Exhibit No.:	
Issue:	Price Stabilization Fund
Witness:	David Sommerer
Sponsoring Party:	MoPSC Staff
Case No.:	GO-98-484

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

LACLEDE GAS COMPANY

CASE NO. GO-98-484

REBUTTAL TESTIMONY

OF

DAVID SOMMERER

Jefferson City, Missouri
July 1998

NP

****Denotes Highly Confidential Information****

REBUTTAL TESTIMONY

OF

DAVID SOMMERER

LACLEDE GAS COMPANY

CASE NO. GO-98-484

Q. Please state your name and business address.

A. David Sommerer, P. O. Box 360 , Jefferson City, Mo. 65102

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

A. I am the Manager of the Procurement Analysis Department with the Missouri Public Service Commission.

Q. How long have you been employed with the Commission?

A. Approximately 14 years.

Q. Please describe your educational background and experience.

A. In May 1983, I received a Bachelor of Science degree in Business Administration with a major in Accounting from Southern Illinois University at Carbondale, Illinois. In May 1984, I received a Master of Accountancy degree from the same university. Also, in May 1984, I sat for and passed the Uniform Certified Public Accountants examination. Upon graduation, I accepted employment with the Commission.

Q. What has been the nature of your duties at the Commission?

A. From 1984 to 1990 I assisted with audits and examinations of the books and records of public utilities operating within the State of Missouri. In 1988 the responsibility for conducting the Actual Cost Adjustment (ACA) audits of natural gas utilities was given to the Accounting Department. I assumed responsibility for planning and implementing these audits and trained available Staff on the requirements and conduct of the audits. I participated in most of the ACA audits from early 1988 to early 1990. On November 1, 1990, I transferred to the Commission's Energy Department. Until November of 1993, my duties consisted of reviews of various tariff proposals by electric and gas utilities, Purchased Gas Adjustment reviews, and tariff reviews as part of a rate case. In November of 1993, I assumed my present duties of managing a newly created department called the Procurement Analysis Department. This Department was created to more fully address the emerging changes in the gas industry especially as they impacted the utilities' recovery of gas costs. My duties have included managing the five member staff, reviewing ACA audits and recommendations, participating in the gas integrated resource planning project, serving on the gas project team, and participating in matters relating to natural gas service in the State of Missouri.

Q. Have you previously testified before this Commission?

A. Yes. A list of cases in which I have filed testimony is included as **Schedule 1** of my testimony.

Q. What is the purpose of your testimony in this case?

A. To rebut the testimony of Laclede Gas Company (Company) witnesses Kenneth Neises, and Scott Jaskowiak. Staff Witness James Busch will discuss weaknesses of the Company's proposal in more detail.

Q. Could you provide an overview of your why you are opposing the Company's proposals?

A. Yes. The Company has proposed an elaborate plan which has distinct speculative elements. The stated goals of the Company's proposal are admirable on the surface; however, the proposal is contradictory to these goals, and the stated opportunities may be achieved at the customers' expense. The Company has neglected to cite the physical or "cash" side of the program and therefore has incorrectly characterized their proposal as a risk free improvement to the current hedging program.

Q. Please explain what you mean by physical/ cash side of the analysis.

A. In any hedging program an evaluation should be done to assess the risk exposure to price increases in the actual commodity. In this instance, the commodity being hedged is the gas supply of the Company. **______________________________ ____ ____.** As a result of the price fly-up during the winter of 1996-97, a number of state Commissions (or their staffs) have expressed concern about the over-reliance on index priced contracts. Attached as **Schedule 2**, is a copy of a New York Public Service Commission policy statement that illustrates the concern. **____ ____.**

Q. Do the reformed Purchased Gas Adjustment (PGA) processes and prudence reviews protect the customer from such an undesirable outcome?

NP

A. No, not completely. An unscheduled winter PGA filing might subject the customer to an extremely burdensome sales rate. Even if such a temporary rate was based on unreasonable price levels, prudence disallowances are typically delayed many months after the harm has already been done and are always difficult to prove.

