BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the PGA Filing for Laclede Gas Company.	**)** **)**	**Case No. GR-2004-0273**

STAFF'S POST-HEARING BRIEF

COMES NOW the Staff of the Missouri Public Service Commission (Staff), by and through counsel, and for its Post-Hearing Brief states:

How Laclede was Imprudent

Laclede was imprudent in its planning and decision-making for the 2003-2004 ACA period because:

1) Laclede did not perform an updated analysis for FOM pricing as compared to daily pricing for swing gas, and

2) Laclede relied on a flawed 1996 study to plan its purchases of swing supply gas in 2003, and

3) Laclede's imprudent planning caused it to overlook the tremendous increase in producer demand charges for swing gas and pass those charges on to its on-system customers in the PGA in order to continue making off-system sales that primarily benefitted its shareholders.

4) Customers were harmed by Laclede's inadequate planning in the amount of $2,055,864.

What Laclede didn't know but should have

Laclede relied on a 1996 study to plan its 2003-2004 gas supply portfolio. Mr.

Godat applauded the 1996 study in his direct testimony.[1] It was the only quantification Laclede had ever done comparing FOM pricing to daily pricing.[2] And the 1996 study was the blueprint for a second study done in 2005, after the 03-04 ACA.[3] But because of the 1996 study's limitations and flaws pointed out by the Staff, Laclede now wants to back away from the study and refer to it as a "data point" in analyzing its gas supply portfolio[4] and convince the Commission that it really relies on its experience in the gas market to plan its supplies. In this way, Laclede hopes to redirect the Commission's attention from Laclede's lack of analysis in planning the 03-04 period and focus the Commission on the notion that off-system sales have made its customers whole in spite of Laclede's imprudence.

There are many problems with the 1996 study that Laclede wants to minimize by distancing itself from the only quantitative analysis it had ever done on FOM pricing. The 1996 study considers a single year, 1995-1996, to analyze the cost and benefits of FOM pricing.[5] Had the study been done in the spring of 1999 using a single year of data it would have shown a loss of $4.4 million. Had it been done in 2000 it would have shown a $1.4 million loss. And in 2002, it would have shown a loss of $3.3 million.[6] How fortuitous that Laclede chose 1995-1996 as its study year.

The 1996 study assumed demand charges for FOM pricing were the same as demand charges for daily pricing.[7] Laclede failed to quantify and consider the cost of daily demand charges and how that would affect the costs and benefits of purchasing gas

[1] Transcript, p. 215, l. 17-19.
[2] Transcript, p. 216, l. 22 to p. 217, l. 4.
[3] Id, l. 4-10.
[4] Transcript. p. 215, l. 15.
[5] Transcript, p. 216, l. 19-21 and exhibit 18.
[6] Exhibit 19; transcript. p. 221, l. 8-13.
[7] Exhibit 18.

at FOM prices. The only recognition of this fact was a footnote to the study, which made no attempt to quantify or analyze the effect of daily demand charges on the results.

The 1996 study fails to separate Laclede's gas supplies into their baseload, combo and swing supply components. Only by doing so can Laclede really determine if any particular supply at FOM pricing is cost-effective in and of itself. Instead, Laclede would rather not know if any particular supply is economical so it can keep its eyes on what it sees as the real prize: off-system sales profits. The way Laclede's off-system sales engine generates profits for Laclede's shareholders is like this: Laclede plans gas supplies at FOM prices. Laclede's customers pay the $20 million or more for demand charges to buy FOM gas. When the daily price of gas rises above the FOM price, Laclede makes off-system sales and shareholders pocket the profit. What Laclede doesn't want the Commission to know is that when gas is $8.00 per MMBtu, the effective price at FOM prices may be $8.80 per MMBtu because of demand charges.[8] Only when on-system customers are forced to pay the extra $.80 per MMBtu can Laclede's shareholders make their profit.

