BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Purchased Gas Adjustment (PGA) to be Audited in its 2004-2005 Actual Cost Adjustment	))))	Case No. GR-2005-0203

STAFF RECOMMENDATION

COMES NOW the Staff of the Missouri Public Service Commission and files its memorandum with recommendations in this case. Staff states:

1. On October 28, 2005, Laclede Gas Company (Laclede or Company) filed a tariff sheet proposed to become effective on November 11, 2005.

2. On November 2, 2005, Laclede filed a substitute tariff sheet to change the proposed effective date to November 14, 2005, to meet the required ten business day notice for a Purchased Gas (PGA) filing.

3. The Procurement Analysis Department (Staff) has reviewed Laclede Gas Company's (Laclede or Company) 2004-2005 Actual Cost Adjustment (ACA) filing and the results of Staff's analysis are contained in Appendix A to this pleading. Both HC and NP versions are being filed.

4. Staff audited and evaluated the Company's gas purchasing practices to determine the prudence of the Company's purchasing and operating decisions. Staff conducted a reliability analysis of estimated peak day requirements and the capacity levels needed to meet those requirements; peak day reserve margin and the reasons for this reserve margin; and a review of normal and cold weather requirements. Staff also reviewed Laclede's hedging for the period to determine the reasonableness of the Company's hedging plans and risk management strategy.

NP

5. Staff recommends that the Company be required to respond to Staff's recommendations within thirty (30) days, and make several adjustments to the ACA balance as detailed in Staff's memorandum.

WHEREFORE, the Staff recommends that the Commission accept Staff's recommendations and issue an Order consistent with Staff's Recommendations.

Respectfully submitted,

/s/ Robert V. Franson___________

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronic mail to all counsel of record this 28th day of December, 2006.

/s/ Robert V. Franson___________

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Purchased Gas Adjustment (PGA) Factors to be Audited in the Its 2004-2005 Actual Cost Adjustment.	Case No. GR-2005-0203

AFFIDAVIT OF DAVID M. SOMMERER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

David M. Sommerer, being of lawful age, on his oath states: that as Manager of the Procurement Analysis Department of the Utility Services Division he has participated in the preparation of the foregoing report, consisting of 14 pages to be presented in the above case, that he has verified that the following Staff Memorandum was prepared by Staff of the Procurement Analysis Department that have knowledge of the matters set forth as described below; that he has verified with each of the Staff members listed below that the matters set forth in the Staff Memorandum are true and correct to the best of his/her knowledge and belief,

Anne Allee:	Billed Revenues and Actual Gas Costs and Natural Gas Supply Analysis
Lesa Jenkins:	Reliability, Analysis and Natural Gas Supply Analysis
Kwang Choe:	Hedging

that he has knowledge of the matters set forth in such report and that such matters are true to the best of his knowledge and belief.

David M. Sommerer

David M. Sommerer

Subscribed and sworn to before me this 28th day of December 2006.

ASHLEY M. HARRISON NOTARY COMMISSION NUMBER 06898978 SEAL NOTARY PUBLIC STATE OF MISSOURI

Ashley M. Harrison
Notary Public

ASHLEY M. HARRISON
State of Missouri
Expires August 31, 2010
Cole County
Commission #06898978

MEMORANDUM

TO: Missouri Public Service Commission Official Case File,
Case No. GR-2005-0203, Laclede Gas Company

FROM: Dave Sommerer, Manager, Procurement Analysis Department, Utility Services Division; Anne Allee, Regulatory Auditor, Procurement Analysis Department, Utility Services Division; Lesa A. Jenkins, P.E., Regulatory Engineer, Procurement Analysis Department, Utility Services Division; Kwang Choe, Ph.D., Regulatory Economist, Procurement Analysis Department, Utility Services Division

/s/ Dave Sommerer 12/28/06 — Project Coordinator / Date

/s/ Robert Franson 12/28/06 — General Counsel's Office / Date

SUBJECT: Staff's Recommendation in Case No. GR-2005-0203, Laclede Gas Company's 2004-2005 Actual Cost Adjustment Filing

DATE: December 28, 2006

The Procurement Analysis Department (Staff) has reviewed Laclede Gas Company's (Company or Laclede) 2004-2005 Actual Cost Adjustment (ACA) filing. This filing was made on October 28, 2005, and is docketed as Case No. GR-2005-0203. The filing contains the Company's calculations of the ACA and Refund balances. The Staff's review included an analysis of billed revenues and actual gas costs for the period October 1, 2004, through September 30, 2005.

