

Exhibit No.:
Issue: ACA Adjustment
Witness: George E. Godat
Type of Exhibit: Direct Testimony
Sponsoring Party: Laclede Gas Company
Case No: GR-2004-0273
Date: September 8, 2006

LACLEDE GAS COMPANY

GR-2004-0273

DIRECT TESTIMONY

OF

GEORGE E. GODAT

NP

TABLE OF CONTENTS

	<u>Page</u>
Purpose of Testimony	1
History of Contracting Practice	3
Staff's Proposed Adjustment	5
Failure to Show Imprudence	6
Absence of Harm	10
Inconsistency with Natural Gas Price Volatility Mitigation Rule	12

1 **DIRECT TESTIMONY OF GEORGE E. GODAT**

2 Q. What is your name and address?

3 A. My name is George E. Godat, and my business address is 720 Olive Street, St. Louis,
4 Missouri 63101.

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

6 A. I am employed by Laclede Gas Company (“Laclede” or “Company”) in the position of
7 Director of Gas Supply.

8 Q. Please state your qualifications and experience.

9 A. I graduated from the University of Missouri Rolla in 1991, where I received a Bachelor
10 of Science degree in Mechanical Engineering. I joined Laclede in January of 1992 as an
11 Engineer in the Distribution/Design department. I was promoted to Distribution Engineer
12 in 1994 where I was responsible for the Engineering Department of Laclede’s Missouri
13 Natural Division. I was promoted to the position of Gas Supply Administrator in the Gas
14 Supply Department in 1996 and to Senior Gas Supply Administrator in 1998. I became
15 Manager of Energy Services in October 2001, and was promoted to my current position
16 in October 2003. As Director of Gas supply, I am responsible for directing most of the
17 day to day gas supply purchasing, sales, risk management and accounting functions for
18 Laclede Gas Company.

19 **PURPOSE OF TESTIMONY**

20 Q. What is the purpose of your testimony?

21 A. The purpose of my testimony is to respond to the Staff’s recommendation in this
22 proceeding to disallow approximately \$2.4 million **_____

_____.**

Q. Is it your understanding that this is the only remaining issue in this case?

A. Yes. Consistent with the Notice filed by the Staff of the Missouri Public Service Commission on August 24, 2006, it is my understanding that Staff's proposed disallowance **_____** is the only remaining issue in this case.

Q. Does the Company oppose Staff's proposed disallowance?

A. Yes. As I discuss later in my testimony, the Commission should reject Staff's proposed disallowance for three primary reasons. First, there is absolutely no evidence that Laclede's contracting practice **_____** was imprudent. To the contrary, these are the very same hedging practices that Laclede had successfully employed for many years, with Staff's full knowledge. Moreover, they are practices that not only resulted in more stable prices for Laclede's customers, but also created substantial savings for those same customers in the process. Nevertheless, because the Staff mistakenly believes that these practices did not result in savings during the particular ACA period in question, it has proposed to disallow **_____** based on what I believe is a fundamentally unfair, erroneous and impermissible hindsight review.

Second, I believe Staff's proposed disallowance should be rejected because there is absolutely no evidence that Laclede's practice **_____** actually harmed customers. Specifically, while Staff acknowledges that the purchasing practices followed by Laclede have enabled

1 the Company ** _____ **, it fails to offset its proposed disallowance
2 ** _____
3 _____.** Had Staff done so, such an offset would have
4 totally negated its proposed disallowance and shown that Laclede's customers were
5 actually benefited by this contracting practice during the ACA period in question.

6 Finally, Staff's proposed disallowance is fundamentally inconsistent with the
7 Commission's own Natural Gas Price Volatility Mitigation rule. As I discuss later, that
8 rule affirmatively encourages local distribution companies like Laclede to use various
9 contracting practices and financial instruments to achieve greater price stability on behalf
10 of their customers. To that end, the rule explicitly acknowledges and accepts the
11 proposition that prudent efforts aimed at promoting more stable prices may occasionally
12 result in prices that are higher than spot market prices. By seeking to penalize the
13 Company for using a price stabilization practice precisely because it may have resulted in
14 a slightly higher than spot-market price in a particular year, the Staff has proposed an
15 adjustment that eviscerates the core assurances provided by the Commission's Price
16 Volatility Rule. For all of these reasons, I believe that the Commission should reject
17 Staff's proposed disallowance.

