Exhibit No.:	
Issue:	**Gas Supply Incentive Program** **First-of-Month Demand Charges**
Witness:	**George E. Godat**
Type of Exhibit:	**Direct Testimony**
Sponsoring Party:	**Laclede Gas Company**
Case No:	**GR-2007-0___**
Date:	**December 1, 2006**

LACLEDE GAS COMPANY

GR-2007-0___

DIRECT TESTIMONY

OF

GEORGE E. GODAT

DECEMBER 2006

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DIRECT TESTIMONY OF GEORGE E. GODAT

Q. What is your name and address?

A. My name is George E. Godat, and my business address is 3950 Forest Park Boulevard, St. Louis, Missouri 63108.

Q. By whom are you employed and in what capacity?

A. I am employed by Laclede Gas Company ("Laclede" or "Company") in the position of Director of Gas Supply. As Director of Gas Supply, I am responsible for directing most of the day-to-day gas supply purchasing, sales and risk management functions for Laclede Gas Company.

Q. Please describe your work experience prior to assuming your present position.

A. I joined Laclede in January of 1992 as an Engineer in the Distribution/Design department. I was promoted to Distribution Engineer in 1994 where I was responsible for the Engineering Department of Laclede's Missouri Natural Division. I was promoted to the position of Gas Supply Administrator in the Gas Supply Department in 1996 and to Senior Gas Supply Administrator in 1998. I became Manager of Energy Services in October 2001, and was promoted to my current position in October 2003.

Q. What is your education background?

A. I graduated from the University of Missouri Rolla in 1991, where I received a Bachelor of Science degree in Mechanical Engineering.

Q. Have you previously testified before any regulatory bodies?

A. Yes. I have previously filed testimony before this Commission, most recently in Case No. GR-2004-0273.

PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony?

A. The purpose of my testimony is twofold: (i) to support improvements to the Company's Gas Supply Incentive Plan ("GSIP" or "Plan") for the benefit of both the Company and its customers; and (ii) to bring more structure and certainty to the gas supply procurement process by establishing a method for determining an acceptable level of demand charges to be paid for the right to purchase gas at a first-of-month ("FOM") price.

CHANGES TO THE GAS SUPPLY INCENTIVE PLAN

Q. What changes do you propose to improve the Plan?

A. The two changes that the Company proposes to make to the Plan consist of (i) removing the Plan's price band, which currently restrains the Company's incentive to reduce upward price volatility for customers; and (ii) maintaining the incentive amount at a flat 10% for all savings achieved under the Plan. Both of these changes will remove restraints and free the Plan to operate as it was intended, that is, to effectively motivate the Company to reduce gas costs at all times, especially when such costs are at their highest and customers need for price relief is at its greatest.

Q. Please provide some background on the Plan and the price band.

A. The current GSIP was established at the conclusion of the Company's 2002 rate case, GR-2002-356. It permits the Company to earn an incentive award if the cost of the Company's physical gas purchases, adjusted by gains and losses from financial hedging, are below a benchmark index. If Laclede can generate savings by bringing these net costs in below the benchmark, it is eligible to receive 10% of the first $50 million in savings, and 1% thereafter. In 2002, the GSIP originally featured a pricing band of $3 to $5 per MMBtu (Million British thermal units), such that Laclede was only rewarded, and thus incented, if the benchmark was above $3, and Laclede's net costs were below $5. Thus, as actual gas prices, represented by the benchmark index, rose above $5 per MMBtu, the incentive increasingly weakened.

Q. What was the theory behind the price band?

A. My understanding of the theory is that, for the low end of the price band ($3), an incentive award was <u>not</u> considered necessary because there was presumably little marginal value to be achieved in the way of savings when gas prices were already so low. For the high end of the price band (then $5), the theory assumed that an incentive award was <u>not appropriate</u> because at such prices is was presumably too painful for customers to pay an incentive award and simultaneously bear the cost of the higher commodity price.

