Exhibit No.:

Issue(s): Experimental Incentive Price Stabilization Plan

Witness/Type of Exhibit: Busch/Direct

Sponsoring Party: Public Counsel

Case No.: GO-2000-394

DIRECT TESTIMONY

OF

JAMES A. BUSCH

Submitted on Behalf of the Office of the Public Counsel

LACLEDE GAS COMPANY

Case No. GO-2000-394

July 10, 2001

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of Laclede Gas Company's Experimental Price Stabilization Fund.	))	Case No. GO-2000-394

AFFIDAVIT OF JAMES A. BUSCH

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

James A. Busch, of lawful age and being first duly sworn, deposes and states:

1. My name is James A. Busch. I am the Public Utility Economist for the Office of the Public Counsel.

2. Attached hereto and made a part hereof for all purposes is my direct testimony consisting of pages 1 through 22 and Schedules JAB-1 through JAB-5.

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

James A. Busch

Subscribed and sworn to me this 10th day of July, 2001.

Bonnie S. Howard, Notary Public

My commission expires May 3, 2005.

DIRECT TESTIMONY

OF

JAMES A. BUSCH

CASE NO. GO-2000-394

LACLEDE GAS COMPANY

Q. Please state your name and business address.

A. My name is James A. Busch and my business address is P. O. Box 7800, Jefferson City, MO 65102.

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

A. I am a Public Utility Economist with the Missouri Office of Public Counsel (Public Counsel).

Q. Please describe your educational and professional background.

A. In June 1993, I received a Bachelor of Science degree in Economics from Southern Illinois University at Edwardsville (SIUE), Edwardsville, Illinois. In May 1995, I received a Master of Science degree in Economics, also from SIUE. I am currently a member of the American Economic Association and Omicron Delta Epsilon, an honorary economics society. Prior to joining Public Counsel, I worked just over two years with the Missouri Public Service Commission as a Regulatory Economist in the Procurement Analysis Department and worked one year with the Missouri Department of Economic Development as a Research Analyst. I accepted my current position with Public Counsel in September 1999. Furthermore, I am

currently a member of the Adjunct Faculty of Columbia College, Jefferson City Campus, teaching Economics at both the undergraduate and graduate level.

Q. Have you previously testified before this Commission?

A. Yes. Attached is Schedule JAB-1 which is a list of the cases in which I have filed testimony before this Commission.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to present Public Counsel's position regarding Laclede Gas Company's (Laclede or Company) Experimental Incentive Price Stabilization Plan (PSP).

Q. How is your testimony organized?

A. First I will provide a history of the PSP and hedging as it relates to Laclede. Then I will give Public Counsel's recommendation.

THE HISTORY OF HEDGING AND LACLEDE

Q. Please provide a history of Laclede's hedging plans.

A. Laclede's initial hedging plan began when the Commission approved the Stipulation and Agreement in Case No. GO-97-401, In the Matter of the Operation of Laclede Gas Company's Purchased Gas Adjustment Clause, 6 Mo. P.S.C. 3d 418 (1997).

Q. What was the scope of the approved hedging program?

A. As described in the Stipulation and Agreement, an Experimental Price Stabilization Fund was established "for purposes of reducing the impact of natural gas price volatility on Laclede's customers during the 1997/1998 winter season..." (Stipulation and Agreement, Case No. GO-97-401, page 7). To achieve this goal, Laclede could purchase natural gas call options not to exceed $4,000,000. This

money was to be collected from its ratepayers by adding a $.0047 per therm charge in the Company's PGA calculation. The options purchased by Laclede were to have strike prices of no less than $2.80 per MMBtu and no greater than $3.20 per MMBtu, with the caveat that the strikes could be altered if market conditions changed.

Q. Did Public Counsel or Staff have the ability to propose prudence disallowances under this program?

A. No. Neither party could propose any prudence adjustment or other disallowance in connection with Laclede's activities under this plan, provided that the options were within the authorized price range and at prices generally prevailing at the NYMEX (New York Mercantile Exchange) at the time that the purchases were made.

Q. Were there any other basic parameters of the original hedging program?

A. Yes. Laclede was required to protect approximately 70% of expected normal winter (November through March) flowing supplies with the purchase of options.

Q. Please explain the concept of "hedging."

A. According to a definition from NYMEX, a hedge is

> The initiation of a position in a futures or options market that is intended as a temporary substitute for the sale or purchase of the actual commodity. The sale of futures contracts in anticipation of future sales of cash commodities as a protection against possible price declines, or the purchase of futures contracts in anticipation of future purchases of cash commodities as a protection against the possibility of increasing costs.

Q. What is an option contract?

A. An option is a contract that gives the holder the right, but not the obligation, to purchase or sell the underlying futures contract at a specified price (strike price) within a specified period of time for a given premium.

Q. Please give an example.

A. If a Local Distribution Company (LDC) such as Laclede would want to purchase call options to protect its customers from rising prices, it can go to the NYMEX and purchase a call option for a price, or premium. This call option gives the LDC the right, but not the obligation, to purchase a futures contract of natural gas at the strike price the LDC purchased the call option. For instance, if the LDC wanted to cap the prices its customers were to pay at $5.00, the LDC could buy a call option with a strike price of $5.00. This option would have a cost called a premium. Currently, a $5.00 strike price for a January 2002 option has a premium around $0.35 per MMBtu. By paying this premium, the LDC has capped the price it will pay for natural gas at $5.00, the strike price, plus the premium. If the actual price of natural gas for January is below $5.00 per MMBtu, then the LDC is just out the premium it paid. If the price is above $5.00, the LDC would exercise its option, thus insuring the price its customers pay is only $5.00, plus the premium.

Q. What volume of natural gas does a LDC protect by purchasing one contract?

A. One futures contract, and therefore one options contract, covers 10,000 MMBtus. So in my example above, to lock in prices at $5.00 with a $0.35 premium would cost the LDC $3,500 per contract (10,000 * .35).