Laclede Gas Company serves approximately 648,000 residential, commercial and industrial customers in the St. Louis metropolitan area and the surrounding southeastern counties.

Staff conducted a reliability analysis for Laclede, including a review of estimated peak day requirements and the capacity levels to meet those requirements, peak day reserve margin and the rationale for this reserve margin, and a review of normal and cold weather requirements. The Staff also reviewed Laclede's gas purchasing practices to determine the prudence of the Company's purchasing and operating decisions.

RELIABILITY ANALYSIS

The Company is responsible for conducting reasonable long range supply planning and the decisions resulting from that planning. One purpose of the ACA process is to examine the reliability of the Local Distribution Company's (LDC's) gas supply, transportation, and storage capabilities. For this analysis, Staff reviews the LDC's plans and decisions regarding estimated peak day requirements and the capacity levels to meet those requirements, peak day reserve margin and the rationale for this reserve margin, and natural gas supply plans for various weather conditions.

Staff has the following comments and concerns regarding the Company's reliability information:

1. **Pipeline Capacity Planning**

a. **Downstream Pipeline Capacity**

The volumes from the downstream pipelines, ** ________________________
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Staff recommends that Laclede provide an analysis of how it evaluates the pipeline capacity available to serve ** ______________________________
____ ** to assure that the available capacity is sufficient for a peak cold day.

b. **Upstream Pipeline Capacity**

To support the quantity of upstream pipeline capacity needed, Laclede evaluated usage for a record cold day in March and also referred to its 2004/2005 Reliability Report (Data Request No. 70). In the 2003/2004 ACA, GR-2004-0273, Data Request No. 107, Laclede stated that it is the most vulnerable to daily peak sendout situations late in the winter season when on-system peak shaving resources and its storage in MRT's Unionville site are potentially depleted. Laclede's evaluation for the 2004/2005 ACA of a record cold day in March is consistent with prior information evaluated by Staff.

Staff does not agree with all of the assumptions in Laclede's Data Request No. 70 response in its justification of the upstream capacity. However, Staff's review shows that the upstream capacity contracted by Laclede would be required for a cold winter. The analysis, however, does not support why Laclede chooses to split the capacity in the manner that it does between the various pipelines. The lack of information raises the question of how Laclede evaluated the cost of sourcing the supply on each pipeline. The lack of information makes evaluation of the Company's prudence much more difficult. Staff will pursue this in more detail in future ACA reviews.

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Staff continues to have concerns that ** ______________________________
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____________________________________ ** for the months of November through April. Staff will request this information through the data request process in the ACA review.

3. **Targets for Physical Supply**

The Company's reliability report does not contain targets for actually acquiring physical supply. Having major portions of the physical supply not under contract until near the start of the heating season may pose a reliability issue. The reliability report should specify target dates for acquiring physical supply with consideration given to contracting for this supply earlier than just prior to the heating season. This issue was also a concern in the 2003/2004 ACA, Case No. GR-2004-0273.

NATURAL GAS SUPPLY ANALYSIS

Based on its review of Laclede's gas purchasing practices Staff proposes an adjustment reducing Laclede's cost of gas for its decisions regarding ** ____________________________ ______________________ ** Staff proposes Laclede conduct additional study of its producer demand charges and an analysis of ** ________________________________ ** natural gas volume requirements. Additionally, Staff recommends that Laclede revise its tariff for interruptible service and provide documentation related to its natural gas supply.

1. **Swing Supply Demand Charges**

Staff recommended a disallowance in the prior ACA case related swing demand charges. Staff continues to have the same concern regarding swing supply demand charges, and Staff's quantification of the excess charges is as follows:

ACA Period	Case No.	Adjustment
2003/2004	GR-2004-0273	$ 2,424,020
2004/2005	GR-2005-0203	$5,542,242
	Total	$ 7,966,262

The Staff recommended adjustments for the 2003/2004 ACA period is provided for reference only. The 2003/2004 ACA, Case No. GR-2004-0273 hearing is scheduled for January 29-30, 2007. The cost of the disallowance is different for the 2004/2005 ACA because there are additional swing contracts and the supply demand charges are different for each ACA.

Staff recommends that the issue be held in abeyance pending a decision for the similar issue in the 2003/2004 ACA, GR-2004-0273.

2. **Cost/Benefit Analysis for Producer Demand Charges**

In the 2003/2004 ACA, GR-2004-0273, Staff recommended an annual cost/benefit analysis to evaluate ** ____ ____ __________________ **

- ** ____ ____ ________
- ____ ____ **

- It should isolate and separately identify "off-system sales" so that costs and benefits related to on-system customers can be separately identified.