Q. What happened with the 2002 version of the Plan?

A. The first year of the Plan was successful, as the Company achieved significant savings below the benchmark and received an incentive award as a result of its efforts. Due to the upward migration of gas prices soon after the Plan began, however, it quickly became apparent that, with the $3-5 price band, the Plan would cease to operate as an incentive. This, in fact, was the case for both the winters of 2003-04 and 2004-05.

Q. What happened then?

A. An attempt was made to address this shortcoming in Laclede's 2005 rate case, GR-2005-0284. In that case, both the bandwidth and the ceiling of the price band were increased, from the aforementioned $3-$5 per MMBtu, to $4-$7.50 per MMBtu, respectively. However, continued increases in gas costs once again priced the Plan out of the market, and undermined its usefulness as an incentive.

Q. Do you agree with the price band approach?

A. No. I disagree with the price band because it appears that the price band is based on the theory that the incentive performance can be separated from the incentive award. Incentive programs are structured around the basic theory of rewarding performance. Program designers should not expect to encourage the performance without the reward, nor to pay the reward without receiving the performance. It should be obvious that encouraging efforts to reduce the effect of upward pressure on gas prices is most crucial when those prices are high and that this is exactly the wrong time to remove incentives that have been specifically designed to do just that.

Q. Is that why you are proposing to remove the price band?

A. Yes, the parties to Laclede's two most recent rate cases agreed that an incentive plan on overall gas commodity prices was appropriate as a means of encouraging the Company's efforts to outperform a benchmark price for the benefit of its customers. This is especially important to customers, since gas prices constitute more than 70% of their bills. Given this consideration, it follows that one should always want the reduction of these costs to be at the forefront of Laclede's portfolio planning, regardless of the price level of the underlying commodity.

However, the price band reduces or entirely eliminates this incentive under certain circumstances to the disadvantage of customers.

Q. How does the price band disadvantage customers?

A. First, the price band causes opportunity losses for customers. It eliminates any extra incentive to reduce gas commodity costs at levels outside the band, which is counter-productive to an incentive program that should optimize price reduction at any price level. Since customers will retain the vast majority (at least 90%) of any savings achieved under the Plan they should affirmatively want Laclede to have this extra incentive whether gas prices are $5, $10 or $20 per MMBtu. If Laclede can generate a savings of 20 cents per MMBtu, customers will always be better off, regardless of whether the 20 cent savings resulted in gas costs being $2.80 instead of $3.00, or $9.80 instead of $10.00.

Q. Please continue.

A. Second, as discussed above, under the current Plan, the price band only creates an incentive when gas costs are within or near the band. As prices increase above the band, the incentive increasingly fades, just when the customers need for price relief is greatest.

Q. Are the same considerations true when prices are below the band?

A. While it may be less critical to reduce prices when they are already low, the savings from doing so are still meaningful. Indeed, an extra cost reduction should always be welcome regardless of whether prices are already low.

Q. Turning to your second proposed change, why does Laclede believe that the Commission should change the incentive award to a flat 10%?

A. At the outset, a flat 10% incentive makes more sense than providing a 10% incentive for the first $50 million saved, and then basically eliminating any extra incentive for Laclede to generate savings above that arbitrary level by having the percentage that may be retained plummet to 1%. In fact, in order to maximize the savings that customers may enjoy, it makes more sense to <u>increase</u> the incentive for savings above a given level. However, for purposes of this testimony, Laclede is not proposing an increase above the 10% level.

Q. Would the sharing mechanisms proposed by Laclede in this case also limit the amount it might collect under the Plan?

A. Yes. Laclede proposes to include Plan earnings with the other earnings subject to the sharing mechanisms set forth in the Company's Regulatory Compact proposal in this case. To the extent that Laclede's earnings otherwise exceed its authorized rate of return, the sharing mechanisms will dilute the amounts Laclede would otherwise retain under the Plan. Dilution of a 10% incentive level can still provide the desired motivation. However, if an award level is already at 1%, as provided in the current Plan, further dilution will certainly eradicate any meaningful incentive.

