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September 27, 2002

FILED[3]

SEP 27 2002

Missouri Public
Service Commission

Mr. Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
200 Madison Street, Suite 100
P.O. Box 360
Jefferson City, Missouri 65102

RE: *Laclede Gas Company*, Case Nos. GR-2001-387 and GR-2000-622.

Dear Mr. Roberts:

Enclosed for filing in the above-referenced matter on the behalf of Laclede Gas Company is an original and six (1) copies of the Highly Confidential version of the Direct Testimony of Steven F. Mathews and one copy of the Non-proprietary version of the Direct Testimony of Steven F. Matthews. The copies of the HC version have been filed under seal, pursuant to the terms of the Protective Order.

Copies of the foregoing have been hand-delivered or mailed this date to the Office of the Public Counsel and Dana K. Joyce, General Counsel. Thank you for your attention to this matter.

Sincerely,

James M. Fischer

James M. Fischer

Enclosures

cc: Office of the Public Counsel
Dana K. Joyce, General Counsel

Exhibit No.:	
Issue:	**ACA Issues**
Witness:	**Steven F. Mathews**
Type of Exhibit:	**Direct Testimony**
Sponsoring Party:	**Laclede Gas Company**
Case No.:	**GR-2001-387/GR-2000-622**
Date:	**September 27, 2002**

FILED[3]

SEP 2 7 2002

Missouri Public Service Commission

LACLEDE GAS COMPANY

GR-2001-387/GR-2000-622

DIRECT TESTIMONY

OF

STEVEN F. MATHEWS

NP

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Purchased Gas Adjustment Tariff Revisions to be Reviewed in Its 2000-2001 Actual Cost Adjustment	))))	Case No. GR-2001-387
In the Matter of Laclede Gas Company's Purchased Gas Adjustment Factors to be Reviewed in Its 1999-2000 Actual Cost Adjustment	))))	Case No. GR-2000-622

<u>AFFIDAVIT</u>

STATE OF MISSOURI)
) SS.
CITY OF ST. LOUIS)

Steven F. Mathews, of lawful age, being first duly sworn, deposes and states:

1. My name is Steven F. Mathews. My business address is 720 Olive Street, St. Louis, Missouri 63101; and I am Assistant Vice President-Gas Supply of Laclede Gas Company.

2. Attached hereto and made a part hereof for all purposes is my direct testimony, including one schedule.

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

Steven F. Mathews

Steven F. Mathews

Subscribed and sworn to before me this 26th day of September, 2002.

Joyce L. Jansen

JOYCE L. JANSEN
Notary Public — Notary Seal
STATE OF MISSOURI
ST. CHARLES COUNTY
My Commission Expires: July 2, 2005

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DIRECT TESTIMONY OF STEVEN F. MATHEWS

Q. What is your name and business address?

A. My name is Steven F. Mathews and my business address is 720 Olive Street, St. Louis, Missouri 63101

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

A. I am employed by Laclede Gas Company ("Laclede" or "Company") in the position of Assistant Vice President - Gas Supply.

Q. Please state how long you have held your present position, and briefly describe your responsibilities.

A. I have held this position since December 2000. In that position, I am responsible for the overall management of the Company's gas supply resources. This includes negotiating Laclede's natural gas supply and transportation arrangements under the supervision of Kenneth J. Neises, Laclede's Executive Vice President-Energy and Administrative Services.

Q. What is your educational background?

A. I graduated from William Jewell College with a Bachelor of Science degree in Business Administration.

Q. Please describe your experience with Laclede.

A. I was hired by Laclede in 1989 as an Assistant to the Executive Vice President of Operations and Marketing. Prior to my present position I have held numerous positions, including Manager of Gas Supply Administration and Director of Gas Supply.

