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BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the Laclede Gas Company's Tariff Sheets to Extend and Revise the Company's Gas Supply Incentive Plan.	)	**Case No. GT-99-303**

REPORT AND ORDER

Issue Date: September 9, 1999

Effective Date: September 21, 1999

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OF THE STATE OF MISSOURI

In the Matter of the Laclede Gas Company's Tariff Sheets to Extend and Revise the Company's Gas Supply Incentive Plan.	)))	**Case No. GT-99-303**

APPEARANCES

Michael E. Pendergast, Associate General Counsel, and **Thomas M. Byrne**, Associate Counsel, Laclede Gas Company, 720 Olive Street, St. Louis, Missouri 63101, for Laclede Gas Company.

Edward F. Downey, Bryan Cave LLP, 221 Bolivar Street, Suite 101, Jefferson City, Missouri 65109, for Adam's Mark Hotels, Alcoa Foil Products (Alumax, Inc.), Anheuser-Busch Cos., Inc., The Boeing Company, Ford Motor Company, General Motors Corporation, Hussmann Refrigeration, MEMC Electronic Materials, Inc., Monsanto Company, Paulo Products Company, Procter & Gamble Manufacturing Company, and Ralston Purina Company, collectively known as the "Missouri Industrial Energy Consumers" or "MIEC".

Robert J. Hack, Vice President, Pricing and Regulatory Affairs, Missouri Gas Energy, 3420 Broadway, Kansas City, Missouri 64111, for Missouri Gas Energy, a division of Southern Union Company.

Douglas E. Micheel, Senior Public Counsel, Office of the Public Counsel, Post Office Box 7800, Jefferson City, Missouri 65102, for the Office of the Public Counsel and the public.

Thomas R. Schwarz, Jr., Deputy General Counsel, and **Bruce H. Bates**, Assistant General Counsel, Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102, for the staff of the Missouri Public Service Commission.

REGULATORY LAW JUDGE: Vicky Ruth.

REPORT AND ORDER

Background

Laclede Gas Company (Laclede) currently has an experimental Gas Supply Incentive Plan (GSIP), which was recommended to the Commission by Laclede, the Staff of the Missouri Public Service Commission (Staff) and several other parties as part of the Stipulation and Agreement filed in the Company's 1996 general rate case proceeding, Case No. GR-96-193. The plan was approved on an experimental basis for a three-year term to begin on October 1, 1996, and expire on September 30, 1999. The decision now before the Commission is whether to allow Laclede to extend the GSIP, and if so, with what modifications and for what term.

Procedural History

On January 14, 1999, Laclede filed a tariff with the purpose of extending and revising the Company's GSIP for an additional three years. Laclede also requested that the Commission establish an expedited procedural schedule.

On January 25, 1999, Staff filed a Motion for Procedural Schedule and for Protective Order. Staff proposed a procedural schedule which established hearing dates of July 26-30, 1999. Also on January 25, the Office of the Public Counsel (Public Counsel) filed a Response in Opposition to Laclede Gas Company's Request to Establish an Expedited Procedural Schedule.

On January 28, 1999, Staff filed a Memorandum regarding the tariff filed to extend the GSIP. Staff noted that these tariff sheets would allow the company to leave a GSIP in place for three more years, through September 30, 2002. Staff recommended that these proposed tariff sheets be suspended for a period of at least six months beyond the requested effective date of February 14, 1999.

Laclede filed a response to the procedural schedule recommendations of Staff and Public Counsel on February 2, 1999. Staff filed a response to this document on February 4, 1999, and Public Counsel did so on February 8, 1999. The Commission issued an order on February 10, 1999, which suspended the tariff sheets for 120 days, to June 14, 1999, granted a protective order, and denied the motion for expedited procedural schedule.

On February 19, 1999, Laclede filed a Motion for Prompt Approval of Laclede Gas Company's Proposed Price Stabilization Program and a One-Year Extension of Laclede's Existing Gas Supply Incentive Plan, and a Request for an On-the-Record Presentation. Public Counsel filed a response in opposition on March 2, 1999, and Staff did so on March 5, 1999. Laclede filed a response to Staff's reply on March 15, 1999. The Commission issued an order Granting Intervention, Denying Motion for On-the-Record Presentation and Amending Procedural Schedule on April 13, 1999.

