BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's tariffs designed to permit early implementation of Cold Weather Rule provisions and to permit Laclede to collect the gas cost portion of its write-off's through the PGA	))))))	Case No. GT-2009-0026 Tariff number JG-2009-0033

INITIAL BRIEF

OF

LACLEDE GAS COMPANY

FEBRUARY 13, 2009

TABLE OF CONTENTS

Page

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's tariffs designed to permit early implementation of Cold Weather Rule provisions and to permit Laclede to collect the gas cost portion of its write-off's through the PGA	))))))	Case No. GT-2009-0026 Tariff number JG-2009-0033

INITIAL BRIEF OF LACLEDE GAS COMPANY

COMES NOW Laclede Gas Company ("Laclede" or "Company") and pursuant to the briefing schedule established in this case submits its initial brief for the Commission's consideration.

A. INTRODUCTION/EXECUTIVE SUMMARY

On July 9, 2008, Laclede filed tariff sheets designed to enhance the ability of the Company and its customers to function more effectively in today's environment of increasingly volatile energy prices, including wholesale natural gas prices. To that end, the proposed tariff sheets would authorize the Company to reflect and reconcile through its Purchased Gas Adjustment ("PGA")/Actual Cost Adjustment ("ACA") mechanism the ***gas cost*** portion of its bad debt write-offs so as to more accurately charge customers for the amounts actually paid by the Company to acquire gas supplies in the increasingly volatile natural gas marketplace.[1]

[1]The proposed tariff sheets would have also provided customers with additional tools to proactively address the payment challenges posed by these volatile prices though early implementation of the provisions of the Commission's Cold Weather Rule. With the passage of time, this latter proposal has been rendered moot. However, Laclede's proposal to use the PGA mechanism to reconcile decreases and increases in the gas cost portion of its bad debt write-offs remains ripe for consideration and decision by the Commission.

1. Regulatory policy has always permitted bad debt expense to be recovered in rates, so the issue before the Commission is one of rate design, not of raising rates to recover an increased or new cost. In fact, due to falling gas prices, customer rates are just as likely to go down if the Company's proposal is implemented.

In determining whether the Company's proposal should be approved, it is important to recognize that bad debt write-offs have always been recognized as a legitimate cost of providing service. Like any other business that provides a product or a service, utilities like Laclede invariably have some customers who cannot or, in some cases, simply won't pay their bills. The regulatory process has consistently recognized this unfortunate fact of life and has customarily included an estimated allowance in base rates to recover bad debt write-offs. (Ex. 1, pp. 3-4; Ex. 3, p. 3). As a result, the issue in this proceeding isn't whether Laclede should be allowed to recover its bad debt write-offs, but instead what ratemaking approach or rate design is best suited to achieve that objective, as it relates solely to the gas cost portion of this expense item.

Nor is the issue in this case one of whether Laclede should be permitted to increase its rates outside the context of a rate case to recover a new cost. As the Commission well knows, and as the record in this case demonstrates, there has been a tremendous decline in the wholesale price of gas since Laclede made the tariff filing that initiated this case back in July of 2008. Not surprisingly, these declines have been reflected in lower PGA rates. As Laclede witness Michael Cline testified during the evidentiary hearing, the approximately $8.1 million in bad debt-related gas costs from which the Company would measure any increases or decreases in this cost item was established during a period when Laclede's PGA rate was, on average, in excess of $1.00

a therm. (Tr. 89). Today, Laclede's PGA rate is approximately 83 cents per therm, due in part to these declines in the wholesale price of gas. (*Id.)*

While other factors, such as the impact of the current economy on customers ability to pay, may ultimately offset the impact of these price and rate declines, they make it increasingly likely that the Company's uncollectible levels will decline rather than increase – a decline that would result in *lower* rates for the Company's customers under Laclede's proposal. (*Id.)*. Even though it might be contrary to the Company's short-term financial interests, such an outcome would be a perfectly acceptable result to Laclede. Laclede has not made its proposal to gain some interim advantage in the amount of costs it recovers, but to ensure that there is a more accurate matching of the amount it actually incurs for this cost item and what it charges customers, regardless of whether those charges go up or down. Simply, put Laclede believes there should be no "winners and losers" when it comes to gas costs.

2. Including the gas cost portion of bad debt in the PGA/ACA mechanism is more consistent with the Commission's treatment of similar costs than the current approach of including the gas cost portion of bad debt in base rates

Although the Staff of the Commission ("Staff") and the Office of the Public Counsel ("OPC") would have the Commission believe that the Company's proposal represents some kind of ill-advised and perhaps even unlawful departure from sound ratemaking principles, just the opposite is true. Indeed, if the goal is to treat this cost item in a way that is consistent with the regulatory and legal treatment that has been afforded other costs that have similar characteristics, then reconciling the gas cost portion of bad debt write-offs through the PGA is not just a permissible thing to do, it's the most appropriate thing to do. Laclede believes this to be true for several reasons.

a. For nearly fifty years, the PGA has been used in Missouri as a tracking mechanism to reflect increases and decreases in gas costs.

First, there is absolutely no need to create a new adjustment mechanism in order to process these gas costs. Instead, the Commission can simply use the same PGA/ACA mechanism that Laclede has used for nearly half a century now to reflect increases and decreases in gas costs, a mechanism that the courts have reviewed and approved as lawful and that the Commission has consistently supported. And that's because the only portion of bad debt write-offs that Laclede is proposing to recover through that mechanism is the portion comprised of gas costs. (Ex. 1, p. 7).

b. Except for the gas cost portion of bad debt, Laclede collects all of its gas costs through the PGA/ACA mechanism, and recovers its distribution costs through base rates

Second, Laclede's proposal would allocate gas costs to the PGA more effectively than the current method. Notably, Laclede currently recovers all of its distribution costs, both paid and unpaid, through its base rates and all gas costs through the PGA, with one significant exception – the gas costs incurred by the Company to provide service to customers who ultimately don't pay their bill. The Company's proposal would simply correct this anomaly by moving these unpaid gas costs back to the mechanism, namely the PGA, that is already used to recover all other gas costs. (Ex. 1, pp. 3-7).

c. Employing the PGA to reflect changes in the gas cost portion of bad debt will permit a better matching between the bad debt cost Laclede actually incurs and the amounts it charges to customers

Third, implementation of the Company's proposal would undoubtedly result in a more accurate matching of the rates charged for utility service with the actual costs incurred to provide that service. (Ex. 2, pp. 7-8). As Staff witness David Sommerer acknowledged during the hearing in this case, the existing approach does not keep either the Company or its customers whole when actual bad debt levels vary from the estimates used to establish rates. (Tr. 224-225). Although the Company's proposal to use the PGA to reflect changes in the gas cost portion of bad debts will not completely cure this problem, it will unquestionably result in charging customers more accurately for what it actually costs to serve them than does the guesstimate approach used in a rate case. There is little or no justification for a ratemaking approach that is virtually destined to ensure that customers will almost always pay more or less than it actually costs to provide service, and almost never pay what it actually does cost to provide service. (Exh. 1, p. 6) The ratemaking process can do better than that – and it should – particularly with a cost item like the one under consideration in this case.

