

Exhibit No.:

Issue: PGA revisions to
address gas cost
portion of bad debt
write-offs

Witness: Michael T. Cline

Type of Exhibit: Surrebuttal Testimony

Sponsoring Party: Laclede Gas Company

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LACLEDE GAS COMPANY

GT-2009-0026

SURREBUTTAL TESTIMONY

OF

MICHAEL T. CLINE

NOVEMBER 2008

Laclede Exhibit No. 2
Case No(s) GT-2009-0026
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TABLE OF CONTENTS

1.	Purpose of Testimony	1
2.	The Gas Cost Portion of Bad Debts Is a Direct Gas Cost	2
3.	The Company's Proposal Is Not Single Issue Ratemaking	4
4.	The Company's Proposal Is Not Retroactive Ratemaking	5
5.	Potential Changes in the Gas Cost Portion of Bad Debts in Today's Volatile Market Warrants a New Recovery Approach....	6
6.	The Concern That the Gas Cost Portion of Bad Debts Cannot Be Precisely Quantified Is a Red Herring.....	7
7.	Miscellaneous Matters.....	8

1 **SURREBUTTAL TESTIMONY OF MICHAEL T. CLINE**

2 Q. Please state your name and address.

3 A. My name is Michael T. Cline and my business address is 720 Olive Street, St.
4 Louis, Missouri 63101.

5 Q. Are you the same the same Michael T. Cline who previously filed direct testimony
6 in this proceeding?

7 A. Yes.

8 **Purpose of Testimony**

9 Q. What is the purpose of your surrebuttal testimony in this proceeding?

10 A. The purpose of my testimony is to respond to certain rebuttal testimony filed by
11 Staff witnesses Thomas Solt and David Sommerer and Office of the Public
12 Counsel ("OPC") witness Russell Trippensee. Specifically, I will: 1) explain why
13 the gas cost portion of bad debt write-offs is a direct gas cost that should be
14 eligible for true-up through the Company's Purchased Gas Cost Adjustment
15 ("PGA") clause; 2) address allegations related to single issue and retroactive
16 ratemaking; 3) illustrate why the Company's proposal is necessary in light of the
17 recent volatility and magnitude of gas costs; 4) explain why concerns regarding a
18 precise quantification of the gas cost portion of bad debts are exaggerated; and 5)
19 address other miscellaneous matters. Company witnesses Glenn Buck and Russell
20 Feingold will respond to certain other rebuttal of my direct testimony.

The Gas Cost Portion of Bad Debts Is a Direct Gas Cost

1
2 Q. On page 4 of his rebuttal testimony, Mr. Solt states that "bad debt is not a gas cost".
3 And again on page 5, Mr. Solt states that "bad debts are not direct gas costs". Do
4 you agree?

5 A. Under the assumption that Mr. Solt is referring to the gas cost portion of bad debts,
6 which is the particular cost that is being addressed in the Company's proposed tariff
7 filing, my answer is obviously no. The gas cost portion of bad debts is, in fact, a
8 gas cost and a direct one at that. It is hard to believe that one could rationally
9 construe it any other way. There is no denying that bad debts, or more precisely
10 from an accountant's perspective, the provision for bad debts, occupies a different
11 line in the Company's income statement. However, there is also no denying that
12 the revenues that are being written-off when a customer fails to pay a bill are
13 predominantly gas cost related. The fact that a customer failed to pay their gas bill
14 does not alter the gas cost origin of most of the charges that were billed to that
15 customer.

16 Q. What are the various types of costs that are considered gas costs for recovery
17 through the Company's PGA clause today?

18 A. These costs include the cost of the gas supply itself, the costs to reserve those
19 supplies, the various costs incurred by the Company to provide for the
20 transportation of those supplies from producing regions to the St. Louis area, and
21 the cost of natural gas pipeline company storage of such gas. These costs, as well
22 as financial hedging costs, deferred gas cost carrying costs and gas inventory
23 carrying costs, are all indistinguishable from, and in fact are identical to, those costs

1 which comprise the gas cost portion of bad debts, the only difference being whether
2 a customer has paid their gas bill or not. For example, if Mr. Solt and his neighbor
3 both purchased the same amount of gas from Laclede, the cost of gas for Laclede to
4 serve both of these customers is identical. Yet, if Mr. Solt pays his bill but his
5 neighbor does not, Mr. Solt somehow would have us pretend that the gas cost origin
6 of his neighbor's bill suddenly and inexplicably disappears.

7 Q. Isn't your proposal analogous to what occurs today through the Actual Cost
8 Adjustment ("ACA") portion of the Company's PGA clause?