18 **HISTORY OF CONTRACTING PRACTICE**

19 Q. What are "swing" supplies?

20 A. In contracting for gas supplies, Laclede has to take into consideration the extremely
21 variable demands for natural gas that its customers can and do impose during the winter
22 heating season. ** _____
23 _____

_____.** Laclede has a variety of tools at its disposal to meet these varying demands, including storage gas, propane peak shaving capabilities and, of course, flowing gas supplies that are purchased and then received on a daily basis from producers and marketers over the interstate and intrastate pipelines that are connected to Laclede. A portion of these gas supplies are "baseload" supplies that Laclede is obligated to take in even increments each day to serve those minimum load requirements that Laclede expects it will experience each day, regardless of weather conditions or other factors. Another component of these supplies are called "swing" supplies. These consist of supplies which Laclede may or may not need on a given day to serve its customers depending on how weather conditions are affecting the demand for gas and the availability of other supply options for meeting that demand.

Q. Why does Laclede **_____?***

A. **_____

_____.**

Q. How does this hedging strategy benefit Laclede's customers?

A. This hedging strategy benefits Laclede's customers because **_____

1 _____
2 _____
3 _____
4 _____
5 _____.

6 Q. How long has Laclede been paying ** _____? **

7 A. Laclede's practice ** _____
8 _____ ** is a long-standing one. In fact,
9 Laclede had been following that practice for at least ten years prior to the ACA period
10 under consideration in this case.

11 Q. Was Staff aware of Laclede's practice ** _____? **

12 A. Yes. Throughout the entire ten year period preceding the ACA period in this case, Staff
13 was fully aware of Laclede's practice in this regard. In fact, the Staff had reviewed this
14 practice in detail, not only in various ACA proceedings, but in other proceedings as well.

15 Q. Did Staff ever voice any concerns throughout this period ** _____
16 _____? **

17 A. No. In fact, in case after case over this period, the Staff gave every indication that
18 measures ** _____
19 _____ ** -- were a good thing that should
20 be aggressively pursued by local distribution companies.

21 **STAFF'S PROPOSED ADJUSTMENT**

22 Q. Why then has Staff suddenly proposed to disallow ** _____
23 _____ **?

1 A. Since I do not believe there is any valid justification for such an adjustment, all I can do
2 is point to what Staff has stated in its recommendation in support of its proposed
3 disallowance. As I understand it, Staff bases its proposed adjustment on the theory that
4 Laclede did not adequately support, with a formal study that was prepared prior to
5 contracting for gas supplies,** _____
6 _____.** According
7 to Staff, the need for such a study was particularly compelling ** _____
8 _____
9 _____
10 _____
11 _____
12 _____.**

13 **FAILURE TO SHOW IMPRUDENCE**

14 Q. Do you agree with Staff's position that Laclede was imprudent?

15 A. Absolutely not. Legal counsel has advised me that to make an adjustment based on
16 imprudence, the Staff must show, and the Commission must find, that utility management
17 acted imprudently compared to what a reasonable person would or should have done at
18 the time the transaction took place. I have also been advised that any prudence
19 determination must be based on the facts and circumstances that existed at the time the
20 transaction took place and may not use hindsight to arrive at its conclusion. In view of
21 this standard, I do not believe that the Staff has come anywhere close to establishing that
22 Laclede acted imprudently ** _____
23 _____** during the ACA period.

