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March 25, 2003

FILED[3]
MAR 25 2003
Missouri Public Service Commission

Mr. Dale Hardy Roberts
Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102

Re: Case Nos. GR-2001-387 and GR-2000-622

Dear Mr. Roberts:

On behalf of Laclede Gas Company, I deliver herewith for filing with the Missouri Public Service Commission ("Commission") in the referenced matter an original and eight (8) copies of an Initial Brief.

Copies of this filing will be provided this date to all parties of record.

Would you please bring this filing to the attention of the appropriate Commission personnel.

Thank you very much for your assistance.

Very truly yours,

James C. Swearengen

James C. Swearengen

JCS/lar
Enclosures
cc: All parties of record

FILED[3]
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Missouri Public
Service Commission

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Purchased Gas Adjustment Tariff Revisions to be Reviewed in Its 2000-2001 Actual Cost Adjustment.	))))	Case No. GR-2001-387
In the Matter of Laclede Gas Company's Purchased Gas Adjustment Factors to be Reviewed in Its 1999-2000 Actual Cost Adjustment.	))))	Case No. GR-2000-622

INITIAL BRIEF OF LACLEDE GAS COMPANY

March 25, 2003

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INITIAL BRIEF OF LACLEDE GAS COMPANY

Pursuant to the briefing schedule established by the Commission in this case, Laclede Gas Company ("Laclede" or "Company") hereby submits its initial brief in this proceeding.

I. Introduction

The issue in this case concerns the proper treatment to be afforded nearly $4.9 million of the roughly $33.5 million in hedging proceeds that Laclede achieved under its Price Stabilization Program ("PSP" or "Program") during the late summer, fall and winter of 2000/2001. This $4.9 million represents the remaining portion of Laclede's share of the tens of millions of dollars in financial benefits that were achieved by the Company under the PSP during the 2000/2001 ACA period under consideration in this case (the "ACA Period").[1]

[1] As discussed, *infra*, Laclede was actually entitled to retain a total of approximately $8.9 million under the Overall Cost Reduction Incentive component of the PSP. (Exh. 4HC, p. 4). However, with the Commission's approval, the Company voluntarily contributed $4 million dollars of this amount to supplement the funding of the PSP during its third year of operation -- an action that led to tens of millions of dollars in additional savings for the Company's customers. (Exh. 4HC, pp. 4, 8-9).

In seeking to deprive the Company of this remaining portion of its share of the financial benefits achieved under the PSP, the Staff faces a daunting task. Among other things, it must convince the Commission:

- that a Program which provided the Company's customers with returns approaching 500% or more on the money that Laclede was authorized to collect from them to fund the Program was a failure rather than one of the most financially successful endeavors ever approved by this Commission;
- that the tens of millions of dollars in real cash money created by the Company as a result of its efforts under the Program do not qualify as real ratepayer savings, even though the Staff itself has acknowledged that such amounts were, in fact, realized and promptly flowed through to Laclede's customers in the form of Purchased Gas Cost reductions;
- that it is lawful and permissible for the Commission to retroactively rewrite the terms of tariff provisions that were thoroughly reviewed by the Staff and approved by the Commission in order to produce a radically different treatment of the financial results of past transactions than the one that was clearly and unambiguously mandated by those tariffs;
- that the Commission may lawfully take such action even in the face of a subsequent Stipulation and Agreement that was freely signed by the Company, Staff and Public Counsel and that explicitly reconfirmed that the tariff provisions, which Staff now seeks to ignore or rewrite, were to "remain in full force and effect"; and

- that the Commission should take all of these impermissible actions for the sake of a proposed adjustment that uses an entirely new method for determining savings under the Program – a method that is not even true to the standard it is supposedly designed to reflect and that employs hindsight in a highly selective way to engineer the precise kind of benchmark for measuring savings that will retroactively serve to deprive the Company of the last remaining share of Program benefits to which it is lawfully entitled.

In apparent recognition of how unlawful and unreasonable these recommendations are, Staff seeks to make them more palatable by coloring them with observations regarding how much natural gas prices increased during the ACA Period, notwithstanding the substantial level of price protection achieved under the Program. The Commission should not be misled by these obvious and irrelevant attempts to prejudice its consideration of the real issues in this case. Yes, there were substantial increases in wholesale natural gas prices throughout the United States during the ACA Period – increases that were not of Laclede's making. But what really matters is how effectively and vigorously Laclede responded to those radical price changes in the marketplace for natural gas.

In terms of effectiveness, the Staff's own evaluation of the comparative PGA rates of local distribution companies across the country during January 2001 – when natural gas prices were at their highest -- shows that Laclede had the third lowest PGA rate of the 17 companies surveyed and was only one penny above the second lowest. (Tr.

268-269).[2] Similarly, when viewed over the longer term, Staff witness Sommerer acknowledged that Laclede's PGA rates, even taking into account the winter of 2000/2001, have been cumulatively lower than those of both Missouri Gas Energy and AmerenUE (Tr. 143-144).

And in terms of vigor, the evidence is clear that Laclede responded to these radical changes in wholesale market prices in an aggressive and persistent manner. Rather than just sit on its hands and hope for the best, Laclede engaged in a long and largely unsuccessful effort to convince the Staff and Public Counsel that revisions to the PSP, including additional funding and an expansion in the kind of instruments that could be used, should be made to procure additional protection. (Exh. 5HC, pp. 14-15). And when support for those requests was not forthcoming, the Company did the best it could to take the limited resources it had and turn them into a meaningful level of price protection for its customers. Laclede succeeded in that regard under an extraordinarily difficult set of circumstances and it is proud of that success.

Undoubtedly, if the Company knew then what it knows now it could have done even better, as Staff seems to suggest throughout its testimony. And based on that same hindsight, Staff and Public Counsel undoubtedly recognize that they could have contributed to a better result for utility customers in Missouri by agreeing to the proposals that were made by Laclede and others for additional approvals that we now know were right on the mark and would have produced tens of millions of dollars in additional

[2]Staff's evaluation was included in the Final Report submitted by the Commission's Natural Gas Commodity Task Force on August 29, 2001. (Tr. 267). It shows that on January 1, 2001, Laclede had a PGA rate of $6.45 per MMBtu. Most of the other companies surveyed had rates that were one to four dollars higher than Laclede's rate. (Tr. 268-269). Presumably, by including this evaluation in the Commission's Task Force Report, the Staff believed that it told the Commission something both meaningful and representative regarding the events of the winter of 2000/2001.

financial benefits. In the end, however, the blame game contributes nothing to fashioning a constructive approach for dealing with such situations in the future. Instead, it should be assumed that all parties did the best they could to respond to a dramatic and unprecedented situation in the way that their respective experiences, viewpoints and good faith assessments led them to believe was right. At a minimum, however, the Commission should not permit the Staff to besmirch one of the truly successful efforts to respond to that situation by adopting an adjustment that cannot possibly be reconciled with the approved Program terms under which that effort was undertaken.

A. Structure and History of the Price Stabilization Program

To understand why Staff's proposal to deprive the Company of this remaining portion of its share of savings under the PSP is both unlawful and unreasonable, it is necessary to begin with a brief overview of the structure and history of the PSP and the results that were achieved by the Company under that Program during the ACA Period.