Q. How is this discussion relevant to the Company's proposal?

A. When the Company indicates that the risk of its program is limited to the original approved expenditure of **________,** it fails to mention the risk of additional price increases on the physical (cash) side of the business. For example, Company witness Kenneth Neises indicates on page 10, lines 1 though 10, that the risk for the ratepayer is limited to the **__________**cost of the program (plus transaction costs). Company witness Scott Jaskowiak echoes this on page 3, lines 16 through 23. If, however, the Company's actions increase **______________________________________ ___________**, the losses will be reflected on the physical side of the program.

Q. Please explain how this could happen?

A. Higher **_______________** mean greater exposure on the physical side. Higher **__________** also mean less costs on the financial side of the program. By giving up lower **_________** the Company can conceivably reduce program costs, thereby increasing the "savings" that it shares in, while exposing the customers to increased price risk for the cost of the actual commodity.

Q. Do you believe the Company's proposal to be an improvement to the existing plan?

A. No. The existing strategy can be characterized as ** ______________**. One of the beneficial aspects of the initial program was the potential to help curb volatile gas costs. The second year of the price stabilization fund was designed to offer an earlier approval for more time to acquire hedges and to let the program function beyond what was considered to be a mild winter in 1997/98.

In addition the Staff was concerned about unlimited **________** authorization and speculative buy and sell activity during the operation of the program. These are, the reasons for the modifications from the first year.

Q. On page 5, line 8 through 24, Mr. Neises explains why he believes the existing limitation on trading is inappropriate. Do you agree with his analysis?

A. No. Although there are speculative opportunities whereby the Company and the customer could potentially profit, there is also risk. For example, if during the intervening time period of trading the Company attempts to realize a gain on its **____ ____** or no coverage at all.

Q. On pages 7 and 8 Mr. Neises describes the two incentive components of the Company's proposal. Do you agree with his perspectives on the merits of these components?

Q. No. Once again, on the surface, the general concepts seem to be logical. The first aspect is to try to give the Company an incentive to achieve a **_________** as low as possible, while the second attempts to reward the Company for reducing the costs of the program. The two concepts are inconsistent. The Company can reduce the **__________** cost of the program in many ways. First, it could simply obtain higher **__________** up to the CPL (the adder that gives the Company an inappropriate incentive to get higher **_____**) . If the Company's tariffs and proposals are followed closely, it appears that the Company is assuming any behavior that brings the cost down is appropriate. This could include obtaining higher **_____**, reducing coverage, and perhaps not spending the money to hedge in the first place.

Once the Company has the "bird in the hand" because costs are less than **________**, it is unlikely that the Company would then forgo these incentive savings for several "birds in the bush" by spending more money to achieve the lowest **____ _____** possible.

Q. On page 9, lines 1 though 12, Mr. Neises discusses the need for a 90 day window to hold the Company harmless if the Company is unable to purchase **______ ________** below the CPL. Do you agree with this concept?

A. No. This is another risk reducing proposal for the Company, not the ratepayer. If in the Company's interpretation, a radical market change occurs, there is no obligation to obtain **___________** at the already artificially inflated CPL. The Commission and ratepayers are supposed to take solace in the fact that the Company will notify it one month after something very unusual has happened.

Q. On page 9, lines 15 through 25, Mr. Neises, indicates that the Company's proposed modifications will actually tend to mitigate ratepayer risk by reducing the

NP

speculation inherent in the current program's requirement that all **______** coverage be based on one-time purchases of these financial instruments. Do you agree?

A. No. This statement is somewhat disingenuous when viewed in light of the Company's purchasing **____ ______**. That philosophy exemplifies a risky hope that prices won't get too high. The current program was designed to offer a tool to manage that risk.

Q. On page 10, line 13, of his Direct Testimony Mr. Neises discusses the Company's proposal for a three year term for the Incentive Price Stabilization Program. Do you agree?

