NP

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the PGA Filing for Laclede Gas Company	))	**Case No. GR-2004-0273**

PRE-TRIAL BRIEF OF LACLEDE GAS COMPANY

COMES NOW Laclede Gas Company (hereinafter "Laclede" or "Company") and, pursuant to the Commission's procedural order, submits its Pre-Trial Brief in this case.

I. Introduction

For nearly a decade prior to the 2003-2004 Actual Cost Adjustment ("ACA") period under consideration in this proceeding, Laclede routinely paid **______________ ____ ____ ____**[1] This practice of contracting for **________________** has affected customers in two ways. First, it has contributed to more stable gas prices by providing a **___________________________________** – spikes which had grown in their severity and magnitude in the years immediately prior to the ACA period under consideration in this case. Second, **___________** has enabled Laclede to make sales of gas to customers located off its system when supplies were temporarily unneeded to meet system demands; a benefit that has also been shared with

---

[1] "Swing" contracts are gas supply arrangements that permit the Company to purchase as much or as little gas as it requires on any given day to meet the variable, temperature sensitive demands of its customers. These are in contrast to "baseload" contracts which require the Company to take a fixed volume of gas each and every day. In addition to purely swing and purely baseload contracts, Laclede also has "combination" contracts in its gas supply portfolio which contain elements of both. Laclede also paid **____________** on these other kind of contracts, but such **_____________** are not at issue in this case.

customers, either through a recognition of the resulting revenues in the Company's PGA rates or, later, in its base rates. While it is widely believed that hedging will tend to increase the price of a commodity over the long-term (in return for greater price stability), the net effect of the price and revenue impacts resulting from the practice under consideration in this case has been to reduce the cost of utility service for Laclede's customers over a multi-year period. (Godat Direct, pp. 8-9).

Notably, Laclede's practice of **____** was undertaken throughout this period with the full knowledge of the Commission Staff ("Staff"). In fact, this contracting practice had been subject to review by the Staff's Procurement Analysis Department in multiple ACA proceedings prior to the instant one as well as by the Staff's Engineering and Management Services Department in a separate management audit. (Godat Direct, p. 5). It was also thoroughly discussed in separate proceedings involving the Company's gas supply incentive plans and highlighted in statewide task force reports that had been prepared for the Commission in response to rising gas prices.

At no point during this period, did the Staff state, or even imply, that it had a concern about the prudence or efficacy of this contracting practice. (*Id.).* To the contrary, Staff's many pronouncements on the need for local distributions companies ("LDCs"), like Laclede, to stabilize their prices through hedging and other contracting practices strongly indicated that Laclede's practice of **_________________________ __________** was not only prudent but highly desirable. (Godat Direct, pp. 5, 7).

Nevertheless, despite this history and without any advance warning, the Staff has proposed in this case to disallow approximately $2,055,000 **________________________

____

________** In support of its proposed disallowance, Staff alleges that since the **____** had nearly doubled in the past year, Laclede should have conducted a formal, historical study of the costs and benefits of paying such charges **________________** before continuing this long-standing practice. (Sommerer Direct, pp. 9-11). Since Laclede did not conduct such an historical study but instead relied on a more contemporaneous evaluation of market conditions, and since, in Staff's view, the cost of such charges outweighed any associated benefits, Staff asserts that such a disallowance is appropriate. (Sommerer Direct, pp. 9-18).

The Commission should reject Staff's proposed adjustment for several reasons. Perhaps most significantly, the Staff's proposed disallowance is an egregious example of the kind of impermissible hindsight review that Missouri courts and this Commission have repeatedly rejected as inconsistent with the proper standard for assessing the prudence of utility management decisions and actions. Indeed, to support its adjustment, the Staff has had to rely on a retrospective and highly distorted review of the actual results that were achieved under a given set of gas supply contracts and a given set of weather and pricing conditions. In doing so, Staff simply ignores the fact that such results could not have been known at the time the decisions to enter such contracts were made. Even worse, Staff's analysis studiously ignores all of the factors and considerations that *were* known at the time and that, to this day, strongly militate against the kind of gas purchasing mix that Staff has so confidently endorsed after-the-fact. These include, among others, the fact that the gas purchasing practices criticized by Staff in its adjustment were the very same ones that had historically resulted in substantial savings for Laclede customers – a result that, even under Staff's view of how such savings should be calculated, could have easily been repeated during the ACA period had actual weather or pricing conditions turned out differently.

Staff's proposed disallowance also fails to satisfy another critical legal requirement that Missouri courts have deemed essential to any permissible prudence adjustment, namely a showing of harm. Specifically, while Staff asserts that the contracting practice at issue in this case has enabled the Company to make off-system sales, it fails to offset its proposed disallowance with the off-system sales revenues that have actually been generated by the Company and flowed through to its ratepayers. Had Staff done so, as the prevailing legal standard and previous agreements approved by this Commission require, such an offset would have totally negated its proposed disallowance. (Godat Direct, pp. 10-12).