1 Q. Why do you say that?

2 A. As I previously indicated, at the time Laclede made its decision **
3 _____,** it had been employing such a
4 practice for at least ten years. Moreover, it had been doing so with Staff's full knowledge
5 and apparent concurrence **
6 _____.** Indeed, had Staff believed that this
7 long-standing contracting practice was unreasonable or flawed for some reason, it had
8 numerous opportunities in prior ACA proceedings and other venues to say so. Staff
9 never did, however. To the contrary, as a result of the unprecedented run-up in gas prices
10 that was experienced in December 2000, and the \$3.50 per MMBtu increase in intra-
11 month prices that occurred in February 2003 (just months prior to Laclede contracting for
12 gas supplies for this 2003-04 ACA period), the Commission initiated a formal process to
13 evaluate the adequacy of the hedging practices being followed by LDCs to stabilize
14 prices, and promulgated a rule (4 CSR 240-40.018, effective December 30, 2003) in
15 which it strongly urged utilities to utilize price mitigation and other efforts to stabilize gas
16 prices -- ** _____.**
17 A timeline summarizing events relevant to this process is set forth in Schedule GEG-1
18 attached hereto. In view of this background, I do not see how anyone, least of all the
19 Staff, could assert that it was somehow imprudent for Laclede to continue a practice that
20 it had consistently employed for years under Staff's watchful eye.

21 Q. Isn't Staff correct, however, in claiming that Laclede was imprudent for not conducting a
22 formal study before it decided to continue this practice, ** _____

23 _____?***

1 A. No. Such an argument is completely fallacious. First, at the time these decisions were
2 made, Laclede had every reason to believe, based on many years of real world experience
3 in the natural gas markets, that such a practice was, and remained, a reasonable one, both
4 in terms of its impact on gas costs and in terms of its usefulness in stabilizing prices. In
5 fact, a study conducted by Laclede in the winter of 1995-1996 ** _____
6 _____
7 _____.** Since that time, Laclede had continued to monitor this hedging strategy and,
8 prior to the subject ACA period, had seen no evidence to indicate that such hedging
9 strategy had become imprudent or was not cost-effective. To the contrary, as discussed
10 above, as recently as six months before it entered the winter of 2003-2004, Laclede had
11 seen ** _____ ** in the natural gas markets that, given their magnitude,
12 had broadly reconfirmed the wisdom of using such a hedging strategy to mitigate such
13 spikes. In view of this readily available data, there was absolutely no need for a formal
14 "study" to prove what Laclede had observed the natural gas markets prove on a regular
15 basis each month. Moreover, when Laclede did in fact conduct a formal study, as
16 acknowledged by Staff on page 9 of its Recommendation in this case, ** _____
17 _____
18 _____
19 _____.**

20 Q. Are there other reasons why a formal study was not needed?

21 A. Yes. I think it is important for the Commission to recognize that ** _____
22 _____
23 _____

1 _____
2 _____
3 _____.**
4 Q. What is your response to Staff's assertion that a formal study was needed ** _____
5 _____
6 _____?***
7 A. The Staff's observation ** _____
8 _____ ** says nothing about the prudence of the Company's actions in this case.
9 ** _____
10 _____
11 _____
12 _____
13 _____
14 _____
15 _____
16 _____
17 _____
18 _____.** Moreover, as in the past, had weather and pricing conditions
19 turned out differently during the ACA period, ** _____
20 _____
21 _____, ** I would
22 not be surprised if Laclede would now be facing a Staff adjustment premised on the
23 Company's failure to protect its customers ** _____.** In view of all

1 of these considerations, I do not believe there is any basis for concluding that Laclede
2 acted imprudently by continuing a long-standing strategy that had proved its value over
3 the years. Staff's effort to focus with 20/20 hindsight on a particular ACA period, as
4 opposed to the merits and results of the long-term strategy, should be rejected by the
5 Commission.

6 **ABSENCE OF HARM**

7 Q. Even if the Commission decides that this long-standing hedging strategy was somehow
8 imprudent, should it nevertheless reject Staff's proposed disallowance?

9 A. Yes. I have also been advised by legal counsel that a disallowance of gas costs is
10 impermissible without also finding that the allegedly imprudent action resulted in actual
11 harm to ratepayers.