<u>ESTABLISHING AN ACCEPTABLE LEVEL OF FOM DEMAND CHARGES</u>

Q. Why does Laclede want to establish a method for determining an acceptable level of FOM demand charges?

A. For the reasons set forth below, Laclede believes that FOM pricing provides valuable protection to customers from intra-month price spikes caused by real or perceived pressures on supply and demand and other benefits in the form of off-system sales revenues. However, criticisms leveled by Staff have created uncertainty regarding an appropriate level of demand charges to pay for the right to buy gas at an FOM price. Therefore, Laclede seeks to establish guidelines constituting an acceptable level, or safe harbor, for FOM charges.

Q. What is FOM pricing?

A. FOM pricing means that Laclede is entitled to purchase gas for an entire month at the price established at the first day of the month. Laclede's gas purchasing portfolio consists of three basic types of purchasing options, based on the Company's flexibility in making a purchase commitment. These include "Baseload" "Swing" and "Combination" purchase arrangements. The Company is required to make purchase Baseload gas in uniform daily amounts through the month, so it carries the least flexibility. With Swing supplies, however, the Company has the right, but not the obligation, to buy whatever amount of such supplies it needs on any given day. Accordingly, Swing supplies have the most flexibility. In between these two is "Combination," or "Combo" gas, in which the Company need not commit to a particular daily level, but must meet monthly or annual minimum requirements. Combo gas has some flexibility. Beginning in the first half of the 1990s, when Laclede became responsible for purchasing gas supplies for its customers, Laclede has arranged to purchase all types of gas at FOM prices.

Q. How is the FOM price derived?

A. The FOM price is derived by averaging the fixed price trading activity the week prior to the beginning of each month. Most fixed price baseload gas is bought and sold just before the start of a month and publications (such as Inside FERC) collect the trading data from the activity that took place during that week and post an FOM price for all the different locations where the trading activity took place. For example, under an FOM arrangement, Laclede will be able to buy gas during the month of December 2006 based on the prices of the gas that was traded from November 27 through November 30.

Q. Why is the right to FOM pricing desirable?

A. This pricing process permits Laclede and its customers to avoid incurring the cost of temporary intra-month price spikes. These daily spikes are normally caused by either real or feared stresses on the supply/demand balance that may arise during the month when either the demand exceeds, or is perceived to exceed, normal levels, or when there is a real or feared shortage or disruption in supply. At such times, FOM pricing acts as an insurance policy or hedge by providing Laclede the right to buy gas for its customers at a stable FOM price, rather than paying an unpredictable daily rate.

Q. Could you provide examples of supply/demand imbalances?

A. High demand can be caused by colder than normal weather. For example, in December 2000, and again in February 2003, when the weather turned cold, spot prices for gas shot up tremendously. Low supply can be caused by an event such as a storm in the Gulf of Mexico. Hurricanes Katrina and Rita were responsible for causing a supply shortage in 2005, which also resulted in a huge, but temporary price increase.

Q. What are FOM demand charges?

A. FOM demand charges are fixed costs that gas producers charge Laclede for the right to reserve supplies and buy gas at FOM prices. By analogy, if one equates the right to buy gas at an FOM price as being akin to an insurance policy against intra-month price spikes, then FOM demand charges are akin to an insurance premium.

Q. Please explain what drives the price for FOM demand charges.

A. As you might expect, FOM prices are driven by two main factors: price volatility and the underlying price for natural gas. Price volatility is the main driver. It basically is a measure of how much prices tend to change during any given month, as compared to the FOM price. FOM demand charges will increase as price volatility increases. The underlying price is the actual price level, including forward strip prices, as represented by NYMEX rates. Generally, higher price levels result in higher FOM demand charges. Since the well-publicized natural gas price increase that occurred in December 2000, prices have repeatedly hit historically high levels on the daily spot market. The result of these developments has been a strong and, thus far, accurate perception in the market that there is a high likelihood that prices will reach these or higher levels again -- a factor that has placed upward pressure on FOM demand charges.

Q. Has Laclede increased the amount it has spent for FOM demand charges over the past five years?

A. Yes we have. Since the supply/demand balance tightened in early 2000, natural gas prices have trended upward, as have FOM demand charges. Not surprisingly, as both the daily fluctuation in price and the underlying prices have climbed to higher and higher levels, the cost to protect against these fluctuations has also increased.