Q. Have you previously submitted testimony before this Commission?

A. Yes. I presented testimony in Case No. GR-93-149, Case No. GR-98-297 and Case No. GR-2002-356.

Purpose of Testimony

Q. What is the purpose of your direct testimony?

A. The purpose of my direct testimony is to address the two issues remaining in these cases. The first centers on whether Laclede can or should be required to flow through to its customers the remaining portion of the Company's share of the $28.5 million in financial instrument proceeds that the Company achieved during the 2000-01 ACA period under the Price Stabilization Program ("PSP"). In its June 28, 2002 Recommendation in this case, the Staff has proposed that this remaining share, which totals approximately $4.9 million, be flowed through to the Company's customers in addition to the $23.6 million in proceeds that customers have already received as a result of the Company's efforts under the Program. For the reasons I discuss below, Laclede believes there is no basis for such an adjustment.

Q. What is the second issue you will address?

A. The second issue relates to the one Staff recommendation regarding reliability analyses that the Company and Staff had not yet resolved at the time we filed our respective pleadings in this case. As discussed below, the Staff and Company have now reached agreement on this issue and my testimony will briefly discuss the terms of that agreement.

Price Stabilization Program

Q. Please describe the origins and structure of the PSP.

A. The PSP under consideration in this case was a tariffed program that was approved by the Commission in Case No. GO-98-484 for a three year term beginning in 1999. The purpose of the PSP was to authorize and encourage Laclede to reduce the impact of natural gas price volatility on the Company's customers through the use of certain financial instruments. The PSP provided incentives for the Company to: (i) lower the effective price of gas through the purchase of call options (the "Price Protection Incentive"); and (ii) achieve savings through a reduction in the cost of the program either through favorable purchase prices or intermediate option sales (the "Overall Cost Reduction Incentive").

Q. What results did the Company achieve under the PSP during the ACA period under review in this case?

A. During the winter of 2000-2001, the Company managed to achieve approximately \$28.5 million in savings under the PSP through its purchase and sale of financial instruments. These proceeds were generated with an initial, authorized expenditure of approximately \$4 million, plus transaction costs.

Q. Under which of the incentive features of the PSP were these savings achieved?

A. Of the overall amount, approximately \$11.5 million was attributable to the Price Protection Incentive portion of the PSP.

Q. Did Laclede retain a share of these savings?

A. No. Because Laclede opted out of participating in the Price Protection Incentive for 2000-2001, Laclede kept none of these proceeds, but instead flowed all of them through to its customers. Moreover, Laclede requested and received the Commission's permission to flow these amounts through to its customers on an expedited basis.

Q. What about the remaining $17 million in savings?

A. The remaining $17 million in savings was attributable to the Overall Cost Reduction Incentive portion of the PSP. Pursuant to the terms of the PSP tariff, Laclede's share of these savings was approximately $8.9 million, with the remainder again flowed through to Laclede's customers in their entirety.

Q. Did Laclede seek to retain its full share of these savings?

A. No. Of the $8.9 million that Laclede was entitled to retain pursuant to these tariff provisions, Laclede volunteered to, and in fact did, contribute $4 million to supplement the funds available for option purchases under the 2001-2002 PSP in the event the Commission decided to continue the program for its third year. As a result, Laclede retained in total only about $4.9 million of the $28.5 million in gains and savings that it achieved for it and its customers during the 2000-2001 PSP period. It is this last $4.9 million in savings that the Staff seeks to take from the Company with its proposed adjustment in this proceeding.

Q. Why is it appropriate for Laclede to retain this amount?

A. The entirety of the $17 million in proceeds earned by Laclede under the Overall Cost Reduction Incentive were achieved through intermediate option liquidations (i.e., liquidations that took place prior to the last three days before an option would have expired). Pursuant to Sections G.4(b) and (c) on page 28-f of Laclede's tariff and the Price Stabilization Program Description (the "Program Description") referred to in paragraph G.1 of Laclede's tariff, any proceeds earned by Laclede as a result of such intermediate liquidation activity is to be accounted for under the provisions of the Overall Cost Reduction Incentive. Copies of the applicable tariff pages and Program Description are set forth in Schedule 1.