The PSP was approved by the Commission in July of 1999 for a three year term. ***See Re: Laclede Gas Company,*** Case No. GO-98-484, Report and Order issued June 15, 1999.[3] Although Laclede had been operating under some form of Commission-approved hedging program for the two preceding years, the PSP was approved on an experimental basis in 1999 to determine whether financial incentives would be effective in encouraging the favorable acquisition of price protection for Laclede's customers. To that end, the PSP authorized the Company to purchase and sell call options under two separate

[3] Upon the conclusion of this three year period, the Program was then terminated in the wake of Staff's and Public Counsel's continued opposition to any extension of the Program.

incentive components – a Price Protection Incentive and an Overall Cost Reduction Incentive. (Exh. 4HC, p. 3). [4]

The Price Protection Incentive applied to call options that were liquidated ***during*** the last three business days of NYMEX (New York Mercantile Exchange) option trading, (Exh. 1, Schedule 6-3, Section 2.A.). The Overall Cost Reduction Incentive pertained to savings in the $4 million Maximum Recovery Amount ("MRA") that Laclede was authorized to collect from its customers through its PGA to fund the Program. Such savings could be achieved by Laclede either through favorable option purchases or by intermediate trading activities in which the option was sold ***prior*** to the last three business days of NYMEX option trading. (Exh. 1, Schedule 6-4, Section 3; Exh. 4HC, p. 3).

The Price Protection Incentive also included a provision which permitted the Company to declare the Price Protection Incentive crediting provision inoperable during a particular program year. (Exh. 1, Schedule 6-4, Section 2.B.ii). The Company was permitted to exercise this right in the event there were radical changes in the market price for natural gas during the first 90 days of each Program year. (*Id.*).

Unfortunately, the very circumstances that had been contemplated by this provision actually arose in the second year of the Program, which commenced in March 2000 with the setting of the Target Strike Price ("TSP") and Catastrophic Price Level ("CPL") for the Price Protection Incentive. (Exh. 5HC, p. 12). Historically, March had

[4] Call options are a form of financial instrument sold on the New York Mercantile market. In exchange for paying a specific amount, the call option entitles, but does not require, the buyer to receive a specific quantity of natural gas in a future month at a predetermined "strike price." (Tr. 57). Generally speaking, as the market price for natural gas increases, the value of the option will also increase. Conversely, to the extent the market price for natural gas decreases or remains constant, the option will generally lose value and may even expire worthless. To the extent the option increases in value and is sold "in the money" (i.e., generates proceeds at the time it is sold), such proceeds can be used to offset increases in the market price of gas and thus provide price protection for the utility and its customers. (Tr. 57-59).

been a low price month for call options. From the very outset of March 2000, however, the prices for call options were at historically high levels; a circumstance that resulted in a TSP and CPL of $4.70 and $5.20, respectively. (Exh. 5HC, p. 12).[5] Although the Energy Information Administration ("EIA") and respected analysts such as Goldman Sachs and Risk Management Inc. ("RMI") were claiming that natural gas prices were overvalued and should decline in the near future, they never did. Instead, they ultimately increased and increased dramatically. (Exh. 5HC, pp. 12-13). As a result, Laclede had to submit a notice on June 1, 2000, in which it exercised it right under the Program to declare the Price Protection Incentive inoperable for the ACA Period. (Exh. 5HC, p. 13).

Laclede did not, however, diminish its efforts to obtain price protection for its customers. To the contrary, the Company immediately initiated a series of meetings with the Staff and eventually Public Counsel in an effort to explore various alternatives for addressing these unprecedented changes in market prices for financial instruments. As a part of that effort, the Company also filed an application with the Commission requesting authorization to make temporary revisions to the Program during the ACA Period. (Exh. 5HC, pp. 14-15). These proposed changes included a request to relax or eliminate the Program's requirement that the Company purchase call options sufficient to cover 70 percent of its normal flowing winter supplies. (*Id.*). They also included a request to increase, from $4 million to $10 million, the amount that could be collected from customers to fund the purchase of call options under the Program; and a request to

[5] These strike prices were also well above the maximum strike price level of $4.40 per MMBtu at which Missouri Gas Energy was authorized to purchase call options under its Commission-approved hedging program. (Tr. 117). They were also in excess of the strike prices that the Staff had recently criticized the Company for purchasing call options at during the previous PSP year. (Exh. 5HC, p. 13).

broaden the kind of financial instruments that could be used to provide price protection. (*Id.*).

Ultimately, the Company, Staff and Public Counsel filed a Stipulation and Agreement with the Commission on September 1, 2000, in which they indicated that the parties had only been able to reach agreement on eliminating the 70% coverage requirement. (Exh. 5HC, p. 15). In light of the parties' inability to agree on any other revisions to the PSP, the Stipulation and Agreement also indicated that all other terms of the PSP then in effect would remain in "full force and effect." (Exh. 6HC, p. 10). As the Staff itself has recognized, these remaining provisions included the Overall Cost Reduction Incentive of the PSP -- a fact that was subsequently confirmed by the compliance tariff sheet filed by Laclede to implement the Stipulation and Agreement. (Exh. 6HC, p. 10; Tr. 93, 227). That compliance tariff, which was reviewed by the Staff and then approved by the Commission on October 12, 2000, explicitly stated that the Company's procurement of financial instruments under the PSP would continue to be "subject to the incentive features described below ... except as modified by the terms of the September 1, 2000 Unanimous Stipulation and Agreement approved by the Commission in Case No. GO-2000-394, and subject to the Company's notice of opting out of the price protection incentive features in year two ...." (Exh. 6HC, pp. 10-11; Schedule 1, p. 2).

As a result of these developments, by the time the Company entered the winter heating season of 2000/2001, it was operating pursuant to the terms of a PSP Program under which: (a) the Overall Cost Reduction Incentive remained in full force and effect, (b) the 70% coverage requirement had been eliminated, and (c) no additional funding had been provided to purchase call options in the much more expensive environment that had emerged due to the radical increase in natural gas prices.

B. Results Achieved Under the Program During The ACA Period

Faced with the difficult challenge of having to procure price protection with a level of funding that fell far short of what was needed to address the new market realities, the Company pursued a vigorous policy of buying and selling options in an effort to increase the value of the resources available to it for procuring price protection. As a result of those efforts, the Company still managed, despite these limitations, to produce tens of millions of dollars in price protection for its customers.

Specifically, through its purchase and trading of call options, Laclede managed to transform the $4 million that the Company had been authorized to collect from its customers to fund the Program into a total of some $33.5 million in financial proceeds. (Exh. 7, p. 3). Of this amount, Laclede reinvested approximately $5 million toward purchasing additional options, thereby increasing the total amount spent on purchasing call options to about $9 million. (Exh. 4HC, pp. 6-7). The Company was able to more than double the funding for the Program by actively and successfully pursuing the very kind of intermediate trading of options that was contemplated by the Overall Cost Reduction Incentive. (*Id.*). And it was ***only*** by undertaking these activities that the Company was able to generate the remaining $28.5 million dollars in net proceeds that were ultimately achieved under the Program. (Exh. 5HC, p. 8).

Of this $28.5 million dollars in net proceeds, approximately $11.5 million was attributable to the Price Protection Incentive since they were achieved through the sale of call options during the last three business days prior to their expiration. (Exh. 4HC, p. 3).

Because the Company had declared the crediting features of the Price Protection Incentive component inoperable in June of 2000, however, the entirety of this $11.5 million was immediately flowed through to customers pursuant to expedited procedures that had been requested by Laclede and approved by the Commission. (Exh. 4HC, p. 4).

The remaining $17 million in proceeds was achieved by the Company through its intermediate trading of call options prior to the last three business days of options trading and were therefore subject to sharing under the Overall Cost Reduction Incentive which had remained in full force and effect. (*Id.*). As a result, those proceeds were split between the Company and its customers with approximately $8.9 million going to the Company and $8.1 million being immediately flowed through to customers pursuant to the expedited procedures mentioned earlier. (*Id.*).