The Commission issued a Order Directing Notice on June 7, 1999, setting an intervention deadline of June 28, 1999. The Commission granted intervention to the following parties: Missouri Industrial

Energy Consumers (MIEC), Missouri Energy Group,[1] and Missouri Gas Energy (MGE). On July 26, 1999, Missouri Energy Group requested that it be dismissed from the proceeding, and the Commission later granted this request. None of the intervenors offered evidence at the hearing.

A hearing was held on July 22-23 and July 26-27. Initial briefs were filed on August 16 and reply briefs were filed on August 25.

Discussion

The current GSIP has a three-year term, and consists of four main components: procurement of gas supplies; off-system sales; capacity release; and pipeline discount. These components, and the parties' proposed modifications, are discussed below.

I. Procurement of Gas Supplies

A. Current GSIP

Under the first component, the procurement of gas supplies, the actual cost incurred by Laclede to obtain its gas supplies is measured against a benchmark cost of gas that is based on a weighted average first-of-the-month index of spot gas prices, plus a 3.2 percent incremental amount to reflect the cost of reserving these supplies. If the company outperforms this benchmark, it is allowed to retain one-half of the resulting savings subject to an overall floor equal to 94 percent of the benchmark. However, if the company's costs exceed the benchmark

[1] Missouri Energy Group consists of the following: Barnes-Jewish Hospital, DaimlerChrysler Corporation, Emerson Electric Company, SSM HealthCare, and Unity Health Systems.

by more than 4 percent, it must absorb 50 percent of such excess costs up to 110 percent of the benchmark.

B. Laclede's Proposal

Laclede proposes to modify the existing Gas Procurement Component by incorporating a fixed demand charge into the gas procurement benchmark in place of the current "percentage index" demand charge. The fixed demand charge would be established each year by a Request for Proposal (RFP) process which would enable the company to assess the market costs of reserving baseload, swing and combination supplies in each of the producing regions where it purchases gas supplies. Laclede would exclude only the highest 10 percent priced volumes received during the bidding process for purposes of calculating the benchmark (rather than both the highest and lowest 10 percent priced volumes as originally proposed). Laclede would calculate a weighted average of the remaining bids as the fixed demand cost component. Laclede argues that as so modified, the GSIP will continue to provide a powerful incentive for the company to minimize the cost of gas supplies, but the company's share of the savings will no longer increase or decrease with the index price of gas supplies.

Laclede also proposes to add a firm Fixed Price Component. Under this provision, to the extent that Laclede enters into firm fixed price contracts with a price equivalent to or lower than both a) the historical five-year average of gas prices for the applicable winter or summer period; and b) the current market price prevailing during the month or months for which the gas was purchased, the company would share in the savings. Laclede's share of the savings would be based on a sliding scale that begins at 10 percent and increases to a maximum of 50 percent for savings in excess of $.40 per MMBtu. Gas volumes covered by the firm fixed price contracts would be excluded from the Gas Procurement Component of the plan.

Furthermore, Laclede indicated its willingness to modify this component further so that Laclede would be required to absorb 10 percent of the losses and be permitted to retain only 10 percent of the gains associated with its use of firm fixed price contracts, as the Commission prefers. Laclede alleges that this would provide a moderate and balanced set of risks and rewards that would provide the company with a realistic opportunity to use firm fixed price contracts as a part of its gas supply portfolio. Public Counsel indicated that it would accept Laclede's recommendation to modify the sharing percentages to 10 percent of the benefit and detriment of use of fixed price contracts.

C. Public Counsel's Proposal

Public Counsel believes that it is inappropriate to allow Laclede to obtain financial benefits from contracts resulting from a competitive bidding process and referenced to spot market indices. Public Counsel argues that Laclede should not be given an incentive for items over which it does not reasonably exercise control, and emphasizes that Laclede neither controls the competitive market response to its bidding process nor the spot market rate after execution of the contract.

Public Counsel recommends that the traditional PGA/ACA[2] process be utilized for competitive bid contracts referenced to the volatile spot market indices. Public Counsel also recommends that Laclede be given an incentive to enter into fixed price and option contracts for its gas supply; in these situations, Laclede determines its involvement in the design, timing, and amount of activities intended to mitigate market volatility and escalating gas costs. Public Counsel recommends that ratepayers and Laclede share equally in the financial benefits and detriments associated with fixed and option contracts.