Q. What was the duration of Laclede's initial hedging plan?

A. The initial design was for one winter heating season. In the spring of 1998, two modifications were made to the plan for the 1998/1999 winter heating season. The first modification was to limit the strike prices that the Company could purchase to under $4.00 per MMBtu. The second modification prohibited the Company from

selling out of its positions prior to the third day before expiration. These modifications were approved by the Commission in Case No. GO-98-484 with an effective date of May 29, 1998.

Q. How did the ratepayers benefit during the first two years of this program?

A. The ratepayers benefited by having price protection on a majority of the normal expected flowing winter volumes.

Q. Were any of the options exercised during the first two years of the program?

A. Very few. This was due to favorable price movements during those winters. According to a report from Laclede concerning its first year's activity, Laclede spent ** _____ ** on the purchase of call options and realized ** _____ ** in gains from the sale of those options.

Q. How long was this second plan in effect?

A. One year. In June 1998, Laclede filed for an expanded experimental incentive price stabilization plan (PSP). Within this filing, Laclede proposed to make significant modifications to the hedging program. Upon reading the opposition to its modifications in Staff's testimony, Laclede proposed additional changes in its surrebuttal and eventually gained Commission approval by a 3 – 2 vote, with dissenting opinions, in Case No. GO-98-484 for the current plan that is in effect.

THE CURRENT EXPERIMENTAL INCENTIVE PSP

Q. Please describe Laclede's current experimental incentive PSP as approved by the Commission in Case No. GO-98-484.

A. Laclede is obligated to hold call options on 70% of its gas supply purchase requirements, assuming normal weather, for the months of December and January,

and 70% of its aggregate supply purchase requirements, assuming normal weather, for the months November through March. (Laclede's Description of Incentive Price Stabilization Program, page 1, referenced to in Laclede's tariff sheet P.S.C. MO. No. 5 Consolidated, Second Revised Sheet No. 28-e) To procure these call options, Laclede is still authorized to collect $4,000,000 from its ratepayers. In addition, the ratepayers must pay transaction costs during the term of the experimental incentive PSP. The program has a term of 3 years, which expires after this winter heating season.

Q. Please continue.

A. ** _____ **, a Target Strike Price (TSP) is established based on option prices for the upcoming winter. Once the TSP is set, a Catastrophic Price Level (CPL) is set ** _____ ** The TSP is the minimum price guarantee on the program's pre-defined volumes for the upcoming winter (ibid. page 2). Laclede then has two ways in which it can profit.

Q. Please describe how Laclede can profit from the experimental incentive PSP.

A. The first way Laclede can profit is by liquidating the options that are "in-the-money." This means that the actual price is above the strike price of the option. Of the gains realized from strikes above the CPL, the ratepayers shall retain 100% of those gains. For gains realized from strike prices between the TSP and the CPL, 75% of the gains go to the ratepayers, and the Company retains 25% of the gains. Finally, for gains realized from strike prices below the TSP, 40% of the gains shall go to the ratepayers, and the Company retains 60% of the gains as profits. Also, if the Company has strike prices above the CPL, the ratepayers would receive 100% of

the difference between the lower of the strike price or the average of the last 3 days before expiration. However, the Company can decide within 90 days to opt out of this portion of the plan. This means that there would be no price protection to the consumers, and Laclede can not profit from these activities.

The second profit area is from Laclede's ability to trade in and out of positions. By "reducing" the cost of the program below the $4,000,000, Laclede can profit from those activities. Laclede retains 40% of reductions up to $6,666,666 and 60% of reductions greater than $6,666,666.

Q. On what date does the experimental incentive PSP expire?

A. There is not an exact date when the experimental incentive PSP expires. As stated earlier, the program was for the three winter heating seasons, beginning with the winter of 1999/2000. The winter of 2001/2002 will be the last year of the program. No options will qualify under the program once the March 2002 options expire in late February 2002. The charge that the ratepayers are paying in the PGA rate will end with the Company's 2002 Winter PGA rate filing in October or November of 2002. The final reconciliation will also occur during the 2002 Winter PGA filing.

PUBLIC COUNSEL'S RECOMMENDATION

Q. What is Public Counsel's recommendation concerning Laclede's experimental incentive PSP?

A. Public Counsel recommends that the Commission allow the experimental incentive PSP to expire after this winter heating season.

Q. Why does Public Counsel recommend that the program end?

A. Public Counsel believes that the program has not achieved its goals. The program did not provide any meaningful price protection during last year's unprecedented price run up despite this being the type of winter that the plan was designed to protect against. Further, in the three years that Laclede has been operating under the plan, the Company has chosen to opt out of the price protection portion once, and recommended substantial modifications twice. Clearly, if the program was sufficient to provide the protection it was intended to provide, there would not have been the need for modifications these past two years and ratepayers would have seen substantial price protection against the price spikes of last winter. Secondly, the formulaic approach of the program does not give Laclede the flexibility it needs to adjust its activities in the dynamic natural gas market. Finally, the profit motive built into the program is at odds with the goal of price protection.

Q. What are your specific complaints against the program?

A. In the next two sections I will discuss what happened during the second year of the program and what is happening currently.

THE EXPERIMENTAL INCENTIVE PSP DURING YEAR 2, WINTER HEATING SEASON 2000/2001

Q. What was the TSP for the second winter of the experimental incentive PSP?

A. The TSP was set pursuant to definition in the Description of the plan during the ** _____ **

Q. What was the CPL?

A. The CPL was set pursuant to definition in the Description of the plan at ** _____ _____ **

Q. Please describe Laclede's purchasing activities during that time frame?

A. Laclede purchased a limited number of call options during the beginning of its buying period. It then did nothing for the next two months.

Q. What happened in early May of 2000?

A. Around the first week of May, the futures price for natural gas began its unprecedented price run. Prices spiked to near $4.00 per MMBtu, challenging the highest prices seen for natural gas in decades. By this time, Laclede had missed the opportunity to purchase its required volumes at levels below the CPL.