In addition, the Company also voluntarily contributed $4 million of its $8.9 million share of the proceeds under the Overall Cost Reduction Incentive towards supplementing the funding of the Program for the third year of its operation. (*Id.*). This action produced another $30 million in benefits for the Company's customers during the subsequent ACA Period.[6] In fact, the Company believed in the Program so much that it also offered to contribute another $4 million of its share of these proceeds to supplementing the funding of the Program in the event it was extended beyond its 3 year initial term. Unfortunately, that possibility did not come to pass because of Staff's continued opposition to any extension of the Program. Nevertheless, as a result of

[6]As the undisputed evidence in this case demonstrated, this supplemental funding allowed the Company to purchase and substitute additional call options for more expensive fixed price gas and in the process saved its customers some $30 million dollars. (Exh. 4HC, p. 9). Had the Company instead "locked-up" gas at fixed prices during this time, it would not have been able to take full advantage of the significant declines in gas prices that subsequently occurred.

Laclede's efforts, approximately $23.6 million dollars in financial proceeds were ultimately passed through to the Company's customers, for a net benefit of almost $20 million after taking into consideration the initial $4 million that was collected from customers to fund the Program.[7]

By virtually any measure, the results achieved by the Company under the PSP were exemplary. Indeed, the Commission will search long and hard to find other Commission-approved programs that have achieved the same kind of cost/benefit ratio and generated the same kind of 500% returns for customers that were ultimately achieved as a result of the PSP.

C. Staff's Proposed Adjustment

Despite the magnitude of these benefits, however, the Staff persisted in its efforts to eliminate the PSP and now, with its adjustment in this case, seeks to deprive the Company of the remaining $4.9 million in proceeds that Laclede was entitled to retain under that Program. Staff attempts to accomplish this objective by asserting that the Company's share of savings under the PSP should be determined based on an entirely new method that is nowhere to be found in either the PSP Tariff or Program Description. As proposed by the Staff, this method is purportedly designed to compare the level of financial proceeds that Laclede actually achieved under the Program by selling call options prior to the last three business days of options trading to a hypothetical level of proceeds that Staff asserts the Company *could* have achieved had it instead held those options until the last three business days. (Exh. 8, p. 3; Exh. 1, p. 13; Tr. 228).

[7]The approximately $23.6 million returned to customers includes the $11.5 million that was attributable to the Price Protection Incentive, the customer's roughly $8.1 million share of the $17 million in savings generated under the Overall Cost Reduction Incentive and the $4 million that the Company contributed out

According to Staff, this kind of hypothetical "buy and hold" benchmark is necessary to provide an "objective way" of determining whether the savings achieved by the Company as a result of its intermediate trading activities under the Overall Cost Reduction Incentive were "real" savings. (Exh. 1, p. 13; Tr. 239).

II. ARGUMENT

As discussed more fully below, the Staff's proposed adjustment is unlawful, flawed and unreasonable and must therefore be rejected by the Commission. The adjustment is unlawful because the new method advocated by Staff conflicts directly with the terms of the controlling tariff sheets and program description that were in effect at the time these transactions took place. The evidentiary record substantiating such a conclusion could not be any more definitive or compelling. Time and time again the only Staff witness testifying on this issue either acknowledged or affirmatively demonstrated:

- that in both this case as well as the immediately preceding ACA case, Laclede had calculated its share of the benefits achieved under the PSP in accordance with the terms of the controlling tariff sheets that were in effect at the time these benefits were generated; (Tr. 62-65);
- that these same tariff sheets were, and always have been, completely barren of any language that even references, let alone authorizes, the method that Staff has now proposed be used to determine and allocate such benefits (Tr. 227); and
- that Staff's proposed method was indeed developed long after the transactions to which it would be applied took place and is being

---

of its share under the Overall Cost Reduction Incentive to supplementing the Program's funding in its third year. (*See* Exh. 4HC, pp. 2-4; Exh. 7, pp. 3-4).

retroactively applied to accommodate Staff's hindsight assessment of "what makes sense" rather than what the controlling tariff actually said. (Exh. 1, pp. 11-12; Exh. 2 , p. 3; Exh. 3, pp. 1-3; Tr. 53).

Given this evidence, there is simply no way to reconcile Staff's proposed adjustment with the fundamental legal principle that tariff provisions approved by the Commission have the full force and effect of law and cannot be retroactively modified, as the Staff has proposed to do in this case, to accomplish a different result than what was authorized by those tariffs at the time the transactions at issue took place. *See* ***State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission,*** 585 S.W.2d 41, 49 (Mo. banc. 1979). Nor is it possible to reconcile Staff's proposed adjustment with the September 1, 2000 Stipulation and Agreement that both the Staff and Public Counsel signed and this Commission approved in Case No. GO-2000-394 -- an Agreement that clearly reaffirmed the continuing effectiveness of the very PSP Tariff and Program terms that the Staff now seeks to ignore or retroactively change. In short, Staff's proposed adjustment directly violates both long-standing principles of general law as well as the specific terms of an Agreement freely undertaken by the Staff and approved by the Commission. It also constitutes, in both form and substance, an impermissible collateral attack on the Commission's decision in Case No. GO-98-484 to approve the PSP in direct violation of §386.550 RSMo. 2000. Staff adjustment must therefore be rejected by the Commission as unlawful and impermissible.

Moreover, even if Staff's proposed adjustment was not so clearly unlawful -- which it is -- it should nevertheless be rejected by the Commission on the grounds that it is fundamentally flawed and unreasonable. As evidence in this case showed, it is flawed because it is not even true to the standard that it is supposedly designed to reflect. In proposing its method, Staff indicated that it was designed to compare the monetary benefits that the Company achieved as a result of its intermediate trading activities to what it could have achieved had it sold the options closer to their expiration. The very analysis that Staff submitted in support of that method, however, shows that it was only through the Company's intermediate trading activity that Laclede was able to generate the $9 million ultimately spent on purchasing call options, an expenditure that was more than double the $4 million Laclede had been authorized to collect from its customers for that purpose. (Exh. 4HC, p. 6-7). Indeed, had the Company not engaged in such intermediate trading activities it would have only produced about half of the $28.5 million in total benefits that were ultimately generated under the Program. (Exh. 6HC, p. 3).

In addition to this basic flaw, it is equally clear that Staff's method is, in any event, unreasonable in that it employs hindsight in a highly selective way to engineer the precise kind of benchmark for measuring savings that will retroactively serve to deprive the Company of the last remaining share of Program benefits to which it is lawfully entitled. (Exh. 4HC, pp. 7-9). As discussed more fully below, the record is replete with examples of how Staff has reached back to pick and chose only those concepts, facts and considerations that purportedly support the propriety of this retroactive standard for determining savings while studiously avoiding those that do not. Given all of these flaws, as well as the others discussed below, Staff's proposed adjustment should be rejected by the Commission.