D. Staff's Proposal

Staff suggests a fixed price natural gas commodity cost whereby that price will be set based upon consideration of Laclede's historical gas costs and NYMEX future prices, historical demand and swing service premiums, and historical costs for lost and unaccounted-for gas.

Public Counsel indicated that it is willing to modify its proposal to include the caps recommended by Staff witness Busch in his rebuttal testimony.

II. Off-System Sales

A. Current GSIP

The second component is the Off-System Sales Component, which pertains to the off-system sales of gas to nonjurisdictional customers who are located "off" the company's system. The existing GSIP provides

[2] PGA/ACA refers to the Purchased Gas Adjustment/Actual Cost Adjustment procedure generally used in the natural gas industry to permit interim adjustments for gas price changes.

that the company receives 30 percent of the net revenues and the customers receives 70 percent, beginning with the first dollar of off-system sales revenue.

B. Laclede's Proposal

In response to concerns voiced by other parties, Laclede suggests modifying this component by recognizing an aggregate baseline amount of $2.0 million in combined revenues from both off-system sales and capacity releases, provided that Laclede is permitted to retain 50 percent of any revenues it achieves which exceed this baseline amount.

C. Public Counsel's Proposal

Public Counsel believes that a certain amount of off-system sales are inherent in Laclede's mix of pipeline services, and that Laclede has not demonstrated any new or innovative initiatives in the area of off-system sales that have resulted from the implementation of the GSIP. Therefore, Public Counsel recommends modifying this component so that in lieu of Laclede's proposed experimental incentive for off-system sales, $2.4 million should be included in revenue for off-system sales when determining rates in the current rate case, Case No. GR-99-315. Under this plan, Laclede would receive a dollar-for-dollar financial benefit if net off-system sales exceed $2.4 million. However, if Laclede didn't at least achieve its historical average, it would incur financial detriment. Public Counsel argues that including net off-system sales revenues in base rates provides a reasonable balance between the company's interests and the ratepayers' interests.

Public Counsel states that in the alternative, should the Commission wish to maintain Laclede's current off-system sales GSIP structure, Public Counsel recommends that Laclede be allowed to retain 30 percent of the net off-system sales revenues in excess of $2.4 million.

D. Staff's Proposal

Staff proposes a historical, baseline amount of off-system sales that will be included as an offset to transportation rates. If Laclede achieves greater off-system sales than the historical amount, it keeps all revenues from such sales.

III. Capacity Release Component

A. Current GSIP

The current GSIP provides that revenues derived from the release of pipeline transmission or storage capacity were to be shared as follows:

Capacity Release Revenues		Company Percent	Customer Percent
First	$1,500,000	10%	90%
From	$1,500,000 - $2,500,000	20%	80%
Over	$2,500,000	30%	70%

B. Laclede's Proposal

In order to address concerns of Staff and Public Counsel, Laclede stated that it is willing to impute an aggregated baseline of $2.0 million in combined revenues from off-system sales and capacity release, provided that it is permitted to retain 50 percent of any capacity release revenues it achieves which exceeds the baseline.

C. Public Counsel's Proposal

Public Counsel's arguments for modifying this component are similar to its arguments for modifying the Off-System Sales Component. Public Counsel believes that a certain level of capacity release revenues are inherent in Laclede's current mix of pipeline services, and that Laclede has not demonstrated any new or innovative initiatives in the area of capacity release as a result of the capacity release component of the current experimental GSIP.

Public Counsel recommends that, instead of Laclede's proposal, $3.3 million should be included as revenue for capacity release when determining rates in Laclede's current rate case, Case No. GR-99-315. Under Public Counsel's proposal, Laclede would receive a dollar-for-dollar financial benefit if net capacity release revenues exceed $3.3 million. However, Laclede would be subject to financial detriment if it cannot achieve the $3.3 million level of capacity release revenues. Public Counsel argues that including capacity release revenues in base rates provides a reasonable balance between the company's interests and the ratepayers' interests.

Public Counsel proposes an alternative plan should the Commission desire to retain the structure of the current GSIP for the capacity release component. In this plan, Laclede would keep 30 percent of capacity release revenues in excess of $3.3 million.

D. Staff's Proposal

Staff includes an historical baseline amount for capacity release in its calculation as an offset to transportation rates. If Laclede achieves capacity releases greater than the historical average, it will retain all such revenues.