d. The Commission has routinely established tracking mechanisms for costs that are hard to predict due to volatile market forces or changing regulatory requirements, including gas costs, pension and other post-retirement benefits, safety and environmental costs, and bad debt expense associated with changes to the Cold Weather Rule

Fourth, the Commission has routinely permitted other cost of service items to be tracked and reconciled back to actual costs. The Commission has generally done so when a particular cost cannot be reliably estimated for purposes of establishing base rates because it varies so much, either due to volatile market prices, the impact of changing governmental mandates, or other factors beyond the utility's control. (Ex. 3, pp. 3-5). Thus, we have a PGA/ACA mechanism which tracks and reconciles the very kind of gas costs at issue here. (Ex. 3, p. 3). There is simply no disputing how volatile and difficult to predict these costs are, as evidenced by the recent and thoroughly astounding decline in NYMEX prices, from a high in excess of $14.50 per MMBtu in July of last year to a NYMEX low of $6 to $7 last month. (*See* Ex. 2, p. 6). And since then, prices have dropped even further. It is difficult to imagine any other utility cost that can rise or fall by 50% or more in such a short time frame – and for that very reason the Commission has concluded that such costs should be tracked and reconciled back to actual costs.

The same considerations have also led the Commission to approve accounting mechanisms which permit changes in pension expense and other post-retirement benefits to be tracked between rate cases and reconciled back to actual costs. (Ex. 3, pp. 4-5). Once again, such trackers are deemed appropriate due to the degree to which such costs can fluctuate as the financial markets change; a reality that has once again been demonstrated all too keenly over the past year. With regard to governmental mandates, the Commission has also approved trackers or adjustment mechanisms for such things as safety-related investments and environmental costs. (Ex. 3, p. 4).

e. Tracking and reconciling the gas cost portion of bad debt write-offs is amply supported by these prior Commission decisions and practices because such costs are difficult, if not impossible, to predict or control and can vary widely due to changes in natural gas prices, weather, economic conditions, and governmental mandates such as the Cold Weather Rule.

Significantly, the bad debt expenses at issue in this case are affected, to one degree or another, by *all* of the factors that have traditionally warranted the kind of tracking and reconciling treatment being proposed by the Company in this case. (Ex. 1, p. 5). In terms of market forces, increases and decreases in the wholesale price for natural gas will ultimately affect the amounts that customers have to pay to receive utility service; a circumstance that will also impact the level of bad debts incurred by the utility. The same kind of impact arises from decreases and increases in the customer’s bill due to weather and other factors that affect usage. Similarly, general economic conditions can affect bad debt levels as they enhance or diminish the ability of customers to pay for service. Another significant driver are the changes in governmental mandates – most notably changes to the Commission's Cold Weather Rule – that affect when and under what circumstances utilities must provide service to non-paying customers during the winter heating season. Indeed, in just one recent winter heating season alone, such changes resulted in more than $4.1 million in costs, much of it related to increased or uncollected customer arrearages.

There are only two things that are certain about these factors. Neither Laclede nor any other utility can control them and no one – not Laclede, the Commission Staff or the Commission itself – can predict with any accuracy how such factors will change over time, let alone what impact they will have on the level of bad debts experienced by the utility. Given all of these considerations, if there is a cost item that cries out, and cries out legitimately, for the kind of tracking and reconciling approach being proposed by the Company in this case, it is the gas cost portion of bad debt write-offs. And the historical record amply demonstrates that fact.

f. The Commission has given de-facto recognition to the concept that at least a portion of bad debt expense should be tracked and reconciled by repeatedly approving accounting measures for Laclede that have done just that.

Over the first eight years of this decade alone, Laclede's entire bad debt expense, not just the gas cost portion of that bad debt expense, has been subject to some kind of tracking and reconciling process to reflect the impact of Cold Weather Rule changes on bad debt levels, whether as a result of stipulations and agreements in rate cases or as a result of rules that have been approved by the Commission. Accordingly, whatever arguments one may wish to make in opposition to the Company's proposal, the assertion that it is inconsistent with the regulatory practices and policies that have been adopted by this Commission is simply untrue.

3. A significant and growing number of state commissions have also recognized the propriety of tracking and reconciling this cost item through their approval of various ratemaking and accounting mechanisms.

For many of these very same reasons, a growing number of regulatory commissions have seen fit to adopt tracking and reconciling mechanisms similar to the one proposed by the Company in this case. As Laclede witness Russell Feingold discussed in his surrebuttal testimony, nearly half of the commissions in this country have approved, and more than 40 local distribution companies now operate under, mechanisms that are designed to track and reconcile all or the gas cost portion of their bad debt write-offs. (Ex. 5, pp. 12-14; Schedule RAF-2). Moreover, as Mr. Feingold testified during the evidentiary hearing, many of those mechanisms are similar to the one that has been proposed by Laclede in this case. (Tr. 106). For all of the reasons discussed herein, Laclede submits that adopting its proposed treatment of such costs in this case is the right policy course for Missouri as well.

4. Neither Staff nor OPC has offered any substantive legal or policy reasons to support their position that the Company's proposal cannot and should not be approved by the Commission.

In suggesting otherwise, the Staff and OPC have raised a number of legal and policy arguments in support of their opinion that the Commission is either powerless to approve the Company's proposal or would be ill-advised to do so assuming it had such power. Laclede would respectfully submit that none of these arguments are substantive, let alone compelling enough, to warrant rejection of the Company's proposal.

a. The Company's proposal to reconcile the gas cost portion of bad debt write-offs through the PGA/ACA mechanism does not constitute unlawful single issue ratemaking because Missouri courts have already determined that the PGA/ACA mechanism can be lawfully used to recover gas costs.

One of the legal arguments raised by Staff and OPC is that the Company's proposal would constitute unlawful single-issue ratemaking because it would allow rates to be adjusted to reflect this one cost element without considering other cost elements. As discussed in the argument section of this brief, however, Missouri courts have already determined that recovery of gas costs through the PGA/ACA mechanism is lawful. ***State ex rel. Midwest Gas Users' Ass'n v. Public Service Comm'n,*** 976 S.W.2d 470 (Mo.App. W.D. 1998) ("***MGUA***"). And notwithstanding all of the legal and accounting obfuscation that Staff and OPC have offered to the contrary, the gas supply, transportation and storage costs used to serve customers who do not pay their bills are identical, and indeed the same, in every respect to the other gas supply, transportation and storage costs that the Courts have determined may lawfully be recovered through that mechanism. (Ex. 1, pp. 2-4). Given this consideration, there is absolutely no reason why the Commission should engage in anticipatory surrender and determine in advance that it is not vested with the power that Missouri courts have already accorded it.

b. The Company's proposal does not constitute unlawful retroactive ratemaking because by its very terms its only reflects and reconciles <u>prospective</u> changes in the gas cost portion of the Company's bad debt write-offs

The contention that the Company's proposal cannot be approved by the Commission because it constitutes unlawful, retroactive ratemaking is equally invalid. In fact, the contention is false on its face. By its very terms, the Company's proposal would only act *prospectively* to track and reconcile *future* changes in this expense item.