A. No. The proposal is a drastic change from the existing program, while at the same time the Company has provided no scenarios or examples of how its proposal would be implemented. Therefore, a three year "lock-in" is inappropriate. As an example of the ambiguity, the Company assumes **____________________________ ____________________________** for the winter months they want to hedge. There is no description of how the process would work if these prices are not available, nor any provision for a safe harbor if a lack of liquidity results in unreasonable TSP levels.

Q. Do you have any comments regarding Mr. Jaskowiak's Direct Testimony on page 3, lines 5 through 12?

A. Yes. Mr. Jaskowiak describes, in general terms, the requirement that the Company ultimately achieve levels of coverage at *some point* during **____________ ____________________________** for a particular month could be traded. (emphasis

NP

added). It is conceivable that this could mean the Company could be **____________ ____________________________________** to meet this vague requirement of the program. In passing, Mr. Jaskowiak's throws in an authorization for speculative summer month **_____** as well, in lines 11 and 12. No explanation is provided, just the proposal. This same lack of specificity and clarity applies to the suggested use of **__ _____** in the final page of his testimony.

Q. Please respond to pages 4 and 5 of Mr. Jaskowiak's Direct Testimony.

A. On page 4, starting on line 12, Mr. Jaskowiak describes the calculation of the TSP. No numerical example is provided. Based on the narrative it is unclear how these **________** will vary from month to month and how the weighting will be applied to the **_______**. On page 5, lines 14 through 16, he implies that NYMEX will be determining the TSP. NYMEX will do nothing more than provide the market place for any trades that may be referenced. If there are no trades on the cited days, it is unclear how the Company will calculate a TSP.

Q. Mr. Jaskowiak makes the claim that the Company is at risk for the **____ ____** incentive feature of its proposal on page 7, lines 10 though 25. Please respond to this.

A. This risk is defined in such a way that it will likely never take place. The Company only holds itself accountable for **__________** obtained over the so called "Catastrophic Price Level." The Company simply would not enter into **_____** above

NP

this level. In addition, the Company has provided itself with a 90 day window where all bets are off, and even the CPL is no ceiling.

Q. On page 9, lines 11 through 14, Mr. Jaskowiak claims that the Company is at risk for the cost savings component of its incentive. Please comment.

A. The Company will simply address this alleged risk by not exceeding the **_______** expenditure. Furthermore, the physical price risk is not even mentioned, but under no circumstance should the Commission provide the Company with a guarantee of no prudence review in this area.

Q. Mr. Jaskowiak discusses transaction fees on page 9, line 15 though 21 of his Direct Testimony. What comments do you have here?

A. The Company's proposal seems to be one of unlimited transaction costs without review. It would be poor policy to allow the Company the discretion to buy and sell **_____** frequently, give the Company a monetary incentive to increase trading activity, and then fund the transaction costs with ratepayer money.

Q. Please summarize your rebuttal testimony.

A. My testimony has addressed several problems with the Company's incentive proposal. Most fundamentally, the Company's proposal is not an improvement for the customers over the existing plan (which should be viewed as a baseline for any proposed "improvements"). A major flaw in the two major goals of the Company's incentive program is that **__________________________** cost less money. If the Company obtains higher **_________**, the customers will be exposed to higher costs on the

NP

physical side of the business. In addition, the proposal is vague regarding various calculations, and requirements for hedging. The proposal includes unexplained uses of **________________________________**. The program allows a type of churning of transaction fees, and requires the customer to fund both the transaction fees and the program costs of **__________**. This program contains very limited risk for the Company while providing many ways to profit at the customers' expense. The Commission should encourage the Company to diversify the *pricing* of its gas supply portfolio, and allow the existing program to work for the second year.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

NP

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

Laclede Gas Company's Tariff to Extend Additional Period for Experimental Price Stabilization Fund	))	Case No. GO-98-484

AFFIDAVIT OF DAVID SOMMERER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

David Sommerer, is, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 10 pages to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

RANDALL Z. WRIGHT NOTARY SEAL NOTARY PUBLIC STATE OF MISSOURI

David Sommerer

Subscribed and sworn to before me this 30th day of July, 1998.