Q. Has this increase in the cost to provide price stability been seen in areas outside the physical commodity?

A. Yes it has. Laclede has had numerous conversations with Staff regarding the increase in the amount of money it has authorized to purchase financial hedging instruments. Back in early 2000, Laclede's Gas Supply Department was authorized to spend $4 million on financial call options and was limited to purchasing options at a strike price of no more than $4. The current authorization level has been increased to $15 million, with option-based protection at strike prices in the $8 to $13 range. As you can see, the *range* in which strike prices for options may fluctuate is now larger than the *entire strike price* for the option earlier in this decade.

Q. How much have the Company's gas commodity costs increased over this time period?

A. The Company's physical gas costs have increased steadily since the late 1990's. For example they have gone from an average of $3.01/MMBtu in 1999-2000, to and average of $7.74/MMBtu in 2005-06.

Q. How much has price volatility increased over this period?

A. I've attached a chart as schedule 1 that shows the daily prices for Centerpoint Energy field zone price, where Laclede buys a large portion of its supply, from late 1996 until November 1, 2006. As you can see by the chart, the daily price fluctuations have become extremely unstable with huge fluctuations up and down day to day. Since the big run-up in late 2000, the daily prices have become extremely volatile with prices dropping below $2.00/MMBtu in 2001 and reaching as high as $19.13 in February 2003. This is the price for a field zone location and the daily spot price in locations such as Chicago and the Northeast have been even more dramatic than the field zone.

Q. To what extent have the FOM demand charges increased compared to the overall increase in volatility and gas commodity costs?

A. The FOM demand charges have been driven up by both price volatility and price levels. Still, they have remained at or below 5% of our overall gas costs when normalized for weather over this five-year period. The increases in the Company's physical gas costs and the gas supply demand charges have been proportionate.

Q. Has the Company recently altered its approach to buying FOM contracts?

A. Yes, it has. During discussions between Staff and the Company regarding the level of imputation of off-system sales in the Company's 2005 rate case, the Staff, for the first time, raised the subject of FOM demand charges. At the same time that Staff was proposing a base rate imputation based on a five-year average of off-system sales revenues, it questioned the amounts Laclede spent on the FOM demand charges that supported these off-system sales. Although Laclede had for the past <u>decade</u> been paying demand charges for the right to FOM pricing, just a few months later in 2005, the Staff proposed a disallowance of $3.3 million in the Company's 2003-04 ACA case, based on FOM demand charges paid by Laclede on swing supply gas during that ACA year.

Q. How did the Company respond?

A. The Company is opposing the disallowance in that ACA case because the practice of paying demand charges to obtain FOM pricing has benefited customers financially over the years. However, for the winters of 2005-06 and 2006-07, the Company changed its mix of supplies to add daily priced contracts in place of some of its traditional flexible FOM supplies.

Q. Why did the Company substitute gas based on daily price versus FOM price?

A. The disallowance case brought by Staff in Fiscal 2006 represents a threat to roughly 10% of the Company's entire authorized return for that year. Given the fact that Laclede basically passes on the cost of gas to its customers without mark-up or profit, the Company simply cannot afford to take the kind of risks posed by the kind of Staff disallowances being sought in Case No. GR-2004-0273. Because it was not until 2005 that Staff first questioned the amount of these FOM demand charges, there was nothing Laclede could do about the actions it had already taken in 2003-04 (or 2004-05, for that matter). However, Laclede can, and did, react to the threat posed by Staff's asserted disallowance by reducing its overall use of FOM demand charges and, at the same time, its overall flexibility in acquiring gas supply, for the ensuing winters of 2005-06 and 2006-07.

Q. Does the Company think its approach beginning in the winter of 2005-06 is the ideal portfolio for its customers?

A. The Company does not believe that the portfolio it had in place for the 2005-06 ACA period included the level of FOM pricing that our customers ideally need. Given the Staff's position on FOM demand charges, however, the Company felt compelled to limit its expenditures on such demand charges.