(Ex. 2, pp. 5-6; Ex. 5, p. 22). Since it does not operate retroactively, the Company's proposal cannot possibly run afoul of any prohibition against retroactive ratemaking. In fact, the same case law that held that PGA treatment of gas costs was *not* single-issue ratemaking also found that PGA treatment of gas costs was not retroactive ratemaking - (***MGUA** at 480-81)* – a result that further supports the Company's position in this case.

c. Contrary to Staff's and OPC's contention, the Commission clearly has the authority to consider and approve the Company's proposed modifications to its PGA/ACA tariffs, even though no general rate case is pending, because the Commission has routinely demonstrated that it has such power on numerous occasions.

Nor should the Commission conclude that because the Company's proposal is being considered between rate cases, it is powerless to modify Laclede's PGA/ACA tariffs between rate cases. In fact, the Commission has routinely considered, approved and/or modified Laclede's PGA/ACA tariffs over the years, including ratemaking and incentive provisions that have had a direct financial impact on the Company. For example, the Commission has on several occasions extended, modified and even eliminated gas supply incentive programs for Laclede between rate cases. ***Re: Laclede Case Company,*** Case No. GO-2000-395 (Order issued June 20, 2000); ***Re: Laclede Gas Company,*** Case No. GT-2001-329 (Order issued September 21, 2001). It has also approved and modified natural gas hedging programs between rate cases, including hedging programs that provide the utility with a financial incentive to achieve superior results. ***Re: Laclede Gas Company,*** GO-97-401 (Order issued July 18, 1997); ***Re: Laclede Gas Company,*** Case No. GO-98-484 (Order issued June 15, 1999). Other, more modest changes to Laclede's PGA/ACA tariffs have also been made between rate cases, including changes to how and how often Laclede may change its PGA rates, changes to how carrying costs are determined, and changes designed to reflect the financial impact of the Company's hedging activities. *See e.g.* ***Re: Purchased Gas Adjustment Clause,*** Case No. GO-2002-452 (Order issued June 6, 2003). Indeed, the Commission has even entertained making basic changes to the entire rate design structure of Laclede's PGA between rate cases. ***Re: Laclede Gas Company,*** GR-94-328 (Order issued August 22, 1999).

Aside from these numerous changes to Laclede's PGA/ACA tariffs, the Commission has also made modifications to other rules and tariff provisions that have had a direct financial impact on Laclede and other utilities even though no rate case was pending. The most notable of these are the various changes the Commission has made to its Cold Weather Rule over the past several years as well as the procedures the Commission has instituted for tracking and reconciling the costs that utilities incurred to comply with such changes between rate cases. Even though all of these regulatory actions did or could have had a significant financial impact on the Company, to Laclede's knowledge Staff and OPC seldom, if ever, asserted that the Commission was powerless to act because there was no rate case pending. Nor were assertions made, as they have been in this case, that the Commission should refrain from acting because the changes under consideration might affect the Company's risk and hence require some kind of adjustment to the Company's return on equity. In short, the "Commission can't do anything between rate cases" argument is a one-way canard that only seems to be raised by Staff and OPC when the thing being done is something they don't like.

d. There is nothing in the Stipulation and Agreement from the Company's 2007 general rate case proceeding that precludes either Laclede's pursuit of its proposal or the Commission's consideration and approval of the proposal.

The assertion that Laclede is precluded from pursuing its proposal by the Stipulation and Agreement in its 2007 general rate case proceeding is also without foundation. The standard language in that Stipulation and Agreement clearly provides that nothing therein is intended to prejudice the rights of any party in any other proceeding. (Ex. 4, p. 7). Notably, OPC itself has relied on the language in its recent efforts to challenge the very Cold Weather Rule compliance cost method that it developed and the other parties agreed to in the 2007 Stipulation and Agreement. Needless to say, if OPC is free to change its position and pursue regulatory and legal outcomes that are diametrically opposed to what it agreed to in the rate case, Laclede is equally free under that same Stipulation and Agreement to pursue a mechanism that is merely similar to what it proposed in the rate case. What's good for the goose should be good for the gander.

e. The few policy arguments raised by Staff and OPC in opposition to the Company's proposal are fundamentally flawed.

In the end, the legal arguments raised by Staff and OPC are so transparently weak that it begs the question of why they have been raised at all. Laclede would respectfully submit that Staff and OPC have sought to focus the Commission's attention on these legal contentions for one reason and one reason only: because their policy arguments against the Company's proposal are even weaker.

i. ***The contention that moving the gas cost portion of bad debt expense to the PGA/ACA will result in the Company not having sufficient incentives to aggressively pursue collection activities ignores the fact that Laclede would continue to be at risk for one-fourth to one-third of any increase in its bad debt expense, and flies in the face of numerous other incentive programs approved by the Commission that rely on equal or smaller sharing percentages to encourage optimal results.***

Staff and OPC have contended that the Company's proposal should be rejected because Laclede may not have sufficient incentive to aggressively pursue collection activities if it is permitted to recover the gas cost portion of its bad debt expense through the PGA. Such an argument, however, simply ignores the fact that Laclede would continue to be at risk for one-fourth to one-third of any increase in its bad debt expense and, conversely, would still be able to retain one-fourth to one-third of any decrease. The assertion that this does not constitute a significant enough incentive to aggressively pursue collection efforts is absurd on its face. It also flies in the face of numerous incentive mechanisms that the Commission has approved – mechanisms that rely on equivalent or even smaller retention percentages to encourage optimal performance. (Ex. 4, pp. 9-10).

ii. ***Such a contention also ignores the reality that the Commission, Staff and OPC exert as much or more control than does the Company over such collection efforts by virtue of their promotion and implementation of regulatory policies that affect such activities.***

When considering which approach provides the most appropriate incentives, it is also important to keep in mind that the Commission, Staff and Public Counsel have as much, if not more, control than Laclede over the level of bad debt expense the Company ultimately incurs by virtue of their ability to promote and approve restrictions on how, when and under what financial terms the Company can discontinue or refuse to provide service. (Tr. 194-97) Indeed, if there is any change warranted to the incentive regimen governing bad debt expense it is a change like the one proposed by the Company in this case. Specifically, by effecting from the outset the transparent and certain sharing of any financial impact that changes in regulatory policy may have on the level of bad debts incurred by the Company, Laclede's proposal would better ensure that the Commission and all parties are "on the same page" when such changes are considered. Today, the Company may resist such changes solely because it must bear the *entire* financial brunt, including both the distribution cost portion of bad debt and the larger gas cost portion of bad debt, of any change in regulations between rate cases. On the other hand, a party like OPC may propose such changes because it believes it can promote more lenient credit terms for certain customers while deferring or even escaping altogether the financial costs of doing so. While Laclede does not believe it should have to absorb any costs associated with changes in such requirements, the sharing provided by the Company's proposal would at least serve to better align all parties' interest from the outset and, in the process, ensure that regulatory policies are made with a straightforward recognition of both the benefits and costs of such policies.

iii. The contention that the Company's proposal might permit it to over-recover its bad debt expense, or that it would be too difficult to implement, are equally flawed.