The 1996 study fails to separate the off-system sales costs and revenues from on-system supplies.[9] Only by doing so can Laclede determine if customers receive any benefit from FOM pricing versus daily pricing. Laclede's answer to this argument is that since off-system sales are a part of the regulatory process, they must be included in the study.[10] In effect, their argument is that even though customers may pay more in demand charges in the PGA than they recoup in off-system sales benefits, that's prudent. For example, in 2003-2004, customers paid $4.2 million for swing demand charges.

[8] Transcript, p. 207, l. 12-16.
[9] Transcript, p. 223, l. 16-18.
[10] Transcript. p. 224, l. 3-8.

Customers received only $2 to $2.5 million in revenue imputation from off-system sales.[11]

By failing to properly analyze their gas supply portfolio and engage in proper planning, the following are the things that Laclede should have known when planning the 03-04 ACA but didn't know until the Staff did the work and demonstrated what Laclede should have known:

1. Laclede didn't know that 52% of all swing supply volumes went to off-system sales.[12] Customers used only 48% of the swing gas purchased with their money. Customers paid $4.2 million for demand charges for swing supplies and used only 48% of the gas.[13] Laclede argues that because $2 to $2.5 million is imputed in revenues for off-system sales thereby reducing base rates for customers, that customers are better off. But Laclede overlooked the fact that customers paid over half of $4.2 million in swing demand charges just to generate off-system sales from swing supplies. The swing demand charges alone off-set any benefit from off-system sales. And as pointed out in paragraph 2 below, Laclede didn't need swing at FOM prices to generate these off-system sales.

2. Laclede didn't know that only 23% of total off-system sales came from swing volumes.[14] 77% of off-system sales were made using combo and baseload gas supplies or spot purchases.[15] Laclede can easily make off-

[11] Transcript, p. 164, l. 1-5.
[12] Transcript, p. 167, l. 3-7.
[13] Id. l. 10-11.
[14] Transcript, p. 156, l. 22-24 and exhibit 15. (In fact, reviewing the transcript and Laclede's attempts to suppress this information Laclede should have had readily at hand, Laclede apparently didn't want this information known. See Transcript, pp. 157 to 169 for Laclede's many objections)
[15] Transcript, p. 226, l. 24 – p. 227, l. 9.

system sales with supplies other than swing and customers need not pay $4.2 million for swing demand charges.

3. Laclede didn't know that it could easily make its revenue imputation through capacity release and off-system sales by using only the combo and baseload gas supplies.[16] Customers would have saved $3.7 million in swing demand charges. Customers would have paid about $500,000 for daily demand charges rather than $4.2 FOM swing demand charges.[17] The difference is $3.7 million. But Laclede didn't know, nor had Mr. Godat considered it.[18]

4. Laclede doesn't understand that the "savings" declared by Laclede in its 1996 and after-the-fact 2005 study include off-system sales. The entire savings attributed to off-system sales do not go to on-system customers. Only the savings negotiated in the rate case for both capacity release and off-system sales goes to on-system customers. Savings above this level go to Laclede's stockholders; a gain to stockholders is not a "savings" to customers.

5. Laclede didn't know that swing demand charges comprise 20% of the total cost of swing gas.[19] That's five times greater that the 2-5% Laclede argued is appropriate. At hearing, Laclede sought to make a point with Mr. Sommerer that total demand charges were only 4 or 5% of total gas costs for 2003-2004. Laclede used a Task Force report suggesting that

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[16] Transcript, p. 164, l. 16-23.
[17] Transcript, p. 229, l. 24 – p. 230, l. 16.
[18] Transcript, p.229, l. 18 to p. 230, l. 15.
[19] Transcript, p. 172, l. 5-13.

demand charges under 5% were reasonable. But this effort backfired on Laclede because Laclede didn't know that swing demand charges constituted such a large percentage of swing gas costs and their point was lost. Laclede paid $4.2 million for swing demand charges while the total cost of swing gas amounted to about $20 million. This could have been calculated by Laclede prior to the 03-04 ACA but Laclede failed to do so.