Q. How did this portfolio work out for the 2005-06 period?

A. As it turned out, there was no adverse impact on our customers for this particular year because, fortunately, we experienced an extremely mild winter with downward pressure on demand, and thus downward pressure on price. Although January is usually the coldest month, we instead experienced the third warmest January on record, with less degree days than either December or February. However, if the weather had been colder, customers could have been exposed to some very high intra-month prices on daily swing supplies.

Q. What is Laclede's proposal in this case regarding FOM pricing and demand charges?

A. Laclede's goal is to return to a portfolio that is made up primarily of FOM supplies. The Company believes that the small percentage of overall gas cost that is required for this price stability is well worth the expense, given the recent high priced environment and intra-month price spikes that have occurred when the supply/demand balance is subjected to real or feared stresses.

Q. In addition to the value of FOM pricing as an insurance policy, is there any other way for Laclede to add further value from FOM pricing?

A. Yes, Laclede can create value by making off-system sales to customers located off its system.

Q. How do off-system sales create value?

A. On any given day when Laclede's customers do not temporarily need gas that is available to Laclede for purchase at an FOM price (and the daily price is higher than the FOM price), Laclede can create value by purchasing gas at the FOM price and selling it to buyer off its system at a higher price. In the past, the Company has had some crediting mechanism in place to share this value with customers. The Company proposes to continue to share these benefits through the Regulatory Compact discussed in the direct testimony of Laclede witness Kenneth Neises. Assuming that Laclede first earns its authorized rate of return, customers will share in all of these benefits derived from these off-system sales at the approved sharing level.

Q. How do you propose to calculate the appropriate, or safe harbor, level of FOM demand charges?

A. The Company proposes to establish a "safe harbor" benchmark using an historical average of FOM demand charges as a percentage of physical commodity gas costs, normalized for weather. This gas cost percentage will be applied to a projected forward normal annual purchase cost based on the market at the time Laclede's request for proposal ("RFP") is sent to suppliers. For purposes of providing certainty to the Company and a limit sought by Staff, FOM demand charges at or below this limit shall be deemed to be prudent.

Q. What other benchmarks will be available to make sure the Company is not spending too much for its FOM demand charges?

A. The Company is willing to consider using a benchmark similar to the one that was used in prior gas supply incentive plans based on design contracted volumes and the results of bids received through its RFP process.

SUMMARY

Q. Please summarize your testimony.

A. Two changes to the Company's Gas Supply Incentive Plan will improve the Plan for the benefit of both the Company and its customers. These changes consist of (i) removing the Plan's price band, which currently restrains the Company's incentive to reduce upward price volatility for customers; and (ii) maintaining the incentive amount at a flat 10% for all savings achieved under the Plan. Both of these changes will remove restraints and free the Plan to operate as it was intended, that is, to effectively encourage the Company to reduce gas costs <u>at all times</u>, especially when such costs are at their highest and the customers' need for price relief is at its greatest. In addition, the Commission should approve a method for determining an acceptable level of demand charges to be paid by the Company for the right to purchase gas at an FOM price. This will benefit both the Company and its customers by bringing more structure and certainty to Laclede's gas supply procurement process, and by ensuring that customers have adequate access to FOM-priced gas.

Q. Does this conclude your direct testimony in this case?

A. Yes, it does.

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of Laclede Gas Company's	)	
Tariff to Revise Natural Gas Rate Schedules	)	Case No. GR-2007-0___

AFFIDAVIT

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

George E. Godat, of lawful age, being first duly sworn, deposes and states:

1. My name is George E. Godat. My business address is 3950 Forest Park, St. Louis, Missouri 63108; and I am Director-Gas Supply of Laclede Gas Company.