9 A. Yes. The ACA recognizes that, even though customers' bills include charges to
10 recover the cost of gas, there needs to be a true-up to ensure that in the end the
11 Company's gas cost related revenues match its gas costs. For example, if the
12 Company sells more or less volumes of gas than the level used to establish rates, it
13 may over recover or under recover its fixed gas supply costs. As a result, the ACA
14 subsequently credits or charges customers to correct that mismatch. The same type
15 of correction is warranted for the difference between the gas charges that are left
16 unpaid by customers when the Company writes off bad debts and the gas charges
17 that were included in the bad debts used to establish rates in the Company's last
18 general rate proceeding. In both of these instances there is a mismatch between
19 what the Company paid for gas and what it collected from customers to recover
20 those costs. In summary, it's perplexing to me how someone with any knowledge
21 at all of the Company's cost structure and the nature and characteristics of the gas
22 supply and transportation resources it acquires to serve its customers can somehow

1 contend that, by customers not paying bills, the gas cost portion of the bill loses its
2 identity as a gas cost.

3 **The Company's Proposal Is Not Single Issue Ratemaking**

4 Q. How do you respond to Mr. Trippensee's allegation on page 6 of his rebuttal
5 testimony that the Company's proposal "constitutes single issue ratemaking"?

6 A. Mr. Trippensee's label for the Company's proposal is a convenient and familiar
7 crutch on which he relies to attempt to dissuade the Commission of the merits of the
8 Company's proposal and which also appeals to a principle that has not been
9 consistently applied over the years.

10 Q. Please explain.

11 A. First, I have been advised by legal counsel that the Company's proposal does not
12 run afoul of any kind of single issue ratemaking prohibition, notwithstanding Mr.
13 Trippensee claims to the contrary. Second, PGA treatment can undeniably go both
14 ways for both the customer and Company. The Company's proposed PGA
15 treatment of the gas cost portion of its bad debt write-offs is decidedly unlike other
16 instances where it could be argued that addressing a single issue in between rate
17 cases was likely to have a one-sided impact on customers. To the contrary, given
18 the extreme volatility in natural gas prices and the recent and dramatic declines in
19 those prices, PGA treatment of the gas cost portion of bad debts is just as likely to
20 have a positive impact on the customer over the short-term. Third, while Mr.
21 Trippensee may choose to ignore it, the fact remains that the Commission has
22 routinely considered or made changes in the Company's tariffs between rate cases,
23 some of which have been recommended by OPC itself. Among others, these have

1 included: (1) consideration of changes to the rate design of Laclede's PGA; (2)
2 revisions to Laclede's Gas Supply Incentive Plan; (3) changes to the Cold Weather
3 Rule which significantly affected the Company's ability to collect past due amounts
4 as a condition of restoring or retaining service; (4) implementation of financial
5 hedging requirements and measures for gas supply costs, together with PGA
6 revisions designed to address the cost of such requirements; and (5) changes to
7 other terms and conditions of providing service to the Company's customers.
8 Notably, some of these changes did or could have had a financial impact on Laclede
9 equivalent to or even greater than anything that might result from the Company's
10 proposal in this case. If parties are free to propose, and the Commission is free to
11 adopt these kinds of changes between rate cases, I can see absolutely no practical,
12 equitable or theoretically consistent basis for OPC's single issue ratemaking claims
13 in this case. This is especially true in a situation such as this where there is a direct
14 link between gas costs and the gas cost portion of bad debts and even when, unlike
15 the other examples I cited above, the customers' rates are just as likely to be
16 lowered as raised due to volatile natural gas prices.

17 **The Company's Proposal Is Not Retroactive Ratemaking**

18 Q. Do you agree with Mr. Trippensee's characterization on pp. 13-14 of his rebuttal
19 testimony that Laclede's proposed treatment "perfectly describes retroactive
20 ratemaking"?

21 A. No. Again, I have been advised by legal counsel that there is no merit to Mr.
22 Trippensee's claim. In fact, it is apparent to me that Mr. Trippensee is simply
23 resorting to using another regulatory taboo in his efforts to misrepresent the nature

1 and effect of Laclede's proposal. Despite Mr. Trippensee's claims to the contrary,
2 the Company only intends to implement its bi-directional proposal on a prospective
3 basis. The Company does not seek to recover or return any difference, positive or
4 negative, in the gas cost portion of past bad debt write-offs. Instead, as clearly
5 described in the Company's proposed tariff sheets, the gas cost portion of bad debt
6 write-offs would be used in the Company's ACA gas cost reconciliation beginning
7 only with those write-offs that occur with the effective date of the proposed tariff
8 sheets, not for any write-offs occurring before that time. For Mr. Trippensee to
9 suggest otherwise is misleading.

