel worksheet to support these statements (Data Request No. 107-HC), but the worksheet does not explain what gas can be sourced on MRT or on each of the upstream pipelines in this late winter analysis. Nor does the worksheet explain why Laclede split the upstream capacity among the various pipelines for the 2003/2004 ACA period. The lack of information raises the question of how Laclede evaluated the cost of sourcing the supply on each pipeline. The lack of information makes evaluation of the Company's prudence much more difficult.

Staff recommends that Laclede provide more details of its analysis for subsequent ACA reviews to address these issues and that this information for 2004/2005 and 2005/2006 be submitted no later than June 1, 2006. If Laclede does not have such an analysis for the 2004/2005 or 2005/2006 ACA periods, Staff recommends that the Commission order Laclede to provide, no later than June 1, 2006, a more detailed analysis prior to the 2006/2007 ACA period.

3. School Aggregation

Laclede excludes basic transportation and interruptible customer requirements in its peak day estimate because there is no obligation to provide back-up gas supplies for these customers. However, Laclede includes requirements for School Aggregation Service, a service similar to basic transportation, in both its pipeline capacity and peak day requirements, even though schools obtain capacity through Laclede capacity release and are responsible for their own supply. Capacity release for the school aggregation program is 19.01 MMcf/day (19.39 BBtu) for November through March and 8.45 MMcf/day (8.62 BBtu/day) for April through October. Laclede has developed estimated requirements for schools for each month of November through May. Using these Laclede factors and an expected historical peak cold day of minus eight degree Fahrenheit, estimated peak day usage for these schools is 23.2 MMcf. Released capacity only covers 81.9% of school peak day needs and schools are only paying for this level of capacity for five months of the year. The remaining seven months of the year, schools are paying for capacity equal to 36.4% of peak day needs. The downstream capacity (MRT, Southern Star, and Panhandle/ Missouri Pipeline Company) for firm customers (mainly residential and small commercial customers) is paid for 12 months a year. Thus, these firm customers (mainly residential and small commercial customers) are carrying

the extra load for schools for all the months that schools are not covered for peak day capacity.

Supply nominated by the schools participating in the school aggregation program, versus the actual usage is shown below. In three of the six months where data was provided, the school nomination and the actual usage were more than 20% different.

Laclede School Aggregation Information	Nominations (therms)	Actual Usage (therms)	Nominations as % of Actuals
Nov-03	1,563,031	788,196	198%
Dec-03	2,797,804	2,315,868	121%
Jan-04	3,537,988	3,036,658	117%
Feb-04	3,027,811	3,436,059	88%
Mar-04	1,843,900	1,853,232	99%
Apr-04	775,840	997,455	78%
May-04	-		
Total	13,546,374	12,427,469	109%

4. Data for Volumes for Interruptible Customers

Although Laclede excludes volumes for interruptible customers from the peak day estimate, it uses estimated values, not actual values. In the 2002/2003 ACA review, Case No. GR-2003-0224, Staff commented on this lack of verification. Staff recommended that for subsequent ACA periods, the 2003/2004 ACA and forward, Laclede submit interruptible customer daily volumes for the winter months of December through February. Although Laclede responded that the interruptible customers account for deminimus amounts of the total purchases, it agreed to obtain the daily usage data for these customers for any periods of sustained cold weather in 2004/2005. Staff will review this information in the 2004/2005 ACA. If Laclede does not provide the data because there were no periods of sustained cold weather in 2004/2005, Staff recommends that Laclede submit, no later than June 1, 2006, this information for 2005/2006.

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6. Targets for Physical Supply

The Company's reliability report does not contain targets for actually acquiring physical supply. Having major portions of the physical supply not under contract until near the start of the heating season may pose a reliability issue. The reliability report should specify target dates for acquiring physical supply with consideration given to contracting for this supply earlier than just prior to the heating season.

GAS SUPPLY ANALYSIS

Based on its review of Laclede's gas purchasing practices Staff proposes adjustments reducing Laclede's cost of gas for Laclede's decisions regarding contracted volumes of ** _____
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Staff's review reveals a large difference in Laclede's baseload contracts for 2003/2004 compared to the prior ACA of 2002/2003.

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As shown below, Laclede did not follow its study when setting the baseload volumes for November through April and its baseload volumes for May through September are not consistent with the RFP.

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Laclede's decision to baseload less volumes of natural gas than called for in its study resulted in additional costs to its customers of $2,329,295. Staff recommends that these costs be disallowed for the 2003/2004 ACA period.

2. Swing Supply Demand Charges

Natural gas supply contracts may include a demand charge for the amount of gas a local distribution company (LDC) can nominate on any given day. Usually, baseload contracts have no demand charge or a relatively small demand charge, while swing contracts generally have the highest demand charges. ** _____ _____ _____ **

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_____ ** When added to the earlier adjustment of $2,329,295, the total adjustment is $3,322,773.

3. Cost/Benefit Analysis for Producer Demand Charges

Given the level of demand charges, ** _____ _____ _____ _____ **

- ** _____ _____
- _____ _____ **
- It should isolate and separately identify "off-system sales" so that costs and benefits related to on-system customers can be separately identified.

The Company should also, maintain, and make available for review, in electronically readable format, all workpapers that support the study. These workpapers should maintain full functionality with readable cell formulas, macros, or other program add-ins that were used in the spreadsheet calculations. Finally, the study should be a before-the-fact study that is completed in time to help the Company assess the cost/benefits of ** _____ **

HEDGING

The Staff reviewed the Company's Risk Management Strategy and its hedging transactions applicable to the 2003-2004 ACA period. Weather during the winter period was warmer than normal. Laclede's hedged coverage comes from financial instruments and from storage withdrawals. The Staff also reviewed monthly hedged coverage.

