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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

MORRIS L. WOODRUFF, Presiding,
SENIOR REGULATORY LAW JUDGE.

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STEVE GAW,
BRYAN FORBIS,
COMMISSIONERS.

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P R O C E E D I N G S

JUDGE WOODRUFF: Let's go on the record.

We're here for the hearing in Case No. GR-2001-387, which is consolidated with GR-2000-622. This concerns Laclede Gas Company's purchased gas adjustment tariff revisions for 2000-2001 and 1999-2000 actual cost adjustments.

And we initially convened in this case on Monday, and I granted a continuance at that time because of illness of counsel, and we took entries of appearance at that time. Now we're ready to begin with opening statements, and we'll begin with Staff.

MR. BATES: Your Honor, will you want to mark exhibits first or --

JUDGE WOODRUFF: We'll do that after opening statements.

MR. BATES: All right. Thank you.

Good morning, your Honor. Good morning, Commissioners.

This case was created originally to address Laclede's actual cost adjustment or ACA filing for the 12 months ending September 30th, 2001.

The two issues in this case set out in the parties' joint issues list are, one, what were the controlling price stabilization program tariff and program description terms for the October 1st, 2000 through September 30th, 2001 ACA period? And, two, do the controlling PCS tariff and program description terms for the October 1st, 2001 through September 30th -- excuse me -- October 1st, 2000 through September 30th, 2001 ACA period entitle Laclede to retain approximately $4.9 million of the $33.5 million in financial proceeds received by Laclede through its purchase and sale of call options during that period?

Therefore, the overarching question in issue in this case is how approximately $4,873,000 in undistributed proceeds should be treated under the terms of Laclede's price stabilization program or PSP.

Based upon a review of documents filed with the Security and Exchange Commission, it is apparent that Laclede views these funds as income. Staff disagrees and believes that gas costs should be reduced by the approximately $4.9 million that was being held in an account at the end of September 2001.

First a little history. A price stabilization fund was established in Commission Case No. GO-97-401. This fund was not incentive based. The underlying concept for establishing the fund in that case was that, given the high-priced gas -- high gas price volatility seen in the winter of 1996-1997, and the relatively new techniques in use at that time to reduce the gas price volatility, it was appropriate to develop a fund for the procurement of financial instruments.

In its July 18th, 1997 Order, the Commission stated, quote, the agreement allows Laclede to use financial instruments in its efforts to reduce the volatility of Laclede's cost of natural gas. To assure recovery by Laclede of the direct costs incurred in connection with procurement of these financial instruments, Laclede is authorized under the agreement to implement a price stabilization charge. The agreement provides that the price stabilization charge shall take effect August 1st, 1997. The revenues generated from the price stabilization charge and gains from the use of financial instruments shall be accounted for separately and credited to a price stabilization fund on a monthly basis, unquote.

The PSP concept changed drastically in 1999 with Laclede's proposal to redefine the fund into an incentive program. The PSP can be compared to a customer-funded insurance policy where Laclede guaranteed to indemnify the customer from catastrophic gas price increases. In exchange for this guarantee, Laclede was allowed to participate in the sharing of savings related to the program.

The fact that a guarantee was made by Laclede and was done so in exchange for the hope of sharing a potential savings is readily apparent, based upon a review of the Commission's Report and Order approving the PSP on June 15th, 1999, in Case No. GO-98-484. Here the majority of the Commission summarized, quote, second, Laclede proposes to incorporate an incentive feature into its PSP. Laclede argues that in exchange for undertaking the risk inherent in guaranteeing price protection, it should have a corresponding opportunity to benefit from it if it achieves positive results, unquote.

Laclede sought modifications to its program in Case No. GO-98-484. In a May 26th, 1998 Order Granting Modifications, the Commission stated, quote, the Commission originally approved the program in Case No. GO-97-401. The tariff approved in that case provides that the program shall be terminated July 31, 1998, unless otherwise ordered by the Commission. In this filing Laclede seeks to extend that fund for another term and modify in several respects.

Laclede proposes to change the parameters within which it uses financial instruments in two respects. First, it proposes a new authorization price range for financial instruments. Second, it proposes a new restriction on the timing of the sale of exchange-traded financial instruments. Laclede also proposes to modify the tariff approved in Case No. GO-97-401 in two respects to clarify procedures to be followed at the end of the term of the experiment.

First, the tariff provides that the price stabilization charge shall be terminated on the effective date of the 1999 summer PGA filing. Second, the tariff provides that any fund balance remaining in the fund at the end of the term shall be charged or returned to customers through the ACA factors established in the applicable winter PGA filing, unquote.

Still using Case No. GO-98-484, the company argued for a considerable expansion of its price stabilization fund to start in the winter of 1999-2000. It argued for three main changes. These changes were explained in the Commission's June 15th, 1999 Order in Case No. GO-98-484.

In describing Laclede's position, the Commission stated, quote, first Laclede proposes to eliminate the program's existing restriction on when financial instruments may be sold and adopt an approach that gives Laclede greater flexibility to trade in and out of these instruments when market conditions warrant. This would allow Laclede to more effectively manage the volatility of the market. Laclede alleges that this will create opportunity to reduce the overall costs of acquiring price protection for Laclede and for its ratepayers.

Second, Laclede proposes to incorporate an incentive feature into its PSP. Laclede argues in exchange for undertaking the risks inherent in guaranteeing price protection, it should have a corresponding opportunity to benefit from it if it achieves positive results.

Third, Laclede proposes a three-year term for the program. Laclede contends that the longer authorization period would provide the Commission with sufficient experience with the operation of the program under varying conditions and permit a fair assessment of its effectiveness, and that this would reduce the expense of the annual review, which is costly to both the Commission and to Laclede, unquote.

Staff argued against authorizing incentives as part of the program. It argued that a general policy of diversification of the gas supply portfolio was a better approach. It further argued that Laclede's program was speculative, its provisions were vague and offered Laclede outs from any real guarantees of price protection.

The Commission ultimately approved a version of Laclede's original proposal submitted in Laclede's surrebuttal testimony. A key provision of the new plan was that it granted approval for the winters of 1999-2000, 2000-2001 and 2001-2002.

There were two major components to the incentive part of the plan. First, a price protection incentive was developed. Depending upon where price protection was achieved, realized gains would be shared between the customer and the company. The other incentive provision was called the overall cost reduction initiative incentive. Excuse me.

As the Commission knows, a call option is an option that gives the buyer or holder the right, but not the obligation, to buy a futures contract, which involves entering in a long futures position for a specified price within a specified period of time in exchange for a one-time premium payment. A strike price or exercise price is the price at which the underlying futures contract is bought or sold in the event an option is exercised.

Call options can be used like insurance. For the payment of a premium, a certain amount of price protection can be achieved. Strike prices determine the price level that the protection will be effective at. Much like deductibles for car insurance, the higher the strike price, the less costly the premium is. If the catastrophe doesn't occur, you lose the premium but have still obtained some intangible value because of the protection received.

Similarly, with natural gas call options, if prices stay below the strike price, the premium will be lost. Before the option expires, it trades in its own market and may be bought and sold.

One more similarity to insurance is the concept of volatility. The more volatile the market, the costlier the premium. If accidents are happening quite frequently, the cost of car insurance premiums will go up. Price volatility in the futures market has a similar effect on call option premiums. Prices moved up dramatically in the weeks after the target strike price, or TSP, and catastrophic price level, or CPL, were set in March 2000.

In a June 1st, 2000 letter to the Commission, Kenneth Neises, senior vice president of Laclede, advised the Commission that, quote, as a result of the company's decision to declare the price protection incentive component of the program inoperable this year, the company will retain no gains under that component of the program or incur any losses resulting from the purchase of price protection above the catastrophic price level established by the program; i.e., $5.20 per MMBtu, unquote.

In June, July and August, OPC, Staff and Laclede met to discuss possible actions to protect ratepayers. On September 1st, 2000, the parties filed a Unanimous Stipulation & Agreement in Case No. GO-2000-394 which relaxed the PSP's existing requirements that the company procure price protection equal to 70 percent of its flowing supplies. The agreement stated that by permitting Laclede to obtain price protections for lesser volumes, this revision would help reduce the price at which such protection would be triggered for those volumes.

The winter of 2000-2001 set the highest NYMEX closing prices ever experienced. PGA rates for Laclede were also at record levels. On June 1st, 2000, Laclede opted out of the guarantee part of the PSP as it watched prices continue to escalate in the late spring of 2000. With no insurance policy coverage, the customer was left exposed to price flyups.

Laclede subsequently negotiated a Stipulation & Agreement with Staff and the Office of the Public Counsel that allowed the company to use its own discretion in obtaining levels of coverage, including zero original. This was to recognize that obtaining the required level of coverage, originally a significant percentage of natural gas purchases, made no sense if the deductible or strike price was ridiculously high.

Ultimately, Laclede was able to sell and resell smaller amounts of the insurance coverage, ending up with levels of coverage that were mere fractions of the original guarantees. Although the $24 million of gain that resulted from the program seems significant, it pales in comparison to the $63 million that would have been generated had Laclede maintained its guarantees.

Concerning Case GO-200-394 proceedings on December 22nd, 2000, Staff filed a Staff recommendation requesting that the Commission terminate the third year of the experimental PSP. An on-the-record hearing was held February 2nd, 2001 to address this issue. On February 13th, 2001, the Commission ordered modification to the PSP for year three. It ordered a reduction in the 90-day window to 60 days and ordered the company to implement its offer to contribute for the third year of the program an additional $4 million of its own claims of funds to the $4 million that's currently authorized.

Finally, Laclede received authorization, over Staff's objections, to reduce the required price protection volume percentages in the company's PSP from 70 percent to 40 percent for the upcoming winter in order to permit a corresponding reduction in the TSP or CPL.

Staff noted the call options had been extremely expensive relative to past years coming out of the 2000-2001 winter, given the tremendous price volatility at the prevailing price levels. Early trading per Laclede's interpretation was encouraged by Laclede's reading of the PSP. However, the program description does contain vague terminology, as Staff will show.

Of course, the cost reduction incentive

appears to reward such behavior by limiting sharing claims to trades taking place at least several days prior to expiration. So even though the effective price for a certain package of gas supply may have been reduced from $10 to $9 because of a $1 gain from an early trade, an option with a $6 strike could have brought the affected price of the gas down to $6 if held until near expiration.

Staff does not believe Laclede should share in any of the alleged savings. The Staff believes that there was a link between the price guarantees that were part of the price protection incentive and the overall cost reduction incentive. Once Laclede opted out of the price protection incentive feature, the overall cost reduction incentive or cost reduction feature made no sense.

According to Tariff Sheet 28-f, the cost reduction feature was meant to compare the maximum recovery amount, or MRA, of $4 million to the net cost of price stabilization or actual cost, exclusive of the gains and costs covered by the price protection incentive.

The cost reduction feature made no sense after the commitment for price protection was removed, because there was a real and measurable value to an absolute guarantee of price protection. Obviously, obtaining this value required the expenditure of funds.

Price insurance is not free. The MRA

represents a benchmark that implicitly assumes a certain amount of price protection in volumes covered at a specific price level. If Laclede no longer has an obligation to cover any volumes and no longer has an obligation to guarantee any price level, then what is Laclede buying for the customer?

If the valuable product that was originally supposed to be purchased at a guaranteed price that's disappeared, how can there be any real cost savings? In other words, when Laclede revoked the guarantee, savings as contemplated by the program were not available since the foundation of the savings calculation did not exist. Certainly there were proceeds that were generated by the call options, but a truly meaningful savings calculation should not ignore that gas costs increased, were unprotected and were escalated to astronomical levels.

Incremental proceeds from early training are not nearly as beneficial to the customer as an expectation that Laclede should be held to its original standard, that catastrophic price level guarantee. Staff believes that savings under the cost reduction component of the PSP cannot be shared with Laclede unless the overall early trading was indeed favorable and resulted in savings, not merely proceeds that exceed option premiums.

To go back to the agreed-upon issues list by the parties, the first question, what were the controlling price stabilization program tariff and program description terms for the October 1st, 2000 to September 30th, 2001 ACA period? Staff believes the answer is that the PSP was originally proposed by Laclede in Commission Case No. GO-98-484. The first year of the program's operation related to the 12 months ended September 2000. The ACA period for this case is the 12 months ended September 2001 and, therefore, relates to the second year of the PSP program.

Laclede's gas costs escalated to record levels during this same period, as shown in Schedule 1 of the surrebuttal testimony of Staff Witness David Sommerer. Because of enormous rise in gas costs, the value of call options increased.

The PSP tariff provisions are interrelated and their meaning is dependent on other elements. The PSP tariff provisions never contemplated the change that occurred in June and September 2002.

As a result of these changes, certain critical program terms became ambiguous. Terms such as overall cost of price stabilization, savings, net cost of price stabilization lost meaning when Laclede opted out of various guarantees.

The program was granted on a fundamental triad of principles. A certain quantity of natural gas was to be protected at a certain price level given a certain level of funding. With the September Stipulation & Agreement, the volume guarantees were removed, and with the June 2nd, 2000 opt-out letter, the specified price protections premised in the PSP were gone.

The June and September 2000 changes require a study to determine the level of price protection contained in the modified tariffs before any determination of savings can be made. Staff performed such a study. In direct testimony Staff provided a calculation to identify the level of price protection contained in the modified program.

David Sommerer's Schedule 9 showed the outcome had Laclede simply held its options until maturity. The result showed no overall reduction in the cost of price stabilization, no net savings and no reduction in the net cost of price stabilization.

To address Laclede's concerns that Staff had not considered additional funds generated by early trading, Staff evaluated the outcome of holding the options versus Laclede's actual results, assuming that only initial MRA funds were used to establish and reestablish positions, as shown in Schedules 2 and 5 of Mr. Sommerer's surrebuttal testimony. The results showed no overall reduction in the cost of price stabilization, no net savings and no reduction in the net cost of price stabilization.

As to the second issue, do the controlling PSP tariff and program description terms for the October 1st, 2000 to September 30th, 2001 ACA period entitle Laclede to retain approximately 4.9 million of the 33.5 million of financial proceeds received by the company through its purchase and sale of call options during that period, the Staff's answer is no.

Staff believes that Laclede simply wants to have its results viewed as a stand-alone trading operation. In other words, any time there is a gain in proceeds received and proceeds received exceed cost, the company claims savings are experienced.

If Laclede were a trading operation without any obligation to purchase physical supply but only to speculate for profit, its claims might be accurate. However, the program was not defined that way. The modified tariffs controlling the PSP program contain no language defining Laclede's role to be a speculator in option trading. The tariff contains language that supports the assertion that Laclede's activities were to be directed toward price stabilization of the gas Laclede must buy to satisfy its customers' demands.

The program recognizes savings could be achieved while protection was left in place. Once the levels and amounts of coverage were removed, the meting of savings had to be evaluated in light of what was actually being purchased under the modified tariffs. Laclede was no longer procuring a fixed level of insurance at a fixed level of coverage against catastrophic loss.

Staff views a reasonable interpretation of the tariffs and remaining provisions of the program description to be that savings can only be recognized if Laclede's actions resulted in savings when compared to simply holding the options until maturity. Staff is making no disallowance here. Laclede claims that savings happen virtually any time cash comes through the door.

Laclede's own program architect indicates a lack of how the program was to operate when price protection was removed.

Laclede's key policy witness in Case No. GO-98-448, Kenneth Neises, stated in his surrebuttal, quote, of course, if the company believes market conditions have changed radically enough to warrant such actions, it does not believe it should continue to have an opportunity to profit under the program. Accordingly, if Laclede invokes this provision during the first 90 days, it agrees that the incentive aspects of the program should terminate for that year, unquote.

Again, Staff does not believe Laclede should share in any of the alleged savings. The Staff believes that there was a link between the price guarantees that were part of price protection incentive and the overall cost reduction incentive. Staff believes that gas costs should be reduced by the approximately $4.9 million that was being held in an account at the end of September 2001.

Staff believes after PSP protections were disabled by Laclede in Year 2, the term price stabilization became ambiguous. The Commission should ask itself what price stabilization was the customer entitled to in Year 2?

Thank you very much.

JUDGE WOODRUFF: All right. Thank you. And we'll go to Laclede.

MR. PENDERGAST: Your Honor, since Public Counsel is aligned with Staff, do you think it might make some sense for them to go next?

JUDGE WOODRUFF: Okay. If that's what Public Counsel wants to do, go ahead.

MR. MICHEEL: Whatever you want to do, Judge. Do you want me to go now or after Laclede?

JUDGE WOODRUFF: Go ahead and go now.

MR. MICHEEL: Okay. May it please the Commission? Doug Micheel on behalf of the Office of the Public Counsel.

As you noted in our statement of issues, we wholeheartedly support the Staff, and what this case is about is, it's about a price stabilization program. I think Mr. Bates did a very good job of giving you the long and sordid background of this proposal, but let me just say there are two incentives included in that price stabilization program tariff, and they're found at Sheet 28-f.

And the first incentive is the price protection incentive, and that incentive, to boil it down, was Laclede's guarantee that customers were going to see a specific price protection for gas. The program plan description allowed Laclede Gas to opt out of that price protection incentive, and during this ACA period Laclede exercised its unilateral ability to opt out of that price protection incentive.

The second incentive included in Sheet 28-f, found at paragraph 4, is the overall cost reduction incentive, and that's the incentive portion that is at issue here today in this proceeding. And the issue in this proceeding in my view is, given the fact that Laclede has opted out per its right, its unilateral right of the price protection incentive, what does it mean with respect to the overall cost reduction incentive?

And I think that the evidence will show in Mr. Sommerer's testimony that critical terms of that tariff are undefined, that critical processes of that tariff are undescribed in light of the opting out of the price protection incentive, for example, the maximum recovery amount.

If the tariffs, the evidence will show, are working in tandem with the price protection incentive being enabled and the overall cost reduction incentive being enabled, the term "maximum recovery amount" will be clear, or it's called in this case the MRA. It becomes unclear what the MRA is and how the MRA operates and what the starting point of the MRA is once the price protection portion of the incentive is disabled.