2. Attached hereto and made a part hereof for all purposes is my direct testimony, on behalf of Laclede Gas Company.

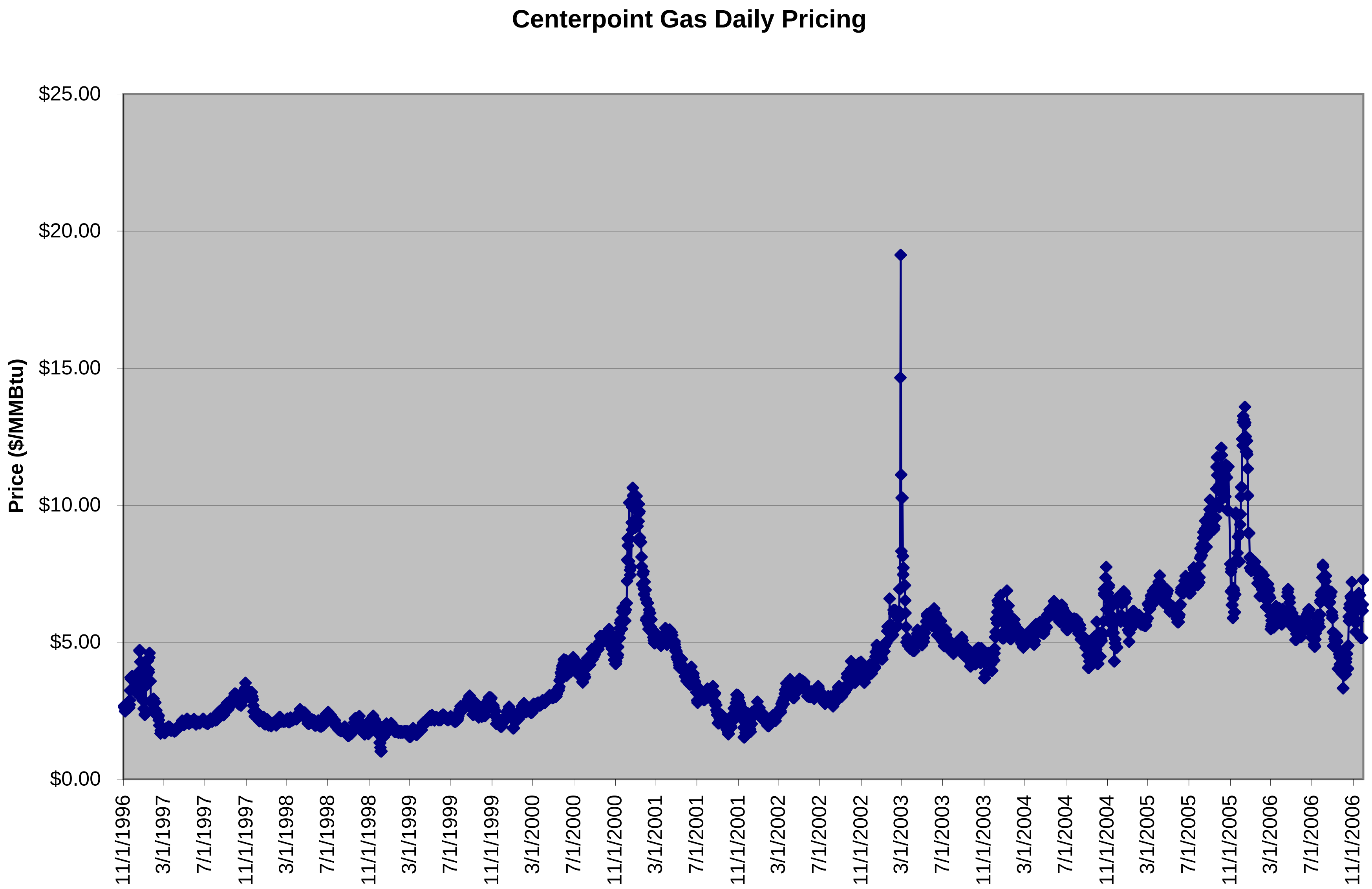
3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Geo E. Godat
George E. Godat

Subscribed and sworn to before me this 30th day of November, 2006.

Brian Scott Davis
Notary Public

BRIAN SCOTT DAVIS
NOTARY PUBLIC - NOTARY SEAL
State of Missouri
Jefferson County
My Commission Expires May 26, 2008



Schedule GEG-1