Q. How many contracts had Laclede purchased by early May 2000?

A. Laclede had purchased a total of ** _____ ** as of May 4, 2000. This is out of an approximate ** ____ ** contracts needed to provide the 70% protection as outlined in the tariffs. (Source: Laclede Quarterly Reports)

Q. What happened next?

A. Due to Laclede's inactivity and the subsequent price run up, consistent with its tariff, Laclede elected on June 1, 2000 to opt out of the price protection portion of the experimental incentive PSP under its 90-day window passing all of the risk of price spikes to its ratepayers. Laclede's decision to opt out of the program was expressed to the Commission in a letter dated June 1, 2000 from Mr. Kenneth Neises. In this letter, Mr. Neises cited the increase in the price of natural gas as the reason why the price protection incentive component was inoperable for the second year of the program. The letter is attached as Schedule JAB-2.

Q. Did this mean that Laclede would not have any profit potential in the procuring of call options?

A. No. Laclede was still able to profit from the cost reduction portion of the program. Laclede's opting out of the program only eliminated the price cap portion of the program that would protect ratepayers against price spikes.

Q. Why did Laclede not purchase any significant volumes during its 90-day window?

A. According to Laclede's response to Staff Data Request 5005-23, Laclede indicated that on advice from its broker Risk Management Inc. (RMI), Laclede was waiting until prices fell, which was the belief of RMI. Laclede also claimed in the February 2001 hearing that due to certain Staff criticisms it felt it should not purchase options due to the price levels in March and April. However, Laclede by definition of the program was immune from prudence reviews for its purchasing activities associated with the experimental incentive PSP. Laclede could have purchased its required volumes at levels below the CPL and would not have had to worry about any prudence reviews from any party.

Q. Are there other reasons that may have prevented Laclede from purchasing options during March and April?

A. Yes. The profit motive may have played an important role in Laclede's decision making process during March and April of 2000. Under the price protection program, Laclede's profit levels would be higher if it could purchase options with strike prices below the TSP. When the strike prices it could have purchased fell between the TSP and CPL, Laclede could wait for prices to fall, thereby enhancing its profit potential.

Q. Are you aware of any information that discusses Laclede's profit motive concerning the experimental incentive PSP?

A. Yes. In Laclede's Strategic Plan, in the ** _____

_____

_____ ** This indicates that Laclede is making the experimental incentive PSP a major factor in increasing its earnings.

Q. Have you reviewed any other information regarding Laclede's strategy for operating the program?

A. Yes. Laclede's broker is RMI, a Chicago based brokerage firm. This firm sends reports out to Laclede at various times, giving Laclede RMI's position of current and future market conditions. Contained in the report dated March 31, 2000, attached as schedule JAB-3, is a summary from RMI ** _____

_____

_____

_____

_____

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_____

_____

_____ **

Q. But when Laclede waits, doesn't it have the risk of having to purchase strikes above the CPL?

A. No. The 90-day window eliminated all risk from Laclede for decisions made during this time frame. If the price moved against Laclede as it did, Laclede could simply

opt out of that portion of the program, eliminating the price protection for its ratepayers. This is exactly what Laclede did.

Q. Did Laclede request from the Commission to be allowed to implement new modifications last summer?

A. Yes. On July 7, 2000, in its Verified Application, Laclede requested permission to collect more money from the ratepayers to purchase options, and permission to use collars, fixed price instruments, and reduce the volumes that it was required to protect.

Q. What happened to Laclede's request?

A. Through negotiations, the parties agreed to allow Laclede out of its obligation to protect 70% of the required volumes. The Commission approved this Unanimous Stipulation and Agreement on October 8, 2000.

Q. What happened during the end of summer and the winter of 2000/2001?

A. Attached, as Schedule JAB-4 to my direct testimony is Laclede's activity during the second year of the experimental incentive PSP. As you can see, Laclede began purchasing options early in the year, started to **sell** those same options in August, right when it was trying to get permission to spend more ratepayer money for protection, and then Laclede's activity throughout the fall and winter.

Q. It appears that Laclede was selling options at various times in the fall and winter. Why did Laclede do this?

A. The reasons could be numerous. Laclede could have felt that the price was going to fall so it was trying to sell high, or Laclede knew it could only profit from sales made before the last three days before expiration. Laclede's explanation is that it

was trying to get as much value for its options as possible. However, not knowing where the price was going to end up, a safer approach for the consumers would have been to hold the options until the last three days. That approach, however, would not have allowed Laclede any profit opportunities.

Q. What evidence do you have that Laclede may have sold out of positions solely to profit?

A. Look at the activity near the end of December on page 3 of Schedule JAB-3. Laclede sold out of positions four days before expiration. This meant that Laclede was allowed to receive approximately 50% of the realized gains from the sale of those options as profit. If Laclede would have held them for one more day, in which the price was not likely to move to drastically, and in fact increased, Laclede would have received zero profit and the ratepayers would have received even greater benefits.

Q. What are your concerns with Laclede's profit motive from the use of option contracts under this program?

A. First of all, Laclede is profiting from the use of ratepayer money earmarked for ratepayer protection. Therefore, ratepayers are bankrolling Laclede as if Laclede were a gambler heading to Las Vegas. The program allows Laclede to play the market with ratepayer money and share in the winnings while assuming no risk. Secondly, the purpose of the hedging program was to provide price protection for Laclede's ratepayers. The catastrophic price protection envisioned in the program did not materialize during last year's unprecedented price movements. Therefore, the plan simply does not work to the benefit of consumers the way it was intended.

Q. Does the plan offer consumers guaranteed price protection?

A. No it does not although throughout its testimony, both written and oral, and its briefs in Case No. GO-98-484, Laclede's witnesses and attorneys emphasized the fact that the plan as they presented it was a guaranteed price protection plan. The following are excerpts from the various witnesses from the last case that I believe led the Commission to believe that the plan the Commission was agreeing to was going to provide price protection to the citizens of St. Louis.