The evidence will show, and I think nobody will argue about this, that the purpose of the price stabilization program was to result in lower gas costs to ratepayers, and any profits Laclede made were secondary to that effort.

I think that the evidence will demonstrate that once the price protection incentive was disabled under the overall cost reduction incentive, that Laclede Gas Company is taking proceeds from the insurance that was supposed to be procured on the customers' behalf before we knew what the damages were of the event that we're utilizing the insurance for; i.e., before we knew what the final price of gas would be.

Remember, under the overall cost reduction incentive, the evidence will show there are two prongs of that incentive. One prong is, if the company holds these options until the last three days, 100 percent of the benefit of holding those options goes to the ratepayer.

But if the company trades out of those options before the last three days, the evidence will show that there is a sharing grid, I think it's 40 percent of the first 6 million and a little bit more above 6 million. And so the question is, when do we start and what, indeed, are the -- what's the damage that we're utilizing the proceeds for?

I think the evidence will show that Staff's calculation probably takes into account the damages, i.e., the increase in overall gas price to the customers, before the insurance proceeds are distributed either to Laclede or to the ratepayers. And it's important to keep in mind the fundamental purpose of this program was to protect ratepayers from price increases. The incentive portion of this program was only secondary.

When Laclede opted out, as was its unilateral right, of the price protection program, the evidence will demonstrate that the tariffs became ambiguous, that critical processes were undescribed.

In the end, though, the Commission's analysis and the evidence will demonstrate that the proper way to interpret those ambiguous tariffs and decide those undescribed critical processes is to the benefit of the ratepayer and price protection to the ratepayer.

And in my view, that's all that Staff has done. I think at the end of the day, it will be appropriate to make the adjustment that Staff is requesting.

JUDGE WOODRUFF: Thank you. Now we'll go with Laclede.

MR. PENDERGAST: Your Honor, just before I begin, on a personal note, I once again want to thank the Commission and the parties for their consideration and courtesy last Monday in accommodating my illness. I do appreciate that. I wanted to say that again for the record.

If it please the Commission, we are here today to determine the proper treatment of a portion of the hearing proceeds that the company achieved under its price stabilization program during the late summer, fall and winter of 2000-2001.

As you've already heard, that program, which in incentive form was adopted by the Commission in 1999 and then subsequently modified in late summer of 2000, had two main incentive components, a price protection incentive component and overall cost reduction incentive component.

Because of radical changes in the market price for financial instruments in the first half of 2000, the company had to exercise its right to declare the price protection incentive inoperable for the 2000-2001 program year.

The overall cost reduction incentive, however, remained in full force and effect, and it is the remaining $4.9 million in hedging proceeds achieved under that second incentive component that is at issue in this case. And I say remaining because in total the company's hedging efforts during that period, which consisted entirely of the purchase and sale of call options, actually produced around $33.5 million in proceeds.

Where did the rest of those proceeds go? Well, approximately $5 million went to purchasing the options themselves on top, on top of the $4 million in program funds that the company had actually been authorized by the Commission to collect from its customers for purposes of buying those options.

And how was the company 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. And it was only by undertaking these activities that the company was able to generate the remaining $28.5 million in proceeds that were ultimately achieved under the program.

Of this $28.5 million in proceeds, approximately 11.5 million was attributable to the price protection incentive, since they were achieved through the sale of options during the last three business days prior to their expiration.

Because the company had exercised its right to declare the crediting features of the price protection incentive component inoperable in June of 2000, 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.

The remaining $17 million in proceeds was achieved by the company through its intermediate trading of options prior to the last three business days before they expired, and there were -- and, therefore, were subject to sharing under the overall cost reduction incentive, which had remained in full force and effect.

As a result, those proceeds were split between the company and its customers, approximately 8.9 million going to the company and 8.1 million being immediately flowed through to customers, pursuant to the expedited procedures that I mentioned earlier.

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 operations.

As Mr. Mathews points out in his direct testimony, this action also produced substantial benefits for the company's customers during the subsequent ACA period, in that it effectively allowed the company to purchase additional call options during that period and forego the purchase of more expensive fixed price contracts, which because of subsequent declines in the market price for natural gas ultimately wound up saving our customers another $30 million during the subsequent ACA period.

I've heard a lot of discussion from both Mr. Bates and Mr. Micheel about the program and how it didn't function as well as they might have wished it to during the second year, but you hear very little about how it functioned during the third year and the tens of millions of dollars it permitted the company to save during that period.

In fact, the company believed in the program so much that it also offered to contribute another $4 million of its share to supplement the funding of the program in the event it was extended for another year beyond its three-year initial term, an eventuality that, unfortunately, did not come to pass because of continued opposition to such an extension.

But nevertheless, as a result of the company's efforts, approximately $24 million in benefits were passed through to customers for a net benefit of approximately $20 million after taking into consideration the initial $4 million that was collected from customers to fund the program.

Under virtually any measure, these are spectacular results. Indeed, how wonderful it would be if every program approved by this Commission had the same kind of cost/benefit ratio and generated the same kind of 500-plus returns for customers that were ultimately achieved as a result of the PSP.

You've often heard arguments in other incentive cases before that, how do you really determine whether there were savings if you're comparing what was achieved versus something that might or might not have been achieved? Well, there's nothing unfirm, speculative about these savings at all. This is $20 million in cash money that was sent back to our customers in addition to another 4 million that paid the entire cost that they had contributed to the program.

But we are here today because even these kind of results are not sufficient to satisfy the Staff or Public Counsel, which persisted in their efforts to eliminate the program and now seek, with Staff's adjustment, to deprive the company of the remaining $4.9 million in proceeds that Laclede was entitled to retain under that program. The Staff succeeded in the former, but it cannot and it should not be allowed to succeed in the latter, and that is true for two reasons.

First and foremost, Staff's adjustment is unlawful and impermissible because it directly conflicts with the controlling tariff sheets that were in effect at the time these transactions took place.

As Laclede Witness Michael T. Cline shows in his rebuttal testimony and surrebuttal testimony, a sentence-by-sentence review of the provisions contained in those tariff sheets demonstrates as clearly as anything can be demonstrated that the company calculated its share of savings in strict compliance with those tariff provisions.

And if -- for the Commission's convenience, your Honor, with your permission, could I provide a handout as --

JUDGE WOODRUFF: You may.

MR. PENDERGAST: For the Commission's convenience, we've furnished you with a handout that includes these tariff provisions as they existed at the time these transactions took place, with the actual dollar amounts that were produced under the program, amounts that have not been disputed by anyone and inserted to show exactly how the tariff mandates the exact result that was calculated by the company. Mr. Cline will be happy, when he testifies, to go over these straightforward calculations and answer any questions you might have.

I've also provided you as part of the handout the kind of tariff language that would have had to have been in effect -- and that's on the second sheet -- at the time these transactions took place to permit the result that Staff has proposed in this proceeding, based on its development of an entirely new method for determining how the company's share of savings under the overall cost reduction incentive is to be determined.

Given the obvious absence of such language in the actual tariff, the Staff has never asserted, because there is no way that it could assert, that language setting forth its proposed tariff -- that language setting forth its proposed method is to be found under the company's PSP tariff or program description.

Indeed, Staff concedes that its proposed method is based on an after-the-fact calculation, but nevertheless claims that it is necessary for things to make sense in light of the company's exercise of its right to declare the price protection incentive inoperable and given the temporary revision that the parties agreed to make to the PSP in September of 2000 to eliminate the program's 70 percent volume requirement for that year.

Suffice it to say that there is nothing in the tariff, let alone Missouri law, to suggest that Staff or any other party may unilaterally rewrite a tariff after the fact to accord with its retrospective view of what would have made the most sense.

Moreover, if such rewriting was to be done, it should have been accomplished at the time temporary revisions to the PSP were agreed upon and approved by the Commission in the late summer of 2000. Rather than doing so, however, paragraph 4 of the Stipulation & Agreement, as well as the tariffs filed by the company in compliance therewith, clearly say that all terms of the PSP tariff, including the overall cost reduction provisions, were made in full force and effect. And that can be seen from the third and fourth sheets of the handout.

The first -- the third sheet contains the language of the Stipulation & Agreement, which clearly specifies that, except for the agreed-upon modifications to eliminate the volume requirement, the company's exercise of its right to declare the price protection incentive inoperable, all remaining provisions of the PSP currently in effect were to remain in effect, a fact that is confirmed by the second sheet, the next sheet that shows the tariff that was filed in compliance with the Stipulation & Agreement.

Please note that while the tariff references the elimination of the volume requirement and the company's opting out of price protection incentive features, it makes absolutely no change to the structure, wording or incentive aspects of the overall cost reduction incentive.

In short, Staff's proposed adjustment is not only contrary to the tariff that was in effect at the time these transactions took place, but also represents a direct violation of the Stipulation & Agreement that explicitly provided for all other remaining provisions of the PSP to remain in full force and effect. Given these considerations, such an adjustment cannot and should not be adopted by the Commission.

Secondly, Staff's proposed adjustment should be rejected because it is nothing more than a plea that this Commission deny the company something to which it is lawfully entitled to because, based on a retrospective review, we now know that wholesale gas prices rose higher than anyone expected them to and because it is possible, as it always is when hindsight is employed, to construct scenarios under which the company could have done better.

The company has absolutely no apologies to make, however, regarding the efforts it made to respond to these radical changes in the marketplace. We did not simply sit on our hands and hope for the best, but engaged in a long and largely unsuccessful effort to convince the Staff and Public Counsel that revisions to the PSP, including additional funding and expansion in the kind of instruments that could be used, should be made to procure additional protection.

And when support for those requests was not forthcoming, we did the best we could to take the limited resources we had and turn them into something meaningful for our customers.

We succeeded in that regard under an extraordinarily difficult set of circumstances, and we're proud of that success. Undoubtedly, if we knew then what we know now, we'd have done even better, as Staff repeatedly suggests 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, Missouri Gas Energy 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 financial benefits for customers.

In the end, however, the blame game gets us nowhere and it contributes nothing to fashioning a constructive approach for dealing with such situations in the future.

Instead, let us assume for a change that we all did the best we could to respond to a dramatic and unprecedented situation in the way that our respective experiences, viewpoints and good faith assessments led us to believe is right. And let us not besmirch one of the truly successful efforts to respond to that situation by adopting an adjustment that cannot be reconciled with the approved program terms under which that effort was undertaken.

Thank you very much.

JUDGE WOODRUFF: Thank you. That concludes the opening statements.

At this time we'll take about a five-minute break, and when we come back we'll premark exhibits and go with Mr. Sommerer as the first witness. We'll come back at -- let's call it 9:25.

(A BREAK WAS TAKEN.)

(EXHIBIT NOS. 1 THROUGH 8 WERE MARKED FOR IDENTIFICATION.)

JUDGE WOODRUFF: Mr. Micheel, you probably want to repeat that on the record. Let's go on the record at this time, then.

MR. MICHEEL: Your Honor, it's my understanding that the parties have agreed -- that the parties have agreed that the Schedules 6-1 through 6-4 attached to Mr. Sommerer's direct testimony, which is Exhibit 1, description of incentive price stabilization program, is no longer highly confidential, and that same document appears the last four pages to Exhibit 1 of Mr. Mathews' direct testimony, Exhibit 4. And it's my understanding that those are no longer highly confidential and we can talk about those in the open.

JUDGE WOODRUFF: And, Mr. Pendergast, the company agrees with that?

MR. PENDERGAST: We do, your Honor.

JUDGE WOODRUFF: We'll certainly make that clear that those documents are not highly confidential, and as you go through your testimony, if you'd in-- if it comes up that something that you've done in your prefiled testimony that you've marked as highly confidential, if you'd let the Commission know that it's no longer highly confidential, so that we don't have to speculate on that.

All right. Any other matters before we go ahead and start taking witnesses?

(No response.)

JUDGE WOODRUFF: All right. Then call your first witness.

MR. BATES: Thank you, your Honor. We call David Sommerer.

(Witness sworn.)

JUDGE WOODRUFF: You may inquire.

MR. BATES: Thank you.

DAVID M. SOMMERER testified as follows:

DIRECT EXAMINATION BY MR. BATES:

Q. Would you state your full name for the record, please.

A. David M. Sommerer.

Q. And what is your business address?

A. P.O. Box 360, Jefferson City, Missouri, Missouri Public Service Commission.

Q. And you are employed by the Missouri Public Service Commission?

A. That's correct.

Q. And in what position?

A. I am the manager of the procurement analysis department.

Q. Did you prepare and cause to be filed in this matter direct testimony marked for purposes of identification as Exhibits No. 1NP and HC?

A. Yes.

Q. Are there any corrections, changes or additions to that testimony which you would like to make at this time?

A. Yes.

Q. And what are those?
A. On page 10 my direct testimony, line 3, the number currently says $20 million. I would like to change that to $24,500,000.
JUDGE WOODRUFF: I'm sorry. I'm not finding that. On page 10 of your direct, did you say?
THE WITNESS: That's correct.
MR. MICHEEL: Page 10, line 3 of the HC direct, your Honor.
JUDGE WOODRUFF: Okay.
THE WITNESS: I would also note that I believe that that is public information now.
BY MR. BATES:
Q. Do you have any other changes?
A. Yes. On that same line, line 3, page 10, where it says net of, I would like to change that to before. Line 4, page 10, currently says 8 million. I would like to change that to 8,900,000.
On the highly confidential Schedule 9-1, right underneath the heading November 2000 Contracts, the word "gain," I would like to change that to proceeds. And that change would carry through the rest of the pages of that schedule. So on Schedule 9-2, the word "gain" needs to be changed to proceeds. Schedule 9-3, the word "gain" should be changed to proceeds. Schedule 9-4, the word "gain"

should be changed to proceeds. Schedule 9-5, the last column, that's headed by the word "gain" should be changed to proceeds.

Those are the only changes I have to my direct testimony.

Q. Did you also prepare and cause to be filed in this matter rebuttal testimony, both NP and HC, that has been marked for purposes of identification as Exhibit No. 2NP and HC?

A. That's correct.

Q. Are there any corrections, changes or additions to that testimony which you would like to make at this time?

A. Yes.

Q. And where would that be?

A. This is on page 4 of the rebuttal testimony, line 8. The sentence that starts with the words "Staff used," I would like to delete the phrase arithmetic mean of closing prices and replace that with the following: Lowest closing price for the last three trading days. And then on line 9, that same page, page 4, where the words "fair trading range to use to making a comparison as the weather," I would like to change the word "the" to the word "to," T-O. Those are my only changes to rebuttal testimony.

Q. Very well. Did you also prepare and cause to be filed in this matter surrebuttal testimony that has been marked for purposes of identification as Exhibits No. 3NP and HC?

A. Yes.

Q. And are there any corrections, changes or additions to that testimony which you would like to make at this time?

A. No.

Q. If I asked you the same questions today, would your answers be substantively the same?

A. Yes.

Q. Are your answers true and correct to the best of your information, knowledge and belief?

A. Yes.

MR. BATES: Your Honor, at this point I move into -- for admission Exhibits No. 1NP and HC, 2NP and HC and 3NP and HC.

JUDGE WOODRUFF: Okay. Exhibits 1, 2 and 3, both in NP and HC versions, have been offered into evidence. Are there any objections to their receipt?

(No response.)

JUDGE WOODRUFF: Hearing none, they will be received into evidence.

(EXHIBIT NOS. 1NP, 1HC, 2NP, 2HC, 3NP AND 3HC WERE RECEIVED INTO EVIDENCE.)

MR. BATES: And, your Honor, I tender this witness for cross-examination.

JUDGE WOODRUFF: Thank you. And for cross-examination of Mr. Sommerer, we will begin with Public Counsel.

MR. MICHEEL: No questions at this time, your Honor.

JUDGE WOODRUFF: Thank you. Then for Laclede.

MR. PENDERGAST: Thank you, your Honor.

CROSS-EXAMINATION BY MR. PENDERGAST:

Q. Good morning, Mr. Sommerer.

A. Good morning, Mr. Pendergast.

Q. Last Monday I indicated that I would try and complete my cross-examination of you in three hours, and if you'll be kind enough to answer all the questions the way I want you to, I think we can achieve that goal.

I'd like to begin with just a few housekeeping matters. I take it that you're familiar with the testimony that has been filed by Laclede Witness Michael Cline in this proceeding?

A. Yes.

Q. And do you have a copy of that testimony?

A. I have a copy of both rebuttal testimony and surrebuttal testimony of Mr. Cline.

Q. Okay. Good. And I'd like to direct your attention to the bottom of page 3, line 22, where Mr. Cline tries to describe the language that he says would have had to have been in the tariffs to authorize the approach that Staff has taken for determining savings under the overall cost reduction incentive component. Do you have that reference?

A. Is that in the surrebuttal testimony of Mr. Cline?

Q. Yes.

A. Yes, I have that reference.

Q. Okay. And if you turn over to page 4 of his testimony and look at the last sentence, Mr. Cline describes Staff's approach as one that uses the arithmetic mean to calculate closing prices. Do you see that?

A. Yes, on line 9.

Q. Yes. And as we just went through, that is, in fact, how you describe Staff's method in your rebuttal testimony; is that correct?

A. That's correct.

Q. But just now -- and I think on page 14 of your surrebuttal testimony, you corrected that by stating that the Staff had actually used the lowest closing price rather than the arithmetic mean of the closing prices during the last three business days for purposes of its calculation; is that correct?

A. That's also correct.

Q. And this is all referring, just so we're clear, to the method for calculating savings that you had presented in your direct testimony; is that right?

A. That's also correct.

Q. Can you tell me, Mr. Sommerer, why when you wrote your rebuttal testimony you were under the impression that Staff had used the arithmetic mean during the last three business days rather than the lowest closing price?

A. The Staff had considered both methods, and I think the arithmetic mean was something that had been referred to in the program description, but I also believe that it was important to be conservative in the calculation, and I knew with the use of the lowest closing price, that would be more in favor in terms of -- from Laclede's perspective between the two options. And that's ultimately what Staff chose, but both options had been considered.