6. The total volume of swing gas contracted in the 2003-2004 period was less than the volumes contracted in 2002-2003 but Laclede paid more in swing demand charges in the 03-04 period.[20] Laclede sought to show that swing demand charges increased by only $600,000 between the 02-03 and 03-04 ACA periods. Mr. Sommerer was quick to point out what Laclede didn't know or chose to ignore: The swing volumes for 02-03 were sigficantly less than the 03-04 period. Laclede did finally admit that the increase was 30% when comparing only comparable swing contracts.[21] This ignores the demand charges associated with the other swing contracts that are not "comparable." However, Staff calculated the increase at 67.5% for all swing contracts based on documentation provided by Laclede.[22] Either way, this kind of an increase should have caught Laclede's attention. It would have but for Laclede's focus on shareholder profits from off-system sales. A price increase of 30% for demand charges should not be "pleasantly surprising"[23] as Mr. Godat describes it. Rather, such an

[20] Transcript, p. 173, l. 18-25.
[21] Transcript, p. 205, l. 4-9.
[22] Transcript, p. 174, l. 2-7, and exhibit 16HC.
[23] Transcript, p. 211, l. 20-25.

increase is cause for alarm and sufficient evidence of a change in the market that reasonable people would at least consider another course, such as daily pricing, and send an RFP for daily pricing. Laclede did not do so.[24]

7. The 1996 study fails to consider the current cost of demand charges when planning gas supplies and instead relies on historical information that in 2003 was seven years out of date. Surely Laclede realized the information it was relying upon was stale and had little significance to the current gas market. This begs the question of why would Laclede plan its gas purchases with arguably irrelevant information. The reason: Laclede's focus on off-system sales profits clouded their judgment, resulting in a failure or reluctance to engage in additional analysis. This cost customers millions of dollars.

Laclede should have known all these things but it didn't. Instead of in-depth mathematical analysis, Laclede relied on a 1996 study and a feeling it calls experience. The 1996 study was not disclosed to Staff for 10 years.[25] Not until 2005 when the Staff was investigating Laclede's rate case did Laclede finally produce the 1996 study. Because the study was stale and out-of-date, Laclede updated it with data from 1998 to 2003 resulting in the 2005 study. But because the same methodology was used for the 2005 study, failing to separate types of supply and removing off-system sales volumes, Laclede knew little more than it knew in 1996 when the original study was done.

Contrary to Laclede's contentions, FOM pricing is not hedging. The price of

[24] Transcript, p. 193, l. 21-23.
[25] Transcript, p. 180, l. 14-15.

FOM gas is an absolute unknown until the price is set during bid week. If gas prices are spiking during bid week, the FOM price will be set near the spike price and Laclede and its customers will be stuck paying high prices for the entire month.[26]

Laclede's efforts to convince the Commission that FOM pricing is hedging should be critically examined by the Commission. Other agencies have rejected this contention.[27] In fact, the New York Public Service Commission has said that FOM pricing "provides no price protection, as there is no certainty as to the level of the price on the first day of any given month. [T]he value to customers by having the LDC eliminate daily price volatility over a month is unclear."[28] Mr. Godat disagrees with this proposition but the Commission should consider his motivation for doing so: To admit that FOM pricing is not hedging and offers no price protection eliminates the primary reason for FOM pricing and leaves only off-system sales profits for FOM's *raison d'etre*.