> Mr. Kenneth J. Neises, direct testimony, page 10, lines 5 - 8, "Laclede's ratepayers stand to receive a far greater level of price protection than that enjoyed by customers of other LDCs which have no hedging program in effect."
>
> Mr. Scott E. Jaskowiak, direct testimony, page 2, lines 16 – 19, "the basic objective of the Incentive PSP is to ensure that Laclede's customers receive the greatest amount of price protection at the lowest possible cost...."
>
> Mr. Scott E. Jaskowiak, direct testimony, page 2, lines 23 - 25, "The Incentive PSP would require Laclede to obtain price protection, in the form of natural gas ** _____ ** on ** ____ ** of its gas supply requirements...."
>
> Mr. Kenneth J. Neises, surrebuttal testimony, page 10, lines 15 - 23, "** _____ _____ ** If it does not do so, the Company must assume financial responsibility for the difference between the CPL and the contract settlement price. By undertaking this risk, I believe the Company has provided the Commission with the most powerful type of assurance possible that the mandated volumes will be protected."
>
> Mr. Kenneth J. Neises, surrebuttal testimony, pages 13 and 14, lines 9 – 27 and lines 1 - 18, Q. "** _____ _____ _____ _____ _____ ** A. ** _____ _____ _____

_____ **. 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 programs should terminate for the year."

Mr. Kenneth J. Neises, surrebuttal testimony, page 17, lines 6 – 11, "To the extent there is any lingering concern over the Company's commitment to actually obtain the required level of price protection on ** _____ **, it should be completely eliminated by the Company's agreement to absorb 100% of the financial consequences associated with its failure to do so."

Mr. Kenneth J. Neises, surrebuttal testimony, page 18, lines 13 - 20, "Because Laclede will only ** _____ **."

Mr. John B. Snell, surrebuttal testimony, page 4, lines 24 – 27, "** _____ **."

Mr. John B. Snell, surrebuttal testimony, page 7, lines 1 - 9, "Laclede would be absolutely required to ** _____ **, no matter what. Laclede would also be required to guarantee a certain level of price protection to its ratepayers regardless of **

_____ ** it purchases to provide the required protection."

From Laclede's Initial Brief, page 6, "Laclede proposed to provide its customers with a firm guarantee that such price protection would, in fact, be provided on at least ** _____ **." "... should be no question regarding the substantial value to ratepayers of an actual guarantee that such protection will, in fact, be provided."

From Laclede's Initial Brief, page 8, "As Mr. Jaskowiak explained, Laclede would be required to obtain ** _____ _____ _____ _____ ."** "Laclede would be permitted to recover a maximum of ** _____ ** each year for the program through the existing surcharge in the PGA. Any additional costs required to obtain the specified levels of price protection would be borne by Laclede's shareholders. (Exh. No. 6HC, p. 3)"

From Laclede's Initial Brief, page 10, "If, during the 90 days immediately following the establishment of the TSP, market conditions change radically and Laclede determines it is necessary to purchase ** _____ _____ **, Laclede would notify the Commission in writing, and the Price Protection Incentive would not be operational for that year. This feature was designed to insure that ratepayers would receive price protection, and Laclede would not suffer from catastrophic losses, if a radical change in the market occurs early in the program. (Exh. 3HC, p. 9; Exh. No. 6HC, pp. 7 – 8)."

From Laclede's Initial Brief, pages 11 - 12, "Laclede's Alternative B guarantees Laclede's payment of 100% of such increased costs for the volumes which are required to be covered under the program. This provides an absolute cap on the cost of those volumes – a feature which represents a significant enhancement to the price protection Laclede has provided in the past. (Exh. No. 4HC, p. 16 – 17)."

From Laclede's Initial Brief, page 17, "Under the plan, Laclede's customers will receive an absolute guarantee of price protection for ** _____ _____ _____ **."

From Laclede's Initial Brief, page 18, "First, with regard to the issue of cost, it is clear that the maximum amount that ratepayers will be required to pay for price protection under any circumstances is ** _____ _____ **. This cost can, and almost

> certainly will, decrease as Laclede generates ** _____ _____ **, but it can never increase under any circumstances."
>
> From Laclede's Initial Brief, page 19, "At the same time, ratepayers will be guaranteed a substantial level of price protection under any scenario. Even in the unlikely event that Laclede was to leave itself 'completely unhedged,' ratepayers would still have price protection, paid for by Laclede, above the CPL."
>
> From Laclede's Reply Brief, page 2, "b) guaranteeing, for the first time, catastrophic price protection for ratepayers under virtually all circumstances."

As the above quotes indicate, this plan was presented to the Commission as providing guaranteed price protection plan. As the events of this past winter have shown, this plan failed in that task resulting merely as another profit protection center for Laclede's shareholders.

THE CURRENT YEAR, WINTER HEATING SEASON 2001/2002

Q. Is Laclede going to have price protection this year according to the parameters of its plan?

A. No.

Q. Why isn't Laclede going to have price protection in line with the parameters of its approved program?

A. One of the caveats of the current plan is that the Commission has the right, but not the obligation, to review the plan before February 15 of each year to determine if the plan should be terminated. This past February, the Staff and Public Counsel presented evidence to the Commission is support of eliminating the third year of the program, or at least removing the incentive (i.e. profit motive) portion from the program. During the hearing, Laclede agreed to donate some of its claimed profits

to double the funding of the program for the third year. In addition, the Commission modified the 90-day window to 60 days.

Q. What was the effect of last winter's natural gas prices on this year's experimental incentive PSP?

A. Due to the extraordinarily high prices seen last winter, the prices established this year have also been high. Therefore, Laclede asked for and received permission by Commission Order on April 18, 2001 in Case No. GO-2000-394 to only have to protect up to 40% of its volumes instead of the original 70%. This marks the second yearly modification of the three-year plan. With these modifications in place, Laclede is now in the process of locking in 40% of its expected winter flowing supplies with $8,000,000 at targeted strike prices near $8.00 per MMBtu.

Q. What is the current price for natural gas?

A. The current 12-month futures strip is approximately $3.60 per MMBtu.

Q. Laclede showed that due to its efforts during last year's price run-up it turned the upfront investment of $4,000,000 into $28,000,000. Doesn't that prove the effectiveness of the program?

A. No. Staff pointed out in the hearing on February 2, that Laclede could have saved $45,000,000 this past winter. Attached, as Schedule JAB-5 is my analysis that shows that Laclede could have saved the ratepayers approximately $54,000,000 this past winter.