Q. So when you submitted your rebuttal testimony, were you under the impression that Staff had chosen the arithmetic mean option as opposed to the lowest closing price option?

A. My intention when I wrote that testimony was to use the lowest closing price, and it was just mischaracterization of Staff's position.

Q. Were you the one that performed the

calculations that are set forth in your direct testimony?
A. Yes.
Q. Okay. And are you the one that authored Staff's approach to that calculation method?
A. Yes.
Q. Okay. And can you tell me when you authored that approach to Staff's method?
A. That method was developed sometime prior to the filing of direct testimony, probably within two to three weeks of the filing of that testimony.
Q. And is that when you made a final decision as to whether or not to use the lowest closing price during the last three business days versus the arithmetic mean?
A. I don't recall exactly when that decision was made, but it was made prior to the filing of direct testimony.
Q. Okay. Well, in any event, what modifications would have to be made to the last sentence of Mr. Cline's description where he says it would have had to have been in Laclede's tariffs to permit Staff's method in order to be consistent with the corrected version of that method that you presented in your surrebuttal testimony and that you offered today?
A. I think he would need to use the same phrase that I corrected my rebuttal testimony for, which was to

replace the average or rather the arithmetic average of closing prices to the lowest closing price for the last three trading days.

Q. And if you were to do that, would that sentence then be consistent with your understanding of your method?

A. Yes.

Q. Okay. Next I'd like to ask you a few questions about the history and structure of the price stabilization program. And if we refer to that as PSP, we'll be referring to price stabilization program; is that your understanding?

A. That's my understanding.

Q. Okay. And the company's first price stabilization program was approved a little more than five years ago in 1997 as part of a Stipulation & Agreement; is that correct?

A. That's correct.

Q. And the approval of the price stabilization program was just one of the items that was addressed by that Stipulation & Agreement?

A. Yes.

Q. It also set up a new PGA filing framework which essentially reduced the number of PGA filings to, I believe it was, no more than three per year and made other changes to how the PGA worked; is that correct?

A. That's correct.

Q. And since its inception and right up to when it expired, the program relied on the use of call options as the financial instrument that would be used to obtain price protection on some portion of the company's flowing winter supplies; is that correct?

A. That's also correct.

Q. And by winter flowing supplies, we mean those supplies that are actually purchased by the utility during the winter rather than that portion of supplies that it takes out of storage during the winter to serve its requirements; is that correct?

A. That's correct.

Q. Okay. And when we say that it's always relied entirely on calling options, there have been different proposals made by the company at various times to expand the kind of instruments that could be used under that program; isn't that correct?

A. That's also correct.

Q. And do you recall whether the company had gone ahead and proposed, as part of its incentive modifications in 1999, that it had the ability to buy and sell puts as well as call options?

A. Yes, that's also correct.

Q. Okay. And that is something that the Staff opposed; is that right?
A. Yes.
Q. Did the company also, at the time it proposed those incentive modifications, propose that it be able to obtain price protection for summer volumes as well as winter flowing volumes?
A. That I don't recall.
Q. Okay. But you have no reason to believe that the company did not propose that?
A. I don't recall either way.
Q. Okay. And when we came to 1998, I think you referenced in your testimony that certain changes were made. In 1997 when the first PSP was approved, did it not have a sort of flowing strike price where, if the market price for gas increased or decreased, the strike price would increase or decrease?
A. That's my recollection, yes.
Q. And then in the second year of the program, in 1998, that flowing or adjustable strike price was eliminated in favor of a strict $4 ceiling; is that correct?
A. That's correct.
Q. Is that something that Staff was interested in seeing happen, that Staff had proposed?
A. That's my recollection, is that was one of two

elements, I believe, that Staff had discussed with two or three of the utilities that had those types of programs.

Q. And another element of that was that under the original program as it was approved in 1997, there was no explicit requirement that the company hold those options until expiration or the last three business days; is that correct?

A. During the first year of the program, that is correct.

Q. And, once again, during the second year of the program when modifications were made, one of the modifications that Staff suggested was that there be a requirement that those be held 'til the last three business days; is that correct?

A. That is also correct.

Q. Okay. And by call options, which as you clarified is the only instrument that was to be used under the program, you pay a predetermined amount to have the right, but not the obligation, to buy a set quantity of gas in the future at a certain price. Is that generally how you would describe a call option?

A. That's a fair definition, yes.

Q. And the set quantity of gas to be bought is, what, 10,000 MMBtu?

A. That's correct.

Q. Okay. And the price at which you have a right to buy the gas is called the options strike price; is that right?

A. That's also correct.

Q. Okay. So, for example, I might pay 10 cents for the right to buy an MMBtu of gas at $5 in December, and under that scenario $5 would be the option strike price?

A. That's correct.

Q. Okay. Now, if the market price for gas declines, the value of that option will decline as well, is that correct, as a general matter?

A. Option prices are affected by two or three things; the market's volatility, the price of the underlying which would be affected by the price of natural gas, the amount of time that you have until the option expires.

Generally speaking, if natural gas prices go down, all other things being equal, the cost of the option would go down as well.

Q. Fair enough. And if that market price of gas is at or below the $5 strike price level at the time the option expires, it would generally expire worthless; is that correct?

A. Certainly without any value in terms of proceeds coming in, that's correct.

Q. Right. I mean, it would expire. You would not receive any sort of proceeds for that option and you'd just be out the 10 cents that you spent on it; is that correct?

A. That's correct.

Q. Okay. And looking at it the other way, to the extent that market price for gas rises instead of declines, all else being equal, will the value of the call option increase as well?

A. Yes.

Q. So, for instance, an option that costs 10 cents when you purchased it could rise in value to $1.10 or even higher; is that right?

A. That's correct.

Q. Okay. And if you sold the option at that time, you'd have an additional dollar, as well as the 10 cents you started with; is that correct?

A. If you sold it for $1.10, you would have that additional dollar and the original 10 cents, that is correct.

Q. Okay. And let's say that under the former example it declined worthless and you spent the 10 cents on it. What would the net cost of that option have been?

A. Net cost of that option would have been the premium cost, which would have been 10 cents.

Q. Okay. And let's say under the other example you sell it, you get a dollar's worth of financial proceeds. What would the net cost of that be if it cost you 10 cents to begin with?

A. For that particular option, you would have a net proceed of 90 cents, or rather $1.10 minus 10 cents. I believe it would be a dollar.

Q. Okay. And let's say you -- you're a utility and you take that dollar and you apply it to offset your purchased gas expense. Okay. Do you follow me?

A. Yes.

Q. Would that represent a reduction in those purchased gas cost expenses?

A. Yes.

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.

Q. Okay. And did Laclede's purchased gas expenses during the ACA period under review in this proceeding include a $4 million amount that Laclede was authorized by the Commission to spend on the purchase of call options and to collect from customers pursuant to the terms of its price stabilization program?

A. I believe that would be an additional line item that would be added to the overall actual cost of gas, yes.

Q. Okay. Mr. Sommerer, how much in the way of proceeds did Laclede generate from all of its option sales during the ACA period under review in this proceeding?

A. There were -- was a total of $33,499,000 of proceeds generated.

Q. And of that amount, would you agree with me that Laclede accounted for $11,566,000 as falling under the price protection incentive?

A. According to Mr. Cline's schedule attached to his rebuttal testimony, Laclede says that savings realized under the price protection feature was $11,566,000.

Q. Okay. And do you have any reason to disagree with that calculation?

A. Not in the context of the way Laclede is characterizing its position, no.

Q. Well, let me ask you that. Was $11,566,000 real cash money flowed back to the company's customers?

A. Part of these proceeds were flowed back to the customer. Part of the proceeds were reinvested into Year 3 of the price stabilization program or price stabilization fund, and so I can't say that all of those proceeds came back to the customers. It could be that part of the proceeds were flowed back into Year 3 of the fund.

Q. Well, let me ask you this: Did Laclede reduce its purchased gas expenses by recognizing as an offset at least $11,566,000?

A. That's correct.

Q. Okay. And that resulted in a reduction in purchased gas expenses and represents a savings, as you define the term at page 2 of your rebuttal testimony; is that correct?

A. Again, in terms of that specific example, that does represent a savings from the perspective of making a comparison between the actual gas cost and money used to reduce actual gas cost, yes.

Q. Okay. And how much in the way of proceeds did Laclede generate as a result of its intermediate trading activity during the ACA period under review in this proceeding?

A. The proceeds should be the difference between

33,499,000 and 11,566,000.

Q. Does 21,933,000 sound about right or would you like to verify that?

A. Actually, it appears the number is 24,576,550.

Q. Well, would you agree with me that Laclede went ahead and achieved savings from both -- well, would you agree with me that we attributed 11,566,000 in proceeds to the overall or to the price protection incentive?

A. I would agree that certainly that became a credit or some portion of that became a credit to the overall program.

Q. Okay. And those were proceeds from options that resulted during the last three business days; is that correct?

A. That's correct.

Q. Okay. And for options that were sold prior to the last three business days, would you subtract the 11,566 from 33,499 to get that number?

A. That would give you the proceeds that were related to sales, purchases of options prior to the last three business days.

Q. Okay. And I'm using that as being synonymous with intermediate trading. Okay?

A. All right.

Q. So the amount of proceeds associated with intermediate trading would be approximately 21,9-- 21,933,000; is that correct?

A. Yes, I think that's correct.

Q. Okay. Now, let's subtract from that 21,933,000 the 4,992,450 that was actually spent by Laclede on call options in excess of $4 million that was authorized, that it was authorized to collect from its customers under the program, and what amount would we get?

A. Number's approximately $17 million.

Q. Okay. $17,010,550 sound right to you?

A. Yes.

Q. And if I were to apply to that amount the sharing percentages that were reflected on Section G4 of the PSP tariff sheet that was in effect at the time, and I'm referring specifically to Sections B and C of the overall cost reduction incentive, how would those proceeds be divided between Laclede and its customers?

A. You would take the approximately 17 million. The first grid according to the cost reduction incentive is 6,666,667. Laclede's share of that initial amount has 40 percent applied to it. Then the second tier, which would be the amount of the 17 million that's in excess of 6,666,666, would have 60 percent applied to it.

Q. And what would the result of that be?

A. The 40 percent applied to the 6,666,667 would be 2,666,667. The amount of the 17 million in excess of the first tier would be 10,343,883. 60 percent applied to that number is 6,206,330.

Q. Okay. And if you add those up, to just kind of simplify things here, would that suggest a share for Laclede of 8,872,997?

A. Yes.

Q. Okay. And is that approximately equal to the $8.89 million that Laclede had claimed it was entitled to?

A. That's correct.

Q. Okay. And the other 8,137,433 million would be the customers' share; is that correct?

A. Could you restate that?

Q. Yes. And the other 8,137,433 would be the customers' share; is that correct?

A. I think that's correct, yes.

Q. Okay. And can you tell me, in addition to the 11.566 million, did Laclede flow through $8,137,433 to its customers?

A. I believe that's also correct.

Q. Okay. And were all of those proceeds used to reduce Laclede's purchased gas expenses?

A. That's correct.

Q. Okay. Purchased gas expenses which included a $4 million amount for purposes of purchasing options under the program; is that correct?

A. That is correct.

Q. Okay. Now, is it fair to say, Mr. Sommerer, that under your approach for determining the level of savings that in your view the company should be eligible to share in under the overall cost reduction incentive, one has to look at what Laclede actually sold an option for prior to the last three business days of trading and then look at what it could have sold that option for if it had held the option until the last three business days?

A. That's correct.

Q. So the benchmark, in effect, is what Laclede could have sold the option for during the last three business days; is that correct?

A. That is correct.

Q. Now, you've been involved in the development and/or review of numerous gas cost incentive mechanisms for Missouri utilities; is that correct?

A. Yes.

Q. And to your knowledge, are all or were all of the terms and conditions of those incentive mechanisms described in tariff provisions that were filed and approved by the Commission?

A. My recollection is, is that the critical terms that were undefined or were used for the first time had sufficient definition in the tariffs to understand them, yes.

Q. Okay. So the terms and conditions of those incentive programs, to your knowledge, without exception were all included in tariffs?

A. Generally speaking, it's my recollection that there was enough specificity in those tariffs that you could determine what the savings were, yes.

Q. Well, and to the extent that they used a benchmark for purposes of doing that, was that benchmark also included in the tariff?

A. Yes, it was.

Q. Okay. So, for example, if it was a gas procurement incentive feature, the benchmark might be an index of monthly gas prices that was spelled out in detail in the tariff; is that correct?

A. That's correct.

MR. PENDERGAST: If I could distribute an exhibit.

JUDGE WOODRUFF: You may.

This will be No. 9.

(EXHIBIT NO. 9 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

BY MR. PENDERGAST:

Q. Okay. Mr. Sommerer, could you identify the exhibit that I've handed you and that's been marked as Exhibit 9?

A. Yes. This appears to be a copy of Laclede Gas Company's tariff sheet that relates to the current gas supply incentive plan effective November 1st, 2002.

Q. And this is the gas supply incentive plan relating to the company's commodity cost that was approved in the company's last rate case; is that correct?

A. That's correct.

Q. And I'd like to direct your attention down to the bottom of the first page of that, if I could, and do you see the discussion there in the last paragraph relating to the annual benchmark price?

A. Yes.

Q. And once again, this is one of those benchmarks that's used to determine and calculate savings; is that correct?

A. That's correct.

Q. Okay. And this basically says that to calculate the annual benchmark for each month of the ACA period, you'll take a first-of-the-month index price as shown below and as reported in the inside FERC gas market report and weight it by the percentages that are presented below to develop a first-of-the-month composite price; is that right?

A. That's correct.

Q. Okay. And on the next page it tells you exactly what those percentages are?

A. Yes.

Q. Then it tells you how to go ahead and calculate the annual benchmark price; is that correct?

A. That's correct.

Q. And it says you do that by taking a monthly, first-of-the-month composite price as calculated for each of the months above and weighting them by each month's associated actual purchased volumes for on-system customers; is that correct?

A. That's correct.

Q. And is that reasonably representative of a tariff provision that would show somebody how to go ahead and calculate a benchmark?

A. Yes.

Q. Okay. Can you tell me where in the PSP tariff there is language saying that in calculating the benchmark that you have used that you're supposed to go ahead and base that on what options could have been sold for during the last three business days?

A. Are you referring to the PSP tariff or the PSP program description?

Q. Either.

A. I will not find that specific language in the PSP tariff or the program description. I can say that Staff drew upon various provisions in the PSP program description to develop the benchmark and use that as the standard for its comparison and its calculation.
Q. But you won't find any specific language in the tariff that says use a benchmark based on the -- what an option could have sold during the last three business days; is that correct?
A. That's correct.
Q. Okay. We just talked about this other tariff that talks about using information from inside FERC's gas market report for purposes of calculating that benchmark.
Where in the tariff or the program description that was in effect at the time these transactions took place would I find language specifying how you're supposed to get the prices that you've used in your method?
A. That language is not contained on the PSP or the program description.
Q. Okay. And what prices did you use?
A. The prices that were used, as we discussed earlier, were derived from the last three days of trading for the call option in question.
Q. Okay. But what source -- I mean, where did you pull those numbers from?

A. Those NYMEX numbers were generated from the Wall Street Journal that reports the daily activity.

Q. Okay. From the Wall Street Journal. And there's obviously nothing in the PSP tariff or the program description that says use prices found in the Wall Street Journal for purposes of calculating this benchmark that you've used, is there?

A. That's correct.

Q. Okay. And where in the tariff would I find something that would provide guidance on whether, if you're using this particular method, you use the lowest closing price during the last three business days versus the arithmetic mean versus the highest price?

Is there anything in the tariff or the program description that would address that?

A. No.

Q. In fact, I think you indicated earlier that the choice of whether to go ahead and use the lowest versus the arithmetic mean was a choice that Staff only made sometime before it filed its direct testimony in this case; is that right?

A. That's correct.

Q. And when did you file your direct testimony in this case?

A. I don't have the specific date, but it appears that it was on or around September 27th, 2002.

Q. And about how long before that would you say -- give me a ballpark estimate -- that you made these finishing determinations on how to calculate closing prices and what to use and that sort of thing?

A. The final determination would have probably been made sometime in September.

Q. September of 2002?

A. That's correct.

Q. Okay. Fine. And when did the transactions that are under issue in this proceeding, when were they completed?

A. I think the last transactions may have taken place as late as January 2001.

Q. 2001. Okay. Now, in your testimony you indicate that it was necessary, at least in your view, for Staff to adopt this method which was calculated sometime in the summer of 2002 because it was required to make the overall cost reduction incentive make sense in light of the company's decision to declare the price protection incentive component of the program inoperable in June of 2000 and in light of the subsequent elimination of the minimum volume requirement in the late summer of 2000.

Is that basically correct?

A. That's correct.

Q. Okay. And I'd like to talk about that a little bit. Once again, as you pointed out in your testimony, Laclede's price stabilization program consisted of both of the PSP tariff and the program description; is that correct?

A. That's correct.

Q. And you've attached that program description as Schedule 6 to your direct testimony; is that right?

A. Yes.

Q. Okay. And just so that the record's clear, that's no longer being maintained on a confidential basis; is that right?

A. That's correct.

Q. Okay. And you've also attached the tariff section consisting of pages 28-e, f and g to your direct testimony as Schedule 7; is that correct?

A. Yes.

Q. Okay. Isn't it true that Tariff Sheet 28-e was amended effective October 12th, 2000 to implement the Commission's approval of the Unanimous Stipulation & Agreement that had been filed by the parties to this case on September 1st, 2000?

A. That's correct.

Q. And would you agree with me that a copy of the revised Sheet 28-e is attached as Schedule 1 to Mr. Mathews' surrebuttal testimony? Or Exhibit 1, I'm sorry.