The argument that the Company's proposal may result in a double recovery of its bad debt expense is also misplaced. Indeed, it is as if those making the claim had simply failed to read the Company's proposal, which explicitly recognizes the $8.1 million in gas costs built into existing base rates and only provides for recognition of changes above or below that level. Finally, the contention that implementing the Company's proposal is just too complicated or difficult should be rejected out of hand. As previously indicated, nearly half of this country's regulatory jurisdictions have adopted and been able to implement similar mechanisms and there is no reason to believe that the Staff of this Commission and or members of the OPC are not similarly equipped and competent to handle the modest changes in the regulatory process that are being proposed by Laclede. For all of these reasons, Laclede respectfully requests that the Commission approve its proposal in this case.

B. ARGUMENT

1. Can the Commission lawfully permit Laclede to recover the gas cost portion of its uncollectible revenues (bad-debt expense) through the PGA/ACA process?

Laclede believes that its tariff proposal to reflect and reconcile changes in the gas cost portion of its bad debt write-offs through the PGA/ACA mechanism is fully consistent with Missouri law and that the Commission has the requisite authority to approve it. Such gas costs are indistinguishable from the commodity, pipeline transportation and storage costs that are already being recovered by Laclede through the PGA/ACA mechanism. (Ex. 2, pp. 2-3). Notably, that same PGA/ACA mechanism has been used by Laclede, in one form or another, for nearly a half century to reflect increases and decreases in such gas costs and its lawfulness has been explicitly acknowledged by Missouri courts.

Nevertheless, both Staff and OPC have argued that the Commission is powerless to adopt the Company's proposal because including the gas cost portion of bad debt write-offs in the PGA would allegedly constitute unlawful, single issue ratemaking, as well as unlawful retroactive ratemaking.[2] The very case they cite in support of these

---

[2]Staff and OPC's erroneous conclusion regarding the legality of the Company's proposal may be due, in part, to a fundamental misunderstanding of what the Company's proposal actually is. Throughout its

contentions, however, indicates just the opposite. In ***State ex rel. Midwest Gas Users' Ass'n v. Public Service Comm'n,*** 976 S.W.2d 470 (Mo.App. W.D. 1998) ("***MGUA***"), the Western District Court of Appeals specifically considered whether the PGA mechanism ran afoul of the same prohibition against single issue ratemaking that the Court relied on in ***State ex rel. Utility Consumers' Council of Missouri, Inc. v. Public Serv. Comm'n,*** 585 S.W.2d 41 49 (Mo. 1979) ("*UCCM*") to invalidate the fuel adjustment clause for electric utilities.[3] After an extensive analysis, the Court ultimately determined that the PGA mechanism did not suffer from this legal deficiency because "[t]he gas costs which the PGA mechanism allows the companies to pass on [to customers through a surcharge] are almost entirely the cost of obtaining the gas itself; they do not include the type of labor and materials costs used in making electricity." ***MGUA*** *at 482.*

In reaching this conclusion, the Court summarized the history, purpose and effect of the PGA mechanism in a way that is particularly instructive for the issue under consideration in this case. As the Court noted, the Commission first approved a PGA clause in Missouri in 1962 in response to an increase in rate cases caused by increasingly frequent changes in the wholesale price of natural gas.[4] *Id.* at 474. A PGA was also in place at the federal level wherein interstate pipelines used it to deal with variations in their costs for gas. In cases decided in 1987 and 1989, the Commission reaffirmed that the PGA was still the most efficient method of recovering purchased gas costs. *Id.* In

---

pleading and much of its testimony in this case, both parties imply that Laclede is seeking to reflect *all* of its bad debt write-offs through the PGA by repeatedly referring to bad debt expenses in general rather than only the gas cost portion of the Company's bad debts. As Laclede's tariff filing and the transmittal letter accompanying it make clear, however, the Company is seeking to have only the ***gas cost*** portion of its bad debt write-offs reconciled through the PGA. The portion relating to the Company's distribution costs would continue to be recovered through base rates.

[3] It should be noted that the Missouri General Assembly subsequently enacted Section 386.266, which authorized the Commission to approve a fuel adjustment clause.

[4] It should be noted, as discussed *infra,* that the original approval of the PGA in 1962 was also done outside of a rate case. *In Re Laclede Gas Company, 10 Mo. P.S.C. (N.S.) 442 (1962).*

1996, in the case that resulted in the ***MGUA*** decision, the Commission reconfirmed the PGA, stating that it is an effective way to handle the risk associated with short term fluctuations in the price of natural gas. *Id*. at 475. The Commission added that eliminating the PGA would be detrimental to both the ratepayers and the utility, because the volatility of gas costs could result in large swings that would create either windfalls or damaging losses. *Id*.

The Court in ***MGUA*** validated the PGA, finding that, like taxes subject to a tax adjustment clause,[5] the Commission was not required to treat all items of cost and expense in exactly the same way. *Id*. at 479-80. The Court further noted that the Commission had necessarily found that, due to their unique nature, gas costs are different than other costs and should be treated differently. *Id*. at 480. The Commission therefore properly and lawfully created a mechanism that allowed both gas cost increases and savings to be passed on in the amount incurred. *Id*.

There is absolutely nothing in the Company's proposal to recover the ***gas cost*** portion of its bad debt write-offs through the PGA that would in any way change or disturb this key element of the PGA mechanism that the Court relied upon in upholding its legality. As the term implies, the gas cost portion of the Company's bad debt write-offs are just that --- <u>gas costs</u>. In fact, they are the very same gas supply commodity, storage and transportation costs that are routinely recovered through the PGA mechanism; an attribute that is in no way altered by whether or not the cost is ultimately paid for by a particular customer. (Ex. 2, pp. 2-3). To illustrate, dollars spent by Laclede to acquire, store and transport gas supplies to its service territory are considered gas costs

---

[5]The Missouri Supreme Court approved a tax adjustment clause in the case of ***Hotel Continental v. Burton,*** 334 S.W.2d 75 (Mo. 1960).

recoverable through the PGA. These dollars remain gas costs when Laclede bills them to customers along with approved charges billed for Laclede's distribution service. However, if the customer fails to pay the bill causing a bad debt, Staff and OPC would have the Commission believe that these dollars suddenly and inexplicably "lose" their character as gas costs. (Exh. 8, p. 3; Tr. 185-87; Exh. 2, p. 3)

In order to recover bad debts today, Laclede bills for its entire bad debt expense in its distribution charge, despite the fact that the large majority of that bad debt arose out of gas costs. Laclede's tariff filing simply rights this imbalance by including in the PGA that which belongs in the PGA.