Q. How could Laclede have saved the ratepayers approximately $54,000,0000?

A. I simply assumed that Laclede purchased its required volumes in the two months it had prior to the price run-up. If it had simply followed that strategy, the strategy of

price protection for its ratepayers, it would have purchased options to protect its supplies at $5.20 per MMBtu or less. Even using that number is a little high, but I wanted to be conservative.

Q. Please explain why the months of November and March have the same totals on your Schedule JAB-5.

A. Certainly. When option contracts are used as a hedging tool, the buyer has the right but not the obligation to exercise the option. Options are exercised when the option is "in the money." The actual settlement prices for November and March were not "in the money." Therefore, Laclede would not exercise its options; it would simply pay the index price for natural gas. For those two month, the actual cost to the ratepayers would have been the index price, plus the premium.

Q. Would two months provide Laclede with enough time to make the required purchases?

A. Yes. In its GSIP proceeding, Case No. GT-2001-329, Laclede indicated that it would only need five days to fix the price on 30% of its total volumes. Two months would give it plenty of time to purchase 70% of its winter volumes.

Q. Isn't your analysis simply a hindsight review of Laclede's activities?

A. No. I am not proposing to disallow anything. I am simply pointing out the fact that the plan as originally designed was supposed to provide protection to the ratepayers. My analysis shows what could have happened if Laclede had simply used the program as a vehicle to protect its ratepayers against price spikes versus a much different vehicle as a profit center for the Company.

Q. How much did Laclede's ratepayers pay in transaction costs for this program?

A. With all of the trading activity conducted by Laclede, the ratepayers paid almost $100,000 in transactions costs.

FUTURE ROLE OF HEDGING

Q. Does Public Counsel oppose the use of options as part of a LDCs overall gas supply portfolio?

A. No. Public Counsel believes that LDCs should use whatever tools are available to help reduce ratepayer risk from price spikes such as those that hit the industry last year. Public Counsel is not in favor of giving the companies a profit motive to compete against the other goal of providing price protection.

Q. Please explain what you mean by that last statement.

A. Simply put, Laclede's current PSP provides it with profit opportunities. Due to the potential to profit from its actions, Laclede may not act in the best interests of its ratepayers. This can be seen by the actions Laclede demonstrated last year. Laclede did not acquire price protection in the appropriate time and opted out of price protection responsibilities during the worst winter price run up in history. Laclede's profit motive also may have played a role in it selling out of contracts prior to the last three days prior to expiration. This action allowed Laclede the opportunity to profit whereas waiting would have precluded any profits from accruing to the Company.

Q. Does Public Counsel have any recommendations concerning an alternative incentive plan for Laclede?

A. No. At this time Public Counsel is not aware of any predesigned and preapproved hedging plans that can properly align ratepayer and shareholder interests. Laclede,

as all LDCs in the state of Missouri, should be exploring the use of options, as well as fixed price contracts, to supplement its natural gas supply portfolio.

Q. What is Public Counsel's position regarding the use of options?

A. As stated earlier, Public Counsel believes that the use of options in an overall gas supply portfolio can provide substantial benefits to the ratepayers.

Q. Does Public Counsel have any recommendations if the Commission decides that the experimental incentive PSP should continue in some form?

A. Yes. Even though Public Counsel feels very strongly that the experimental incentive PSP should be eliminated, Public Counsel does have some recommendations concerning the potential continuance of the current experimental incentive PSP.

First, the 60-day window that is currently in effect due to an earlier order in this case should be completed eliminated. The Company, if allowed to have a reward system in place, needs to have a risk factor. The 60-day window is an improvement over the original 90-day window, but it still has the same flaws. Laclede still has the ability to hold the ratepayers hostage in its determination if it has the potential to profit from lower strike prices. Second, the TSP should be changed. As can be shown with this year's TSP calculation, when the prices spike in the winter, it may take months before it settles into a more normal, relatively less volatile range. In the meantime, the TSP may be set at a price that can only provide cursory price protection to the ratepayers. Since the TSP is set based on a formulaic approach in a very dynamic market, a mechanism that is more responsive to the needs of the ratepayers, or a complete elimination of this feature should occur. Elimination of

this feature would put the onus on the Company to do the right thing, and the Staff and Public Counsel should be given back the authority to do prudence reviews of the purchasing decisions of the Company. Furthermore, elimination of the TSP would for all intents and purposes eliminate the price protection profit piece from the plan.

Finally, the volumetric requirement should be modified. Currently, the requirement is for 70% of expected normal winter volumes to be protected. However, during the past two years of the program, Laclede has requested to lower that requirement to 40%. Even though all parties agreed to these changes, lowering the requirements can lead to substantial detriment to the ratepayers, especially during cold winters. With colder winters, the number of volumes used is above normal. This means that a loosening of the requirements from 70% to 40% means that even less than 40% of winter volumes are protected. As prices rise, this leads to less protection and higher gas costs. On the flip side, a warmer winter could lead to too many volumes being protected. Again, the Company should have the flexibility to protect the volumes it feels is necessary to protect its ratepayers. Along with that flexibility, Staff and Public Counsel will need the ability to review the Company's decisions and actions to ensure that the Company acted in a prudent manner in lining up the appropriate protection.

Q. Does this conclude your direct testimony?

A. Yes it does.

Cases of Filed Testimony
James A. Busch

Company	Case No.
Union Electric Company	GR-97-393
Missouri Gas Energy	GR-98-140
Laclede Gas Company	GO-98-484
Laclede Gas Company	GR-98-374
St. Joseph Light & Power	GR-99-246
Laclede Gas Company	GT-99-303
Laclede Gas Company	GR-99-315
Fiber Four Corporation	TA-2000-23; et al.
Missouri American Water Company	WR-2000-281/SR-2000-282
Union Electric Company d/b/a AmerenUE	GR-2000-512
St. Louis County Water	WR-2000-844
Empire District Electric Company	ER-2001-299
Missouri Gas Energy	GR-2001-292
Laclede Gas Company	GT-2001-329

LACLEDE GAS COMPANY
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FILE COPY

KENNETH J. NEISES
SENIOR VICE PRESIDENT
ENERGY & ADMINISTRATIVE SERVICES

June 1, 2000

Mr. Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
301 W. High Street
Jefferson City, MO 65101

RE: Case No. GO-2000-394; Notice Regarding Price Protection Incentive

Dear Mr. Roberts:

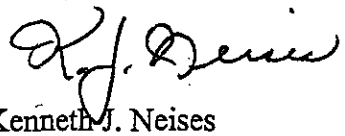
The above-referenced case was established by the Commission to monitor Laclede Gas Company's ("Laclede") revised Price Stabilization Program ("Revised PSP"), as approved by the Commission in its Report and Order dated June 15, 1999, in Case No. GO-98-484. Pursuant to the terms of the Revised PSP, the 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.