Given the level of demand charges, ** [redacted] **

The Company should also, maintain, and make available for review, in electronically readable format, all workpapers that support the study. These workpapers should maintain full functionality with readable cell formulas, macros, or other program add-ins that were used in the spreadsheet calculations. Finally, the study should be a before-the-fact study that is completed in time to help the Company assess the cost/benefits of ** [redacted] **

3. ** [redacted] **

Additionally, Laclede has ** [redacted] ** Baseload contracts have little or no fixed costs.

** [redacted] **

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As shown below, Laclede did not follow its study when setting the supply volumes for November through April. Additionally, its supply volumes for May through September are not consistent with the RFP.

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Staff recommends that Laclede complete an updated study that considers at a minimum the deficiencies pointed out by Staff. These deficiencies include the following:

- ** ____________________
- ____________________
- ____________________
- ____________________
- ____________________ **

The Company should also, maintain, and make available for review, in electronically readable format, all workpapers that support the study. These workpapers should maintain full functionality with readable cell formulas, macros, or other program add-ins that were used in the spreadsheet calculations.

4. **Interruptible Services**

The PGA charges for natural gas used during interruption for interruptible customers that was in effect during this ACA period was only $0.36359 per therm ($3.6359 per dekatherms or per MMBtu). The Fourteenth Revised Tariff Sheet No. 7, effective October 1, 2005, (after this ACA period) increased the tariff rate for gas used during a period of interruption to$2.00 per therm ($20 per dekatherms or per MMBtu). The rate is not tied to a penalty above a daily rate that could be obtained in the daily market. During periods of interruptions, there is a potential that prices in the daily market may be higher than $2.00 per therm. Thus, interruptible customers could be using and paying for natural gas during periods of interruption from Laclede that are less than the cost that could be obtained in the daily market. Staff recommends that Laclede revise this tariff to tie the charge for natural gas used during interruptions to the higher of $20 or the daily NYMEX price plus an adder.

5. **Laclede Energy Resources Supply Contracts**

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6. **General Concerns Regarding Natural Gas Supply Documentation**

Through various requests during this review the Staff asked for the following information:

- Reconciliation of gas nominated at pipeline receipt points with the city-gate deliveries on a system wide basis. This comparison would ensure that there is an evaluation of the total gas that is ordered on the various upstream pipelines and downstream pipelines that is reconciled with the volumes delivered at Laclede's various city-gates. It would help verify that volumes purchased in the production area are balanced with the deliveries and Laclede's city-gates.

- An evaluation of the reconciliation of end-user and marketer Daily Scheduled Quantities (DSQs) with actual pipeline nominations made by marketers would ensure that there is an evaluation of the gas that is nominated with Laclede at its city gate points versus the gas that is actually placed on the interstate pipeline for delivery to end-users. This is done in consideration of imbalances.

- A clear diagram or matrix that aligns Laclede's various supply packages with particular receipt points on the upstream and downstream pipelines serving Laclede with a system to monitor the status of minimum purchase requirements of the various supply packages.

Laclede provided some general material regarding these requests but was unable to show that these documents and processes exist. Staff recommends that Laclede develop such documentation and provide copies to Staff in the ACA process. If such documentation already exists, Staff recommends that Laclede identify and provide the documentation.

7. ** **

HEDGING

The Staff reviewed the Company's Risk Management Strategy and its hedging transactions applicable to the 2004-2005 ACA period. Weather during the winter period, November 2004 through March 2005, was warmer than normal. Laclede's hedged coverage comes from financial instruments and from storage withdrawals. This was not a winter that tested the hedging plan with market extremes.

The Staff also reviewed monthly hedged coverages. Because Laclede uses a combination of various option strategies that provide limited or partial hedging, Laclede should test their proposed hedges to evaluate the impact on customers of various gas price scenarios (scenarios that may occur during various winter conditions).

Laclede's board currently allows multi-seasonal hedges beyond one year depending on price-driven parameter. It is recommended that the Company's gas supply planning horizon incorporate a longer time horizon for hedging.