A. That's correct.

Q. Now, the tariff sheets containing these provisions were filed by Laclede on June 25th, 1999; is that right?

A. Yes, that's the date of issue.

Q. And the Staff memorandum that reviewed those tariffs and recommended they be approved as being in compliance with the Commission's Report and Order in Case No. GO-98-484 was filed on July 12th, 1999; is that correct?

And just to help you out, you can look at Schedule 1 of Mr. Mathews' rebuttal testimony, if that's helpful.

A. Yes, that's correct.

Q. And does that memorandum state that the Staff had reviewed both the tariff and program description and found them to be in compliance with the Commission's order?

A. Yes.

Q. In fact, the memorandum indicates that Staff had actually suggested a number of changes to the tariffs that Laclede had submitted and that the company had filed substitute tariff sheets to incorporate those changes; is that correct?

A. Where do you see that specific language?

Q. I believe it's in the first paragraph, but I

better look, too. Do you recall, did Staff suggest any changes to those?
A. I don't recall any specific Staff suggestions, no.
Q. I'm sorry. It is kind of hidden in there, Mr. Sommerer. I apologize. If you look at the last sentence in the first paragraph.
A. Yeah, apparently there were some changes that were suggested.
Q. By the Staff?
A. That's correct.
Q. Okay. And those would have been changes to reflect what Staff thought needed to be done in order to make the tariffs consistent with the Commission's Report and Order?
A. That's correct.
Q. Okay. Do you recall what those changes were?
A. No, I do not.
Q. But in any event, the final tariff sheet that was ultimately filed and that you have a copy of, as well as the program descriptions, were ones that Staff had given its approval to after reviewing them, suggesting changes, and then reviewing the final product with those changes incorporated. Is that a fair statement?
A. I think it's fair, except I would have to say

that the Staff is limited only to those changes that had been recommended by the Commission. So there is a fairly strict limitation put upon the Staff when it's reviewing those compliance tariffs that it not wander too far afield from what the Commission's intent is in its order approving the program.

Q. Well, I appreciate that clarification, but my question was, they were, in fact, in Staff's view, in compliance with the Commission's Report and Order; is that correct?

A. That is correct.

Q. And let's look at those tariff sheets and the program description as they existed at the time Staff reviewed them and said they were in compliance. And I'd like to begin by directing your attention to the program description first, as contained in Schedule 1 to your direct testimony. Do you have that?

A. Yes.

Q. And on page 3 of the program description, we have the beginning of the section of the program that sets forth the price protection incentive; is that correct?

A. That's correct.

Q. And I'd like to direct your attention to subsection B, small Roman Numeral ii of the price protection incentive that appears on page 4 of the program description.

Do you see that?
A. Yes.
Q. And this would be one of those provisions that Staff reviewed and found to be in compliance with the Commission's Report and Order in Case GO-98-484; is that correct?
A. That's correct.
Q. And is this the section under which the company exercised its right to declare the price protection incentive inoperable for the 2000-2001 ACA period?
A. Yes.
Q. Now, aside from saying that the company shall not be obligated to provide a credit in the event there are radical changes in market conditions that required it to purchase gas at strike prices above the CPL, does this provision say anything about making changes to the overall cost reduction incentive in the event the company exercises that right?
A. It is silent with regard to that matter.
Q. Okay. Is there anything in that provision that talks about instituting the method you have proposed for determining whether there are savings under the overall cost reduction incentive in the event the company exercised its right under section B, small Roman Numeral ii?
A. No.

Q. And Laclede did, in fact, exercise that right by a letter dated June 1st, 2000; is that correct?

A. That's correct.

Q. And is that the letter that's attached to your direct testimony as Schedule 3?

A. Yes.

Q. Okay. And I'd like to quote from the first paragraph of that letter: Pursuant to the terms of the revised PSP, the purpose of this letter is to notify the Commission that Laclede is exercising its right to declare the price protection incentive component of the program inoperable for the second year of the program. Is that a correct reading of that letter?

A. Yes.

Q. Was there any mention in that sentence of overall cost reduction incentive?

A. No.

Q. And was there any indication in that or elsewhere in the letter that the overall cost reduction incentive was to be rendered inoperable or had to be modified?

A. No.

Q. In fact, there was no indication at all that the overall cost reduction incentive was to be affected by this letter; is that correct?

A. That's correct.

Q. And you were copied on this letter, as was Mr. Schwarz as Staff attorney; is that correct?

A. That's correct.

Q. Did you read this letter when you received it?

A. Yes.

Q. After reading this letter, did you communicate to anyone at Laclede that you thought the overall cost reduction incentive should be inoperable because Laclede had opted out of the price protection incentive or declared it inoperable?

A. No.

Q. During this time period, are you aware of whether anyone at Staff had communicated to anyone at Laclede that the overall cost reduction incentive should be deemed inoperable or modified because Laclede had opted out of the price protection incentive?

A. I don't have any knowledge of any Staff member who made that contact.

Q. Okay. Well, after reading the letter, did you communicate to anyone at Laclede that you thought, because of the company's exercise of its right under the price protection incentive, that savings under the overall cost reduction incentive should be calculated by comparing what options were actually sold for versus what they could have been sold for had they been held to the last three business days before they expired?

A. No.

Q. Okay. Are you aware of anybody at the Staff that after this period of time communicated to anyone at Laclede that, because of the company's exercise of its right under the price protection incentive, that the overall cost reduction incentive had to be calculated by comparing what options were actually sold for versus what they could have been sold for had they been held until the last three business days before they expired?

A. No.

Q. Shortly after that letter was filed, do you recall meeting with the company, Mr. Sommerer, in a meeting held on June 9th to discuss the situation with gas prices and to consider potential revisions to the PSP?

A. I do recall that there was a meeting that took place in June, yes.

Q. Okay. And do you recall one of the first questions you asking the company when we met was whether or not the company intended to continue to maintain the incentive mechanism if the -- the overall cost reduction incentive mechanism if revisions were made to the program, and the company replying absolutely?

A. No.

Q. You do not recall that. Okay.

Okay. Do you recall at any time making a -- well, let me ask you this: Eventually the parties agreed to make a -- one of a number of changes that the company had proposed to the PSP; is that correct?

A. That's correct.

Q. And let's just talk about those changes a little bit. One of them was to increase the funding amount from 4 to $10 million; is that correct?

A. I believe that's correct, yes.

Q. And another was to use various additional kinds of financial instruments, like fixed price instruments and options or collars; is that correct?

A. That's correct.

Q. Okay. And to use a collar, you generally need to go ahead and have a put as well as a call option; is that correct?

A. That's correct.

Q. So this was basically Laclede coming in and saying, we had proposed in the past to use these puts, and we'd like to go ahead and have the flexibility to use them again in light of this price situation; is that correct?

A. Well, I think certainly in the context of costless collars, there was more definition on how they would be used. In Laclede's original filing, I believe

Laclede had the right to sell the put, buy a put, not necessarily hook it up with a call option, which you would need to do in order to fulfill a costless collar.

Q. Let me put it this way: When you opposed Laclede's ability to buy and sell puts when it made its proposed modifications to the PSP in 1999, you didn't say, well, okay, as long as you use them with a costless collar, you just said no puts period, didn't you?

A. That was Staff's position, yes.

Q. Okay. And we've done a lot of looking back over what happened during the winter, and I'd just like to ask you if Laclede had the authority to use collars, would it have been able to go ahead and acquire more price protection if it did?

A. That's possible. It depends upon the range of the costless collars, whether Laclede entered into those costless collars or not, the timing of the costless collars. Depends upon numerous factors.

Q. Well, if you -- if you go ahead and sell a put, do you get money for it?

A. Yes.

Q. Okay. And can that money then be used to go ahead and buy additional call options?

A. That's correct, although there's a downside to selling that put, because when you sell a put, it turns the obligation around to where it's no longer the right but not the obligation. It becomes an obligation. Sure --

Q. If prices decline you've got an obligation, right?

A. That's right.

Q. Okay. But on the other hand, if prices increase, you're able to go ahead and basically buy a call option, use the proceeds from the put to do that, and not pay anything for that ceiling price protection; is that correct?

A. Again, given a certain floor and a certain ceiling, you can create a costless collar, yes.

Q. In fact, that's why they call it costless, isn't it, because what you've essentially done is locked in a ceiling, locked in a floor, and you've done it without having to shell out any money?

A. That's correct.

Q. Okay. And --

A. I would supplement that answer by saying just in terms of that particular transaction, because you might have to shell out a lot of money to the extent that the ceiling is extremely high and gas costs go up.

Q. Well, I suppose anything's possible, Mr. Sommerer, but what I'm asking is, compared to not having any protection at all, having a put, selling it and using the proceeds to buy a costless collar will give you additional protection; is that right?

A. That's right, assuming you had no other protection other than that costless collar.

Q. In fact, you reviewed a significant amount of material that was provided to us by the various people that were advising Laclede at that time, did you not?

A. That's correct.

Q. Okay. And were a lot of those recommendations that Laclede should consider costless collars?

A. I think probably that was one of the recommendations that was included over time in some of those recommendations.

Q. Okay. But in any event, we weren't able to reach agreement on that, were we?

A. That's correct.

Q. Nor were we able to reach agreement on increasing the funding from 4 to $10 million; is that correct?

A. That's also correct.

Q. Okay. But we were able to reach agreement on relaxing or eliminating the 70 percent volume requirement; is that correct?

A. Yes.

Q. Okay. And we ultimately submitted a

Stipulation & Agreement to that effect; is that correct?

A. That's correct.

Q. Okay. And you've attached a copy of that Stipulation & Agreement to your testimony?

A. Yes.

Q. And can you tell me where that's located in your testimony?

A. That stipulation is located in my direct testimony as Schedule 4.

Q. Okay. And did that Stipulation & Agreement and in particular paragraph 4 indicate that all remaining provisions of the existing PSP currently in effect would remain in full force and effect?

A. The language is found in paragraph 4 on page 3 of the Stipulation & Agreement, which says since the parties were unable to agree on the company's other proposed revisions to the PSP, all remaining provisions of the existing PSP currently in effect will remain in full force and effect.

Q. So there's not anything in the Stipulation & Agreement that purports to go ahead and change the overall cost reduction incentive, is there?

A. That's correct.

Q. In fact, it says that that, as well as all other provisions, are to remain in full force and effect;

isn't that correct?

A. Except as modified by the June 2nd letter. I think that's found elsewhere in the Stipulation & Agreement.

Q. Which was a letter that specifically talked about declaring the price protection incentive agreement inoperable; is that correct?

A. Could you repeat that question, please?

Q. Which was a letter that specifically said that the price protection incentive was being declared inoperable; is that correct?

A. That's correct.

MR. PENDERGAST: Okay. If I can approach the witness.

JUDGE WOODRUFF: You may. Is this another exhibit?

MR. BATES: Yes.

JUDGE WOODRUFF: This will be No. 10.

(EXHIBIT NO. 10 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

BY MR. PENDERGAST:

Q. Mr. Sommerer, could you please identify the exhibit that -- or the document that's been marked as Exhibit 10?

A. Yes. This exhibit appears to be Staff's suggestions in support of the Unanimous Stipulation &

Agreement filed in Case No. GO-2000-394.

Q. Okay. And if we look at that recommendation, this is referring to the September 1st, 2000 Stipulation & Agreement that we were just discussing which modified or eliminated the 70 percent volume requirement; is that correct?

A. That's correct.

Q. Okay. And in the first paragraph of that letter it talks about -- or that suggestion in support, it talks about the verified application that Laclede filed to make various revisions to the program; is that right?

A. That's correct.

Q. Okay. And then the second paragraph says, basically, after considerable discussion among Laclede, Staff and the Office of the Public Counsel, we were able to agree that prompt action was warranted, but the only step to modify the PSP upon which the parties could agree was the requirement relating to Laclede's procuring price protection for 70 percent of its flowing supplies; is that right?

A. That's correct.

Q. And does the Staff reference here anything about the need to make changes to the overall cost reduction incentive?

A. The Staff simply says that it continues to have concerns about the structure and function of the PSP.

It goes on to ask that the Commission approve the S&A as quickly as possible to afford Laclede the additional flexibility, and those are the comments of the Staff.

Q. Okay. But there's nothing in here that says, because of this Stipulation & 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 & Agreement that says, because of these modifications that we've talked about in the preceding paragraph, 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 percent requirement; is that right?

A. That is correct.

Q. Okay. And then Laclede ultimately filed a tariff, did it not, to implement this Stipulation & Agreement?

A. Yes.

Q. Okay. And that tariff is included as an attachment or a schedule to Mr. Mathews' testimony, is it not?

I'll get a reference for you here.

A. It appears that that tariff sheet is attached to Mr. Mathews' surrebuttal testimony, Schedule 1.

Q. Thank you. And if I could direct your attention to that particular tariff, what does it say its date of issue was?

A. Could you repeat the question, please?

Q. Yes. What does it say its date of issuance was?

A. The date of issue was October the 5th, 2000.

Q. And it has a notation over there saying filed October 12th, 2000; is that correct?

A. That's correct.

Q. Okay. Would that indicate to you when it became effective?

A. Yes, I believe it was effective October 12, 2000.

Q. Okay. And in paragraph 1 of that tariff, it says except as -- and I'm reading one sentence down -- except as modified by the terms of the September 1st, 2000 and the Stipulation & Agreement approved by the Commission in GO-2000-394 and subject to the company's notice of opting out of the price protection incentive features in Year 2, the parameters are included in the description of the incentive price stabilization program filed by the company on June 25th; is that correct?

A. That's correct.

Q. Okay. And is there anything here that purports to address the overall cost reduction incentive?

A. No.

Q. Okay. The only reference is to the price protection incentive; is that correct?

A. That's correct.

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.

MR. PENDERGAST: If I could approach.

JUDGE WOODRUFF: You may. Is this another exhibit?

MR. PENDERGAST: Yes.

JUDGE WOODRUFF: This will be 11.

(EXHIBIT NO. 11 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

MR. PENDERGAST: I'm sorry. This is Exhibit 11?

JUDGE WOODRUFF: 11, yes.

BY MR. PENDERGAST:

Q. Mr. Sommerer, could you identify for me the document that has just been marked as Exhibit 11?

A. Yes. This appears to be a Staff recommendation in Case No. GO-2000-394.

Q. Okay. And it's a recommendation relating to what?

A. Relating to Laclede's October 5th filing that was made in order to comply with the Unanimous Stipulation & Agreement.

Q. Okay. And that's the tariff that we just got done discussing, isn't it?

A. That's correct.

Q. Okay. And looking at this Staff recommendation, is there anything in here that suggests that any change has been made to the overall cost reduction incentive?

A. I would say not explicitly, no, but again, implicitly it's the Staff's position that once this was relaxed --

MR. PENDERGAST: Well, if I could interrupt, I didn't ask him what Staff's implicit position is. I asked him if there was anything here in the tariff, your Honor. I think he's going beyond that question.

JUDGE WOODRUFF: All right. You are going beyond the question. So proceed with your next question.

BY MR. PENDERGAST:

Q. Okay. Is there anything in this Staff recommendation, Mr. Sommerer, that talks in terms of, because of the noted elimination of the 70 percent of the flowing supply requirement, that the overall cost reduction incentive will now be judged based on a benchmark that is premised on what the company could have received for option sales if it held them to the last three business days?

A. Not explicitly, no.

Q. Is there any language at all in there?

A. The language which says -- which provided for relaxes for this year the PSP provisions that require Laclede to procure price protection for 70 percent of its flowing natural gas supplies, in Staff's view, took away the obligation for price protection, and it affected, in Staff's view -- and this is Staff's position in this case -- what the definition of net cost of price stabilization was and what the definition of savings was.

Q. Let me ask you that, Mr. Sommerer. If that was the case, then why don't I see anything in this Staff recommendation? Why don't I see anything in the prior Staff recommendation in support of the Unanimous Stipulation & Agreement? Why don't I see anything in the tariff or any of the other documents that we've talked about that talks about that?

A. It doesn't say either way. It doesn't say that the cost reduction incentive will not only remain in place but Laclede will have the right to earn incentives regardless of whether price protection exists, regardless of any circumstance, Laclede's right to maintain those incentives will be unblemished by Laclede's actions.

Q. Did the Stipulation & Agreement -- and I think you've already agreed with this -- say that all provisions would remain in effect other than those that were explicitly changed?

A. That is correct.

Q. And one of those provisions was the overall cost reduction incentive; is that correct?

A. That is correct.

Q. Okay. And there is nothing in these documents that says it will remain in effect but subject to the method that you had proposed in your direct testimony; is that correct?

A. That's correct.

Q. I'd like to ask you now about the savings calculation that you presented in your surrebuttal testimony. Do you have that?

A. Yes.

Q. Now, is this another method that's being presented as an alternative to the method that was presented in your direct testimony?

A. It is a method that was performed by Staff in order to address Mr. Mathews' concerns that the Staff's initial calculation had not considered the fact that Laclede had additional proceeds because of early trading.

Q. Okay. And this was presented in your surrebuttal testimony; is that correct?

A. That's correct.

Q. Didn't Mr. Mathews raise that point in his direct testimony?

And I'll reference pages 6 to 7 if you have it there.

A. I'm there.

Q. Okay. So doesn't he raise that point in his direct testimony?

A. Yes, he has raised that point.

Q. And, in fact, you responded to that point in your rebuttal testimony, didn't you?

A. Yes, I believe that's correct.

Q. And in responding to that in your rebuttal testimony, you didn't provide the analysis or the calculations that you provided in your surrebuttal testimony, did you?

A. That is correct.

Q. Okay. Can you tell me why you didn't provide that analysis to the point that had been raised in Mr. Mathews' direct testimony in your rebuttal testimony, why you waited until your surrebuttal?

A. The Staff was still trying to understand fully Mr. Mathews' argument about not including the entire intermediate funding, and I think the Staff was still evolving its view of what Mr. Mathews was trying to say and address his concerns.

I think we tried to address those concerns generally by defending the Staff's direct calculation and saying that certainly, in Staff's view, once price protection was gone, there still had to be a concept of a benchmark. There still had to be some meaning to price stabilization.