Laclede has never considered how high the demand charges should go before they change course. When the hearing began in this case the Staff invited the Commission to ask Laclede how high would demand charges have to go before they reconsidered. Mr. Godat answered this question as follows:[29]

> Q. Is there a threshold Laclede has set based upon any study that it has done about how high it will go with producer demand charges?
> A. You know, that's the beauty of the RFP process is that it saves us from having to make that assumption. We send out the RFP as we start the contracting process, and I knew in a short period of time that the 20 million was a number that I had to consider for 03-04…I don't know that we would have had to have went through an exercise assuming some higher number than that.
> Q. The RFPs were all about the same amount, I take it, about the same cost?
> A. Bids were very comparable, that's correct.
> Q. So if they'd all come back at 100 million, there wouldn't have been any

[26] Transcript. p. 197, l. 5-16.
[27] See GW-2006-0110, p. 9 and Transcript, p. 174, l. 20 – p. 175, l. 10.
[28] In re NUI Utilities, Inc., 2002 WL 1025164, N.Y.P.S.C., Mar. 27, 2002 (No. 01-G-0493)
[29] Transcript, p. 213, l. 15 to p. 214, l. 13.

> decision to make, you would have taken the lowest and considered it prudent?
> …
> Q. Is there information that you can take from the 1996 study … that would tell you how high these demand charges can go before there has to be a change?
> A. No.

Consider what Laclede has in mind. When RFPs for FOM pricing are issued and they all come back around $100 million, there is no decision to make. Customers will pay $100 million through the PGA and Laclede will call it prudent. Laclede should have considered what is shown in exhibit 20. This exhibit would show Laclede what current demand charges of $20 million mean. Since demand charges aren't going down[30] it would be prudent for Laclede to consider this.

Laclede has failed to properly analyze its use of storage to avoid daily price spikes while purchasing swing gas at daily prices. Swing gas is primarily used for peak days. When prices spike during peak use, Laclede could turn to storage resources to meet demand.[31] Laclede should have analyzed how best to use storage to avoid daily price spikes and save customers the $3.7 million explained above when buying swing gas at daily prices. Laclede's reluctance to consider this scenario is short-sighted and costs customers millions of dollars every year in demand charges.

Contrary to Laclede's assertions, there was nothing miniscule or pleasantly surprising about an $8 million jump in demand charges from one year to another. When faced with this scenario, Laclede should have issued RFPs for daily pricing, rethought their portfolio decisions, and considered taking swing supplies using the daily price. The record establishes that Laclede failed to issue a single RFP for daily pricing.[32] According to the Staff's generous calcuations, customers paid over $2 million too much.

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[30] Transcript, p. 225, l. 5-12.
[31] Transcript, p. 180, l. 25 to p. 181, l. 15.
[32] Transcript, p. 193, l. 21-23.

Laclede argues that off-system sales were approved in the 2002 rate case and any costs associated with off-system sales should not be addressed in the PGA.[33] Laclede argues that prudence reviews were somehow limited by the Stipulation in GR-2002-356.[34] Yet the demand charges in question are recouped in the PGA and the Stipulation and Agreement and On-the-Record presentation in GR-2002-356 clearly provide that prudence reviews will be conducted.[35]

Laclede did not exercise reasonable care exercising due diligence to assess the information available to it when it planned its gas purchases for the 2003-2004 period. Laclede's decisions raise serious doubts about its prudence and whether its customers should have to pay for Laclede's inadequate planning.

Laclede believes it's enough to argue that gas prices are volatile, they have experience in the industry, and they've always done it this way. It's not enough. Customers are paying million of dollars to support Laclede's off-system sales machine and receiving little benefit while shareholders are reaping the rewards. The Staff has done the work Laclede could have and should have in 2003. The Staff analyzed Laclede's decisions based on information readily available to Laclede. Staff developed the record in this case by providing the charts and calculations that Laclede could have and should have done. The Commission should consider the dearth of analytical evidence offered by Laclede as *imprudence per se*.

WHEREFORE, the Staff of the Commission urges the Commission to find Laclede was imprudent and disallow $2,055,864 in the rates charged by Laclede.

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[33] Transcript, p. 22, l. 21 to p. 24, l. 7
[34] Id.
[35] GR-2002-356

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed with first class postage, hand-delivered, transmitted by facsimile or electronic mail to all counsel and/or parties of record this this 5th day of March, 2007.

/s/ Steven C. Reed