Q. Please describe the relevant portions of the tariff and Program Description contained in Schedule 1.

A. The tariff, through reference to the Program Description, makes it clear that savings from **“ ”** -- i.e. intermediate option liquidations -- must be attributed to and accounted for under the Overall Cost Reduction Incentive. Consistent with this tariff language, and the record evidence in Case No. GO-98-484 which specified how it was to be implemented, all proceeds from such intermediate activities were to be considered a savings from the Maximum Recovery Amount ("MRA") as the result of intermediate option liquidations. During the ACA period in question, the Company achieved $17 million in such proceeds as a result of such liquidations and it is this amount that, pursuant to the tariff and Program Description, the Company used to calculate its savings. This method, as discussed in both the tariff and the Program Description, is the only objective and reasonable way to determine cost savings under the Overall Cost Reduction Incentive portion of the PSP tariff.

Q. Does Staff's proposed adjustment comply with these provisions?

A. No. In proposing its adjustment, Staff asserts that Laclede had no savings and should therefore relinquish the \$4.9 million. Staff appears to have reached this conclusion by comparing the options proceeds Laclede achieved through intermediate option liquidations against the hypothetical proceeds that it claims could have been achieved had Laclede held the options "till near expiration." Although Staff claims that this is an objective standard for determining savings, it is neither objective nor reasonable. To the contrary, Staff's standard is one that has been created long after these transactions took place based on an improper and inconsistent hindsight review of the results of those transactions. In effect, Staff's argument is that Laclede should receive absolutely no portion of the incentive savings, not because there were no savings, but because the savings were not as great as they could have been had Laclede, in hindsight, acted differently. There is simply no support in the PSP tariff for Staff's method of determining cost savings.

Q. Does Staff's approach attempt to calculate the savings from the Company's intermediate option liquidation activities in a consistent manner?

A. No. While the Staff seeks to penalize the Company because it liquidated certain options prior to a time when, based on a hindsight review, they would have had a higher value, it completely fails to recognize that the Company would not even have had the funds to purchase many of those options had it not already liquidated options through its prior intermediate liquidation activities. In fact, Staff's adjustment assumes that the Company had nearly \$9 million to spend on purchasing options when only \$4 million was collected for that purpose pursuant to the terms of the Program. The difference was created by the Company through its intermediate liquidation activities. In short, Staff picks and chooses only those financial aspects of the Company's intermediate activities that favor its position.

Q. Is the standard chosen by Staff inappropriate for any other reason?

A. Yes. In addition to being contrary to the tariff, Staff's proposed standard for measuring savings based on what the value of an option would have been "near expiration" is also vague and indefinite. It cannot be determined if the benchmark is the 1st day before expiration, the 2nd day before expiration, the 3rd day before expiration or some other period. This is another flaw in Staff's "objective" standard since it is possible that an option could have a significant swing during those days.

Q. Are there any other flaws in Staff's proposed adjustment?

A. Until Laclede sees a more complete explanation, it is impossible to determine what other flaws there may be. It is clear, however, that in making its recommendation, Staff does not consider the $11.5 million that Laclede earned solely for its customers through the Price Protection Incentive. Nor does Staff consider the $4 million Laclede voluntarily contributed to the 2001-2002 PSP, nor the portion of the $17 million earned under the Overall Cost Reduction Incentive that was also flowed through to customers, nor other offsets. Instead, Staff considers only the $4.9 million retained by Laclede, and whether that amount can also be taken from the Company by comparing amounts achieved by Laclede to an arbitrary standard. In addition to being unsupported, I believe such a selective approach is also fundamentally unfair in that it seeks to deprive Laclede of every last penny of the significant savings it achieved under a Program that was specifically designed to provide incentives. Moreover, it does so through an incomplete, after-the-fact analysis that not only ignores the savings that the Company achieved and flowed through to its customers during the ACA period, but also ignores the substantial financial benefits that were produced for the Company's customers as a result of Laclede's voluntary contribution of $4 million towards the purchase of financial instruments during the subsequent ACA period.