10 **Potential Changes in the Gas Cost Portion of Bad Debts**
11 **In Today's Volatile Market Warrants a New Recovery Approach**
12

13 Q. On page 10 of his rebuttal testimony Mr. Trippensee downplays the significance of
14 changes in bad debts write-offs in recent years. Do you agree with his conclusion?

15 A. No, I do not agree with Mr. Trippensee for two reasons. First, the gas cost portion
16 of the changes he illustrates while perhaps not significant when translated into rates
17 for an individual customer would have a meaningful impact on the Company's
18 earnings. Secondly, the gas price volatility we have witnessed since the start of this
19 year is cause for concern in terms of its potential impact on bad debts. Natural gas
20 prices peaked above \$14 per MMBtu on the New York Mercantile Exchange earlier
21 this summer, yet today prices have dropped precipitously in a relatively short period
22 of time back to levels below where they were at the start of 2008. Rather than have
23 customers pay more for the gas cost portion of bad debts in a falling price
24 environment or have the Company absorb unnecessary losses in a rising price

1 environment, the Company's proposal should be adopted as a fair resolution for
2 both sides.

3 **The Concern That the Gas Cost Portion of Bad Debts**
4 **Cannot Be Precisely Quantified Is a Red Herring**
5

6 **Q.** On page 6 of his rebuttal testimony Mr. Solt claims that the "bad debt expenses
7 included in a PGA/ACA mechanism are not auditable". Also, Mr. Sommerer on
8 pages 5-6 of his rebuttal testimony makes numerous allegations about the lack of
9 precision in the Company's proposal, leaving the Commission with the
10 impression that such should be a major obstacle to its approval. How do you
11 respond to these concerns?

12 **A.** These statements and accusations are nothing more than a reflection of the Staff's
13 unwillingness to work with the Company on a more progressive and improved
14 means for the Company to recover, and for customers to pay, costs that are far
15 more volatile than any other costs the Company incurs. The fact remains that the
16 gas costs which the Company incurs to serve customers who do not pay their bills
17 are just as auditable as any other gas cost. In fact, they are currently audited in
18 exactly the same way and nothing in the Company's proposal would change that.
19 Indeed, all the Staff needs to do is to ensure that the Company has not recovered
20 any more than its prudently incurred gas costs by tracking what those costs are
21 from year to year and its mission will be complete. Given its access to all
22 supplier invoices that should not be a problem. I am also amazed that Mr.
23 Sommerer would raise a concern that implementation of the Company's proposal
24 would be problematic because of the need to use estimates. In fact,
25 implementation of the Company's proposal will do just the opposite by

1 substituting actual gas costs as the basis for charging customers rather than
2 someone's guesstimate of what those gas costs might be in a rate case. If the
3 Staff is looking for more precision and less estimating in the ratemaking process
4 then implementation of the Company's proposal is the solution, not the problem.

5 Q. In the event the Commission concluded that this was a valid concern, however, is
6 there an alternative approach for addressing it?

7 A. I believe that the Staff would be hard-pressed to deny that gas costs comprise the
8 majority of the Company's costs and that an attempt like the Company's to
9 quantify such costs produces a more accurate result for both the Company and its
10 customers. Nevertheless, if the Staff's main reluctance to embrace the
11 Company's proposal is grounded in some perceived imprecision in attempting to
12 estimate what everyone knows to be reality, that being that bad debt write-offs are
13 predominantly gas cost related, there are alternative methods that could be
14 explored. For example, gas costs and non-gas costs could be split by simply
15 multiplying the ratio of bad debt write-offs to total revenues in each ACA year by
16 the Company's actual gas costs and comparing the result to the level built into
17 base rates.

18 **Miscellaneous Matters**

19 Q. What is the relevancy in this proceeding of Laclede Energy Resources which Mr.
20 Sommerer mentions on pp. 6-7 of his rebuttal testimony?

21 A. Absolutely none.

22 Q. On page 7 of his rebuttal testimony Mr. Solt states that the Company is "proposing
23 to recover 75% of any differential between the level of bad debts it is actually

1 incurring" and the amount of gas cost embedded in base rates. Do you agree with
2 his statement?

3 A. No. The Company's tariff refers to the difference between the amount of gas cost
4 embedded in base rates and the gas cost portion of actual write-offs. The
5 percentage of write-offs related to gas cost will fluctuate from period to period
6 primarily depending on the magnitude of gas prices but will not necessarily be 75%
7 as it was during the period used in the establishment of the Company's base rates.

8 Q. Does this conclude your testimony?

9 A. Yes, it does.

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