1. Hedging Documentation

The Company provided a copy of its risk management strategy along with documentation of its hedging transactions. However, 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. Several other examples illustrate a lack of sufficient hedge documentation detail. ** _____ _____ _____ _____ _____ _____

_____ ** Since the Company tariffs allow the pass-through of prudently incurred hedging costs, Laclede should be obligated to provide justification and support for the reasonableness of those hedging expenditures. Therefore, the Staff recommends that for the 2004-2005 ACA period forward, the Company provide, for each hedging transaction executed, its rationale supporting its decision and a brief narrative of the interplay between the hedging purchase or liquidation and the Risk Management Strategy. This should include all reports that tie the Company's actual hedge results to the targets stated in the Company's risk management strategy and a specific identification of instruments that are used in conjunction to create a particular hedge strategy. The Staff further recommends this documentation should be maintained and be made available to the Staff during each ACA review.

2. Hedge Effectiveness Testing

Based upon the information provided by the Company, it appears that Laclede does not test the hedge effectiveness of its financial instruments, although it does so for its marketing subsidiary, LER. Without measuring hedge effectiveness (required when the Financial Accounting Standards Boards Statement 133(SFAS) is applicable), there is a risk that the hedges that are established do not effectively protect the physical supply risk that is being hedged. ** _____ ** The Staff recommends that the Commission order the Company to test and document the effectiveness of its hedges in a manner consistent with the guidelines contained in the SFAS 133.

RECOMMENDATIONS

It is Staff's opinion that Laclede should do the following:

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, 2004:

   a. If the Company accepts the Staff recommendation for contracted volumes of ** _____ ** and the Staff recommendation for swing supply demand charges:

	Firm Sales non-LVTSS	Firm Sales LVTSS	Interruptible Sales	LP Sales	Firm Transportation	Vehicular Fuel	Refund
Beginning ACA Balance	$ 18,661,505	$1,032,722	$ (3,604)	$ 118,000	$ 464,331	$ 18,752	$ 348,488
Staff Adjustments:							
** _____ _____ _____ **	$ (2,323,370)	$(5,925)					
Swing Supply Demand Charges	$ (990,951)	$ (2,527)					
Ending ACA Balance	**$ 15,347,184**	**$1,024,270**	**$ (3,604)**	**$ 118,000**	**$ 464,331**	**$ 18,752**	**$ 348,488**

b. If the Company rejects the Staff recommendation for contracted volumes of ** _____ ** and accepts the Staff recommendation for swing supply demand charges:

	Firm Sales non-LVTSS	Firm Sales LVTSS	Interruptible Sales	LP Sales	Firm Transportation	Vehicular Fuel	Refund
Beginning ACA Balance	$ 18,661,505	$1,032,722	$ (3,604)	118,000	$ 464,331	$ 18,752	$348,488
Staff Adjustments:							
** _____ _____ _____ **	$ -	$ -					
Swing Supply Demand Charges	$ (2,417,854)	$ (6,166)					
Ending ACA Balance	**$ 16,243,651**	**$1,026,556**	**$ (3,604)**	**$118,000**	**$ 464,331**	**$ 18,752**	**$348,488**

2. Respond within thirty days to the school aggregation comments made by Staff in the Reliability Analysis Section.

3. Address the concerns in the Reliability Summary Section regarding support for the upstream pipeline capacity, data for volumes for interruptible customers, ** _____ _____ ** and targets for physical supply. Submit information addressing these concerns by June 1, 2006.

4. Adjust the ACA balance by $2,329,295 for Laclede's decisions related to ** _____ _____ **

5. Adjust the ACA balance for Laclede's decisions to price its swing contract supplies with ** _____ **

a. If the Company accepts the Staff recommendation for contracted volumes of ** _____ ** (recommendation number 4 above),adjust the ACA balance by an additional $993,478 for Laclede's decision to price its ** _____ _____ **

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b. If the Company rejects the Staff recommendation for contracted volumes of ** _____ ** (recommendation number 4 above) and accepts the Staff recommendation for ** _____ **, adjust the ACA balance by $2,424,020.

6. Provide a cost/benefit analysis for producer demand charges as recommended in item number three of the Gas Supply Analysis section of this recommendation. Provide an analysis for the 2006/2007 year to Staff by June 1, 2006.

7. Document and make available to the Staff, for each hedging transaction executed, the following information for the 2004-2005 ACA period forward:

a. For each hedging transaction executed, Laclede's rationale supporting its decision at the time of the transaction and a brief narrative of the interplay between the hedging purchase ** _____ ** and the Risk Management Strategy. This should include all reports that tie the Company's actual hedge results to the targets stated in the Company's risk management strategy and a specific identification of instruments that are used in conjunction to create a particular hedge strategy.

b. Laclede's evaluation of the market conditions that either support initiating the hedge ** _____ ** the hedge position.

c. ** _____
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d. ** _____
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e. A report of how much of the Company's monthly hedge targets ** _____ _____ ** are actually achieved for that month and cumulatively.

For the 2004-2005 ACA, provide this documentation to Staff by June 1, 2006.

8. Test and document the effectiveness of its hedges in a manner consistent with the guidelines contained in the Statement of Financial Accounting Standard (SFAS) 133. For the 2004-2005 ACA, provide this to Staff by June 1, 2006.

9. Respond to the recommendations herein within 30 days.