There is one other aspect of the ***MGUA*** decision that deserves further elaboration. As discussed by Commissioner Jarrett during the evidentiary hearing, the Court at page 474 of that decision stated that, "While the technicalities of Missouri's PGA clause have varied over the years, the clause's basic purpose has remained the same. A PGA clause allows a local distribution company to automatically adjust the rates it charges its customers in proportion to the change in the rate the local distribution company is charged by its wholesale suppliers." (Tr. 76). Although it is true that changes in the rates charged by local distribution companies move in rough proportion to changes in the prices charged by the local distribution company's suppliers, this provision should not be construed as a legal requirement that customer rates and supplier rates *must* move in exact tandem in order for a cost to be included in the PGA/ACA mechanism. As Laclede witness Michael Cline testified, there are a variety of costs and revenues that are already reflected in and reconciled through the PGA/ACA that are unrelated to supplier rates and that make it impossible for there to be an exact correlation between prices charged by

Laclede's suppliers and PGA rates reflected in customer bills. (Tr. 87-88). For example, the gains and losses that are included in the PGA/ACA mechanism in connection with the Company's purchase of financial instruments for hedging will necessarily cause the rates charged to customers to vary in a somewhat different proportion to the prices charged by its suppliers. (*Id.)*. The inclusion in the PGA/ACA of carrying costs on over- and under-recoveries of gas costs, the inclusion of storage inventory carrying costs, and the inclusion of adjustments to compensate for over and under-recoveries of fixed transportation and storage costs due to weather-related changes in customer usage, will also preclude any kind of match between changes in supplier prices and changes in the rates charged to customers. (*Id*.).

Given this, the Court's reference to customer rates increasing in proportion to increases in supplier prices should only be viewed as a short-hand generality and not as a precise description of how the PGA process works. Indeed, of far more consequence to the issue at hand in this case is the sentence following the one quoted above in which the Court observed: "At the end of every 12-month period, the local distribution company then makes an actual cost adjustment (ACA) filing with the PSC so that the PSC can determine whether the estimated amount previously charged customers accurately reflects *the actual cost to the utility of the gas supplied*." (Tr. 97; emphasis supplied). As long as the ACA process continues to exclude the gas costs incurred by Laclede to serve customers who do not pay their bills, it will never achieve this goal of ensuring that the amount charged by Laclede "reflects the actual cost to the utility of the gas supplied." To the contrary, just as the ACA process annually adjusts rates to correct for over recoveries or under recoveries due to weather, changes in prices, or the impact of carrying costs, so too can and should it be used to adjust rates to correct for gas costs that were over or under-recovered due to the amounts paid or not paid by customers.

For all of these reasons, allowing gas costs currently dealt with outside of the PGA to join their companion gas costs inside the PGA furthers the very purposes of the PGA mechanism that were favorably noted by the Court, namely the prevention of detriments to both ratepayer and the utility that would otherwise arise when volatile fluctuations in gas prices lead to either windfalls or losses for the utility. Given this consideration, it is simply impossible to read the Court's decision in ***Midwest Gas Users*** as precluding the inclusion of these gas costs in the PGA mechanism. Nor is it at all clear to Laclede why the OPC and, in particular, the Staff, would have the Commission surrender its discretion to make such a determination based on such an implausible and counter-intuitive reading of this decision. While administrative agencies should always strive to exercise their powers within the parameters of their statutory authority, they are not required to unilaterally disarm in the face of every potential and, in this case highly improbable, jurisdictional battle.

The assertion that the Company's proposal cannot be approved because it constitutes unlawful retroactive ratemaking is equally without merit. In fact, the same case law that held that PGA treatment of gas costs was *not* single-issue ratemaking also found that PGA treatment of gas costs was not retroactive ratemaking. ***MGUA** at 480-81*. Laclede is not proposing to refund or recoup amounts charged, or not charged, on past bills. Rather, like the other gas costs in the PGA, adjustments to the gas cost portion of bad debt would only apply to future customers on future bills. In short, by its very terms, the Company's proposal is designed to operate <u>prospectively</u> to reflect in rates only future changes to the gas cost portion of its bad debt write-offs. This is in full accord with the ***MGUA*** Court's affirmation of the PGA. ***MGUA** at 481.* In view of these considerations, there is simply no merit to the contention that the Commission is powerless to do what it believes is right and appropriate as a matter of policy in this case.

2. If the answer to No. 1 is "yes," then can the Commission permit Laclede to recover the gas cost portion of its uncollectible revenues (bad debt expense) through the PGA/ACA process by modifying its PGA/ACA tariff outside of a general rate case?

Another legal obstacle that Staff and OPC have erected in an effort to convince the Commission that it is powerless to approve the Company's proposal is their contention that the Commission cannot modify Laclede's PGA/ACA tariff outside of a general rate case. It is exceedingly difficult to understand how either party can make such an assertion, however, given the many occasions on which the Commission has done just that, all without any assertion by Staff or OPC that it was unlawful to do so. Indeed, the entire PGA mechanism itself was first approved by the Commission outside the context of a rate case. *See* ***Re: Laclede Gas Company,*** 10 MO.P.S.C. (N.S) 442-454 (November 2, 1962). In the nearly half a century since that happened, the Commission has considered or made numerous changes to Laclede's PGA/ACA mechanism even though there was no general rate case pending. For example:

- In 1989, the Commission considered tariffs that were designed to clarify that certain pipeline "take-or-pay" costs charged to Laclede by its pipeline suppliers were a cost of gas that could lawfully be recovered through the Company's PGA/ACA mechanism. Although the issues were raised outside the context of a pending general rate case, the Commission nevertheless determined that such costs were gas costs and upheld the tariff provisions over the objections of a group of industrial customers. ***American-National Can Company et al. v. Laclede Gas Company***, Case Nos. GC-89-85, GR-89-136 (Order issued October 19, 1989).

- In 1995, the Commission considered whether it should make certain changes to the rate design set forth in Laclede's PGA. The Commission Staff, Union Electric Company and certain industrial customers recommended, over Laclede's objection, that the allocation of fixed pipeline costs currently embedded in the PGA be revised to move the recovery of more costs out of the summer period and into the winter period. Although no general rate case proceeding was pending at the time, the Commission nevertheless considered and resolved the issue. ***Re: Laclede Gas Company,*** GR-94-328 (Order issued August 22, 1999).
- In 1997, the Commission approved a number of revisions to Laclede's PGA/ACA tariffs, including limitations on the number and frequency of Laclede's PGA filings. As part of those revisions, the Commission also approved an experimental hedging program which established terms and conditions, including funding levels, under which the Company could purchase financial instruments in order to provide price protection for its customers. ***Re: Laclede Gas Company,*** GO-97-401. All of these changes were made and implemented outside the context of a general rate case proceeding.
- In 1999, the Commission approved, over the objections of Staff and OPC, revisions to Laclede's PGA/ACA tariffs that authorized the establishment of an incentive hedging program. Among other things, the program approved by the Commission permitted the Company to retain and/or absorb certain gains and

losses associated with its purchase of financial instruments. *See* ***Re: Laclede Gas Company,*** Case No. GO-98-484 (Order issued June 15, 1999). Again, these tariff provisions were approved by the Commission and implemented by Laclede outside the context of general rate case proceeding.