A. **<u>What were the controlling Price Stabilization Program ("PSP") Tariff and Program Description terms for the October 1, 2000 through September 30, 2001 ACA period?</u>**

As the parties' designation of this issue makes clear, the proper treatment of the amount under dispute in this case should and must be determined by the controlling PSP Tariff and Program Description terms that were in effect during the ACA Period. There seems to be no dispute at all in this case regarding the nature and identity of the tariff provisions and program terms that were in effect during the ACA Period under consideration in this case and that therefore control the Commission's resolution of this issue. To the contrary, as both the Company and the Staff have recognized throughout this proceeding, these controlling provisions can be found in:

(a) the three pages of the PSP Tariff contained in Second Revised Tariff Sheet No. 28-e and Original Tariff Sheet Nos. 28-f and g, which were approved by the Commission in Case No. GO-98-484 and became effective on July 26, 1999 (*see* Schedule or Exhibit 1 to the Direct Testimony of Steven Mathews, Exh. 4HC; Schedule 7 to the Direct Testimony of Staff witness David Sommerer);

(b) a four-page document entitled "Laclede Gas Company Description of Incentive Price Stabilization Program" (the "Program Description") that was incorporated by reference in the foregoing tariff sheets and that also became effective on July 26, 1999 (*see* Schedule or Exhibit 1 to the Direct Testimony of Steven Mathews, Exh. 4HC; and Schedule 6 to the Direct Testimony of Staff witness David Sommerer); and

(c) the Third Revised Tariff Sheet 28-e, which became effective October 12, 2000 in compliance with the Commission Order in Case No. GO-2000-394 which had approved the September 1, 2000 Stipulation and Agreement that revised the PSP (*see* Schedule 1 to the Surrebuttal Testimony of Steven Mathews, Exh. 6HC).

There is no question that each and every one of the PSP Tariff sheets, as well as the Program Description, were approved by the Commission after a thorough examination by Staff to determine whether they were in compliance with the Commission's Orders which had authorized their filing. For example, Schedule 1 to the Rebuttal Testimony of Steven Mathews, Exh. 5HC, contains the Memorandum and Recommendation submitted by Staff on July 12, 1999 in response to the PSP Tariff Sheets and Program Description that had been filed by the Company in compliance with the Commission's Report and Order in Case No. GO-98-484. It is clear from Staff's Memorandum and Recommendation that the Staff was actively involved in reviewing these items and ensuring that they contained the language necessary to fully comply with the Commission's Report and Order. In fact, Staff's Recommendation indicates that the PSP Tariff Sheets were even modified by the Company after they were filed "to incorporate changes suggested by the Commission's Staff (Staff)." (Exh. 5HC, Schedule 1, p. 1). Upon completion of its review, and the changes made by the Company, the Staff stated as follows in recommending that the PSP Tariff Sheets and Program Description be approved by the Commission:

> Staff has reviewed the Company's revised Program Description and tariff sheets filed by Laclede and is of the opinion that they are in compliance with the Order issued on June 15, 1999.
>
> (Exh. 5HC, Schedule 1, p. 1).

The Staff also thoroughly reviewed Third Revised Tariff Sheet 28-e, which had been filed by Laclede in compliance with the Commission Order approving the

September 1, 2000 Stipulation and Agreement that the Company, Staff and Public Counsel had filed in Case No. GO-2000-394. (*See* Schedule 1 to the Surrebuttal Testimony of Steven Mathews, Exh. 6HC). As previously discussed, this was the Stipulation and Agreement and tariff sheet that specifically provided that all terms of the PSP would remain in effect, except for the 70% coverage requirement and the Price Protection Incentive features that the Company had declared inoperable for the ACA Period. (Exh. 1, Schedule, Schedule 4-4, paragraph 4; Exh. 6, Schedule 1, p. 2). Once again, the Staff reviewed this tariff sheet and, as reflected in Exhibit 11, recommended that it be approved as being in compliance with the Commission's Order.

In short, there is absolutely no dispute in this case regarding either the identity or the validity of the controlling tariff and program description provisions that govern the Commission's determination of the amount retained by the Company under the PSP. To the contrary, the only real dispute in this case centers on whether these controlling provisions and terms will, in fact, control the outcome of this issue, as the law requires, or whether methods, standards and provisions that are nowhere to be found in these tariff and program description terms will be used for that purpose, as Staff has proposed. As discussed below, there is only one legally permissible, reasonable and fair answer to that question and it affirmatively requires adoption of the Company's position and rejection of the adjustment proposed by Staff in this case.

B. **Do the controlling PSP Tariff and Program Description terms for the October 1, 2000 through September 30, 2001 ACA period entitle Laclede to retain approximately $4.9 million of the $33.5 million in financial proceeds received by the Company through its purchase and sale of call options during that period?**

1. **The controlling PSP Tariff and Program Description affirmatively mandate Laclede's treatment of the $4.9 million in hedging proceeds that it retained under the PSP.**

The PSP Tariff and Program Description not only entitle Laclede to retain the $4.9 million at issue in this case, but affirmatively mandate such a result. As previously discussed, Laclede's efforts in buying and selling call options during the ACA Period generated proceeds totaling $33,499,000, of which $11,566,000 was attributable to the Price Protection Incentive and $17,010,550 was attributable to the Overall Cost Reduction Incentive. (Exh. 7, pp. 3-4). After deducting the $8,922,450 spent by Laclede to purchase the call options that generated these proceeds, the PSP resulted in a net amount of $24,576,550. (*Id.*). Pursuant to the terms of the PSP Tariff and Program Description that were in effect for that period, Laclede was entitled to retain $8,872,997 of these proceeds. (Exh. 7, p. 4).

This conclusion was thoroughly demonstrated in the rebuttal testimony of Laclede witness Michael T. Cline, in which he showed, through a meticulous, sentence-by-sentence review of the then effective PSP tariff provisions, how the Company had calculated its share of savings under the Program in strict compliance with those tariff provisions. (*See* Exh. Nos. 7 and 8). A replication of that sentence-by-sentence review, together with the specific dollar amounts generated under the Program inserted to show how the Company calculated the amount it was entitled to retain, is replicated on the next page for the Commission's convenience:

P.S.C. MO. No. 5 Consolidated, Original Sheet No. 28-f
CANCELLING All Previous Schedules.

Laclede Gas Company	For	Refer to Sheet No. 1
Name of Issuing Corporation or Municipality		Community, Town or City

SCHEDULE OF RATES

G. <u>Experimental Price Stabilization Fund</u>

3. 3. <u>Price Protection Incentive</u>– To provide an incentive for the Company to procure natural gas financial instruments with the greatest amount of price protection, the Company and all customers other than those billed under the LVTSS rate schedule shall share certain gains and costs as follows:

a) 100% of Type I Gains shall be credited to the PSF;

A. 75% of Type II Gains shall be credited to the PSF and the remaining 25% shall be credited to the IR Account;

c) 40% of Type III Gains shall be credited to the PSF and the remaining 60% shall be credited to the IR Account; and

2. The IR Account shall be debited and the IA Account shall be credited for 100% of Type I Costs.

The foregoing gains and costs shall be calculated in conformance with the parameters approved by the [redacted]

$4,000,000

4. <u>Overall Cost Reduction Incentive</u>– To provide ~~an~~ incentive for the Company to reduce the overall cost of price stabilization, at the end of each ~~ACA~~ year the Company shall account for any [redacted] between the MRA and [redacted] ("Actual Cost") for the preceding heating season, exclusive of the [redacted], in accordance with the following schedule: [redacted]

[redacted]

a) If the Actual Cost exceeds the MRA, the IA Account shall be credited and the IR Account shall be debited for 100% of such excess;

b) If the Actual Cost is less than the MRA, the IA Account shall be debited and the IR Account shall be credited for 40% of the difference between the MRA and the Actual Cost so long as such difference is less than $6,666,666.66; and $6,666,667 x .40=$2,666,667

B. If the difference computed in 4.b) above is greater than or equal to $6,666,666.66, the IA Account shall be debited and the IR Account shall be credited for $2,666,666.66 plus 60% of the amount by which such difference exceeds $6,666,666.66.