As contemplated by the Revised PSP, such action has been necessitated by radical changes in the market conditions governing natural gas prices in general and natural gas financial instruments in particular. Even before the second year of the Revised PSP commenced in March 2000, the cost of financial instruments had already increased to a point where the *targeted* price protection level established for this year was some 70 cents greater than the highest *catastrophic* price levels (i.e. $4.00 per MMBtu) established in prior years. Unfortunately, rather than decline, as most industry experts and observers were expecting, such costs have only continued to escalate to unprecedented levels, with the result that the cost to obtain even catastrophic price protection has more than tripled over the amount authorized for that purpose under the Revised PSP. As shown by the attached articles from the Wall Street Journal and Gas Daily, this radical change in market conditions has been attributed to a number of factors, including the increased use of natural gas in electric generation, less than anticipated supplies of natural gas from Canada, and abnormally low storage levels.

Laclede intends to do whatever it can to procure reasonable price protection for its customers outside the ambit of the Price Protection Incentive in the months that remain before the onset of the winter heating season. However, 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).

Sincerely,



Kenneth J. Neises

cc: Commissioners
Office of the Public Counsel
Thomas R. Schwarz, Jr.
David M. Sommerer

Schedule JAB-2
Page 2 of 5

ECONOMY

Deal Comes Amid Record Prices for Gas

Devon, Santa Fe Snyder Look for Bigger Role In Production in U.S.

By ALEXEI BARRIONUEVO
Staff Reporter of THE WALL STREET JOURNAL

Almost as if on cue, Devon Energy Corp. last week agreed to buy Santa Fe Snyder Corp. for $2.35 billion to take advantage of an unusually strong market for natural gas—and then natural-gas prices rose to all-time highs.

Devon, based in Oklahoma City, and Santa Fe Snyder, Houston, said that combined, they hope to be a bigger player in U.S. production, which is needed now more than ever. Both companies have large holdings in the Rocky Mountains, one of North America's most promising natural-gas regions.

Further, the companies see the natural-gas problem as long-term, not a single day's spike. "Natural-gas supply is reaching a crisis level," said Larry Nichols, Devon's president and chief executive officer.

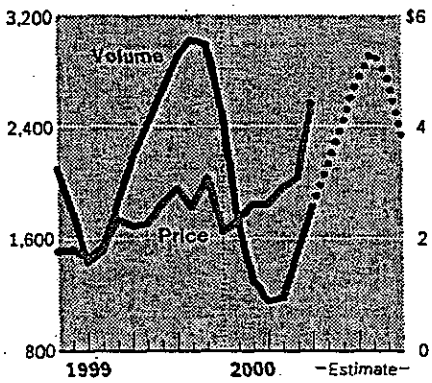
Driving the higher prices is an increased demand for natural gas, coupled with tight supply.

For the better part of a decade, natural-gas prices have lingered around $2 per million British thermal units. Last week, fueled by inventory levels that are 25% lower than last year, prices climbed to more than $4 per million BTUs. On Friday, the June contract settled at $4.41, eclipsing the previous high of $4 in January 1997, according to Stephanie Nichols, a trader at El Paso Energy Corp.

Greater demand from users such as power plants that need more and more natural gas to keep running, disappointing results from some wells and less-than-expected imports from Canada have all contributed to the current supply crunch. Worse, the price had been so low for so long that many companies have been reluctant to spend to drill for new reserves or to recover more from existing wells.

Gas Meter

Natural gas in storage in billions of cubic feet *(left axis)* and the future's price per millions of BTUs *(right axis)*



Sources: Energy Information Administration's May 2000 Short-Term Energy Outlook Database, New York Mercantile Exchange

Drilling has picked up in recent weeks, with both combined oil and natural-gas rig counts up 64% from last year to 849. But natural-gas demand is expected to grow 3% this year, and many analysts think recent production could be too little too late to stave off a serious supply problem this winter.

"I don't see how we are going to make it," said Ronald J. Barone, an analyst with PaineWebber. "You have to have rig counts over 1,000 for a sustained period just to replace production."

Complicating the situation is the increasing use of natural gas to fuel electric power plants, particularly during times of peak demand. The U.S. has a shortage of power capacity generally and that is forcing power plants to use more natural gas when they normally would build storage for the winter months. With crude oil prices running at $30 a barrel, power producers have little incentive to switch to oil to fuel their plants.

"It isn't that there isn't gas available to handle summer demand," says Dave Costello, an economist with the Energy Information Administration. "But we are trading off availability now for availability in the winter when we really need it."

If producers can't boost gas supplies, many analysts are betting prices could shoot up over the $5 per million BTU level this winter.

Natural-gas supply fell when many independents cut back drilling by more than 40% during the oil downturn that began in 1998 and saw crude prices fall to about $11 a barrel in 1999. Drilling activity has yet to return to 1997 levels. "The companies are still shell-shocked over what happened in 1998," said Frederick Leuffer, an analyst with Bear Stearns.

Deepwater areas in the Gulf of Mexico that were thought to be promising for natural gas turned out to be more oil-rich than expected. Shallower areas on the Gulf's shelf contain more gas but require constant investment to stem decline. Low prices also slowed production from Canada, a region the U.S. market relies on for supply. This year, imports are running 40% below expected levels for the year, the EIA said.

In this environment, the stocks of North American energy production companies such as Devon and Santa Fe have been flying. Devon's shares have risen 80% this year, hitting an all-time high of $59.50 last week. However, Devon's shares fell $3.0625 to $55.625 Friday at 4 p.m. in American Stock Exchange composite trading. Analysts blamed the stock's fall on concerns that Devon paid too much for Santa Fe Snyder, Devon's biggest deal to date. Shares of Santa Fe Snyder were up 75 cents to $11.75 at 4 p.m. Friday in New York Stock Exchange composite trading.