But we also recognized through Mr. Mathews' direct and as clarified in his rebuttal testimony that Staff had used the funds that were generated from intermediate trading, and we wanted to go ahead and specifically rebut, and we did that in surrebuttal, his contention that those funds were not included. So Staff was not yet at a point where it had quantified Mr. Mathews' allegations.

Q. So are you saying at the time you submitted your rebuttal testimony, you didn't understand what

Mr. Mathews was saying, but that by the time you did your surrebuttal you did understand what he was saying?
A. I think we more fully understood his concerns by the time surrebuttal testimony was prepared.
Q. Okay. Did the company provide you with work papers underlying Mr. Mathews' direct testimony before you filed your rebuttal testimony?
A. Yes, I believe that is the case.
Q. And did you review those?
A. Yes.
Q. Okay. And do you know how far in advance of your testimony you received those?
A. No, I do not recall.
Q. How much time was there between when direct testimony and rebuttal testimony was filed?
A. It appears the rebuttal testimony was filed on or around December 2nd, 2002. Surrebuttal testimony was filed on or around January the 10th, 2003.
Q. Okay. I'm sorry. Could you go over that again?
A. Rebuttal testimony was filed on or around December the 2nd, 2002, while surrebuttal testimony was filed on or around January the 10th, 2003.
Q. Okay. And direct testimony was filed on what day?

A. That was filed on or around September the 27th, 2002.

Q. So there was approximately a little over two months between the time direct and rebuttal testimony was filed?

A. That's correct.

Q. And during that two-month period, through receiving work papers and having the opportunity to submit Data Requests, you still hadn't arrived at a good enough understanding of Mr. Mathews' question to perform your calculation by the time you filed rebuttal testimony. Is that your testimony today?

A. That is my testimony, yes.

Q. Okay. And you're aware that, because it's been filed as surrebuttal testimony, the company doesn't have an opportunity to file additional testimony in response to that? You're familiar with that procedural fact of life?

A. That's correct.

Q. In any event, under your approach, you essentially say that any amount spent by Laclede toward purchasing call options shouldn't count as being an initial expenditure of the $4 million if the option was sold and then, in your view, later reinstated by the purchase of another option; is that true?

A. That's correct.

Q. And under your approach, you developed a method for allocating purchases between what you call a reinstatement of a previous option purchase and the purchase of a new option, based on what you believe are reasonable assumptions; is that correct?

A. That's correct.

Q. And you spend about five or six pages in your surrebuttal testimony describing how that method works; is that correct?

A. That is correct.

Q. And, once again, Mr. Sommerer, is there anything in the original PSP tariff sheet or program descriptions that references this method?

A. I think the original program as it was set up had price protection, and this is Staff's attempt to replicate what we believed was a consistent application of that original protection.

If your question is in regard to explicit language, again, I would say no, the explicit language isn't there.

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 purchases between 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 description 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 & Agreement that references the concept of reinstatements?

A. No.

Q. Is there anything in the September 1st, 2000 Stipulation & 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 September 1st, 2000 Stipulation & Agreement that speaks to how you're supposed to make those allocations between presumably reinstatements and new option positions?

A. No.

Q. Is there anything in the compliance tariff that was filed to implement the September 1st, 2000 Stipulation & 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 option decisions and option expenditures that will be presumed to be new options, is there?

A. No.

Q. If you had to develop tariff language to describe this method of determining when an initial MRA has been spent with all the reinstatement adjustments and allocations that take place, would it take the same five or six pages to do that that you use to describe it in your view?

A. I don't think it would be that lengthy, no.

Q. A couple pages maybe?

A. Perhaps a page.

Q. Okay. But it's a page that doesn't appear in the tariffs that were in effect at that time; is that correct?

A. That's correct.

Q. Under this surrebuttal analysis, did you limit reinstatements to options having the same strike price? For example, if Laclede sold a November option with a 5.20 strike price and later purchased a November option at a 5.50 strike price, you would consider the purchase to be a reinstatement and not count it towards the 4 million purchases?

A. That's the way it was treated, yes.

Q. So in your view, Laclede can reinstate one option by buying another option, so long as they're both in the same month without regard to -- without regard to strike price; is that correct?

A. That was the assumption, yes.

Q. With respect to your reinstatement approach, for each purchase of an option for a given month that happens to take place after the sale of an option for that month, how did you know that such purchase would not have occurred but for the earlier sale?

A. This was a Staff assumption that Laclede would reinstate a previously established position.

Q. Okay. And that assumption was based on what?

A. Based upon the fact that we had to construct some definition of what price stabilization would be and the cost of the price stabilization. We had finally understood Mr. Mathews' concerns that only the $4 million of the initial MRA should be considered in terms of trying to calculate what that price stabilization should be.

And, therefore, given the lack of clarity with the term price stabilization, we developed this method of trying to calculate what Laclede would have gotten in terms of price stabilization from the initial MRA.

Q. So the assumption that Laclede would have done what you say it did was based on what Staff thought was a need to come up with a different method. Is that what you're saying?

A. I think that what I'm saying is that Staff viewed the term "net cost of price stabilization" as lacking a clear definition after Laclede had opted out of the price protection features, and there was no obligation for a certain volume level. And, therefore, Staff developed an approach to try and define what price stabilization was after the guarantees were removed.

Q. Well, once again, I'd asked you what did you base your assumption on that such purchase would not have occurred but for the earlier sale, and what I hear you saying is it's not based on whether Laclede would or would not have done something, but it's based on what you believe is the need to come up with a method for calculating a different savings. Is that basically correct?

A. This is based upon Staff's belief of what we think is a reasonable assumption of when an option would be reinstated, yes.

Q. Staff believes. Okay. For each option purchased you count towards the 4 million in MRA expenditures, how do you know that at the time of such option purchase the purchase decision was made with a buy and hold until expiration objective, or does that matter?

A. In Staff's calculation, the assumption is that the initial option position is meant for price protection. I think logically you can assume that Laclede's buyers would have been buying an option because they believed it was a favorable time to do so to establish that price protection. And so, for example, the November options that were purchased back in July we believe indicate that Laclede thought at that time, for that specific period, the time was right to establish a position for a November option.

Q. Okay. And how does that translate into a belief that the intention was to hold it until November, all the way through November?

A. Again, this is an assumption that Staff has made. We don't know what was in the mind of Laclede at that time.

Q. Okay. Well, in any event, your analysis is designed to show what would have happened, at least from your perspective, had Laclede followed a buy and hold approach with the adjustments you've made for reinstatements; is that basically correct?

A. That's correct.

Q. And does Schedule 4 to your surrebuttal testimony show how many options Laclede would have held to expiration had it followed this hypothetical buy and hold strategy during the winter months that's -- with the adjustments you've made for reinstatements?

A. Yes, I believe it does.

MR. PENDERGAST: Approach?

JUDGE WOODRUFF: You may. I assume this is another exhibit?

MR. PENDERGAST: Yes, your Honor.

JUDGE WOODRUFF: Will be No. 12.

(EXHIBIT NO. 12 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

BY MR. PENDERGAST:

Q. If I could refer your attention, Mr. Sommerer, to what's been marked as Exhibit 12.

A. Yes.

Q. And could you verify for me whether or not this is an accurate representation of what you say, had Laclede followed the buy and hold approach that you've calculated or described with your reinstatements, whether these are the options that it would have held for the winter of 2000-2001?

A. Yes, that appears to be the case.

Q. Okay. And basically under your hypothetical buy and hold scenario, with reinstatement, you would have Laclede holding 601 option contracts in November; is that correct?

A. Yes.

Q. 952 in December?

A. Correct.

Q. 743 in January?

A. Yes.

Q. 2 in February?

A. Yes.

Q. And 2 in March; is that correct?

A. That's correct.

Q. Let me ask you this, Mr. Sommerer: You've been involved in reviewing various hedging programs for quite some time. If an LDC were to come to you and indicate that its buy and hold hedging program based on call options lined up options in these quantities for these specific months with virtually nothing for February or March, would that at first glance appear to you to be a reasonable hedging strategy?

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.
Q. Okay. And, in fact, if you had an LDC that had pursued an approach of that nature, buy and hold approach, that is, with those amounts, those quantities of option purchases of 2 for February and 2 for March and prices had gone up in those months, March, February, would you have to consider proposing some kind of an adjustment?
A. You would want to look at the whole spectrum of decisions that the LDC made. You would want to know whether there were any other fixed price contracts for February and March, whether this was the only hedging program that there was, whether this was something that was amended from an original hedging program, what the company's total portfolio was, how the company used its storage, which is a physical hedge.
So I think before you answered that question, you would want to know a lot about the decision-making process and also what other alternatives were out there and if this is the only thing that's there.
Q. Okay. Well, let me ask you this: If you knew nothing else, would this go ahead and raise a red flag to you?
A. As the page stands alone, I would be concerned about the lack of coverage in February and March for that

type of an option program.

MR. PENDERGAST: Okay. If I could approach?

JUDGE WOODRUFF: You may.

MR. PENDERGAST: This is another exhibit, your Honor.

JUDGE WOODRUFF: Exhibit 13.

(EXHIBIT NO. 13 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

BY MR. PENDERGAST:

Q. If I could direct your attention to what's been marked as Exhibit 13, Mr. Sommerer, do you have that?

A. Yes.

Q. Okay. And what I'd like to do is to get a sense of how your reinstatement method works. I'd like you to assume for me -- and I've got it written down here just for convenience -- that you purchase -- make three option purchases of 100 contracts in November and you make three sales of option contracts in November, so that in each of those scenarios I have written down here, you have three purchases, three sales and you end up at the end with no options. Do you follow me?

A. Let me review this schedule for a couple minutes.

Q. Sure.

MR. MICHEEL: Your Honor, can we just take a little break while he's reviewing the schedules, just for a couple minutes?

JUDGE WOODRUFF: That's fine. We'll take a short break. We'll come back at 11:15.

(A BREAK WAS TAKEN.)

JUDGE WOODRUFF: We're back from our break and, Mr. Sommerer, have you had a chance to review that document?

THE WITNESS: Yes, I have.

JUDGE WOODRUFF: You may proceed.

MR. PENDERGAST: Thank you, your Honor.

BY MR. PENDERGAST:

Q. Mr. Sommerer, once again, when we broke we were discussing these three scenarios, and in each one I'm asking you to assume that for the month of November Laclede made three option purchases and three option sales, 100 apiece, with the end result that at the end of the month it had sold the three options it had purchased.

And I'd like to ask you, under your reinstatement method, if you'd look at Scenario A and you applied your reinstatement method, how many of those option purchases would count towards the MRA?

A. You really can't tell without having the cost of the option available or the premium available, which you don't have.

Q. Well, let's say they all had the same premium, they all had the same strike price and they all had the same cost.

A. Well, the way the Staff method works is you would take the original position and allocate MRA funds to that position. So in this first example, if you bought 100, you would find the cost associated with that, and let's say the cost associated with that is $4 million. You would have used up your entire MRA at that point and you would stop with that one purchase.

Staff's method creates an inventory of options, and the assumption is, is that you keep spending the MRA until you run out of MRA funds.

Q. Well, let me ask this: Let's assume it was 50,000 for each of those option purchases.

A. Right.

Q. Okay. So we don't have to worry about the hypothetical of all was spent on the first purchase. Okay. And let's assume 50,000 for each option purchase. Under those circumstances, what would your reinstatement method conclude as to the number of options at the end of that series of transactions would count towards the MRA?

A. You would also have to know the proceeds being generated from the sales, because the Staff's method allocates part of sale proceeds to the MRA and part of the proceeds goes to reinstating the initial option. And so really we would need to have proceeds for each one of these numbers and premiums for each one of these numbers.

Q. Okay. Let's say 100,000 in proceeds for each one.

A. For each sale?

Q. Yeah.

A. Okay. Moving through Step 1, the original MRA expenditure would be 50,000. And then No. 2, there would be no effect on the MRA transaction. No. 3, you're reinstating an existing position, and that would have no effect on the MRA. And then No. 4, generated another 100,000 in proceeds. And No. 5, you're just reinstating, no effect on the MRA. And then you've generated another 100,000 in proceeds. So the effect on the MRA for Scenario A would be $50,000 total.

Q. 50,000 would be counted toward the MRA?

A. That's correct.

Q. And how many of the option purchases or buys would be counted toward the MRA?

A. The assumption would be that you would have one block of a hundred November contracts.

Q. Counted toward the MRA?

A. That's correct.

Q. One block and $50,000?

A. Yes.

Q. But at the end of the month, we had bought three and sold three; is that correct?
A. That's correct.
Q. Okay. Could you do the same analysis for me under Scenario B and tell me what result your reinstatement method would produce?
A. Sure. We'd establish your position at $50,000, and that would come from the MRA. You would get 100,000 proceeds. You'd reestablish a position which would not affect the MRA and Staff's position, and that's in No. 3. You would have another additional expenditure in No. 4 for the MRA of $50,000, and you would receive proceeds then two times five and six, both at $100,000. So your MRA would contain two blocks of 100 November options for a total cost of $100,000.
Q. Okay. So once again, under Scenario B, you made three purchases of 100 each. You sold three purchases of 100 each, but because you did it in a different order, this time you would go ahead and have two blocks and $100,000 proceeds that would count; is that correct?
A. That's correct.
Q. Okay. And if you could please do the same calculation for Scenario C.
A. Step 1, you would have $50,000 toward the MRA. Step 2, another $50,000 position. Step 3, another -- or

correct that -- another $50,000 position. And then you would receive $100,000 each for those three sales. And so you would have three blocks of 100 November options with a total cost basis from the MRA of $150,000.

Q. Okay. So under Scenario C, once again, you bought three option -- made three option purchases of 100 each, sold 300, wound up with zero, but this time three of the -- all three of the purchases count and 150,000 counts toward the MRA; is that correct?

A. That's correct.

Q. Okay. So under these three scenarios, what was the difference between Scenario A, B and C as far as the amount of proceeds that were ultimately achieved, not counted toward the MRA, but ultimately achieved?

A. Okay. The proceeds under the assumptions that have been given appear to be 300,000 in Scenario A, B and C.

Q. So the proceeds are identical in all three?

A. That's correct.

Q. Okay. Is the cost that was paid identical in all three?

A. The premium that was paid appears to be the same for all three, yes.

Q. Okay. And once again, in all three you would agree with me that all three scenarios involve three purchases of options of 100 contracts and three sales of options of 100 contracts during the month of November?

A. Well, I'd make -- one slight adjustment to your example is if you're going to be buying and selling November options, you wouldn't be doing it during the month of November. But with that as a correction, I follow what you're saying.

Q. Yeah. Well, November options bought prior to that?

A. Right.

Q. You would agree with that, with that clarification?

A. That's correct.

Q. Okay. So everything is identical with the exception of the order; is that correct?

A. That's correct.

Q. Okay. And it's that order that produces the different results of one block and 50,000 counting to the MRA for Scenario A versus two blocks and 100,000 counting toward the MRA in Scenario B, versus three blocks and 150,000 counting towards the MRA in Scenario C; is that right?

A. That's correct.

Q. Let me refer you, if I can, Mr. Sommerer, to your surrebuttal testimony, Schedule 4. On that Schedule 4, would it be correct to say that under your hypothetical buy and hold approach, with the reinstatements added in, that this reflects how much money you're assuming Laclede would have spent under your buy and hold approach in each of the five months during the winter of 2000-2001?

A. Yes.

Q. Okay. And once again, that reflects an expenditure of a little over $700,000 for November, 1.676 million for December, 1.6 million for January, and then under $2,000 for February and March; is that correct?

A. That's correct.

Q. Okay. Let me ask you this question similar to questions I asked you before. Under a buy and hold scenario where you go in and you're obtaining price protection for the winter and you're attempting to obtain it for the entire winter, and you're relying exclusively on call option purchases to do that, just based on these expenditures, would that appear at first blush to you to be a reasonable buy and hold hedging plan?

A. And I would have the same answer from the ground up, assuming all other things equal, like storage, it appears February and March are very low.

Q. Okay. Very low to the point that it would not appear to be reasonable?

A. I think it would be a red flag that you would want to look very closely at.

Q. Okay. Let me ask you a few more questions about Staff's method for determining savings by comparing the actual results achieved by Laclede against a hypothetical result that could have been achieved had Laclede held options until the last three business days.
When you chose your method, why didn't you simply -- did you consider choosing the sale date that the option peaked in value?
A. For the last three business day assumption?
Q. No. Just instead of even looking at the last three business days, did you consider just using the date when the option sold, whatever the peak value of that option was?
A. I don't know that I follow your example.
Q. Well, in implementing your method and comparing actuals versus what you say could have been achieved, did you consider looking at the peak value day, let's say during the last three business days?
A. No.
Q. We had some discussion earlier, Mr. Sommerer, and I know you're trying to make things, according to your testimony, make sense by coming up with this method for determining what savings could have been achieved. And I'm asking when you considered what kind of benchmark to be used, did you ever consider the benchmark of what savings

the company would have achieved if it had been operating under a program that prevented it from buying any options above $4?

A. No.

Q. Okay. Well, let me ask you about that. I think we've already had some discussions that Staff had proposed back in 1998 that option purchases be -- had a ceiling limitation on them of $4; is that correct?

A. That's correct.

Q. And when we came up with our incentive mechanism or the incentive modifications in 1999, Staff wanted to maintain the program with that same $4 ceiling, did it not?

A. The $4 ceiling was something that was looked at on an annual basis, and so depending upon the time period that you're looking at may have affected that $4 ceiling. I know the $4 ceiling was in pla-- in place for the year prior to the PSP that was under incentives, but whether that would have carried forward or not, I'm not sure.

Q. Well, let's look at it this way. MGE had a hedging program, did it not, that was very similar to Laclede's preincentive program in effect during the 2000-2001 period?

A. It wasn't fully in effect for that period. It was in effect for part of the summer and expired

September 30th, 2000.

Q. Okay. And what ceiling price did it have?

A. For that time period, it referred to the prior year's ceiling price because MGE had a standard call option program in place, and that price was 4.40.