- In 2000, the Commission approved a Unanimous Stipulation and Agreement in ***Re: Laclede Case Company,*** Case No. GO-2000-395 (Order issued June 20, 2000). Among other things, the Agreement provided for a one year extension of the Company's Gas Supply Incentive Plan II; established a limit on the maximum level of savings and/or revenues that Laclede would be permitted to retain under the provisions of the GSIP II, and established a mandatory fixed rate trigger for gas supply commodity costs. Although each of these provisions had financial consequences for Laclede, they were all approved and implemented outside the context of a general rate case proceeding.
- In 2002, the Commission approved a Stipulation and Agreement in ***Re: Laclede Gas Company's Filing to Revise Its Purchased Gas Adjustment / Actual Cost Adjustment Tariff Sheets,*** Case No. GT-2002-387 (Order issued February 19, 2002), in which the parties proposed to make certain revisions to Laclede's PGA/ACA tariffs to "increase by one the maximum number of PGA filings that Laclede would be authorized to make each year …" and to . . . "clarify how . . . Laclede's various gas costs would be reflected and accounted for in such filings." In addition to these revisions, the Commission also specified that the costs and cost reductions associated with Laclede's use of financial instruments, together with interest on payments made or received in connection with such instruments,

would be reflected in Laclede's PGA/ACA mechanism. No rate case was necessary to make these changes.

- In 2003, the Commission issued an Order approving a report that had been submitted by the Commission Staff, gas utilities and other parties in which a host of modifications to the utilities PGA/ACA tariffs were recommended, including Laclede's tariffs. ***Re: Purchased Gas Adjustment Clause,*** Case No. GO-2002-452 (Order issued June 6, 2003). Among other things, these included the use of ACA balances for purposes of computing interest on deferred gas costs; changes to the PGA accounting for pipeline refunds, changes to how interest should be computed for under and over-recoveries of gas costs, and the establishment of revised parameters to govern the number and frequency of PGA filings. Notably, the Commission observed that such changes could be effectuated by a rate case "or other proceeding."

None of these examples include, of course, the numerous gas cost disallowances that the Commission Staff has proposed over the years in connection with Laclede's ACA filings. Nor do they include the multiple changes that the Commission has made between rate cases to its Cold Weather Rule or the special cost tracking and recovery provisions that the Commission has approved to deal with the compliance costs incurred by utilities in connection with implementing such changes.

Given the sheer number, frequency and scope of these proceedings, all of which involved proposals to modify the Company's PGA/ACA tariffs or make changes to other tariffs outside the context of a general rate case proceeding, it is nothing short of astonishing that the Staff and OPC would claim that the Commission is powerless to act on the Company's proposal because there is no rate case pending. To the contrary, it is abundantly clear from the historical record that the Commission not only has the power to consider and approve the kind of proposal that Laclede has made in this case but that it has exercised that power time and time again over the years, often at the behest of Staff and OPC.

On none of these occasions, at least to Laclede's knowledge, did either the Staff or OPC assert, as they have in this case, that the Commission had to wait until a rate case because whatever change was being proposed might necessitate an adjustment to Laclede's return on equity or require a consideration of other factors. Indeed, while many of these proceedings involved financial issues of equal or greater significance to Laclede and its customers than those under consideration in this case, both OPC and Staff apparently perceived no obstacle of any kind to the Commission's exercise of its regulatory powers. In fact, Staff witness Sommerer specifically acknowledged during the evidentiary hearing that the disallowances proposed by Staff in ACA proceedings increased Laclede's business risk. (Tr. 227-228). Nevertheless, Mr. Sommerer concluded that it was not appropriate to even consider the kind of return on equity adjustment that Staff and OPC would have the Commission believe is necessary in this case. (*Id.*). In view of these considerations, there is no basis in either law or fact for suggesting that the Company's proposed tariff modification must be made in a general rate case proceeding.

Finally, OPC and Staff argue that Laclede's proposal should be rejected because the Company's pursuit of it constitutes an abrogation or violation of the Unanimous Stipulation and Agreement in its last rate case, Case No. GR-2007-0208. Again, there is absolutely no basis for this assertion. Simply put, there is not a single provision, paragraph or sentence from that Stipulation and Agreement, to support the contention that the Agreement somehow precludes the kind of filing that Laclede has made in this case. Indeed, the only thing that OPC cites at all is the standard Stipulation and Agreement language which indicates that no party is agreeing to any particular ratemaking methodology or method of cost allocation. Laclede agrees and contends that this language *supports* Laclede's right to make the tariff filing in this case.

In fact, it is Laclede that should be accusing Staff and OPC of violating the Stipulation and Agreement by improperly using it in an attempt to preclude Laclede from making a filing that the Company is free to make. OPC and Staff should not be permitted to use the standard non-acquiescence language of the Stipulation and Agreement as a sword to bind Laclede from pursuing its proposal. Indeed, if carried to its illogical extreme, such an approach would suggest that where a rate case settlement has been reached, no party may thereafter file a complaint that would seek to change the rates charged or terms of service offered by the affected utility because to do so would violate the settlement. Laclede suspects that neither Staff nor OPC would concur in such a view.

To the contrary, OPC itself has relied on this very language in its recent efforts to challenge the very Cold Weather Rule compliance cost method that OPC itself developed and the other parties agreed to the 2007 Stipulation and Agreement. *See* ***Re: Laclede Gas Company,*** Case No. GU-2007-0138. Needless to say, if OPC is entitled to change its position and pursue regulatory and legal outcomes that are diametrically opposed to what it agreed to in the 2007 Rate Case, Laclede should be and is equally free under that same

Stipulation and Agreement to pursue a mechanism that is similar to what it proposed in the rate case. For all of these reasons, it is clear that there is no valid legal basis for the contention that the Commission cannot consider and approve the Company's proposal in this case.

3. If the answer to Nos. 1 and 2 are "yes," then should the Commission permit Laclede to recover the gas cost portion of its uncollectible revenues (bad-debt expense) through the PGA/ACA process?

Because there are no bona fide legal impediments to adopting the Company's proposal in this case, the Commission's decision should be based solely on its determination of whether Laclede's proposed treatment of this cost item is appropriate and reasonable as a matter of regulatory policy. For a variety of reasons, Laclede submits that its proposal should be approved by the Commission because the PGA/ACA mechanism addresses the gas cost portion of the Company's bad debt write-offs in a far more equitable, accurate and effective manner than the current method.

As previously discussed there is no dispute that bad debt write-offs are a reasonable and legitimate cost of doing business and the regulatory process has traditionally recognized such costs in the rates charged for utility service. Accordingly, the only issue in this case is how such costs should be recovered. Under the approach historically employed in Missouri (with some occasional exceptions), such costs have been recovered by providing an allowance for bad debt write-offs in base rates. (Ex. 3, p. 3). Typically, that allowance will be based on an estimate of the bad debt write-off levels the utility may incur once new rates go into effect. This estimate might be based on a multi-year average of actual write-offs, or a multi-year average of the write-off percentage as compared to revenues. (Ex. 3, p. 3). Or it might be derived based on a single year of data, particularly in those instances where there is an upward or downward trend in the cost item. (*Id.*). Whatever method is used to derive the allowance, however, the fact remains that under the current approach, rates are based on an estimate of bad debt write-offs rather than on an ongoing tracking and reconciliation of the actual write-offs incurred by the utility. (*Id.*). This, in turn, means that the rates charged to customers for this expense item will almost always vary from what the utility actually incurs for the expense. (*Id.*).