Randall Z. Wright
Notary Public, State of Missouri
County of Cole
My Commission Exp. 01/02/2001

Notary Public

CASES WHERE TESTIMONY WAS FILED

DAVID M. SOMMERER

COMPANY	CASE NO.
Missouri-American Water Company	WR-85-16
Great River Gas Company	GR-85-136
Grand River Mutual Telephone	TR-85-242
Associated Natural Gas Company	GR-86-86
Empire District Electric Company	WR-86-151
Grand River Mutual Telephone Company	TR-87-25
Great River Gas Company	GM-87-65
KPL Gas Service Company	GR-89-48
KPL Gas Service Company	GR-90-16
KPL Gas Service Company	GR-90-50
Associated Natural Gas Company	GR-90-152
United Cities Gas Company	GR-90-233
United Cities Gas Company	GR-91-249
Laclede Gas Company	GR-92-165
United Cities Gas Company	GR-93-47
Western Resources Inc.	GR-93-240
Union Electric Company	GR-93-106
Missouri Public Service	GA-95-216
Missouri Gas Energy	GO-94-318
Missouri Gas Energy	GO-97-409
United Cities Gas Company	GO-97-410
Missouri Gas Energy	GC-98-335

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 97-G-0600 - In the Matter of the Commission's Request for Gas Distribution Companies to Reduce Gas Cost Volatility and Provide for Alternate Gas Purchasing Mechanisms

STATEMENT OF POLICY REGARDING GAS PURCHASING PRACTICES

Issued and Effective: April 28, 1998

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

COMMISSIONERS PRESENT:

John F. O'Mara, Chairman[1/]
Maureen O. Helmer
Thomas J. Dunleavy
James D. Bennett

CASE-97-G-0600 - In the Matter of the Commission's Request for Gas Distribution Companies to Reduce Gas Cost Volatility and Provide for Alternate Gas Purchasing Mechanisms.

STATEMENT OF POLICY CONCERNING GAS PURCHASING PRACTICES

(Issued and Effective April 28, 1998)

In June 1997, we addressed the issue of volatility in gas commodity prices and determined that:

> The current utility practice of purchasing all supplies based upon a single reference price with a history of volatile movement (or of indices which have a high correlation with it), merits reconsideration. In order to provide diversity in acquisitions and defuse price spikes and valleys for gas supplies,

---

1/ John F. O'Mara served as Chairman of the Commission until April 14, 1998.

> LDCs shall review their gas procurement practices and develop an acquisition strategy to include a mix of purchase options composed of, but not limited to indices, cash market and financial transactions with a view toward fostering price stability. The companies should provide guidelines and limits in support of these strategies, as well as an assessment of risk for each action proposed.[1]

We directed ten of the eleven[2] largest gas distribution companies (LDCs) to file proposals for increased supply diversity.

Utility Responses

Each of the affected utilities filed a response to that order. While several did indicate that they had recently addressed the issue or were in the process of addressing the issue the general tone to the responses was that the strategy currently in place provided the necessary diversity.

It appears that most LDCs buy natural gas primarily through contracts that reset the price monthly based on a specified price index. For the domestic supply, the indices used tie gas prices either directly to the New York Mercantile Exchange (NYMEX) natural gas futures price for the next

---

[1] Case 97-G-0600, Gas Cost Volatility and Alternative Gas Purchasing Mechanisms, Order Requiring the Filing of Proposals to Ameliorate Gas Price Volatility and Requiring Comments (issued June 5, 1997), p.3.

[2] New York State Electric & Gas Corporation is currently operating under a hard price cap, and was therefore exempted from the order.

month("Bid Week" price), or to published production area price indices for the next month. The production area price indices are highly correlated with the NYMEX prices. For the Canadian supply a weighted market basket of oil and gas prices is used, but some of those indices are being reset to NYMEX-based monthly or spot pricing.