Staff has the following comments regarding Laclede's hedging documentation:

- Although the Company provided a copy of its risk management strategy along with some explanations of how each financial transaction fit into the Company's risk management strategies, the Staff did not find sufficient details regarding the rationale for each of its hedging transactions. For example, the Company evaluation of the market conditions that either support initiating the hedge or liquidating the hedge position were not provided. In particular, the Staff did not find any detailed explanation as to how the Company initiated liquidating the hedge position. Several other examples illustrate a lack of sufficient hedge documentation detail. The Company has increasingly used various financial hedges that are not fully explained in the documentation provided to the Staff. For example, workings of 3-way collar and 4-way collar, when placed, should be documented and explained to support how the agreement effectively hedges against possible rising natural gas prices. In addition, certain types of financial instruments were employed to synchronize hedge gains and losses to closely mimic liquidation on NYMEX closing. However, it is difficult with the information provided, to relate compound hedging strategies with the instruments that are used to build them. In addition, the type of reporting that would allow a straightforward assessment of how much of the Company's monthly hedge targets (expected volume component, price driven and time driven, etc.) are actually achieved for that month and cumulatively was not clearly provided as part of the hedge documentation. The Company tariffs allow the pass-through of prudently incurred hedging costs. Therefore it should be obligated to provide justification and support for the reasonableness of those hedging expenditures.

Staff provided similar comments in the 2003/2004 ACA, GR-2004-0273, and Laclede agreed to provide the information beginning with the 2005/2006 ACA. Based on the prior ACA recommendation and the Laclede response, Laclede should provide for the 2005-2006 ACA period forward, for each hedging transaction executed, its detailed rationale supporting its decision and a narrative of the interplay between the hedging purchase or liquidation and the

Risk Management Strategy. This should include all reports that tie the Company's actual hedge results to the targets stated in the Company's risk management strategy and a specific identification of instruments that are used in conjunction to create a particular hedge strategy. The Staff further recommends this documentation should be maintained and be made available to the Staff at the start of each ACA review.

RECOMMENDATIONS

It is Staff's opinion that Laclede should do the following:

1. Establish the following account balances in its next ACA filing to reflect the (over)/under recovery of ACA and Refund balances to be (refunded)/collected from the ratepayers as of September 30, 2005:

	Firm Sales non-LVTSS	Firm Sales LVTSS	Interruptible Sales	LP Sales	Firm Transportation	Vehicular Fuel	Refund
Beginning ACA Balance	$ 26,855,658	$956,225	$ 114,609	$ 4,055	$ 921,984	$ 19,099	$ 222,274
Staff Adjustments:							
Swing Supply Demand Charges	$ (5,528,187)	$ (14,055)					
LER Supply Contract Adjustment	$ (1,677,493)	$(4,265)	$(13,455)				
Ending ACA Balance	**$ 19,649,978**	**$937,905**	**$ 101,154**	**$ 4,055**	**$ 921,984**	**$ 19,099**	**$ 222,274**

2. Respond within thirty days to the comments made by Staff in the Reliability Analysis Section regarding pipeline capacity planning, including downstream pipeline capacity and upstream pipeline capacity, continuation of winter month data for Laclede's Lange underground storage resource, and targets for physical supply.

3. Respond within thirty days to the comments made by Staff in the Natural Gas Supply Analysis Section regarding swing supply demand charges, cost/benefit analysis for producer demand charges, analysis of ** ____ ** interruptible service, and documentation related to its natural gas supply.

4. Adjust the ACA balance by $5,542,242 for Laclede's decisions related to swing supply demand charges.

5. Adjust the ACA balance by $1,695,213 for Laclede's decisions related to its supply contract with Laclede Energy Resources.

6. Respond within thirty days to the comments made by Staff in the Hedging Section.

7. Document and provide to the Staff by March 30, 2007, for each hedging transaction executed, the following information for the 2005-2006 ACA period forward:

a. For each hedging transaction executed, Laclede's rationale supporting its decision at the time of the specific transaction and a narrative of the interplay between the hedging purchase or liquidation and the Risk Management Strategy in greater detail. This should include all reports that tie the Company's actual hedge results to the targets stated in the Company's risk management strategy and a specific identification of instruments that are used in conjunction to create a particular hedge strategy.

b. Laclede's evaluation of the market conditions at the time of specific transactions that either support initiating the hedge or liquidating the hedge position.

c. A written explanation of workings of the various option and spreading strategies utilized by Laclede contained in its hedging reports to management, the hedging committee, and/or the board of directors, especially as to what specific financial instruments are utilized by the strategies, how they work, and why they are used and when the strategies are employed.

d. A written explanation of any swaps that are acquired to synchronizing hedge gains and losses to more closely mimic liquidation an NYMEX closing, including an explanation of how this reduces exposure to upward price volatility. Specific transactions that Laclede actually executed must be utilized to explain the concept.

e. A report of how much of the Company's monthly hedge targets (price driven and time driven) are actually achieved for that month and cumulatively.

8. Respond to the recommendations herein within 30 days.