IV. Pipeline Discount Component

A. Current GSIP

The current GSIP provides that discounts negotiated with interstate or intrastate pipeline companies for firm transportation services were to be shared, starting with the first dollar, as follows:

- 10 percent of the difference between actual pipeline costs and the maximum authorized rates after December 1, 1995;
- 20 percent of the difference between actual pipeline costs and maximum authorized rates after October 1, 1996, for contracts finally negotiated and executed subsequent to such date.

B. Laclede's Proposal

In order to address criticisms of Staff and Public Counsel regarding this component, Laclede indicated that it is willing to build in a baseline level of pipeline discount of $13 million which it must exceed prior to retaining any share of discounts. In return, Laclede must be permitted to retain 50 percent of the discounts achieved in excess of the baseline. Laclede noted that the $13 baseline is based on the average discounts received by shippers from the pipelines utilized by Laclede.

C. Public Counsel's Proposal

Public Counsel recommends that the Commission eliminate this component of the GSIP. Public Counsel argues that this is appropriate because of Laclede's strong negotiating position and due to existing pipeline rate structures. In addition, Public Counsel alleges that the experimental GSIP has not caused Laclede to undertake any new or innovative initiatives in the area of pipeline discounts. Public Counsel believes that Laclede would achieve the same or similar levels of pipeline discounts without the GSIP.

Public Counsel recommends that prudently incurred pipeline service costs be passed through dollar-for-dollar to ratepayers under traditional PGA/ACA process. Public Counsel argues that continuation of Laclede's pipeline discount component is not a reasonable balance of ratepayer and shareholder interests.

D. Staff's Proposal

Staff sets transportation costs based on Laclede's contracted FERC or MPSC rates; the rate will include costs for pipeline fuel and storage. The price to Laclede's customers will be adjusted by a deferred account for take-or-pay or gas supply restructuring surcharges and pipeline refunds. Laclede's actual volumes would be adjusted to reflect differences between the actual temperatures and normalized temperatures (using a thirty-year normal) and for customer growth.

V. Mix of Pipeline Services

A. Current Proposal

The current GSIP does not contain this component.

B. Laclede's Proposal

This component puts the company at risk or allows the company to share in savings if the alteration of mix of pipeline services leads to increased or decreased cost for customers. Laclede states that this component should eliminate any incentive for the company to engage in uneconomic substitution.

C. Public Counsel's Proposal

Public Counsel opposes this proposal as it does not believe that it is appropriate to provide Laclede a financial benefit for simply substituting one supplier or service for another based upon capacity availability and differences in pipeline rate structures. Public Counsel further argues that Laclede should not be given a financial benefit simply because of its historical dependence on certain pipeline suppliers or services.

Public Counsel recommends that Laclede's mix of pipeline services remain subject to the traditional PGA/ACA process with prudently incurred costs being passed through to ratepayers on a dollar-for-dollar basis.

D. Staff's Proposal

Staff proposes no adjustment for changes in Laclede's contracted maximum daily quantity (MDQ). Staff states that demand charges for transport would be calculated based on current level of MDQs and not adjusted for interim changes.

Findings of Fact

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact. The positions and arguments of all of the parties have been considered by the Commission in making this decision. Failure to specifically address a piece of evidence, position or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision.

The Commission finds that the establishment of a modified Gas Supply Incentive Plan (referred to as the GSIP II) is in the public interest. However, the Commission determines that the proposals offered by the parties are unacceptable without additional modification. Furthermore, the Commission will approve the implementation of a one-year term only. This shortened time frame will allow the Commission to monitor any action that the Missouri Legislature may take during the year 2000 in the area of energy deregulation.

If Laclede does not want to implement the GSIP II as modified by the Commission, it may instead return to the traditional PGA/ACA process once the current GSIP expires on September 30, 1999.

Gas Procurement

The Commission has reviewed the evidence and determines that Laclede's proposal to establish a fixed demand cost component which won't be affected by movement in gas prices is reasonable and shall be approved for incorporation into a modified GSIP II. This proposal incorporates a fixed demand charge into the gas procurement benchmark in place of the current "percentage index" demand charge. Fixed demand charge would be established each year by a Request for Proposal (RFP) process whereby Laclede would exclude the highest 10 percent priced volumes received during the bidding process. Laclede would calculate a weighted average of the remaining bids as the fixed demand cost component.

Laclede also proposed to add a firm Fixed Price Component where its share of the savings would vary from 10 percent to 50 percent for savings in excess of $.40 per MMBtu. Gas volumes covered by the firm fixed price contracts would be excluded from the Gas Procurement component of this plan.