Q. What financial benefits are you referring to?

A. If, as Staff has tried to do, the Commission were to look beyond the PSP tariff and Program Description and calculate savings in a manner different than that contemplated by the tariff, it is clear to me that a more comprehensive and balanced calculation of those savings would have to be done. It is equally clear that such a calculation would further erode any support for Staff's proposed adjustment in that it would show that Laclede's activities saved its customers far more than the amounts explicitly recognized under the Program.

Q. Please explain what you mean.

A. As I previously discussed, the Company voluntarily contributed $4 million of its share of the savings achieved during the second year of the Program towards the purchase of additional financial instruments during the third year of the program. As a result of this contribution, the Company was able to purchase call options during the third year of the Program on approximately 20% more of its winter volumes than would have been the case had Laclede not provided this supplemental funding.

Q. What were the financial consequences for the Company's customers as a result of the Company obtaining such additional protection?

A. Because the Company had this additional, upward protection on a significant portion of its winter volumes, it did not feel the need to lock in a fixed price on all or a portion of its gas supplies during the relatively high priced market environment that was being experienced during the late winter, spring and summer of 2001. In other words, since it had call option protection on these volumes that limited the Company's upward exposure to increases in the cost of its wholesale gas supplies, Laclede did not, like a number of other utilities, find it necessary to fix prices on these volumes. As a result, when gas prices declined -- and declined substantially -- throughout the remainder of the year, the Company and its customers were in a position to take full advantage of those price declines. The end result is that the Company was able to save its customers approximately $30 million in gas costs compared to what the Company would have incurred had it not supplied the funds necessary to obtain this protection.

Q. Has Laclede proposed to retain a share of these additional savings?

A. No. Laclede has flowed through or will flow through all of these savings to its customers. And as a result, the financial benefits received by those customers as a result of the Company's hedging efforts during the ACA period will ultimately exceed $50 million -- an amount that is ten times greater than the $4.9 million that the Company has actually retained under the PSP.

Q. Given the magnitude of these savings, why has the Company not proposed to retain a larger share of them?

A. Because under the rules that were in effect at the time these transactions were undertaken, Laclede knew and understood that it was not entitled to retain such a share. Just as there was no tariff authority that would permit the Company to retain a portion of these additional savings, however, there is also no tariff authority for Staff's attempt to deprive the Company of the amounts it has retained under the PSP. Accordingly, neither Staff's adjustment nor any adjustment relating to these additional savings should be made. However, to the extent that the Staff has attempted to go beyond the tariff and establish a new method for determining how savings should be calculated under the PSP, the Commission should be aware that Staff's calculation is as incomplete as it is unauthorized.

Q. Do you have any concluding comments on this issue?

Yes. For the reasons I have discussed, Laclede disputes Staff's position regarding how to evaluate the cost savings generated under the 2000-2001 PSP. Staff's standard is neither objective nor reasonable, and it conflicts with the tariff and Program Description. Laclede opposes the Staff's proposed adjustment to the ACA balance set forth on page 4 of its Recommendation. Laclede maintains that pursuant to the terms of the tariff and Program Description, the Company is entitled to retain the $4.9 million it earned under the 2000-2001 PSP.

Evaluation of Normal Adjustment Factors

Q. Please discuss the second issue that you mentioned previously.

A. In both its June 28, 2002 Recommendation and its earlier Recommendation in Case No. GR-2000-622, the Staff recommended that Laclede be required to evaluate whether the Normal Adjustment Factors ("NAF") used by the Company from a 1990/1991 study are still appropriate for purposes of reliability planning. The Staff recommended that the results of this analysis be presented by April 1, 2003. As in Case No. GR-2000-622, Laclede initially responded that it would make such an evaluation and present its recommendations by November 1, 2003.