A number of utilities highlighted the fact that they make significant use of storage and acquire supplies from a number of sources located in both the United States and Canada. However, a review of the pricing mechanisms associated with these purchases indicate that, as with flowing gas supplies, most are tied to indices which are either based on the NYMEX Bid Week price or indices that have high correlation to that price. Therefore, while sources of supply are diversified, pricing is not.

LDCs also purchase a small amount of gas in the cash (spot) market. Cash market prices can vary significantly from NYMEX prices month-to-month but are also highly volatile.

Some utilities believe that a gas supply portfolio using a number of relatively independent pricing mechanisms may leave them at a price disadvantage against competitors should gas prices subsequently drop. They imply that they want to buy gas at the near-term market price because their competitors are. In fact, however, it appears that marketers use a more diversified strategy.

While some of the LDC's have taken steps to diversify their supply portfolios, including financial hedging,[1/] LDCs are

---

[1/] Hedging is the use of financial instruments, such as NYMEX natural gas or over the counter futures and options contracts, to wither purchase gas at a fixed price, or to doing only a small amount of hedging, primarily for their fixed price option programs. Individual LDCs tend to rely on one type of index and one price trigger. For example, some LDCs rely almost exclusively on a NYMEX bid-week related price for their gas purchases. Other LDCs rely almost exclusively on first-of-the-month production area price indices for delivery at specific pipeline locations. Some of the LDCs have responded to the volatility of the price of gas and our prior order by taking action to bring reasonable diversity to their portfolio; others proposed no or only minimal changes.

Discussion

The current, almost exclusive reliance on spot or monthly pricing does not attempt to recognize or manage price volatility. Under the current approach the price of gas can vary dramatically each month, depending on the level of NYMEX prices for near-month deliveries. Last winter, the price of the November '96 contract was $2.57/MMBtu[1/] while two months later the January '97 contract had risen to $4.25/MMBtu. This winter the price of gas went the other way, with the November '97 contract at $3.51/MMBtu and the January '98 contract being priced at $2.27/MMBtu.

Two themes appear to dominate gas purchasing practices in the LDCs responses to our June 1997 order. The first is the concern that the pricing portfolio be prudent at all times, coupled with the belief that paying the current market price ensures such prudence. The second theme is that using a number

---

retain the option to do so.

[1/] An MMBtu of gas is roughly equivalent to an Mcf of gas.

of relatively independent pricing mechanisms may leave an LDC at a price disadvantage against competition should prices drop.

With respect to the former approach, we note that being tied to the near term market price at all times does not necessarily demonstrate prudence, as it ignores price volatility as a factor to be considered in the purchasing strategy. As to positions relative to competitors, it appears that marketers, unlike most LDCs, are making substantial use of strategies to mitigate price volatility.

Conclusion

Local distribution companies have many ways to meet their loads; they should consider all the available options for purchasing gas and assess the benefits of each approach. Options may include short and longer term[1/] fixed price purchases, spot acquisitions, the use of financial hedges, and contracts which provide for flexibility in the amount of gas taken over the term of the agreement.

We expect companies to manage their gas portfolios to meet the needs of their systems[2/]. We note that since we issued our previous order, several of the LDCs have diversified pricing, while others have remained largely with predominantly non-diversified pricing strategies. While we are not directing any particular mix of portfolio options, volatility of customer bills is one of the criteria, along with other factors such as cost and

---

[1/] Longer term, for these purposes, is defined as several months to a year.

[2/] Parties should be aware that we may reexamine this issue if we consider whether and, if so, how local distribution companies should continue to be gas merchants.

reliability, that LDCs should consider in their gas supply purchasing strategies. Excessive reliance on any one gas pricing mechanism or strategy does not appear to reflect the best management of the gas portfolio. Any utility without a diversified gas pricing strategy will have to meet a heavy burden to demonstrate that its approach is reasonable.

By the Commission,

(SIGNED) JOHN C. CRARY
Secretary