The combined company will be the fourth-largest independent exploration and production company in the U.S. By buying Santa Fe Snyder, Devon will more than double its natural-gas reserves in the Rocky Mountain region, where Devon has specialized in low-cost extraction of natural gas from shallow-water coal deposits. Devon said the region is estimated to hold two trillion cubic feet of gas.

FINANCIAL TIMES Energy

Gas Daily®

Friday, May 26, 2000
Attn: Kenneth J Neises
Fax Edition - 11 pages

Daily Price Survey

Listed in the left column are the midpoints of the daily ranges for the most common prices, paid in $/mmBtu of a typical volume of 5 thousand mmBtu. The middle column shows absolute low-high prices for transactions reported on the date at the top of the column; the third column shows that day's ranges for the most common prices. The prices are generally for gas flowing today; weekends are usually priced using data collected Friday. Ranges are for deals done before nomination deadlines. Boldface indicates the price range is based on data reported the previous day. Plain type indicates insufficient data to reconfirm or change the previous range. The common range is built around the volume weighted average and the midpoint is calculated for the common range. Data in this table is Copyright 2000 by FT Energy.

NATIONAL AVERAGE PRICE: $4.110***

Trans. date	5/25	5/25	5/25
Flow date(s)	5/26	5/26	5/26
	Midpoint	**Absolute**	**Common**
Permian Basin Area			
El Paso	4.040	3.98-4.11	4.01-07
Northern (Mids 1-6)	4.000	3.98-4.06	3.98-4.02
Tex Intras, Waha area	4.070	4.03-10	4.05-09
Transwestern	4.015	3.99-4.05	4.00-03
East Texas-North Louisiana Area			
Carthage Hub tailgate	4.100	4.08-12	4.09-11
Koch (Zones 1&2)	3.865	3.85-88	3.86-87
Lone Star	4.025	3.99-4.04	4.01-04
MRT mainline	4.175	4.12-18	4.17-18
MRT west leg	4.120	4.11-13	4.11-13
NGPL TexOk (West)	4.050	4.04-06	4.04-06
NGPL TexOk (East)	4.055	4.01-11	4.03-08
Tennessee, 100 Leg	4.030	4.02-04	4.02-04
Texas Eastern (ETX)	4.070	4.04-09	4.06-08
Texas Gas (entire Z 1)	4.140	4.10-18	4.12-16
East-Houston-Katy			
Houston Ship Channel	4.155	4.13-18	4.14-17
Katy plant tailgate	4.120	4.09-17	4.10-14
Trunkline North	4.120	4.10-13	4.11-13
North-Texas Panhandle			
NGPL (Permian)	3.925	3.90-96	3.91-94
Northern (Mid 10)	3.800	3.78-82	3.79-81
Transwestern	4.015	3.99-4.05	4.00-03
South-Corpus Christi			
Agua Dulce hub	4.045	4.03-09	4.03-06
Florida Gas	4.125	4.10-17	4.11-14
HPL	4.050	4.03-06	4.04-06
Koch (Zone 1)	3.970	3.96-99	3.96-98
NGPL (STX)	4.040	4.00-08	4.02-06
Tennessee	4.030	3.98-4.06	4.01-05
Texas Eastern (STX)	4.000	3.97-4.04	3.98-4.02
Transco, St 30	4.060	4.01-14	4.03-09
Trunkline South	4.080	4.07-09	4.07-09
PG&E-GTT	3.980	3.96-99	3.97-99
Louisiana-Onshore South			
ANR	4.095	4.02-16	4.06-13
Columbia	4.145	4.08-18	4.12-17
Columbia, Mainline	4.195	4.17-22	4.18-21
FGT Z1	4.125	4.10-17	4.11-14
FGT Z2	4.165	4.14-20	4.15-18
FGT Z3	4.145	4.11-18	4.13-16
Henry Hub	4.175	4.11-21	4.15-20
Koch (Zones 2&4)	4.080	4.05-09	4.07-09
NGPL (La.)	4.105	4.02-16	4.07-14
Sonat	4.155	4.12-18	4.14-17
Tennessee, 500 Leg	4.040	4.00-08	4.02-06
Tennessee, 800 Leg	4.030	3.99-4.08	4.01-05
Texas E. (WLA)	4.040	4.00-08	4.02-06
Texas E. (ELA)	4.055	4.00-10	4.03-08
Texas Gas SL	4.135	4.09-18	4.11-16
Transco, St. 45	4.115	4.06-16	4.09-14
Transco, St. 65	4.140	4.08-20	4.11-17
Trunkline WLA	4.140	4.08-19	4.11-17
Trunkline ELA	4.130	4.09-16	4.11-15
Oklahoma			
ANR	3.980	3.93-4.05	3.95-4.01
NGPL (Midcont)	3.970	3.88-4.03	3.93-4.01
Reliant (North/South)	4.030	3.97-4.10	4.00-06
Reliant (West)	3.970	3.90-4.05	3.93-4.01
Northern (Mid 11)	3.830	3.80-85	3.82-84
OGT	3.975	3.91-4.01	3.95-4.00
PEPL	3.990	3.92-4.03	3.96-4.02
Williams	3.975	3.92-4.02	3.95-4.00
New Mexico-San Juan Basin			
El Paso, Bondad	3.855	3.80-91	3.83-88
El Paso, non-Bondad	3.865	3.82-92	3.84-89

continued on next page

Henry Hub spike could mark new price trend

The move of the average Henry Hub spot price above $3.50/mmBtu on May 18 and near $4/mmBtu on May 22 was unprecedented for this time of year. This most recent period marks only the third time when spot prices at Henry Hub have approached or exceeded $4. In fact, spot prices there have rarely exceeded $3.