Q. Has this issue now been resolved?

A. Yes. Based on subsequent discussions, both the Staff and the Company have agreed that Laclede should submit such findings and commit to either retaining such NAF or proposing an alternative by June 1, 2003. Accordingly, the Company considers this issue to be resolved for purposes of these proceedings.

Q. Does this conclude your direct testimony?

A. Yes, it does.

SCHEDULE 1

Laclede Gas Company — For Refer to Sheet No. 1

Name of Issuing Corporation or Municipality — Community, Town or City

SCHEDULE OF RATES

G. Experimental Price Stabilization Fund

1. Overview - For purposes of reducing the impact of natural gas price volatility on the Company's customers, the Company shall maintain a Price Stabilization Fund ("PSF") for the procurement of certain natural gas financial instruments, which procurement shall be subject to the incentive features described below. The parameters of the PSF are included in the Description of the Incentive Price Stabilization Program filed by the Company on June 25, 1999 in Case No. GO-98-484, which description has been designated "Highly Confidential" and is only available to the Missouri Public Service Commission or to any proper party that executes a non-disclosure statement. Accordingly, the definitions of certain terms have not been disclosed herein but are available in such description.

2. Accounting for Expenses and Revenues - The PSF shall be debited with all costs and expenses associated with the Company's procurement of financial instruments and credited with all gains realized from such instruments, subject to the provisions of the Price Protection Incentive and the Overall Cost Reduction Incentive set forth below.

Effective with the Company's 1999 Winter PGA rates, the Company shall include a Price Stabilization Charge in the Commodity-Related unit gas component set forth in paragraph A.2.c. of this clause, as such charge applies to all rate schedules other than LVTSS. Such charge shall be designed to recover from customers the Maximum Recovery Amount ("MRA") established by the Commission in Case No. GO-98-484 for purposes of procuring natural gas financial instruments. The PSF shall be credited with all revenues collected through such charge.

DATE OF ISSUE June 25, 1999 (month day year) — DATE EFFECTIVE July 26, 1999 (month day year)

ISSUED BY K. J. Neises, Senior Vice President, 720 Olive Street, St. Louis, MO 63101

name of officer — title — address

Laclede Gas Company — Name of Issuing Corporation or Municipality — For Refer to Sheet No. 1 — Community, Town or City

SCHEDULE OF RATES

G. Experimental Price Stabilization Fund

3. Price Protection Incentive - To provide an incentive for the Company to procure natural gas financial instruments with the greatest amount of price protection, the Company and all customers other than those billed under the LVTSS rate schedule shall share certain gains and costs as follows:

a) 100% of Type I Gains shall be credited to the PSF;

b) 75% of Type II Gains shall be credited to the PSF and the remaining 25% shall be credited to the IR Account;

c) 60% of Type III Gains shall be credited to the PSF and the remaining 40% shall be credited to the IR Account; and

d) The IR Account shall be debited and the IA Account shall be credited for 100% of Type I Costs.

The foregoing gains and costs shall be calculated in conformance with the parameters approved by the Commission in Case No. GO-98-484.

4. Overall Cost Reduction Incentive - To provide an incentive for the Company to reduce the overall cost of price stabilization, at the end of each ACA year the Company shall account for any differences between the MRA and the net cost of price stabilization ("Actual Cost") for the preceding heating season, exclusive of the gains and costs covered by Section G.3, in accordance with the following schedule:

a) If the Actual Cost exceeds the MRA, the IA Account shall be credited and the IR Account shall be debited for 100% of such excess;

b) If the Actual Cost is less than the MRA, the IA Account shall be debited and the IR Account shall be credited for 40% of the difference between the MRA and the Actual Cost so long as such difference is less than $6,666,666.66; and

c) If the difference computed in 4.b) above is greater than or equal to $6,666,666.66, the IA Account shall be debited and the IR Account shall be credited for $2,666,666.66 plus 60% of the amount by which such difference exceeds $6,666,666.66.