12 Q. Has Staff shown that ratepayers were harmed ** _____
13 _____ **?

14 A. No. In that regard, it should be noted that another benefit from this hedging strategy is
15 that it provides Laclede with an opportunity to ** _____
16 _____
17 _____
18 _____
19 _____.

20 Q. Has Laclede ** _____ **?

21 A. Yes. Laclede has ** _____.** In its
22 2002 rate case (Case No. GR-2002-356), a Stipulation and Agreement ("Stipulation")
23 approved by the Commission (and in effect during the ACA period) provided that

Laclede’s annual revenue requirement included an imputed \$3.8 million in off-system sales and capacity release revenues. In exchange for this imputation, the Company was permitted to retain all of the revenues realized from off-system sales and releases of pipeline capacity. In effect this means that regardless of the level of off-system sales or pipeline capacity release achieved by Laclede, its customers were *guaranteed* \$3.8 million per year through lower rates. The Stipulation further provided that “no other treatment of such revenues shall be implemented as the result of any action taken in another Commission case...” (Stipulation, p.10). Moreover, as a result of Laclede's success in making off-system sales during this period, Laclede's customers today are benefiting from an even higher imputation.

Q. Why do these factors negate any possible finding that Laclede's customers have been harmed **_____**?

A. **_____

_____.

On the other hand, the failure to reject Staff’s proposed disallowance would deprive Laclede of the value of what it bargained for in the Stipulation – and in the process

1 violate that agreement – by taking away with an ACA adjustment what the Company was
2 entitled to keep under the Stipulation. None of these impermissible results should be
3 permitted by the Commission.

4 **INCONSISTENCY WITH NATURAL GAS**
5 **PRICE VOLATILITY MITIGATION RULE**
6

7 Q. You previously indicated that Staff's proposed disallowance was also inconsistent with
8 the Commission's Natural Gas Price Volatility Mitigation Rule. What do you base that
9 conclusion on?

10 A. The Commission's Natural Gas Price Volatility Mitigation rule, which is set forth at 4
11 CSR 240-40.018, was adopted for the express purpose of encouraging local distribution
12 companies, like Laclede, to use various contracting practices and financial instruments to
13 achieve greater price stability on behalf of their customers.

14 Q. How does the rule promote that objective?

15 A. It facilitates that objective by explicitly acknowledging and accepting the fact that
16 prudent contracting and hedging practices aimed at promoting more stable prices may
17 occasionally result in prices that are higher than spot market prices. In other words, it
18 recognizes that a more stable price is not always going to be the lowest price given the
19 way market prices can decline as well as increase from what was assumed or prevailing
20 at the time a hedging decision was made. By providing this kind of assurance, the rule
21 effectively tells utilities that they will not be penalized with disallowances simply
22 because their price mitigation practices result in higher rates in a given year than would
23 have been the case had the utility simply relied on the spot market.

24 Q. How is Staff's proposed disallowance inconsistent with this rule?

1 A. Staff's proposed disallowance strikes at the heart of the rule and what it was intended to
2 accomplish by disallowing costs precisely because a price mitigation practice allegedly
3 resulted in prices slightly higher than the spot-market prices which prevailed in a
4 particular year. **_____

5 _____
6 _____
7 _____

8 _____** As a result, Staff's proposed disallowance is directly contrary to the explicit
9 wording and intent of the Commission's Price Volatility Rule.

10 Q. What would this mean for hedging strategies in the future in the event the Commission
11 were to adopt Staff's proposed adjustment?

12 A. Contrary to the Rule's intent, it would actively discourage hedging by telling utilities that
13 the practice is acceptable only if, and to the extent, it produces a favorable outcome in
14 each and every ACA period. That would send exactly the wrong message at a singularly
15 inappropriate time given the gas price environment faced by local distribution companies
16 and their customers today. For all of these reasons, Staff's proposed adjustment should
17 be rejected by the Commission.

18 Q. Does this conclude your direct testimony?

19 A. Yes, it does.

SCHEDULE GEG-1

Timeline of Laclede Issues for 0304 Portfolio