For many of the expense items considered in a base rate proceeding, this process of relying on estimates can work reasonably well because the expense being estimated is relatively stable from year to year. As a result, the rates derived from using the estimate will be fairly representative of the actual costs to be incurred by the utility. The base rate method does not work well, however, when the expense item is volatile in nature and thus difficult to predict and/or control. Under those circumstances, there is not only an increased likelihood that actual costs will vary from estimated costs, but also an increased likelihood that the variation will be significant. To the extent such variations occur, the goal of establishing just and reasonable rates that fairly reflect the utility's cost of providing utility service is compromised.

Fortunately, the regulatory policies adopted by this Commission have recognized this problem and adopted various measures to mitigate it, including the establishment of ratemaking or accounting mechanisms that track and reconcile such expense items so that the actual costs incurred by the utility are reflected in rates. The most notable example, of course, are the gas costs that Laclede incurs to buy, transport and store the gas supplies used to serve its customers – a cost that makes up approximately two-thirds to threefourths of the customer's bill. (Ex. 3, pp. 3-4). Rather than simply estimate what these costs may be and then include an allowance for them in rates, the PGA/ACA mechanism tracks and reconciles those costs as they increase and decrease over time so that customers end up paying no more and no less than the actual gas costs incurred to serve them. (Ex. 3, p. 4).

In addition to gas costs, the Commission has also approved various kinds of trackers to address increases and decreases in a number of other cost-of-service items, including pension expenses, post-retirement medical benefit expenses, environmental costs and the cost impact of prior Cold Weather Rule changes. There are varied reasons as to why these costs have been tracked and reconciled to actual costs rather than simply estimated and included in rates. However, most of these costs share at least two of three characteristics which, in combination or alone, make it difficult to rely on estimates as a reasonable means of establishing a representative level of costs for setting rates. Specifically such costs are significant, volatile in nature, and/or significantly influenced by regulatory mandates or other factors that are largely beyond the control of utility management. (Ex. 3, pp. 4-5) For example, as the Commission well knows, natural gas commodity costs are extremely volatile in nature and account for a very large percentage of the typical gas utility's cost of service. Such costs are also driven by changes in the unregulated wholesale price of natural gas and other factors that are beyond the control of the gas utility. (*Id.*) Similarly, pension expense can be both a significant component of a utility's cost of service and may vary widely from year to year based on how well or how poorly the financial markets do – a factor that is also outside the control of the utility. (*Id.*) Expenses incurred in complying with changes in the Commission's Cold Weather

Rule are an example of a significant cost that the Commission has repeatedly determined should be tracked and reconciled to actual costs largely because the cost arose from an external regulatory mandate that, for obvious reasons, was beyond the control of the utility. *(Id.)*

Notably, bad debt write-offs are affected by <u>all</u> of these factors. In terms of market forces, increases and decreases in the wholesale price for natural gas will ultimately affect the amounts that customers have to pay to receive utility service; a circumstance that will also impact the level of bad debts incurred by the utility. (Ex. 1, p. 5). Certainly, the experience in the natural gas markets over the last half of 2008 has shown just how dramatic this volatility can be, with the forward price for natural gas falling by more than 50% from its highs in excess of $14 an MMBtu last Summer to its lows of $6 to $7 in the Fall. (Ex. 1, p. 5; Ex 5, p. 10).

The same kind of impact arises from decreases and increases in the customer's bill due to weather and other factors that affect usage. Similarly, general economic conditions can affect bad debt levels as they enhance or diminish the ability of customers to pay for service. (Ex. 1, p. 5*)*. Another significant driver are the changes in governmental mandates – most notably changes to the Commission's Cold Weather Rule – that affect when and under what circumstances utilities must provide service to non-paying customers during the winter heating season. *(Id.)*. Indeed, in just one recent winter heating season alone (2005/2006), such changes resulted in compliance costs of approximately $4.1 million, an amount that consisted mostly of unpaid utility charges by customers taking advantage of the rule's provisions – unpaid amounts that, absent deferral, would eventually contribute to higher bad debt levels. *See* Case No. GR-2007-

0208, *Order Approving Unanimous Stipulation and Agreement and Authorizing Tariff Filing*, Attachment A, pp. 10-11 (Issued July 19, 2007); Tr. 45-46.

Not surprisingly, these factors have combined to produce significant volatility in the level of bad debt write-offs experienced by the Company from year to year. The following table demonstrates how significantly the Company's total bad-debt write-off levels have varied from year to year over the past decade:

Fiscal Year	**Actual Write-offs**	**Percentage Change**
1998	7,584,521	
1999	5,377,844	-29%
2000	4,583,253	-15%
2001	5,379,383	17%
2002	11,294,193	110%
2003	7,481,477	-34%
2004	9,139,788	22%
2005	10,547,022	15%
2006	10,724,707	2%
2007	11,352,394	6%

(Ex. 3, p. 5). As the data shows, bad debt write-offs declined by double digit percentage amounts in each year between 1998 and 2000, only to more than double from 2001 to 2002. They then declined again by more than 30% in 2003 only to rise by double digit percentage amounts in 2003 and again in 2004. (*Id.*). While year to year changes in bad debt write-off levels would appear not to be as significant in the last few years, it is important to note that such numbers have undoubtedly been understated due to the impact of the changes that were made by the Commission to the Cold Weather Rule in 2005 and 2006. In accordance with those changes, Laclede restored or maintained service to additional customers who might have otherwise contributed to its bad debt levels in 2006 and 2007 and deferred approximately $4.1 million and $2.5 million in compliance costs, respectively, in doing so.

Taken in its entirety, this historical data strongly suggests that bad debt write-offs will continue to be subject to significant volatility in the years ahead. As a consequence, the use of base rate estimates or allowances to recover such costs is a singularly poor and ineffective substitute for the kind of actual cost tracking and reconciling mechanism that is afforded by the Company's PGA/ACA mechanism. (Ex. 3, p. 6).

In addition to being volatile, it is also clear that bad debt write-offs constitute and will continue to constitute a significant cost to Laclede. (Ex. 3, p. 6). While a 50% increase or decrease in bad debt write-offs might affect a residential customer's bill by less than 50 cents a month, the $5 million or so in added or reduced bad debt costs for the Company can equate to 10% or more of its entire net income for a given year. (Ex. 3, p. 6). By any measure, this is a significant cost impact.

Given all of these considerations, if there is a cost item that warrants the kind of tracking and reconciling approach being proposed by the Company in this case, it is the gas cost portion of bad debt write-offs. And the historical record amply demonstrates that fact. Indeed, over the first eight years of this decade alone, Laclede's entire bad debt expense, not just the gas cost portion of that bad debt expense, has been subject to some kind of tracking and reconciling process to reflect the impact of the factors discussed above on bad debt levels, whether as a result of stipulations and agreements in rate cases or as a result of rules that have been approved by the Commission.