DATE OF ISSUE June 25, 1999 (month day year) DATE EFFECTIVE July 26, 1999 (month day year)

ISSUED BY K. J. Neises, Senior Vice President, 720 Olive Street, St. Louis, MO 63101 (name of officer, title, address)

Laclede Gas Company
Name of Issuing Corporation or Municipality

For Refer to Sheet No. 1
Community, Town or City

SCHEDULE OF RATES

G. Experimental Price Stabilization Fund

5. Carrying Costs - At the end of each month carrying costs shall be applied to any balance in the PSF at a simple rate of interest equal to the prime bank lending rate as published in The Wall Street Journal on the first day of such month) minus one percentage point.

6. Reconciliation - At the end of each ACA year, any debit or credit balance in the PSF applicable to the preceding heating season, including interest, shall be charged or returned to the Company's non-LVTSS sales customers through the ACA factor established in the next Winter PGA filing. Also, any debits or credits recorded in the IA Account, including any balance from the previous ACA year, shall be accumulated and combined with the appropriate Deferred Purchased Gas Cost Account balances. The Company shall separately record that portion of ACA revenue recovery which is attributable to recovery of the balance in the IA Account. Any remaining balance shall be reflected in subsequent ACA computations.

7. Term - The Incentive Price Stabilization Program shall apply to the procurement and liquidation of certain financial instruments for the three heating seasons commencing with the 1999/2000 season, subject to revisions, if any, ordered by the Commission in accordance with the terms of the Program.

DATE OF ISSUE June 25, 1999 (month day year) DATE EFFECTIVE July 26, 1999 (month day year)

ISSUED BY K.J. Neises, Senior Vice President, 720 Olive Street, St. Louis, MO 63101
name of officer title address

Laclede Gas Company
Description of Incentive Price Stabilization Program

Required Price Protection: Laclede is obligated to hold
** ____ **

Authorized Financial Instruments: Laclede shall only be authorized under this program to purchase or sell** ______________________________. **

Maximum Recovery Amount ("MRA") for the Program: ** ______________. **

Term of the Program: Effective for 3 years. The Commission has the right, but not the obligation, to review the program annually and revise it to correct major deficiencies on or before February 15.

Incentive Mechanism:

1. Establishing Price Parameters

** ____ .**

A. Determination of TSP and CPL

** ____ .**

Laclede shall provide written notification to the Commission on or before the first day of the month immediately following the ** ____ .**

Specifics of Calculating the TSP

i. ** ____ .**

ii. ____ .**

iii. **____ .**

2. <u>Price Protection Incentive</u>

A. Realized gains from **____ .**

i. For realized gains associated with that portion of price protection at or above the CPL, 100% of such gains shall be retained by ratepayers. (Type I Gain)

ii. For realized gains associated with that portion of price protection between (and including) the TSP and the CPL, 75% of such gains shall be retained by ratepayers and 25% of such gains shall be retained by the Company. (Type II Gain)

iii. For realized gains associated with that portion of price protection below the TSP, 40% of such gains shall be retained by ratepayers and 60% of such gains shall be retained by the Company. (Type III Gain)

NON-PROPRIETARY

B. Unprotected cost increases which occur when the **________________** exceeds the CPL.

i. Laclede shall credit ratepayers 100% of the difference between the lower of the **__________
____
____
______________** and the CPL. (Type I Cost).

ii. However, in no event shall the Company be required to provide a credit if during the 90 days immediately following the establishment of the TSP, market conditions change radically and Laclede determines it is necessary to purchase the **__________________________** above the CPL.

3. Overall Cost Reduction Incentive

Savings achieved through reductions in the cost of the program below the MRA as a result of favorable **____
____
shall be shared by the Company and its customers according to the following schedule.

	Share of Savings	
Cost Saving Increment	Customers	Company
Up to $6,666,666.66	60%	40%
Additional Savings	40%	60%