Off-System Sales

The Commission determines that Public Counsel's position regarding off-system sales has some merit. Public Counsel recommended that in lieu of Laclede's proposed experimental incentive for off-system sales, $2.4 million should be included in revenue for off-system sales when determining rates in the current rate case, Case No. GR-99-315. Public Counsel argued that including net off-system sales revenues in base rates provides a reasonable balance between the company's interests and the ratepayers' interests. The Commission finds that this component should be removed from the GSIP II and instead should be addressed in Laclede's current rate case, Case No. GR-99-315. At this time, the Commission makes no finding regarding whether the figure $2.4 million is the appropriate amount.

Capacity Release

As previously noted, Laclede's Capacity Release proposal established a baseline amount of $2 million in combined revenues from off-system sales and capacity release, with Laclede retaining 50 percent of any capacity release or off-system sales revenues it achieves in excess of the baseline. Since the Commission is unwilling to include off-system sales in the GSIP II, a baseline composed of combined revenues from off-system sales and capacity release is not appropriate. Furthermore, there is insufficient evidence for the Commission to select a different baseline amount for capacity release only. Therefore, the Commission finds that it is appropriate to continue the capacity release component in its current form. Thus, revenues derived from the release of pipeline transmission or storage capacity are to be shared as follows:

Capacity Release Revenues	Company Percent	Customer Percent
First $1,500,000	10%	90%
From $1,500,000 - $2,500,000	20%	80%
Over $2,500,000	30%	70%

Pipeline Discount

The Commission finds that, with a modification of the percentage figure, Laclede's proposal regarding this component is reasonable. The

Commission agrees that the establishment of a baseline level of $13 million is appropriate. Although the Commission finds that a sharing mechanism of 50 percent is excessive, it does recognize that in exchange for the establishment of a baseline level, Laclede should be allowed to retain a slightly higher percentage than the current sliding scale of 10 percent to 20 percent. Therefore, the Commission will allow Laclede to retain 30 percent of the difference between the actual pipeline costs and the maximum authorized rates once the baseline amount has been met.

Mix of Pipeline Services

The Commission finds that Laclede's proposal regarding the mix of pipeline services is reasonable and in the public interest and should be approved.

Conclusions of Law

The Missouri Public Service Commission has arrived at the following conclusions of law.

Laclede is a regulated public utility over which the Commission has jurisdiction in accordance with Chapters 386 and 393, RSMo 1994. The Commission must protect the public interest, ensure that Laclede's rates are just and reasonable, and ensure that Laclede provides safe and adequate service to the public. §§ 393.130 and 393.140, RSMo 1994.

Orders of the Commission must be based upon competent and substantial evidence on the record. § 536.140, RSMo 1994. Based upon its findings of fact, the Commission concludes that a GSIP modified to comply with this order would be in the public interest.

IT IS THEREFORE ORDERED:

1. That the proposed tariff filed by Laclede Gas Company on January 14, 1999, is rejected.

2. That Laclede Gas Company is authorized to implement a modified Gas Supply Incentive Plan (GSIP II) which is consistent with the modifications directed by the Commission in this order. This plan shall be effective for a one-year term of October 1, 1999, to September 30, 2000.

3. That Laclede Gas Company shall file, by September 14, 1999, either (a) a revised tariff implementing a modified Gas Supply Incentive Plan (GSIP II) which is consistent with this order; or (b) a notice that Laclede elects to return to the traditional PGA/ACA process once the current experimental Gas Supply Incentive Plan expires on September 30, 1999.

4. That if Laclede Gas Company files revised tariff sheets implementing a modified Gas Supply Incentive Plan (GSIP II), Staff shall file, by September 20, 1999, a report which states whether or not the company's revised tariff complies with this Report and Order.

5. That any pending motions or objections not specifically ruled on in this order are hereby denied or overruled.

6. That this Report and Order shall become effective on September 21, 1999.

BY THE COMMISSION

Dale Hardy Roberts

Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge

(S E A L)

Lumpe, Ch., Crumpton, Drainer, and
Murray, concur and certify compliance
with the provisions of Section 536.080,
RSMo 1994.
Schemenauer, C., absent.

Dated at Jefferson City, Missouri,
on this 9th day of September, 1999.

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COMMISSION COUNSEL
PUBLIC SERVICE COMMISSION