Q. Let's assume that we had been operating under a program that said we could not buy any call options above, let's say, 4.40. Okay. Under those circumstances, would the company have been able to buy any material call options at all?

A. Certainly. By definition call options were available earlier than that, and the PSP was set for 4.70. So although the PSP was slightly higher than 4.40, the market was moving around in March. So depending upon the timing and how early you got in, it's possible, I think, that you could have gotten in for 4.40.

Q. Let's talk about at the time the PSP was set. PSP was set at what?

A. The PSP was set at $4.70.

Q. And that was 30 cents above 4.40, is it not?

A. That's correct.

Q. And you recall, Mr. Sommerer, filing a recommendation regarding the first year of the company's incentive program about a month before that March period?

A. I don't know -- recall the exact timing, but I do recall filing a recommendation regarding Year 1, yes.

Q. And do you remember in that filing expressing a concern that the company had purchased call options at $4 per MMBtu for the prior year?

A. That was one of the points, but to put that recommendation into context, I think my concern was that I believe the call options were available at prevailing prices that were less than that, and I could see that from the various transaction sheets from Laclede's broker, that Laclede was making decisions to obtain higher strike prices.

It meant more coverage, but it also meant higher strike prices, and I questioned whether enough work had gone into evaluating whether it was appropriate to get more coverage at a higher strike price or get a lower strike price at a higher expense or a higher premium. There's a break even in that analysis, and that's something that I wanted to have evaluated.

Q. But I believe you concluded, did you not, that it wouldn't have made any difference whether, at least for that year, they had been bought at a higher strike price or lower strike price; is that correct?

A. I don't think that any of the options were in the money that year.

Q. That's correct. And you did express a concern in February, this is a month before, couple weeks before the

PSP was set, that $4 seemed to you to be a high strike price; is that correct?

A. In the context of my concerns about whether that was appropriate for the money that was spent, that's partially correct, but it's not a full answer.

Q. Okay. So you did express that concern but in a context?

A. Exactly.

Q. Okay. Did MGE ever obtain any price protection by way of call options under its 4.40 program, this 4.40 ceiling?

A. No.

Q. Okay. And they, like Laclede, requested modifications be made to their hedging program; is that correct?

A. Fairly late in the year, I believe it was late September, may have been very late August, MGE made a filing to change their call option program, yes.

Q. Okay. And was the purpose of that filing to increase the price at which they could buy call options?

A. That's my recollection, yes.

Q. And Staff opposed the Commission granting approval for that request, is that correct?

A. That's correct.

Q. Okay. Given what happened during the

subsequent winter, do you have any regrets about having opposed that, Mr. Sommerer?

A. Not at all. The context of those filings were very large increases with strike prices that were quite high. The strike prices that we saw presented to us were at $10, and those strike prices ultimately wouldn't have even been in the money. Natural gas prices didn't exceed $10 for the winter.

And the concern was, is that option premiums had become so expensive, much like price insurance after the 500-year flood, that it could be adding to the cost of gas, rather than getting guaranteed price protection or additional proceeds.

Q. So in your view, at that particular point in time, Staff's position was that spending additional money on call options was not a wise thing to do?

A. Our position was that the company needed to look at everything that it had available to it in terms of where storage was at, where its gas supply contracts were at, the market and its diversification that it had in its supply portfolio, and that the company should make that decision. It shouldn't be a decision that was preapproved and guaranteed by the Commission.

Q. Well, let me ask you that question. Prior to that time, beginning in 1997, we did have preapproved

programs for hedging, did we not?
A. For call option programs which was a component of Laclede's and other companies' hedging, I would say yes, except it was never meant to preclude companies from looking at fixed price contracts or other tools to hedge gas costs.
Q. Well, whether it was meant to or not, the fact of the matter is those preapproved programs did exist, did they not?
A. That's correct.
Q. Okay. In 1997, they existed?
A. For the winter of '97-'98, yes.
Q. '98-'99?
A. That's correct.
Q. '99-2000?
A. I'm not sure that Ameren was still in a program at that time. They may have chosen to hedge internally at that time.
Q. But Laclede and MGE were; isn't that correct?
A. That's correct.
Q. Okay. And you had supported the MGE program at least up until September of 2000; is that correct?
A. That was part of the Stipulation & Agreement in that case, yes.
Q. And as part of that Stipulation & Agreement you had also supported a preapproval program where the

trigger price for gas went to 2.25, that they would fix all their gas supplies; is that correct?

A. They would fix the commodity cost of gas at the trigger amount, yes.

Q. Okay. So up until that point, at least as far as the two largest gas utilities in the state were concerned, Staff had indicated its willingness to go ahead and go to the Commission and say, this is a reasonable program and this is something that should be preapproved as a reasonable basis for acquiring price protection; is that correct?

A. That's correct.

Q. Okay. And it was when gas prices started to rise during 2000, when we were all looking at approaching winter and we were all sending out letters, warning customers of increases, that's the time when Staff came in and basically said, I can't go with these preapproved programs anymore, you've got to go ahead and go out on your own; isn't that correct?

A. No, that's not correct. Staff has said for years the company has responsibility to diversify its gas portfolio. I've said that in the Laclede cases and I've been on the record in many cases. And the call option programs, in Staff's mind, were viewed as tools.

Laclede had an incentive program or they turned a standard call option program into an incentive program and it took responsibility at that time for price protection. It became Laclede's program, not some sort of mutually developed program. And I think Laclede was in a different type of regulation at that time than MGE was.

Q. Well, whether it was Laclede or MGE, you took the position at that point that the Commission shouldn't preapprove anything, that the LDC should go out and do whatever it wants, and we'll take a look at everything in the future and decide what we think about it. Isn't that true?

A. Again, I would say Laclede already had a program in place that it was willing to be bound by. And those terms were very explicit, and I don't think that Staff had very much flexibility in changing those terms around. They were in the program description.

Laclede opted out in June of 2000, and I would just say that Laclede had its own program at that time the Staff wasn't trying to say, Laclede, you need to do something different than what your obligations are under the program.

Q. What I'm asking you, Mr. Sommerer, is, we came to you, MGE came to you. We all said the gas markets have increased significantly, we think we need to spend more money on these options, we think that we need to have additional flexibility to go ahead and respond to these.

And in response to those, the Staff said, I'm not going to join with you and seek any Commission approval for these; you're on your own. You do what you want to do, the Commission should not be approving these programs. Is that correct?

A. Well, I think the companies have always been on their own in terms of operating their gas supply portfolio in a prudent and reasonable way, and the Staff didn't believe it was appropriate to give broad preapprovals. We still believe that.

Q. But up to that point, you had done precisely that with MGE, had you not?

A. I would simply say that we believed, in terms of MGE, not Laclede, that the call option programs, those buy and hold programs were useful. They were a useful tool. They weren't everything. We still expected companies to look at ways to hedge their gas cost.

But I would say that for that year for MGE, they did have a call option program, and it was a preapproved call option program.

Q. And just like with that Laclede, with MGE, when they said we need to extend or modify that program and we need to change it in order to accommodate changes in the marketplace, at that point the Staff said, we're not going for preapproved programs anymore, you're on your own, we oppose any kind of Commission approval for that; is that correct?

A. Well, I would say that these companies, MGE and Laclede, were coming forward pretty late in the game. I don't recall any company coming forward and saying it wanted to increase its strike price or modify its program in any way prior to June of 2000. And so there was already quite a bit of change in the market that Staff was concerned about, and you could see the volatility.

And I would simply say that the Staff believed, given the diametrics that were taking place, it was better for the gas companies to make those decisions rather than wait for 30 days for the Staff to review something and another 30 days or two weeks for the Commission to review something. We needed to have the companies have the maximum amount of flexibility.

Q. So you're saying that, based on all that information that you were seeing as far back as June of 2000 -- and we were meeting with the Staff back in June; is that not correct?

A. That's true.

Q. Okay. That at that point in time when we were discussing potential revision to the PSP, that Staff believed from that very point in time that it shouldn't agree to any kind of revisions?

A. I think that the Staff was basically there saying, my recollection of the conversations was, company, you need to do what you feel is appropriate. If you believe that this amount of money is what's necessary, then go ahead and make the filing and we will evaluate that filing and give the Commission our recommendation. And we did.

Q. And your ultimate recommendation was, Commission, don't approve anything?

A. That's not true. There was a Stipulation & Agreement, as we've discussed, in September of 2000.

Q. Let me distinguish your initial recommendation from the Stipulation & Agreement. Your initial recommendation was, Commission, don't approve anything?

A. Our initial agreement was that the company should go ahead and make prudent decisions and continue with what programs it had in place to the extent the programs were expired; to do the right thing, in essence.

Q. But the bottom line was, Commission, don't approve anything?

MR. BATES: Excuse me, your Honor. I'm not sure exactly I'm following this very well. Mr. Pendergast, when were these recommendations filed?

MR. PENDERGAST: After our filing of the application in July, I believe.

MR. BATES: Okay. Thank you.

THE WITNESS: And the Staff's recommendation for that July filing was ultimately the September -- for Laclede anyway -- was the September Stipulation & Agreement.

BY MR. PENDERGAST:

Q. And that's what we ultimately agreed upon, but do you know if Staff filed a response to Laclede's application before that?

A. Yes, it did.

Q. Okay. And do you know whether or not Staff said in that application that the Commission should not approve any of the changes that Laclede had proposed?

A. I would need to rereview that, but based upon my recollection, the Staff was concerned about the various funding levels and how various aspects would work. So I'm sure we said something about, this is going to require further study.

Q. So you don't recall for certain whether you said, don't approve anything, or did you think it may have been, this may require further study?

A. I think most likely that would have been the main recommendation, although I wouldn't be surprised at all if Staff said that Laclede needs to take prudent actions.

Q. Okay. Do you recollect whether you would have said approve any of these revisions?

A. I do not think that the Staff supported any of those revisions at the time of its initial answer to Laclede's application.

Q. Okay. Well, while we're reviewing what actually did happen, and -- well, you've, for purposes of your analysis, gone back and looked at what actually did happen, have you not?

A. Yes.

Q. And you've taken the results of what actually did happen and you have applied them in your buy and hold calculation to determine your savings level; is that correct?

A. That is correct.

Q. Okay. If we do the same thing and we go back and we look at what did happen, would there have been a better result achieved if Laclede had been authorized to make the revision it had proposed to spend $10 million?

A. It's impossible to say.

Q. So you have no opinion on that?

A. I have no opinion whether it could have been better or worse.

Q. So Laclede took $4 million and happened to go ahead and generate $33 million worth of proceeds, and you don't know whether $8 million would have resulted in even more proceeds?

A. Well, that's a conclusion that you're drawing without considering the fact that Laclede had already purchased some options when strike prices of $5.50 and $6 were available prior to when the Commission approved the stipulation in October of 2000. And so the strike prices that were available later on were probably a lot higher than what would have been available earlier.

Q. So you're aware that Laclede made purchases after that point where it also had substantial gains, are you not? I mean, that's embedded in your analysis, isn't it?

A. That's correct. There were some gains, and there were some larger gains that were foregone because Laclede traded out of positions that ultimately ended up higher.

Q. Let's just say there were gains, and those gains represented positive dollar amounts; is that correct?

A. That's correct.

Q. And is it your opinion today, is it your testimony today that with additional funding, you don't know whether that would have made any difference?

A. That's correct. That's my testimony.

Q. And would the testimony be the same with respect to if Laclede had ability to use costless collars, you have no opinion today whether that would have made a difference?

A. That's correct.

Q. Okay. And if Laclede had had authority under the PSP to hedge its summer supplies, would you have any opinion as to whether that would have made any difference?

A. No.

Q. Did Staff, after the events of the 2000-2001 winter, hire a consultant to review the hedging practices of various LDCs?

A. Yes.

Q. And can you tell me what his name was?

A. His name is John Herbert.

Q. Was and still is?

A. Correct.

MR. PENDERGAST: Thank you. Approach?

JUDGE WOODRUFF: Yes, you may. Another exhibit?

MR. PENDERGAST: Yes.

JUDGE WOODRUFF: Exhibit 14.

(EXHIBIT NO. 14 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

BY MR. PENDERGAST:

Q. And on behalf of Staff --

JUDGE WOODRUFF: I'm sorry. Before you begin that, let me interject something here.

It's now almost twelve o'clock, and as you're probably all aware, we need to be breaking today at about two o'clock to allow Catch-Up/Keep-Up discussion to go on in this room. What I propose to do is to go ahead and pass twelve o'clock until about one o'clock, rather than taking a lunch break and coming back. Is that going to create a hardship for anybody? We'll break about one o'clock then.

MR. BATES: Excuse me, your Honor. Just so I understand, we're breaking at one o'clock until after Catch-Up/Keep-Up?

JUDGE WOODRUFF: Yes. Catch-Up/Keep-Up may very well take the rest of the day. So we'll probably break at one o'clock and then come back at 8:30 tomorrow morning. Is that acceptable to everyone?

(No response.)

JUDGE WOODRUFF: You may give me some guidance if you do want to continue after Catch-Up/Keep-Up. I'm not involved in that. Do you expect that will take the rest of the day?

MR. PENDERGAST: It's taken quite a long time already. I suspect it probably could, but I can't say for sure.

JUDGE WOODRUFF: That was kind of the thing I got from Judge Ruth, that it might take most of the rest of the day.

MR. MICHEEL: Maybe we should just finish with Mr. Pendergast's cross-examination of Mr. Sommerer and end there for the day.

JUDGE WOODRUFF: That's kind of what I was thinking. I don't know how much further you have to go on it.

MR. PENDERGAST: I would say we probably should be able to do it by one.

MR. MICHEEL: I mean, I'm willing to come back after Catch-Up/Keep-Up, but it's just hard to know how long it's going to last when I have no clue what they're going to ask.

JUDGE WOODRUFF: Let's plan on breaking for the day at one o'clock then.

MR. PENDERGAST: Very good.

JUDGE WOODRUFF: Go ahead.

BY MR. PENDERGAST:

Q. Mr. Sommerer, do you have the document that's been marked as Exhibit 14?

A. Yes.

Q. And you referred to Mr. Herbert as somebody who had been retained by the Staff to analyze the hedging practices of the state's LDCs during the 2000-2001 winter; is that correct?

A. That's correct.

Q. And did he ultimately submit a report with respect to his evaluation?
A. Yes.
Q. Okay. And was that report submitted in March of 2002?
A. Yes.
Q. Okay. And I'd like to refer you to the attached pages from that report that are contained at pages 26 and 27, that reflect pages 26 and 27, and if I could just ask you to read through that until you're familiar with it.
A. (Witness complied.) Okay.
Q. Are you ready?
A. Yes.
Q. Okay. And in your view, was Mr. Herbert retained to review the hedging practices of various LDCs under whatever programs they had in effect during the 2000-2001 ACA year?
A. Yes.
Q. Okay. And was he under instructions to do an accurate review?
A. Yes.
Q. Was he under instructions to try and obtain an understanding of the programs?
A. Yes.
Q. Was he under instructions to provide a report

summarizing his evaluation of those programs?

A. Yes.

Q. Including how they worked?

A. Correct.

Q. And what his opinion was of their features and their effectiveness?

A. Yes.

Q. Okay. And do you believe he fulfilled those responsibilities?

A. Yes.

Q. Okay. And that that evaluation is presented in this report dated March 2002; is that correct?

A. Certainly that is a summary of his conclusions. He continues to be retained for various cases, various hedging cases.

Q. He's, in fact, being used in the MGE case; is that correct?

A. That is correct.

Q. But you have obviously not chosen to use him in our case; is that correct?

A. That's correct.

Q. Okay. I'd like to refer you to the last two paragraphs. First of all, the program he's discussing on pages 26 and 27, he doesn't specifically mention Laclede, but there's no doubt in your mind that he's talking about the Laclede PSP program; is that correct?

A. That's correct.

Q. Okay. And if I could ask you to turn to the last two paragraphs on page 27, and in particular read the next-to-last paragraph for me, beginning with "if the company."

A. If the company purchased the insurance it had an opportunity for an additional return. If it closed out the position prior to the last three days of the contract, it received a portion of any gains associated with the contract.

Q. Okay. Is there anything, anything at all in that paragraph that reflects Mr. Herbert's observations regarding the PSP program during the 2000-2001 ACA year that would suggest that Laclede's retention of those gains that he refers to in that sentence were conditioned on whether or not those gains were greater than what the gains might have been had Laclede held them to the last three business days?

A. Well, if you look at the phrase "if the company purchased the insurance," which the company didn't purchase the insurance, I think Mr. Herbert might be referring to a situation where the company went ahead and did buy the requisite amount of price insurance, and any gains associated with the contract then would flow through.

Q. Well, if he says that when the company received a gain by selling an insurance prior to its maturity the customers would necessarily be exposed to price risk; is that correct?

A. Where are you reading at?

Q. That's the last sentence.

MR. BATES: Excuse me, your Honor. I wonder if Mr. Pendergast could ask questions not calling for speculation.

JUDGE WOODRUFF: Is that your objection?

MR. BATES: Yes, your Honor.

JUDGE WOODRUFF: That it's speculative?

MR. BATES: Yes.

JUDGE WOODRUFF: I'm going to overrule the objection. He can answer it if he can.

THE WITNESS: The last sentence says, When the company received a gain by selling the insurance prior to its maturity; however, the consumers would necessarily be exposed to price risk unless a physical deal was coupled with a financial deal at the time the financial deal was completed.

To me that's not clear whether he's still assuming that gains would be flowing and whether the insurance coverage would have been achieved in full if just part of the insurance coverage would have been achieved. I can't tell.

BY MR. PENDERGAST:

Q. So you're not sure what he means?

A. I think his comments are fairly general, and I understand them from a general standpoint, but they were never meant to be specific.

Q. Well, he does say, though, does he not, that if we closed out our position prior to the last three business days, it received a portion of any gains associated with the contract; is that correct?

Does he say that?