($17,010,550–$6,666,667) x .60=$6,206,330 $2,666,667+$6,206,330=$8,872,997

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As the foregoing illustrates, paragraph G.4 of the Tariff, which sets forth the Overall Cost Reduction Incentive provisions, provides that: "the Company shall account for any differences between the MRA and the net cost of price stabilization ("Actual

Cost") for the preceding heating season, exclusive of the gains and costs covered by Section G.3." (Exh. 1, Schedule 7-2; Exh 7, pp. 3-4). The MRA was $4,000,000, the amount the Company was authorized to collect from customers for expenditures on call options for the 2000/20001 winter heating season. (Exh. 7, p. 2). The net cost of price stabilization is simply the difference between the amount the Company spent on call options ($8,922,450) less the amounts it realized from the sale of those options ($33,499,000), or a negative $24,576,550. (Exh. 7, pp. 2-3).

As indicated in paragraph G.4, the gains covered by paragraph G.3 ($11,566,000), which relate to the Price Protection Incentive because they involve call options sold during the last three business days prior to their expiration, must be subtracted from the net cost of price stabilization. (Exh. 7, p. 3). Subtracting $11,566,000 from $24,576,550 leaves $13,010,550 as the negative net cost of price stabilization exclusive of the gains under the Price Protection Incentive. (*Id.*). Calculating the difference between the positive MRA cost of $4,000,000 and the negative $13,010,550 net cost of price stabilization (excluding the Price Protection Incentive gains) results in a total cost reduction of $17,010,550 that is subject to sharing under the Overall Cost Reduction Incentive. (Exh. 7, p. 4).

Of this $17,010,550, paragraph G.4.b of the sharing formula set forth in Overall Cost Reduction specifies that the Company is to retain 40% of the first $6,666,666.66 of cost reductions which amounts to $2,666,666.66. (Exh. 7, p. 4). Paragraph G.4.c of that same sharing formula then specifies that the Company is to retain 60% of the remaining $10,343,883 amount, or $6,206,330. (*Id.*). Adding these two amounts together ($2,666,666.66 and $6,206,330), results in a total amount of $8,872,997 that Laclede was entitled to under the Overall Cost Reduction Incentive. (*Id.*). As previously discussed, however, Laclede volunteered, and the Commission accepted, an offer to contribute $4 million of this amount toward supplementing the Program's funding during its third year; a contribution that enabled the Company to save its customers another $30 million in reduced gas costs in the subsequent ACA Period. Thus, subtracting this $4 million from the $8,872,997 OCRI total left a remainder of $4,872,997, to which Laclede is entitled. (Exh. 7, p. 4).

The foregoing calculations were also set forth in summary form in Schedule 1 to Laclede witness Michael Cline's Rebuttal Testimony which is found in Exhibit 7. For the Commission's convenience, the contents of that Schedule are reproduced below and show the straight-forward calculations that result in the amount that the Company retained pursuant to the terms of the Overall Cost Reduction Incentive:

Purchases	$8,922,450	
Sales	$33,499,000	
Net Cost	-$24,576,550	
(Less): Savings realized under Price Protection	-$11,566,000	
Net Cost for Overall Cost Reduction Purposes	-$13,010,550	
MRA	$4,000,000	
Cost Reduction	-$17,010,550	
First $6,666,666,66 of cost reductions	$6,666,667	
Company Sharing %	40%	
		$2,666,667
Cost reductions in excess of $6,666,666.66	$10,343,883	
Company Sharing %	60%	
		$6,206,330
Total Company Retention		$8,872,997
(Less): Additional funding in third year		-$4,000,000
Remaining Company Entitlement		$4,872,997

Notably, neither Staff nor Public Counsel offered any testimony challenging Mr. Cline's analysis of how the dollars generated under the Program were to be allocated between the Company and its customers pursuant to the terms of the then effective PSP tariff provisions. To the contrary, when asked during cross-examination to calculate what share of savings Laclede was entitled to retain under the PSP tariff provisions given the specific dollar amounts generated by the Company during the ACA period, Staff witness David Sommerer arrived at the very same results that Mr. Cline had. (Tr. 62-65). Mr. Sommerer also acknowledged that he had reviewed the Company's calculation of its share of savings under the PSP tariff provisions for the preceding 1999/2000 ACA year. (Tr. 157-160). Although the Company had calculated those savings during the preceding ACA year ***in the same exact manner*** that it calculated them for purposes of this ACA Period, the Staff raised absolutely no concerns regarding whether such calculations had been performed in accordance with the requirements of Laclede's PSP tariff provisions. (Exh. 8, p. 2, Schedule 1).

It is equally clear that all of the proceeds that the Company attributed to the Overall Cost Reduction Incentive qualified as eligible savings within the meaning of that incentive provision as set forth in the Program Description. As previously noted, Section 3 of the Program Description states that the Overall Cost Reduction Incentive applies to "[s]avings achieved through reductions in the cost of the program below the MRA as a result of favorable option purchases or intermediate trading activity (prior to the last three days of NYMEX option trading ..." (Exh. 1HC, Schedule 6-4). Although the Staff attempted to suggest in its testimony that there was some ambiguity about whether the $17,010,550 in net proceeds achieved by the Company through its intermediate trading activity actually qualified as savings under the foregoing language, it became clear during cross-examination that no such ambiguity exists. To the contrary, Staff witness Sommerer acknowledged that the Company had, in fact, achieved $17,010,550 in net proceeds as a result of its intermediate trading activities. (Tr. 63-64). Mr. Sommerer further acknowleged that the use of such proceeds from the sale of options to reduce the Company's purchased gas expense, constitute a real "savings" to customers under the dictionary definition of that term that Mr. Sommerer himself cited in his rebuttal testimony. As Mr. Sommerer stated:

> Q. Can I direct you to page 2, lines 1 and 2 of your rebuttal testimony?
>
> A. I'm there.
>
> Q. Okay. There you say that the concept of savings implies a reduction in expenses; is that correct?
>
> A. That's correct.
>
> Q. So to the extent proceeds from the sale of options are used to reduce purchased gas expenses, they can be classified as savings under that dictionary definition cited at page 2, lines 1 and 2 of your rebuttal testimony, isn't that correct?
>
> A. Pursuant to the specific example you gave, that is correct.
>
> (Tr. 60-61).

Finally, Mr. Sommerer acknowledged that the customers' share of the savings generated by the Company under the Overall Cost Reduction Incentive had indeed been flowed through to customers in the form of PGA reductions pursuant to the terms of the sharing mechanism contained in that incentive provision. (Tr. 65-66). In view of this testimony, there is simply no plausible basis for suggesting that there is the least bit of ambiguity regarding the meaning of savings under the Overall Cost Reduction Incentive language of the Program Description. By Mr. Sommerer's own definition, it means real cash money generated by the Company through its intermediate trading activity that can be used to reduce purchased gas expenses and by Mr. Sommerer's own acknowledgment the customers received their proper share of these savings pursuant to the terms of both the PSP Tariff and the Program Description.[8]

In light of this evidence, it is clear that the controlling PSP Tariff Sheets and Program Description terms that were in effect during the ACA Period unambiguously mandate the treatment of the remaining $4.9 million in hedging proceeds that Laclede has given it in this case. It is equally clear that those same provisions and terms require rejection of Staff's proposed adjustment. As discussed below, such instruments have the same legal force and effect as a law enacted by the legislature, ***Allstates Transworld Vanlines, Inc. v. Southwestern Bell Telephone Company,*** 937 S.W.2d 314, 317 (Mo. App. E.D. 1996). As a result, they cannot be ignored or retroactively changed, as Staff has so obviously attempted to do with its unlawful adjustment in this case.