These very same considerations have also been recognized by utility regulators in other states, and an increasing number of them have responded by approving recovery mechanisms for bad debt write-offs similar to the one being proposed by Laclede in this case. As Laclede witness Russell Feingold pointed out, utility commissions have to date approved bad debt ratemaking mechanisms for at least forty-five (45) gas utilities in twenty-four (24) states. (Ex. 5, pp. 12). (*See also* Schedule RAF-2 to Exhibit 5 which presents a map of the U.S. depicting the extent to which bad debt ratemaking mechanisms have been approved in the various states).

As Mr. Feingold explained, these mechanisms have taken three different forms: (1) a tracker or periodic adjustment mechanism; (2) periodic recovery through the utility's current Purchased Gas Adjustment ("PGA") mechanism; and (3) an explicit expense adjustment as part of the utility's PGA mechanism. (Ex. 5, pp. 13-14). The first ratemaking alternative permits recovery of the utility's actual bad debt expense using a deferral account which is periodically "zeroed out" through the application of either surcharges or credits to base rates. (*Id.).* The second ratemaking alternative permits separate treatment and recovery of gas commodity-related bad debt expenses in a manner identical to that used to recover the utility's purchased gas expenses. (*Id*.). The third alternative permits a portion of the utility's bad debt expense to be recovered through its PGA mechanism as a component of its merchant service charges. (*Id*.). These ratemaking methods each recognize the unpredictable nature of bad debt expenses and their close correlation with changes in the commodity price of natural gas.

In addition to the explicit treatment of bad debt expense discussed above, some jurisdictions periodically adjust utility rates for cost and revenue changes in a way that is designed to produce rates of return falling within a band around the utility's authorized rate of return. (Ex. 5, p. 14). In those jurisdictions, the bad debt costs represent one of a variety of costs that are included in that adjustment. (*See also* Schedule RAF-3 to Exhibit 5 which provides a summary of the gas distribution utilities with tracking mechanisms for bad debt write-offs).

Given these considerations, it is clear that the gas cost portion of the Company's bad debt write-offs is the very kind of cost that this Commission has traditionally found warrants the kind of tracking and reconciling treatment being proposed by the Company in this case and that other regulatory commissions, in increasing numbers, have already acted on to provide such treatment. Indeed, the Commission has already afforded such treatment to Laclede's bad debt expense for the lion's share of this decade, with its approval in 2001, 2005 and 2006 of accounting mechanisms that were designed to track and reconcile the impact of various Cold Weather Rule changes on the Company's cost of providing service, most of which ultimately consisted of increased bad debts. There is absolutely no reason why the Commission should not seize this proceeding as an opportunity to formalize once and for all its de-facto use of such mechanisms by approving the Company's proposal in this case. To the contrary, there is every reason why the Commission should do just that since Laclede's proposal will do nothing more and nothing less than better ensure that customers are more accurately charged for what the Company actually incurs to serve them, while protecting both Laclede and its customers from windfall losses or gains due to factors that neither can control.

Moreover, Laclede would respectfully submit that neither Staff nor OPC have offered anything substantive to support a different result. As previously noted, their contention that the Company's proposal should be rejected because Laclede may not have a sufficient incentive to aggressively pursue collection activities, if it is only at risk for a quarter or to one-third of any change in bad debt expense, flies in the face of numerous incentive mechanisms that the Commission has previously approved – mechanisms that rely on equivalent or even smaller retention percentages to encourage optimal performance. (Ex. 4, pp. 9-10).

It also ignores the fact that in the end Laclede's control over the level of its bad debt expense is very limited, given the market and regulatory factors that operate to drive it up and down. In fact, if anyone exercises significant control over this expense item it is the Commission, Staff and OPC by virtue of their ability to promote and approve restrictions on how, when and under what financial terms the Company can discontinue or refuse to provide service. Over the past eight years of this decade, that ability has been exercised repeatedly through numerous changes to the Cold Weather Rule. Given this reality, if there is any change warranted to the incentive regimen governing bad debt expense, it is a change like the one proposed by the Company in this case. Specifically, by effecting a transparent and certain recognition of the financial impact that changes in regulatory policy may have on the level of bad debts incurred by the Company, Laclede's proposal would better ensure that the Commission and all parties are "on the same page" when such changes are considered.

Under the current approach, a utility may oppose such changes solely because it must bear the *entire* financial brunt, including both the distribution cost portion of bad debt and the larger gas cost portion of bad debt, of any change in regulations between rate cases. On the other hand, a party like OPC may propose such changes because it believes it can promote more lenient credit terms for certain customers while deferring or even escaping altogether the financial costs of doing so. The sharing provided by the

Company's proposal would serve to better align each parties' interest and, in the process, ensure that regulatory policies are made with a far more straightforward recognition of both the benefits and costs of such policies.

The argument that the Company's proposal may result in a double recovery of its bad debt expense is also misplaced. Indeed, all one has to do is read the Company's proposed tariff and testimony in this case to see that Laclede has explicitly recognized and accounted for the fact that approximately $8.1 million in gas costs were built into its existing base rates. (Ex. 1, p. 4). As a result, Laclede's proposed tariff would only recognize and reflect any changes in the gas cost portion of its bad debt write-offs that exceeded this level or that resulted in a cost less than this level.

Finally, the contention that implementing the Company's proposal is just too complicated or difficult should be rejected out of hand. As previously indicated, nearly half of this country's regulatory jurisdictions have adopted and been able to implement similar mechanisms and there is no reason to believe that the Staff of this Commission and or members of the OPC are not similarly equipped to handle the modest changes in the regulatory process that are being proposed by Laclede.

C. CONCLUSION

For all of the reasons discussed in this brief, Laclede submits that both the law and the evidence in this case strongly support the legality and reasonableness of its proposal to reflect and reconcile the gas cost portion of its bad debt write-offs through the PGA/ACA mechanism. Such a proposal is fully consistent with the treatment that the Commission has accorded to costs of a similar character, has been endorsed by a significant and growing number of regulatory commissions in other jurisdictions and is, by its very nature, a fair and equitable approach for the Company's customers and its shareholders. It should accordingly be approved by the Commission.

Respectfully submitted,

/s/ Michael C. Pendergast
Michael C. Pendergast, #31763
Vice President & Associate General Counsel
Rick Zucker, #49211
Assistant General Counsel-Regulatory

Laclede Gas Company
720 Olive Street, Room 1520
St. Louis, MO 63101
Telephone: (314) 342-0532
Facsimile: (314) 421-1979
E-mail: mpendergast@lacledegas.com
rzucker@lacledegas.com

CERTIFICATE OF SERVICE

The undersigned hereby certifies that the foregoing Brief has been duly served on the General Counsel of the Staff of the Missouri Public Service Commission and on the Office of the Public Counsel on this 13th day of February, 2009, by hand-delivery, facsimile, electronic mail, or by placing a copy of such Request, postage prepaid, in the United States mail.

/s/ Rick Zucker
Rick Zucker