A. And, again, it says if the company purchased the insurance. I mean, it's part of the same -- same paragraph.

Q. Well, let me ask you this: Was he reviewing the program as it operated during the 2000-2001 PSP period?

A. Yes, he was.

Q. He wasn't reviewing it for the year before, was he?

A. That's correct.

Q. And he wasn't reviewing it for the year after, was he?

A. That's correct.

Q. Okay. So he reviewed it as the program actually operated; is that correct?

A. That is correct.

Q. And based on his review as the program actually operated, does he conclude there, if Laclede closed out its position prior to the last three days of the contract, it received a portion of any gains associated with the contract?

A. And I cannot come to that conclusion based upon what I'm reading there.

Q. Well, what conclusion do you come to as far as what he's saying when he says, if it closed out the position prior to the last three days of the contract, it received a portion of any gains associated with the contract?

A. Well, he may mean one of two things. He may mean that Laclede's claimed gains, which he doesn't say here, but that's what he may mean, since it's given in a general context, or he may mean that assuming that Laclede had bought the insurance, that these would have been the gains associated with the last three days.

Q. Well, he says it received a portion of any gains. How does he qualify that?

A. It's qualified by the words themselves. It says, we know that Laclede received proceeds, and part of those proceeds were returned to the customers. Part of the proceeds Laclede is attempting to have flow to the stockholder.

I think simply -- my interpretation of this is that he believes Laclede has made claims for gains, but I don't think he's made any ultimate decision on how those gains should be calculated, and I know he certainly didn't have detailed input on Staff's position that there are certain terms that are undefined in this program.

Q. Well, did he review the tariff?

A. I believe he did review the tariff, yes.

Q. Did he review the program description?

A. That's my understanding, yes.

Q. Did he review material relating to how Laclede performed under the contract during that year?

A. I know that he reviewed materials from GO-2000-394, and a lot of discussion took place about the operation of the PSP in that case. You might recall that was the case number that was associated with Laclede's renewal -- attempt to renew to -- attempt to renew it to Year 4.

So he was aware of quite a few of the circumstances, but whether he was reviewing each call option like the Staff did, I don't think he got into that amount of detail.

Q. And when it says the closed out the position prior to the last three days, would that be intermediary trading, Mr. Sommerer?

A. Yes.

Q. Closing out the position, if it received a portion of any gains, when he uses the term "portion of any gains," is that to distinguish it from the portion that goes to customers?

A. Yes.

Q. Okay. And when he uses the words "any gains," does that connote to you any and all gains that it was entitled to a portion of it?

A. Again, I think he's making a general statement, and to me that denotes any gains. It's a broad statement, and his statements seem to say any -- any gains that associate with that particular contract. Seems to me like his words have to speak for themselves.

Q. Is it -- is it not only broad but unqualified?

A. Well, I think he qualifies it by saying, if the company purchased the insurance. And to me, again, the statement can say if the company would have purchased the insurance.

Q. You're saying that's what it could say?

A. Yes.

Q. Okay. But that's not what it does say, is it?

A. The words are "if the company purchased the insurance." Those are the words.

Q. In any event, there is nothing in this document that suggests that the company's reception of a portion of any gains was subject to a later determination of whether the proceeds it received were greater or less than the proceeds it might have received had it held it until the last three business days; is that correct?

A. I think that's correct, yes.

Q. You talk in your testimony about the gas cost increases during the winter of 2000-2001, and we've already had some discussion about that, Mr. Sommerer. And you've indicated that you don't know if any of the revisions that the company had proposed, had they been implemented, would have modified those increases; is that correct?

A. That's correct.

Q. Okay. Do you know or did you examine what gas prices did the subsequent year?

A. I'm certainly familiar with what happened the subsequent year. I don't know that I can quote the monthly indices for you, but generally, yes, prices went down from the spring of 2001. And as compared to today's environment, they were relatively low.

Q. Well, you mentioned MGE and AmerenUE in your surrebuttal testimony; is that correct?

A. That's correct.

Q. Okay. And you talk about how MGE has been the recipient of an $8 million disallowance; is that correct?

A. That's correct.

Q. Is that for the 2000-2001 period?
A. Yes.
Q. Do you know how many millions of dollars below MGE's rates Laclede's were during the 2000-2001 ACA period?
A. The PGA rate?
Q. Yes.
A. That analysis is very difficult to make, because part of Laclede's storage is in rate base and it's non-margin cost. So I was aware of that and I knew Laclede's PGA rates were lower than MGE's rates, but there is a reason. There's a ratemaking reason for that.
Q. We'd be happy to correct that if you'd like, Mr. Sommerer.
A. Not necessary.
Q. Not necessary. Make your calculations easier. But you don't have any idea of how much lower they were?
A. No.
Q. Or whether or not you would contribute that to what Laclede might have included in base rates as far as storage is concerned?
A. That would be very difficult. That would be a cost study.
Q. How about comparison with AmerenUE's rates?
A. They tend to be lower. Ameren's main system, its bigger system is the central system. They receive

service off the Panhandle Eastern Pipeline Company. Laclede's main supplier is MRT. MRT's rates are a lot lower than Panhandle rates are.

So, again, you have a hard time making comparisons between the two PGA rates on an absolute basis. In fact, Ameren probably has different levels of storage, and I know you have the same problem. You run into the same problem Laclede has, that aquifer storage field in its rate base.

Q. But despite those difficulties Staff has proposed in the past incentive mechanisms based on that kind of comparison, has it not?

A. That is correct.

Q. Okay. And what I'm asking you is, do you have any idea how Laclede's PGA rates, including the winter of 2000-2001 and the subsequent year, compared to either MGE's or to AmerenUE's?

A. If you look at the PGA rates by themselves, alone, I would say that Laclede's PGA rates on an absolute base, again all of those other things being equal, are lower. Now, there are instances. I can point to you where Laclede's rates were higher than Ameren's back in 2000, I believe it was. Perhaps it was January 2001, you had a fairly significant PGA filing, and that was probably an instance where your PGA factor was higher than Ameren's.

Q. Yes. What I'm saying, taking that into account, I mean, fully reflecting that in the comparison and looking at it on a cumulative basis, Laclede's would still be lower even without taking into account AmerenUE's, that would be your suspicion?

A. Based upon what you see in the tariff sheet, and again, I'm reluctant to do it because it's an apples and oranges comparison, but if you look at the PGA rate numbers, you would see that Laclede is usually lower than Ameren or MGE.

Q. Okay. If I could direct you to your direct testimony. While I'm doing that, I've got one more exhibit to hand out.

JUDGE WOODRUFF: This will be Exhibit 15.

(EXHIBIT NO. 15 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

BY MR. PENDERGAST:

Q. If I could direct your attention first to page 13, Mr. Sommerer, of your direct testimony. Do you have that?

A. I'm there.

Q. Okay. And at lines 11 to 13, you say, The Staff believes that savings under the cost reduction component of the PSP cannot be shared with this company unless the overall early trading was indeed favorable and resulted in savings and not merely proceeds; is that correct?

A. That is correct.

Q. Okay. We had our discussion earlier about reductions to PGA expense and what that means, as far as your dictionary definition of savings is concerned. Do you recall that?

A. Yes.

Q. Okay. You were asked a question, were you not, about -- and by overall trading, do you mean intermediate trading as that term's defined?

A. Yes.

Q. Okay. And if I could refer you now to what's been marked as Exhibit 15, that includes Staff's responses to Laclede's Data Requests. Does that look familiar to you?

A. Yes.

Q. And if I could direct your attention to page 5, Data Request No. 20. Do you have that?

A. I'm there.

Q. Okay. And does that question say, Please state where in the PSP program description it states that overall trading must be favorable, as that concept is defined, used or contemplated by you in your testimony; is that right?

A. That's correct.

Q. Okay. And you say that comes from the program description; is that right?

A. Yes.

Q. Okay. Would you please refer to the section of the program description that you're talking about?

A. That is found on Sommerer Direct Schedule 6-4, which is on page 4 of the program description under the overall cost reduction incentive.

Q. Okay. Would you please read the language that you were referring to to support your contention that early trading or intermediate trading is supposed to be favorable?

A. Yes. It says, Savings 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 business days of NYMEX option trading shall be shared by the company and its customers according to the following schedule.

And Staff has maintained consistently that the term "savings" is somewhat vague and that the cost of the program has become somewhat vague, because Laclede no longer has price protection, and that favorable is simply a word that modifies the general activity that happens prior to three days, next to the closing of the option. And so favorable option purchases are generally the same thing as intermediate trading activity.

And it just -- and my interpretation of that phrase simply means that savings need to be favorable, and savings are favorable by definition, and that we need to make sure we understand what that specific term means in the context of this -- of this provision.

Q. Let me ask you this, Mr. Sommerer: Does it say favorable intermediate trading?

A. No.

Q. And by "it," just to be clear, we're talking about the program description overall cost reduction incentive section; is that correct?

A. That's correct.

MR. PENDERGAST: Can I have just a few moments?

JUDGE WOODRUFF: Yes.

BY MR. PENDERGAST:

Q. Just a couple more questions, Mr. Sommerer.

Let's say that prices have not increased in January but had instead declined under December levels. Would you be proposing an adjustment in this case?

A. Well, the only way you would propose an adjustment is if you had a disagreement with the company, and you would have to evaluate the company's calculation. We would calculate it -- or evaluate it the same way we did here. So I don't know how that would affect Laclede's claimed sharing of 4.9 million. If there was no claim for sharing, then I suspect that the Staff would not have gone any farther with it.

Q. Let's say that Laclede made all the proceeds that it actually made in November and December -- excuse me. I'm losing my voice -- but that prices for January declined instead of increased, so that Laclede's sale of those options earlier turned out to be -- produce proceeds that were above what would have been the case if it had held them until January. Under those circumstances, would you be proposing an adjustment in this case?

A. Well, in fact, I think we would be consistent with our methodology, which makes a comparison between what Laclede actually did in terms of proceeds versus what would have been achieved had the $4 million been spent, the Staff's position in this case. So however those numbers would have come out would have been Staff's position.

Q. So if prices had declined, you would not have proposed an adjustment?

A. If prices would have declined, then I don't think you would have seen many proceeds from the Staff's method. You would have seen the proceeds from Laclede's early sales because the options wouldn't be in the money, so I don't think you would have a Staff adjustment in this case.

Q. And just to clarify, you talk about the ability to buy -- potential ability to buy options at $4, but as of early March, under a 70 percent program, the cost of options was at 4.70; is that correct?

A. That's assuming a 70 percent coverage of Laclede's normal gas supply, yes.

Q. And from that time forward, did they -- was there ever any material decline in those prices?

A. Not a material decline, no.

Q. Was there a fairly material increase later on?

A. Well, there was a certain amount of time in March and probably in April, I recall, where the 4.70 still was achievable. But as you got into May, prices did start to jump up significantly, and that affected the options cost.

Q. Okay. And do you recall when the company and Staff met shortly after it filed its letter on the price protection incentive, the company showing Staff various slides about what kind of protection you would get with $10 million in option purchases versus 6 million versus 8 million? Does that ring a bell with you?

A. I do recall that the company did have a handout which, to the best of my recollection, did discuss the various strike prices and the cost of those strike prices.

Q. Okay. And do you recall the company mentioning anything about how it would be much better to -- if you were going to look at the potential impact of rising prices, to look at the 1 to 2 percent variance in a customer's overall bill associated with going from $4 to $10 million versus the risk of gas prices increasing by $50 or $60 million? Does that sound familiar to you?

A. I know that Laclede has supported the purchase of call options based upon that philosophy, but I cannot tell you if that was discussed in that meeting. I don't recall.

Q. You don't recall. Okay. And just so I'm clear, if Laclede bought a call option for November, say at 4.50 with a strike price, later sold it for $3 profit, that's $3 net coming in after the cost is taken care of, but prices later went up to $4 during the last three business days, that $3 gain you would consider a loss; is that correct?

A. We would make a comparison between what the option had brought in if you had held it during the last three business days versus what Laclede was able to bring it.

Q. Right. And what I'm saying is that, under your analysis, even though Laclede had $3 in cash money coming in, net money, that would be considered a loss under your analysis; is that right?

A. I think it would be considered a trading gain, like a speculated -- speculator -- excuse me -- would make. Certainly you could look at it in that context and say, if all I had to do was buy that particular option and see if I had a profit from the option, that's a speculative gain.

But in terms of hedging, there's another piece to it, as you know, and it was the CPL piece, the guaranteed strike price piece, and that's what Staff's tried to recognize here.

Q. And what I'm asking you, Mr. Sommerer, is, under your analysis and your approach, if I came in and I made $3 on that call option of cash money, would you consider that a loss to the company's customers in the event you could have gotten $4 in the last three business days?

A. Certainly we would not treat it as a gain. It would not be a gain.

Q. On the other hand, if Laclede came in and it made $2 on an option but the sale price for that during the last three business days was $1, you would consider that to be a gain?

A. That's correct.

MR. PENDERGAST: Okay. I have no further questions, but I would move for the admission of Exhibits, I believe it's 10 through 15, or 9 through 15.

JUDGE WOODRUFF: 9 through 15. Exhibits 9, 10, 11, 12, 13, 14, and 15 have been offered into evidence. Any objection to their receipt?

MR. BATES: No objection.

JUDGE WOODRUFF: Hearing none, they will be received into evidence.

(EXHIBIT NOS. 9 THROUGH 15 WERE RECEIVED INTO EVIDENCE.)

MR. PENDERGAST: Thank you, Mr. Sommerer.

JUDGE WOODRUFF: It's time to come up for questions from the Bench, then. And before I give Commissioner Gaw a chance to speak, I do have a general question about your testimony. And that comes up from the fact that some testimony that was previously indicated was highly confidential is not highly confidential anymore, based on the agreement of the parties.

There's a number of items in your testimony that are marked as highly confidential. Is anything in this testimony highly confidential after these changes, or is everything now public?

MR. SCHWARZ: Judge?

JUDGE WOODRUFF: Yes?

MR. SCHWARZ: I think that's a question that Laclede should answer.

MR. PENDERGAST: Could we confer on that for just one minute, your Honor?

JUDGE WOODRUFF: Can you? In fact, I'll give you 'til tomorrow to tell me. What I'm trying to do is make sure we have a clear record as to what is highly confidential and what isn't so when I go to write the Report and Order, that I don't stumble over something and don't know whether it's highly confidential or not.

MR. PENDERGAST: Certainly.

JUDGE WOODRUFF: So if you can tell me, get with Staff and the other parties and tell me what is and is not highly confidential.

MR. PENDERGAST: We will be prepared to do that.

JUDGE WOODRUFF: Okay. Thank you. Then I'll hand it over to Commissioner Gaw. You can go ahead and ask your questions.

COMMISSIONER GAW: Thank you, Judge.

QUESTIONS BY COMMISSIONER GAW:

Q. Good afternoon, Mr. Sommerer.

A. Good afternoon.

Q. Would you give me an idea about when this incentive program that was in effect 2000-2001, when was the initial genesis of that incentive program?

I'm not talking about when it became what it was in 2000-2001. When did it start?

A. The Commission Order authorizing that incentive plan is attached to my testimony, and that appears in Exhibit -- or Schedule 2 to my direct testimony.

Q. All right.

A. And if you look at the date of the Order, I believe the date of the Order was June 15th, 1999. And so that's when the Commission, the majority of Commissioners authorized Laclede to have an incentive plan that was part of their PSP program, and that wasn't effective until the winter of '99-2000.

Q. All right. And, again, I know this is in the record but I want you to, in general, tell me what that program was made up of, the incentive program.

A. Okay. That incentive program had two elements. It had a price protection feature and it had a cost reduction feature.

The price protection feature was designed to encourage Laclede to get as low a strike prices as it possibly could. And in order to evaluate whether it was getting a low strike price or not, they had to derive a benchmark, which was the reason for this term TSP, target strike price.

And so Laclede had to decide on a particular month that it was good to develop that benchmark, and I think the theory was, well, March is sort of a shoulder month and hopefully gas prices will be down. They tend to be down in March, and so let's come up with a target to see what the prevailing cost of options are in March. So that's the reason for the TSP.

The CPL was a 50 cent adder to the target strike price. Ultimately that became the foundation for the guarantee that Laclede made as part of this program. And so if you had a $4.70 target strike price that was developed based upon using this $4 million which was coming in from the ratepayers as a funding level, you could get a CPL or an catastrophic price of $5.20. It was just adding that 50 cents and establishing what the guaranteed price was going to be.

And so for the price protection incentive, there were various grids that were set out in the program description, and depending upon where Laclede's ultimate strike prices were that it was able to obtain fell within those grids it would receive a certain amount of the realized gains. So that was the price protection incentive.

As part of that, Laclede had a guarantee in its program description that said if its strike prices were greater than the CPL, greater than $5.20, it would be obligated to provide credits back to bring the cost back to the guaranteed strike price.

So they were obtaining a certain amount of insurance for $4 million, a certain premium, and certain volumes were covered at a certain strike price guarantee. And they were able to make money any time the strike price went below -- let's say the TSP, for example, they got a certain level of those sharings.

Q. All right.

A. The other aspect of this was that overall cost reduction element. And that was meant to encourage Laclede to keep the cost down as low as possible for obtaining insurance, so that when you looked at their premium expenditures and you looked at any savings that they may have had for call options that they traded prior to the last three days, which was supposed to set their guarantee, Laclede had the potential of making money that way. And that had a certain grid to it as well.

So to the extent it drove its costs down below this sort of benchmark of the MRA, the $4 million level, it was incentized to share in those savings.

Q. And that was -- that's the description of the program as it first existed?

A. That's correct.

Q. All right. And that was for what winter again that it was first implemented?

A. The first winter it was effective was for the winter of 1999-2000.

Q. All right. And how did the program fair in that winter, that time frame?

A. In that winter, Laclede did get the appropriate 70 percent coverage. They covered their volumes. They had a strike price that was calculated based upon the target strike price and they lived up to that. In other words, they had those -- those options in effect.