2. **Staff's proposed adjustment is unlawful and impermissible and must be rejected because it: (a) directly conflicts with, and is unauthorized by, the controlling PSP Tariff Sheet and Program Description terms that were in effect at the time the transactions at issue in this case took place; (b) violates the September 1, 2000 Stipulation and Agreement approved by the Commission in Case No. GO-2000-394; and (c) represents an impermissible collateral attack on the Commission's Report and Order approving the PSP.**

In sharp contrast to the overwhelming support that can be found in the controlling PSP Tariffs Sheets and Program Description for the Company's treatment of the $4.9 million in hedging proceeds it retained, there is literally nothing in either of these

[8] Mr. Sommerer also demonstrated during cross-examination why there is no ambiguity whatsoever regarding the meaning of the words "net cost of price stabilization" as used in the PSP Tariff. (Exh. 1, Schedule 7-2; Tr. 59-61; 258).

documents that authorizes the method that Staff has proposed be used for determining savings under the Overall Cost Reduction Incentive. In fact, it is clear that Staff's method directly conflicts with these controlling instruments. This point was most graphically illustrated by the changes that would have to be made to the controlling PSP Tariff Sheets that were in effect at the time these transactions took place in order to authorize Staff's method. As Mr. Cline demonstrated in his surrebuttal testimony, to accommodate Staff's proposed method, the entire section of the PSP Tariff describing what constitutes a cost reduction or savings for the Overall Cost Reduction Incentive, including its reliance on a comparison of the "net cost of price stabilization" to the MRA, would have had to have been deleted. And in its place the following language would have had to have been included:

> For options that are liquidated prior to the last three business days of NYMEX trading of such options ("Expiration Period") cost reductions are defined as the amount by which the actual proceeds from the liquidation of options prior to the Expiration Period exceeds the proceeds that the Company could have realized had it liquidated such options sometime during the Expiration Period as further specified below. Cost reductions shall be calculated for each such option liquidated prior to the Expiration Period including those options which were financed in whole or in part by the Company's use of proceeds that that been generated by earlier liquidations covered by the Overall Cost Reduction component. For purposes of computing the proceeds that would have been realized had an option been liquidated during the Expiration Period, the value of the option shall be the lowest of the closing price of such option during the Expiration Period.
>
> (Exh. 8, pp. 3-4).

Given the extraordinary level of written detail that would have had to have been included in the PSP Tariff to accommodate Staff's proposed method -- but wasn't -- Staff had to concede the obvious. Specifically, Mr. Sommerer had to acknowledge time and time again during cross-examination that there was nothing in the PSP Tariff (or Program Description for that matter) that in any way purported to describe or authorize the method that it has proposed be used for measuring and determining the treatment of savings under the Overall Cost Reduction Incentive. (Tr. 69-70, 227).[9] In fact, Staff acknowledged that it did not even develop its proposed method for calculating Laclede's share of savings under the PSP until two to three weeks before it filed its direct testimony in this case. (Tr. 53). In other words, Staff developed its method sometime in September 2002, or more than a year and a half after the winter of 2000/2001, when most of the transactions which giving rise to those savings took place. (*See* affidavit to Exhibit 1). Nevertheless, the Staff argued that it was necessary to retroactively develop and apply this method in order for the Program to "make sense" in light of the Company's exercise of its right to declare the Price Protection Incentive inoperable and the parties' agreement in the September 1, 2000 Stipulation and Agreement to eliminate the Program's 70% volume requirement for that year. (Exh. 1, pp. 11-12; Exh. 2 , p. 3; Exh. 3, pp. 1-3).

Suffice it to say that there is nothing in Missouri law to suggest that Staff, or any other party for that matter, may unilaterally rewrite a tariff after the fact to accord with that party's retrospective view of what would have made the most sense. To the contrary, it is a fundamental and long-standing principle of law that it is a utility's filed and approved tariffs that govern its relationship with its customers, ***Bauer v. Southwestern Bell Telephone Company,*** 958 S.W.2d 568, 571 (Mo. App. E.D. 1997). Once such a tariff is approved by the Commission, as the PSP Tariff was in this case, it becomes

[9] As Mr. Sommerer put it in response to a question from Commissioner Gaw: "I would agree flat out that Staff's methodology isn't written in these tariffs." (Tr. 227).

Missouri law and has the same force and effect as a statute enacted by the legislature. ***Bauer v. Southwestern Bell Telephone Company, supra,*** at 571; ***Allstates Transworld Vanlines, Inc. v. Southwestern Bell Telephone Company, supra,*** at 317 (Mo. App. E.D. 1996). *See also* ***Keogh v. Chicago & Northwestern Railway,*** 260 U.S. 156, 162-163; 43 S.Ct. 47, 49 (1922).

As instruments that have the full force and effect of law, such tariffs, and the ratemaking treatment they provide, cannot be retroactively modified by the regulatory body to accomplish a different result than what was authorized by those tariffs at the time the transactions to which they apply took place. *See* ***State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission,*** 585 S.W.2d 41, 49 (Mo. banc. 1979); ***Arkansas Louisiana Gas Co. v. Hall,*** 453 U.S. 571, 577, 101 S.Ct. 2925, 2930. And it is clear that this is precisely what the Staff has attempted to do in this case with its admittedly new method for determining how savings generated under these past transactions should be treated under the Overall Cost Reduction Incentive.

Moreover, if such rewriting of the PSP Tariff was to be done it should have been accomplished at the time those temporary revisions to the PSP, which Staff now claims necessitates use of its method, were agreed upon in the September 1, 2000 Stipulation and Agreement approved by the Commission in Case No. GO-2000-394. Rather than doing so, however, paragraph 4 of the Stipulation and Agreement, as well as the tariffs filed by the Company in compliance therewith, clearly said that all of the terms of the PSP tariff, other than the Price Protection Incentive and the 70% coverage requirement, remained in "full force and effect." (Exh. 6HC, p. 10; Exh. 1, Schedule 4-4). As Staff witness Sommerer acknowledged during cross-examination, among those provisions remaining in "full force and effect" was the Overall Cost Reduction Incentive. (Tr. 93).

Mr. Sommerer further acknowledged that there was nothing in the September 1, 2000 Stipulation and Agreement (Tr. 85), the Suggestions filed by Staff in support of that Agreement (Tr. 88), the tariff that implemented the Agreement (Tr. 90), or the Staff memorandum that recommended approval of the tariff (Tr. 93) that purported to alter either the meaning or operation of the Overall Cost Reduction Incentive in any way, let alone in a manner that would authorize the method proposed by Staff in this proceeding. As Mr. Sommerer confirmed:

> Q. So there's not anything in the Stipulation and Agreement that purports to go ahead and change the overall cost reduction incentive, is there?
>
> A. That's correct.
>
> (Tr. 85).
>
> . . .
>
> Q. Okay. But there's nothing in here [Staff's Suggestions in Support of the September 1, 2000 Stipulation and Ageement] that says, because of this Stipulation and Agreement, the overall cost reduction incentive has been modified in some way, does it?
>
> A. No.
>
> Q. And there's nothing in this Staff Suggestion in Support of Stipulation and Agreement that says, because of these modifications that we've talked about in the preceding paragraph [elimination of the 70% coverage requirement] that a method based on a comparison of what actual amounts you've got from the sale of options to what amount you could have gotten during the last three business days had to be used for the overall cost reduction incentive: is that correct?

A. That's correct.

Q. In fact, it clearly says that the only step that we're taking to modify the PSP is the elimination of the 70% requirement; is that right?

A. That is correct.

(Tr. 88; *see also* Exhibit 10 which contains a copy of Staff's Suggestions).

. . .

Q. And there's certainly nothing in this tariff sheet that talks about instituting a method for benchmarking savings under the overall cost reduction incentive based on what the company could have received from the sale of options during the last three business days, is there?