Special look at Louisiana, *see page 5.*

The average daily spot price at Henry Hub exceeded $3 for the first time in late December 1995. That period marked the most significant spot market price event ever at the Henry Hub. It began on Dec. 21, 1995 when the average posted spot price increased 55¢/mmBtu to $3.70/mmBtu after rising above $3 the previous day. By the end of the following week, though, the price had declined almost $1 from that high level.

Then prices quickly rebounded above $3.50 when the industry realized that working gas in storage levels may have declined to almost 2 trillion cf, a level not experienced that early in the

(continued on page 8)

winter heating season since December 1976 when gas deliveries to customers were curtailed.

It's worth recalling that the winter of 1976 provided much of the needed motivation for the passage of the National Gas Policy Act (NGPA) decontrol of natural gas prices, and the high prices created by the NGPA were the fundamental incentive for the development of the spot gas market.

The average daily price at Henry Hub reached a peak of $14 on Feb. 2, 1996 in response to a sudden drop in temperatures. Prices generally stayed above $3.50 until the end of February 1996. At that time, working gas levels stood at 1 trillion cf, once again an almost unprecedented level for that time of year. By the end of the heating season working gas levels had plummeted to 758 billion cf.

The next heating season — 1996-97 — also experienced low working gas in storage levels. A cold spell early in the heating season contributed to high prices but not nearly as high as the previous year.

Storage levels today are currently higher than then were at the same time in 1996 and in 1997. Prices are also significantly higher than they were, and this is the problem. There is hesitancy on the part of speculators to put gas in storage and take the bet that prices will rise enough at some point in the future to cover the cost of the commodity and storage.

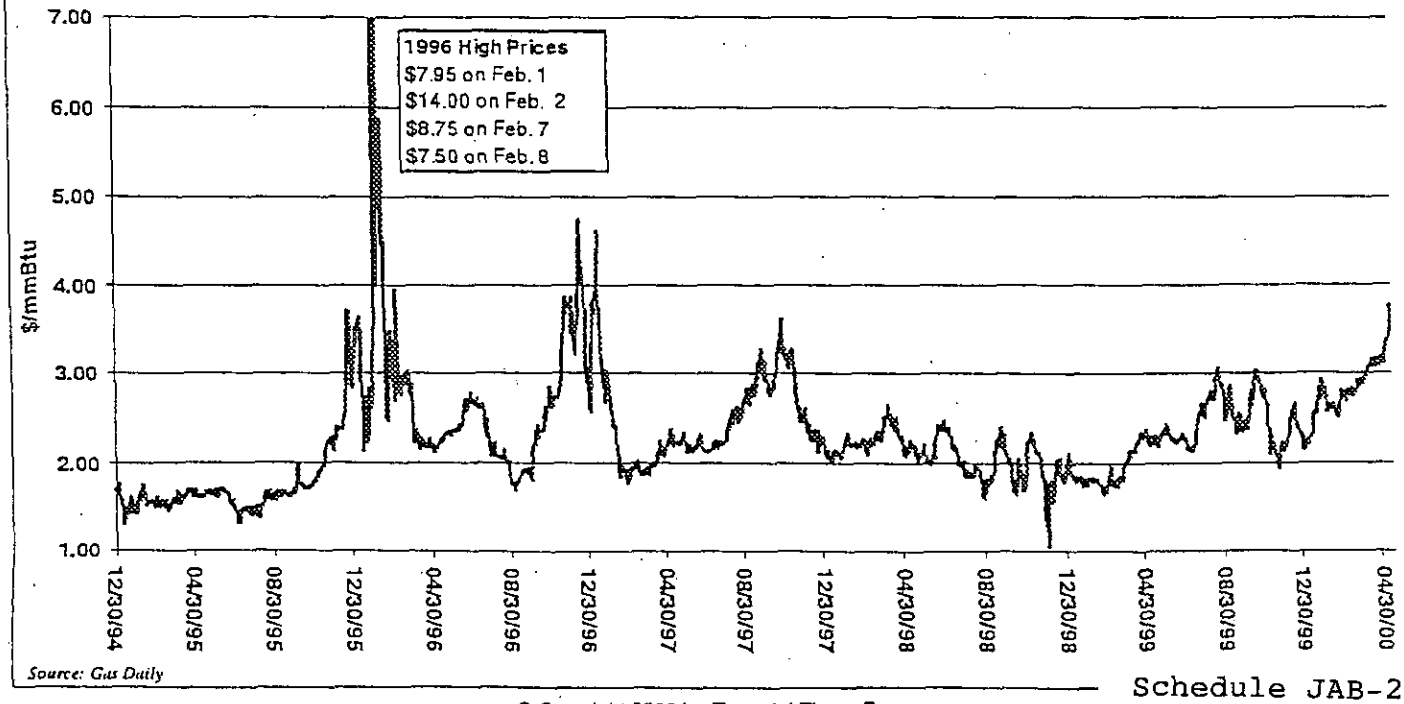
The futures market gives no relief. On May 19, settlement prices revealed that prices were expected to remain high for the rest of the year. The 6-month NYMEX forward curve was significantly above forward curves for past years at this time. In fact, the May 19 forward curve was more than $1.50/mmBtu above these forward curves from the past. This change in price was equivalent to the level of spot prices in 1994 and the first half of 1995 (*see spot price figure below*).

The overall shape of the current forward curve is not that much different from previous years. Yet the rise in price is only 18¢ from June to January, much smaller than in the previous two years, providing little incentive to store gas since the cost of storage for the same period clearly exceeds this difference.

Looking to last year

Current high prices are explained, in part, by the high recent prices that preceded them. Settlement prices at the close of trading for the April and May NYMEX contract were record-setting for those delivery months. Higher prices in April and May were not entirely surprising and were viewed as part of a longer-term trend but the price bar they attained was surprising.

Henry Hub spot prices, 1995-2000



Source: Gas Daily

SCHEDULE JAB-3

HAS BEEN DEEMED

HIGHLY CONFIDENTIAL

IN ITS ENTIRETY.

SCHEDULE JAB-4

HAS BEEN DEEMED

HIGHLY CONFIDENTIAL

IN ITS ENTIRETY.

SCHEDULE JAB-5

HAS BEEN DEEMED

HIGHLY CONFIDENTIAL

IN ITS ENTIRETY.