But because gas prices were low that winter, the options never went into the money, which means that the strike prices were perhaps at $4, let's say, but gas costs were only at 3.

Q. All right.

A. And so there weren't any realized gains coming from that aspect. Now, Laclede didn't spend the entire $4 million. It was able to, I think, procure that guaranteed protection for, let's say, $3,900,000.

Q. All right.

A. So it was close to $4 million, and they calculated their savings for that year as the difference between the MRA, the $4 million and what they thought the price protection for $3,900-some-thousand. And I think their share that year, the stockholder share was perhaps $40,000, something like that, $30 to $40,000.

Q. And did -- as far as the ratepayers were concerned that year, what was the -- was there any realized benefit when you look at that program in that year, with the prices remaining lower and this stabilization of the insurance being procured?

A. I think it's analogous to an insurance policy. I mean, obviously there's some benefits in having a $100,000 insurance policy on your house. You could then have the fire.

Q. Yeah. No fire in this case. The prices didn't spike. So the ratepayers paid for the insurance, but there wasn't any occurrence, so they paid for the protection, but they didn't receive any proceeds because there was no reason to?

A. That's correct.

Q. And because -- if I understand this correctly, because Laclede was able to procure the insurance at a cheaper price than might have otherwise been obtained, they got a little bit of money to them, somewhere around 40,000?

A. That's correct.

Q. I just want to make sure I'm tracking with you.

A. So far you're absolutely there.

Q. Okay. So that's -- Staff -- what happened with that year, by the way, as far as this issue was concerned? Was there any complaint from Staff or from anyone else?

A. Staff had one comment and a recommendation, and I don't recall whether it was in an ACA recommendation or not.

But our concern with it was that, in looking at the various statements that Laclede had for procuring the strike prices or the call options, we noticed that sometimes it was able toe obtain strike prices for, let's say, $3.50 at a certain premium, and sometimes it was able to obtain for a similar time frame, similar amounts of protection, for example, but different strike price less premium, so they'd get it at $4 for certain call options.

And I looked at it and I knew that, generally speaking, that $4 million requires that you buy call options at about 12 cents an MCF. Mathematically, that's pretty well what it comes out to in a traditional call option program.

Q. Okay.

A. And so I saw that the $4 was being purchased at perhaps 10 or 9 cents, and perhaps you could have gotten 3.50 strike at 13 cents, maybe a little bit higher than the traditional average premium rate that you would pay.

And the question that I had was, is it better to really hedge 100 percent of your supply, almost overhedge, and get a whole bunch of protection at $4 but a very high deductible, or is it better to get a little bit less protection in terms of overall volumes covered but your deductibles are less, your strike prices are less.

And to me it just made more sense to get the lower strike prices and stay with that 70 percent, rather than going to 80 or 90 percent coverage levels and get higher strike prices. And so that was my criticism of -- of Year 1. That was Staff's point.

Q. Did anything happen as a result of that critique?

A. Not in my opinion, no.

Q. All right. So rollover in the first year is basically uneventful, from what you've just described. Would you agree with that?

A. I would agree with that, yes.

Q. All right. Go into the next year, which would have been, what, the winter of 2000-2001?

A. Yes.

Q. All right. Now, we get into March of -- let's go -- I guess we're talking about March of 2000?

A. Yes.

Q. Is that supposed to be the beginning of the next year's program as far as the issue of procurement is concerned?

A. Well, various companies start at various times. When they start looking at next winter's activity, some start earlier than others, but in terms of the PSP program, that was sort of the starting month, because that's when the -- the benchmarks were set. That's when the PSP was set.

Q. All right. So when you're looking at it for that year, then, at what point timing-wise -- what happened? Again, I know this is in here, but I want to think this through with you.

A. Right. In March of 2000, Laclede did calculate its TSP, and that's done by simply seeing what the market prices are as it applied to the 70 percent of volumes that you try and cover with $4 million. So it's not a real difficult calculation.

You're quoted the prices, and on certain days in March, you know for a fact that for $4 million you can cover 70 percent of your supply at 4.70. That becomes mathematically the target strike price. The CPL is just 50 cents above that, so it's $5.20.

Q. All right.

A. Gas prices during that time period, I recall them as being relatively stable. I looked at this once before. It's been some time, but what I saw was in March and April, Laclede had a lot of opportunity to really lock in 70 percent of their volumes for 4.70, and certainly very easily for $5.20, the little higher catastrophic price level.

And it wasn't until early May that you had a lot of increased volatility and increased prices, and what happened in May really translated into the options market as well. As you started having higher natural gas prices, the volatility of the options market increased.

Q. When you look at the time frame immediately before March of 2000, do you recall what the market was doing at that point in time?

A. I think it was a low price environment.

Q. When you say low price environment, tell me specifically what that means to you.

A. I want to say that -- and this is going by recollection -- that prices were 2.50 perhaps.

Q. All right. And you say they -- by the time you got to March, they had gone up. Had they gone up to that range of 4.50, 4.70? What did you say?

A. The target strike price was 4.70. And you really have -- when you're talking about a futures contract or the actual gas price in the spot market, it's a little bit of apples and oranges because the strike price is going to be well above the current market price.

Q. The future prices, it seemed to me, before March, though, for similar time frames, do you recall whether or not there was upward movement occurring in, say, January and February, as compared to March, for futures prices in -- if you recall?

A. Yeah. To the best of my knowledge, it's something that could be easily checked, but just based upon my recollection, I think it was not a volatile price period. It was a low price period.

Q. And fairly stable?

A. Yes.

Q. And that's -- of course, I'm sure someone can provide us with an exhibit that illustrates that at some point.

A. I could do that very easily.

Q. All right. If -- and what happened in March with Laclede? What did they do in regard to procuring anything under the plan?

A. I'll have to refer to my schedule here.

Q. All right.

A. Okay. Schedule 9 in my direct testimony has a listing of all the call option activities. So if we want to find out what happened in March, we can go through November activity that's on Schedule 9-1. December activity is on Schedule 9-2, January 2001 is 9-3, February 2001 is 9-4, and March 2001 is on Schedule 9-5.

And these are summarized by option contract. So in order to see what Laclede was doing in terms of call options, you go over to the first column and you look at the date purchased, and they did have some purchases, relatively few, almost none, February 29th, 2000. It looks like they tested the market and bought a contract for each one of the months at those strike prices at those premiums that are reported there.

So the activity was not very material during March. It was just almost kind of testing the prices and establishing just this first very minor position in the market.

Q.   Was it Staff's belief that the incentive program that was being implemented would have resulted in significant activity in March of any particular year?

A.   The Staff was concerned when this program was originally approved, and it was approved over Staff's objections. And so that as a Staff member, I would have hoped that there would be some substantial positions being placed later on just to diversify the risk, almost like a dollar cost averaging. But I can say that we weren't convinced of that even back in 1999 or whenever we litigated it the first time.

Our concern was that this 90-day window could offer a way to just wait and see, and then if things didn't turn out and you didn't get in as a company, you could just say that you had a terrible market, radical change, and then there wasn't much of an obligation there left.

Q. And as I understand it, Laclede had the option to bail out of the program; is that correct?

A. That's correct.

Q. So are you saying that -- that -- when would that 90-day window have been in effect for 2000-2001?

A. According to the program description, that 90-day window started after the establishment of the TSP, and the TSP was established, I think, about the middle of March. So it's 90 days from the middle of March.

Q. All right. So March, April, May, June, middle of June, right?

A. Probably around June 10th or so.

Q. And during that 90 days, what occurred in regard to futures prices? Let me strike that.

At what point was there a change in, if there was any, the stability of prices after the target price was set?

A. Things really started becoming volatile in May, and my recollection is it was early May. And when the volatility increased and the overall natural gas price -- prices increased, the call options went up even more than the futures price, because the perception is the more that those futures prices might end up being, the more you're going to get charged for premiums. So those premiums went up in a material way in May.

Q. And what kind of prices were we talking about, then, if you recall?

A. This is going by recollection again, as well, but I think we were looking at in middle of May, late May, early June, probably $7, $8 strikes to do the same thing that you could have done with 4.70 back in March.

Q. All right. And would that have been -- the $4.70 amount, was there any change in that in April, if you know?

A. Not much that I recall. I believe April was still full of quite a few days that you had an opportunity to get in fairly close to the target strike price.

Q. All right. And was there any activity -- describe the activity for me, or if you point to it in your schedule, in regard to procurement that occurred from the time the target strike price was established until the volatility that you were describing in May.

A. Well, looking quickly through Schedule 9, 9-1, November 2000 contracts, you really don't have any activity from November option calls until July 26th. If you go to December 2000 contracts, and you're looking at a time after the middle of March, you don't see any activity there either. The first purchases is July 26th of 2000.

If you go to January 2001, you do see some activity there in early May. It looks like a position was put on for 50 contracts on May the 4th, but then subsequent to that time, it wasn't until July 26th, 2000 that more significant activity took place. February 2001, really not any activity until December of 2000 for that February contract. And then finally the March 2001 contract, no activity of significance after March 15th until you get to January 16th, 2001.

Q. Okay. And at what point in time did Laclede bring something to the Commission saying that they did not want to continue the program for that -- for that year, 2000-2001?

A. I think the first notification was the Ken Neises letter, which I have as a schedule in my direct testimony. I believe that letter was filed with the Commission June 2nd of 2000.

Q. It would have been subsequent to the beginning of the volatility that you described earlier in your testimony?

A. Yes.

Q. And that letter describes -- it speaks for itself, I realize -- but, in general, it describes that Laclede wishes to withdraw from the program. Put your own take on it if you would.

A. Well, we've read it many times to try and establish the effect of not only this letter but the subsequent Stipulation & Agreement that removed the price volume requirements.

And as I discussed with Mr. Pendergast, it says specifically here that Laclede is invoking its decision to declare the price protection incentive components of the program inoperable this year. The company will retain no gains under that component of the program or incur any losses resulting from the purchase of price protection above the catastrophic price level established by the Commission, i.e., $5.20 per MMBtu.

So it's silent -- there's no discussion in the letter about this other piece one way or another, whether it's going to continue as is or it's modified in some way by this. Subsequent to June and September of 2000, the Staff did sign a Stipulation & Agreement that said, we can only agree that Laclede no longer has an obligation to cover 70 percent.

We already knew that it didn't have an obligation to credit back to $5.20, and at that time there was also a provision that said any other provisions other than the ones that have been opted out of are still in effect, however that term means, but they're still in effect.

Q. And did Staff interpret that to mean that the other portion of the program was still alive and well?

A. I think Staff's view was that we weren't certain how this was going to come out. We were a lot more concerned that the customer get something, and the Stipulation & Agreement let Laclede get higher strike prices because it was still on the hook for covering 70 percent of some strike prices. It just wasn't obligated for crediting back to $5.20.

So what was apparent to us was they could get into $10 strike prices, $12 strike prices, they could be very costly because now price insurance is very costly. And what kind of protection do you get for those strike prices that are that high?

And so we agreed that it would make more sense, however the program was left to function -- and we weren't sure, I can assure you of that. I've had discussions with other staff. I've had discussions with our main negotiator who was working with Laclede at that time. I was there for the meetings. It was not discussed how this cost reduction incentive would work absent the guarantee being gone.

We knew that it was still effective. We just didn't know how it was going to work at that time. And it wasn't an issue that we really spent any time with. It wasn't brought up, and it wasn't evaluated by Staff.

Q. And if you would, help me to understand a little better the concern that Staff had about the first portion of the -- of your analysis about the strike price not -- not having a cap or having a particular figure. Tell me how that -- how you thought that came into play.

A. You mean with regard to our review of the June letter or --

Q. Yeah. Whatever it was that was a part of your analysis. If you'd spell that out, that would be helpful.

A. Okay. Well, after the June letter, I don't know that the Staff believed it could do a whole lot. I know that the Commission was concerned at that time, because it literally said to its staff, we've just received this letter that looks like Laclede has opted out of a major portion of the program or the program. Please someone explain to us what that letter means. And that created, I think, a series of discussions in June between the company and the Staff.

I believe the company did have a filing. I'm trying to recall the date of it. I think it was July, let's say, where they asked for additional funds for call options. They asked for more flexibility in order to cover volumes, and that could include zero volumes being covered.

And so the Staff never did give a specific response to the Commission's inquiry that was in Case

GO-2000-394 of what the meaning of this letter is. It was more of a response to the Commission after there was an agreement worked out between the company and the Staff saying, this is what we're going to do with it. We've got a program that's been changed in some way. Some unusual things are going on.

Laclede's invoked this market out clause, and it is suggesting that certain alternatives or certain additional things take place. And so our evaluation was what -- is what can we do now that we don't have price protection anymore? And we felt like what we could negotiate was tell Laclede, go out and do what you can, you still have the $4 million of the funding from the customer, but we're not going to hold you to this 70 percent.

Because we knew that could create a situation that Laclede would be forced to get $10 strikes, very high strike prices. So we didn't feel like -- the Staff didn't feel like we had a lot of options, alternatives.

Q. All right. Now, if Laclede would have utilized its ability in March and April to make significant hedging happen, would that have been beneficial to the customers of Laclede if that hedging had occurred for the 2000-2001 winter?

A. Yes. I've got a schedule that really illustrates that, and it simply reconstructs what would have happened had the company went ahead and locked in, I think it was at 5.20, and just spent 4 million but locked in during March at the guaranteed price level. And I think that schedule is located at Schedule 5 to my direct testimony.

And my analysis there simply attempts to quantify the proceeds that would have resulted had Laclede contracted for the 70 percent guaranteed coverage and done so at the catastrophic price level that was available back in March of 2000, and held those options until the last three business days.

Q. And what is that -- what does your schedule show as a conclusion?

A. The proceeds would have added up to $63,418,640.

Q. Okay. I recognize there's all sorts of potential criticisms about looking backward and using these numbers, Mr. Sommerer, so I want you to analyze this from a different perspective and looking forward.

If I understand you correctly, your suggestion is that the rationale for setting the target strike price in March is that that traditionally has been the time of year when prices tend to be on the lower side. Is that fairly accurate?

A. That's my recollection of how Laclede had proposed the program.

Q. And so the thought was when the program was at least initially proposed to the Commission, that that March/April time frame would have been an appropriate time to at least get heavily or start getting into in a significant way that the hedging for the -- was it 70 percent --

A. Yes.

Q. -- figure?

But if I understand you correctly, that isn't what occurred?

A. That's correct.

Q. And the letter, again, that was the first notice that the Commission received saying that Laclede was opting out of that portion of the program was when again?

A. That letter was filed June the 2nd of 2000.

Q. All right. So it was filed toward the end of that 90-day window that you were describing?

A. That's correct.

Q. Maybe a week before the end of it?

A. I think perhaps approximately a week, yes.

Q. And analyzing what ended up happening to customers during that winter without that price protection is what you have done in Schedule 5. Is that accurate or is that a misstatement?

A. Well, I think it gives the proceeds that would have been received had Laclede locked in at the CPL. In all fairness, Laclede did receive $33 million -- approximately $33 million from early trading and from holding options, various options until the end.

Now, that has to be reduced by the cost, and they did spend more than the $4 million MRA. It took them $9 million to generate $33 million. And, again, that was due to the very high gas price increases that put the options into a positive mode.

So if you wanted to compare the difference between holding, had Laclede locked in at 5.20 -- and that's 63 million -- you would have to deduct $4 million for the MRA or the cost. So that's approximately $59 million. And I think Laclede's net is around, let's say, $24 million.

Q. All right. If I move -- and, again, when you're talking about the trading days here, so I understand this whole concept a little better, is it -- what would -- how does that compare with actually utilizing those options and -- that were done, as opposed to reselling?

In other words, in comparison to buying on the open market later on in the year, is that comparison anywhere in any of your analyses?

A. Well, the Staff did conduct another analysis in surrebuttal testimony where we attempted to reconstruct what we believe would have been the impact had Laclede basically spent the $4 million but done so on the decisions that it ended up making.

Now, this wasn't Schedule 5 which sort of assumes that it was all done back in March and you had the company no longer making any trades. The Staff's calculation in surrebuttal testimony is, let's try and step back and reconstruct to see what would have happened had Laclede made their same decision to buy in July, buy some in August.

Whatever their purchases were, we didn't change those, but we did try and allocate the dollars to see when it would have gone through the 4 million and make that comparison between what Laclede actually did versus the Staff's calculation.

Q. Uh-huh. And that's in your surrebuttal?

A. That's correct.

Q. But that -- but the question I'm asking you is, if the purchases had been made in March and April, but that -- and this may be a question that is based on a bad assumption -- but if the -- if you are looking at that actually being held and exercised instead of sold, in other words, and being actually utilized if that's possible, is there a comparison of what that would have done in the total of -- with your figures on Schedule 5?

A. Well, I think it's the same thing, and I might be misunderstanding --

Q. It could be.

A. -- the question.

Q. No. I suspect you're not.

A. I think it's the same thing.

Q. All right. Let me get to -- let me get on to the issue of these trades that --

JUDGE WOODRUFF: If I might interrupt, Mr. Gaw -- Commissioner Gaw, it is about time to go ahead and break. We haven't broken for lunch yet. We did not. And we do have the Catch-Up/Keep-Up at 2:30. So to give everybody a chance to break for lunch, we need to go ahead and break now.

COMMISSIONER GAW: Sure.

JUDGE WOODRUFF: Let me ask the parties while we're still on the record, we do have one more day of hearing scheduled for tomorrow. Is there a concern among the attorneys that we might not be able to finish tomorrow or do we look to be on schedule?

MR. MICHEEL: I would just say it depends on their answers to my questions, your Honor. I think we're on schedule, but --

MR. BATES: Your Honor, I would agree. We still have something like approximately four hours total cross-examination for the two Laclede witnesses, and I would say that we're roughly on schedule at this time.

JUDGE WOODRUFF: Okay. Well, what we'll do then is adjourn until 8:30 tomorrow morning, and we'll see you-all then.

Thank you.

WHEREUPON, the hearing of this case was recessed until 8:30 a.m. on February 14, 2003.

I N D E X

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