A. That's correct.

(Tr. 90).

In view of this evidence, there can be no doubt that the September 1, 2000, Stipulation and Agreement, and the tariff that implemented it, preclude adoption of Staff's proposed adjustment. Simply put, the very changes to the PSP that Staff now says necessitate its proposed adjustment were explicitly considered in both of those instruments. And having been so considered, both of those instruments explicitly provided for the remaining provisions of the Program, such as the Overall Cost Reduction Incentive, to continue in effect unaltered -- a result that is diametrically at odds with Staff's attempt to change that provision now. Accordingly, Staff's proposed adjustment must be rejected because it is not only contrary to the then effective PSP Tariff and Program Description, but also represents a direct violation of the terms of September 1, 2000 Stipulation and Agreement and compliance tariff.

Finally, Staff's proposed adjustment is unlawful because it represents nothing less than an impermissible collateral attack on the Commission's initial Report and Order in Case No. GO-98-484 which approved the PSP. Section 386.550 RSMo. 2000 provides that "In all collateral actions or proceedings the orders and decisions of the commission which have become final shall be conclusive." This statute is indicative of the law's desire that judgments be final and therefore makes a decision of the Commission immune to collateral attack. ***State ex rel. Licata, Inc. v. Public Service Commission,*** 829 S.W.2d 515 (Mo. App. W.D. 1992); ***State ex rel. Harline v. Public Service Commission,*** 343 S.W.2d 177, 184 (Mo. App. 1960). In both the design of its proposed adjustment, as well as the various rationales offered in support of its adoption, however, it is clear that Staff is seeking to attack and invalidate the Commission's decision in Case No. GO-98-484.

Staff takes pains throughout its testimony to note that it argued against the PSP that was proposed by Laclede and approved by the Commission with its Report and Order in Case No. GO-98-484. (*See* Exh. 1, pp. 5-6, 10-11; Exh 3, p 6). Indeed, Staff effectively reargues its position in that case by reiterating in this proceeding what it considers to have been the major flaws of the PSP. Among others, these include the fact that the Program had incentive features; that it gave the Company an opportunity to opt out of the Price Protection Incentive, and that it allowed Laclede to engage in intermediate trading of options rather than requiring it to "buy and hold" such options until their expiration. (*Id.*).

Staff is free, of course, to express whatever opinions it holds on the merits of prior Commission decisions such as the Commission's decision to approve the PSP. What Staff cannot do, however, is seek to overturn the results or effect of that decision in a separate proceeding. Nevertheless, that is precisely what the Staff has done in this case. Specifically, by proposing an entirely new method that retroactively deprives the Company of any opportunity to share in the benefits it achieved under the Program, the Staff seeks to convert the incentive program that was approved by the Commission in Case No. GO-98-484 into the non-incentive program that the Staff would have preferred. Similarly, by incorporating a "buy and hold" benchmark into that method, Staff would have the Commission retroactively apply the very hedging concept that Staff advocated and the Commission rejected in Case No. GO-98-484. By the same token, Staff's argument that retroactive application of such a method is appropriate because the Company declared the Price Protection Incentive inoperable during the ACA Period is just another way of saying that Laclede should be penalized for exercising a right that the Commission, but not the Staff, thought the Company should have in Case No. GO-98-484.

Staff had its opportunity to litigate these issues in Case No. GO-98-484. Pursuant to §386.550 RSMo. 2000, it is far too late to litigate them again in this case. For this reason, and in light of the other legal deficiencies discussed above, it is clear that Staff's proposed adjustment cannot be legally sustained and must therefore be rejected by the Commission.

3. Staff's proposed adjustment should be rejected because it is fundamentally flawed.

In addition to being legally impermissible, Staff's proposed adjustment should also be rejected because it is fundamentally flawed. And its most significant defect, among many, lies with the fact that it is not even true to the standard that it is supposedly designed to reflect.

In proposing its method, Staff indicated that it was designed to compare the monetary benefits that the Company achieved as a result of its intermediate trading activities to what it could have achieved had it held and then sold the options closer to their expiration, so as to ensure that there were "real" savings. (Exh. 8, p. 3; Exh. 1, p. 13; Tr. 228, 239). Accordingly, to the extent that the Company's intermediate trading of options produced a greater level of financial benefits than could have been achieved had Laclede simply purchased and held the options until close to expiration, Staff's method should count those additional benefits as savings to be shared between the Company and its customers. Inexplicably, it does not do so – a conclusion that is evident in the very analysis that Staff submitted in support of its method.

As Laclede witness Steven Mathews explained in both his direct and rebuttal testimony, the analysis and calculations underlying Staff's method simply assume that the Company had $9 million to spend on call option purchases for the 2000/2001 winter heating season. (*See* Schedule 2 to Exh. 5HC which contains a reproduction of Staff's analysis, with circles denoting the $8,992,450 in expenditures made by Laclede to purchase call options during the ACA Period). As previously discussed, such an amount is more than double the $4 million Laclede had actually been authorized to collect from its customers for that purpose. What Staff's analysis does not do, however, is give Laclede any credit for the fact that all of this nearly $5 million in additional funding was generated by the Company through its intermediate trading activity. (Exh. 4HC, pp. 6-7; 5HC, p. 8; Exh 6HC, p. 3). Such a failure is critical since it was only by engaging in this activity and producing these additional funding amounts that Laclede was ultimately able to purchase the level of call options and produce the level of financial benefits that it did for its customers. (*Id.*). Indeed, had Laclede not engaged in such intermediate trading activities (but instead ceased purchasing call options once it had spent the initial $4 million that it was authorized to collect from customers to fund the Program) it would have only produced about half of the $28.5 million in total benefits that were ultimately generated under the Program. (Exh. 6HC, p. 3).

Notably, while Laclede first identified this critical flaw in Staff's method in the Company's direct testimony (*see* Exh. 4HC, pp. 6-7), the Staff did not provide any substantive rejoinder to the Company's critique of its method until it filed its surrebuttal testimony. And when Staff finally did file its rejoinder, it came in the form of an entirely new and equally flawed analysis that was supposedly designed to show that the Company could, in fact, have achieved a better result had it bought and held options until close to expiration rather than traded them intermediately. (*See* Exh. 3HC, pp. 7-11; Schedules 1 and 2).

Although the Company had no opportunity to file testimony in rebuttal to this new analysis, its flaws became evident during cross-examination. Specifically, it became evident that to arrive at its conclusion that the Company could have done better by buying and holding its call options until close to expiration, the Staff had to make a series of arbitrary adjustments to the Company's actual purchase of call options. These adjustments took the form of not counting an allocated share of either the expenditures or proceeds from any option purchases that Staff decreed were "reinstatements" of earlier option purchases that the Company had sold to generate additional funding. (Exh. 3HC, pp. 7-11).

Once again, Mr. Sommerer had to concede that there was absolutely nothing in the PSP Tariff or Program Description that in any way mentions, let alone authorizes, this new "reinstatement" method of assessing savings. As Mr. Sommerer confirmed:

> Q. So there's nothing in the PSP tariff sheets or program description as they were originally authored that talks about the concept of reinstatements; is that correct?
>
> A. That's correct.
>
> Q. And there would be nothing in the PSP tariff sheets or program description, as they were originally submitted, that talks about allocating option expenditures that will be presumed to be reinstatements of prior options and option expenditures that will be presumed to be for new options, is there?
>
> A. That's correct.
>
> Q. There's nothing in the PSP tariff sheet or the original program that talks about how that allocation is to be done; is that correct?
>
> A. That is correct.
>
> Q. And is there anything in the September 1st, 2000 Stipulation and Agreement that references the concept of reinstatements?
>
> A. No.
>
> Q. Is there anything in the September 1st, 2000 Stipulation and Agreement that talks about how to allocate option purchases between what are presumed to be reinstatements of prior option positions and option expenditures that will be presumed to be for new options?
>
> A. No.
>
> . . .
>
> Q. Is there anything in the compliance tariff that was filed to implement the September 1st, 2000 Stipulation and Agreement that references the concept of reinstatements?

A. No.

Q. Nor is there anything in that tariff that talks about how to allocate option purchases between what are presumed to be reinstatements of prior options decisions and option expenditures that will presumed be new options, is there.

A. No.

(Tr. 99-100).

In other words, the reinstatement method presented by Staff for assessing savings in its surrebuttal testimony is just as unauthorized and lacking in any conceivable tariff support as the method that Staff presented for this purpose in its direct testimony. And like the method presented by Staff in its direct testimony, the reinstatement method also fails to do what it is supposedly designed to do, namely show what result the Company would have achieved had it followed a buy and hold approach. For as Mr. Sommerer conceded, the series of hedging purchases that result from his artificial exclusion of some purchases and inclusion of others bears no relationship whatsoever to the kind of hedging strategy a utility would actually follow were it to pursue a buy and hold approach. Specifically, Mr. Sommerer acknowledged that his reinstatement analysis assumes that for the winter heating season, Laclede would have purchased and held 601 options contracts for November, 952 option contracts for December, 743 options contracts for January, and only two option contracts each for the months of February and March. (Tr. 104-105; Exh. 12). When asked whether a utility's hedging strategy that had virtually no protection for either February or March was reasonable, however, Mr. Sommerer responded:

A. If that was the hedging strategy that they had built from the ground up, I would say no.

Q. You would not expect to go ahead and have so little coverage for February and March, would you?

A. That's correct.

(Tr. 105-106).

In addition to this disconnection with reality, Mr. Sommerer also acknowledged that his reinstatement method produced radically different results, in terms of whether option purchases were counted or excluded in his analysis, based simply on the order in which such options were purchased and sold in a given month. For example, Mr. Sommerer was asked to consider three different scenarios under which Laclede made three purchases and three sales of 100 options apiece for the month of November, with each purchase costing $50,000 and generating $100,000 in proceeds. (Exh. 13; Tr. 107-108). Although the result at the end of the month was the same (i.e. Laclede had made three purchases and sales of the same quantity of options (with the same cost and level of proceeds), Mr. Sommerer calculated that his reinstatement method would count $50,000 in options purchases under the first scenario, $100,000 under the second, and $150,000 under the third scenario, based solely on the order in which the option purchases were made and sold. (Tr. 110-112). No explanation was provided as to why a method that produces these kinds of dramatically different results for identical transactions with identical outcomes makes any sense. Given these flaws, the new analysis presented by Mr. Sommerer in his surrebuttal testimony cannot be relied upon for any purpose and does nothing to dispel the Company's criticisms regarding the critical flaws that exist in the method that Staff presented in its direct testimony.

In view of these considerations, it is clear that Staff's proposed method for assessing savings is not even consistent with the standard that the Staff itself says it was designed to implement since it substantially understates the value and savings that Laclede created for its customers through its intermediate savings activities. Given this fundamental flaw, Staff's proposed adjustment should be rejected by the Commission.

4. <u>Staff's proposed adjustment should be rejected because it is fundamentally unreasonable and unfair.</u>

In addition to suffering from the foregoing flaws, it is equally clear that Staff's method is, in any event, unreasonable in that it employs hindsight in a highly selective way to engineer the precise kind of benchmark for measuring savings that will retroactively serve to deprive the Company of the last remaining share of Program benefits to which it is lawfully entitled. Indeed, the record is replete with examples of how Staff has reached back to pick and choose only those concepts, facts and considerations that purportedly support the propriety of this retroactive standard for determining savings while studiously avoiding those that do not. While utilizing hindsight to retroactively redistribute the financial benefits of past transactions is bad enough, it is especially objectionable when the method chosen for that purpose has been so obviously manipulated to reach the result -- and only the result -- desired by its architect. And, once again, it is clear from the evidentiary record in this proceeding that this is precisely the kind of highly selective, results-oriented approach that Staff plainly followed in developing and promoting its proposed method in this case.

As an example of Staff's pick and choose approach, Staff chose to apply as a benchmark its previous position in Case No. GO-98- 484 that all options should be held to near expiration, but chose to ignore its previous position in that case that Laclede should not be allowed to purchase options at strike prices exceeding $4.00 per MMbtu. (Exh. 5HC, p. 11). Indeed, Staff made no effort at all to incorporate this latter element of its prior hedging proposals into its retroactively-constructed benchmark. Because had it done so, Laclede's share of savings would have been determined by comparing the approximately $24.5 million in net proceeds the Company actually did achieve under the PSP to the *zero* proceeds that it would have realized had Staff's $4.00 strike price ceiling been in effect. (Id.)[10] Since such a result would have been inconsistent with Staff's obvious goal of devising whatever method or benchmark it takes to completely eliminate Laclede's ability to share in the proceeds it generated, this more comprehensive and balanced use of prior Staff concepts was apparently of no interest to the Staff.

The record also contains other examples of where Staff has reached back to pick and choose only those facts, concepts and considerations that support its method while ignoring those that do not. Among the latter are Staff's failure to give any consideration to Laclede's creation and flow through to its customers of all of the $11.5 million in proceeds it achieved under the Price Protection Incentive and the Company's role in creating $30 million more in additional savings through its contribution of $4 million of its share of savings to supplement Program funding during its third year. (Exh. 4HC, pp. 7-9). Staff's failure to consider the $30 million in additional savings achieved by Laclede is particularly noteworthy. In explaining why it did not do so, Staff suggested in its rebuttal testimony that "hypothetical" examples of saving scenarios that are constructed after the fact and that go "beyond the analysis of the PSP provisions in the ACA period of 2000-2001" are inappropriate (Exh. 2HC, p. 5). It is difficult to imagine a more apt

[10]The benchmark would have produced a zero savings amount because a $4.00 strike price ceiling would have effectively prevented Laclede from purchasing any options (and hence generating any proceeds) during the high price environment that prevailed during the ACA Period, just as Missouri Gas Energy was unable to purchase any call options at its even higher strike price ceiling of $4.40 per MMBtu. (Exh. 5HC, p. 11; Tr. 119).

characterization of Staff's own method or a better illustration of Staff's selective use of hindsight.

Such an unreasonable and biased approach to ratemaking should not be sanctioned by the Commission under any circumstances. But it is particularly inappropriate where it has been employed, as in this case, with such complete disregard for the terms of the controlling tariff provisions that were actually authorized by the Commission to govern these transactions.

III. Conclusion

In view of the foregoing, Laclede submits that the clear language of the PSP Tariff and Program Description, the September 1, 2000 Stipulation and Agreement and implementing tariff as well as a fair appraisal of the tremendous results achieved by the Company under the PSP conclusively establish Laclede's entitlement to the remaining $4.9 million in proceeds earned under that Program. Conversely, Laclede submits that there is simply no basis upon which the adjustment proposed by the Staff in this case can be reconciled with either the requirements of the law or fundamental notions of fairness. It should accordingly be rejected by the Commission.

Respectfully submitted,

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Certificate of Service

The undersigned certifies that a true and correct copy of the foregoing Initial Brief was served on all counsel of record in this case on this 25th day of March, 2003 by hand-delivery, email, fax, or by placing a copy of such Initial Brief, postage prepaid, in the United States mail.

James C. Swearengen