Finally, Staff's attempt to disallow **______________________________________ ______________________________________** is fundamentally inconsistent with the Commission's own Natural Gas Price Volatility Mitigation rule. 4 CSR 240-40.018. (Godat Direct, pp. 11-13). As discussed below, that rule affirmatively encourages local distribution companies like Laclede to use various contracting practices and financial instruments to achieve greater price stability on behalf of their customers. And to that end, the rule explicitly acknowledges and accepts the proposition that prudent efforts aimed at promoting more stable prices may occasionally result in prices that are higher than spot market prices. (*Id.*). By seeking to penalize the Company for using a price stabilization practice precisely because it may have ultimately resulted in a slightly higher than spot-market price in a particular year, the Staff has proposed an adjustment that eviscerates, at a singularly inappropriate time, the core assurances provided by the Commission's Price Volatility Rule. For all of these reasons, the Commission should reject Staff's proposed disallowance. (*Id*.).

II. <u>Argument</u>

As previously noted, Staff's proposed disallowance is based on the theory that Laclede's decision **____ ______________________________** was imprudent. Both Missouri courts and this Commission have previously determined that there are two required elements that must be satisfied in order to warrant a prudence disallowance. First, the Commission must find that utility management acted imprudently compared to what a reasonable person would or should have done at the time the transaction took place. *State ex rel. Associated Natural Gas Co. v. Pub. Serv. Comm'n*, 954 S.W.2d 520 (Mo. App. W.D. 1979). Moreover, the Commission must base its prudence determination on the facts and circumstances that existed at the time the transaction took place and may not use hindsight to arrive at its conclusion. *Id.* Second, the Commission must find that ratepayers have actually been harmed by the allegedly imprudent act. *Id.* As discussed below, Staff's proposed adjustment fails to satisfy either of these legal requirements.

A. <u>Was it imprudent of Laclede to purchase the right to **__________ ______________________________________** during the 2003-2004 ACA period</u>?

Far from being imprudent, Laclede's decision to purchase **______________ ____________________________** during the ACA period was an integral, long-standing and highly effective component of its overall gas purchasing strategy. As explained by

Laclede witness George Godat, in contracting for gas supplies, Laclede has to take into consideration the extremely variable demands for natural gas that its customers can and do impose during the winter heating season. Because most of Laclede's customer base consists of temperature sensitive residential and commercial customers, the demand for gas during the winter heating season can vary significantly from day to day and even hour to hour based on changes in the weather. Laclede has a variety of tools at its disposal to meet these varying demands, including storage gas, propane peak shaving capabilities and, of course, flowing gas supplies that are purchased and then received on a daily basis from producers and marketers over the interstate and intrastate pipelines that are connected to Laclede. (Godat Direct, p. 2). As previously mentioned, a portion of these gas supplies are "baseload" supplies that Laclede is obligated to take in even increments each day to serve those minimum load requirements that Laclede expects it will experience each day, regardless of weather conditions or other factors. Another component are the "swing" supplies at issue here – supplies which Laclede may or may not need on a given day to serve its customers depending on how weather conditions are affecting the demand for gas and the availability of other supply options for meeting that demand. (Godat Direct, p. 3). A final component consists of combination or "combo" contracts that combine features of both of these kinds of contracts.

Over the years, Laclede has consistently paid **

____

____ **

In addition to ensuring that Laclede would have gas available when needed to meet the demands of its customers, this contracting practice also benefits Laclede's customers in several other ways. First, **____________________________________

____

____

____

____

____

____

______________________________________** (Godat Direct, pp. 4-5).

It is difficult to overstate the intrinsic value of such a practice to Laclede's customers. It is commonly understood that while hedging a commodity will help to stabilize the price of that commodity, it will also tend to increase its cost over the long-term. For example, the 2001 Final Report of the Commission's Natural Gas Commodity Price Task Force specifically recognized that while hedging should be part of a balanced portfolio, the use of such instruments may result in higher gas prices over the long term. As the Report stated:

> Part of a balanced portfolio will be over market at times and this is necessary to dampen price volatility. It is also recognized that gas price stability, which is desired and valued by customers, *may result in higher gas prices over the long term due to the costs of hedging and fixed price contracts.* Report, p. 35.

The Commission's own Natural Gas Price Volatility Mitigation rule, which is set forth at 4 CSR 240-40.018, also acknowledges and accepts the principle that it is prudent to use hedging instruments even though they may result in prices that are occasionally above the spot market price for gas.

In contrast to most other hedging strategies, however, the practice of **______ ____________________________________** has actually allowed Laclede to protect its customers from intra-month price spikes at no long-term cost, once all of the financial effects of the practice are taken into consideration. And based on the facts and circumstances that prevailed at the time Laclede made its contracting decisions in 2003, there was every reason to believe that such a practice was, and remained, a reasonable one, both in terms of its impact on gas costs and in terms of its usefulness in stabilizing prices.

As Laclede Director of Gas Supply, George Godat, explained in his testimony, a study conducted by Laclede in the winter of 1995-1996 **________________________ ____**

(Godat Direct, p. 8). Since that time, Laclede had continued to monitor this hedging strategy and, prior to the subject ACA period, had seen no evidence to indicate that such a strategy had become imprudent or was not cost-effective. (*Id.*) To the contrary, as recently as the February before the winter of 2003-2004, Laclede had seen huge **_____ _________________** in the natural gas markets (and record low storage levels that threatened to drive such prices even higher in the future), that had broadly reconfirmed the wisdom of using such a hedging strategy to mitigate such intra-month spikes. (*Id.*).

Notably, the Commission and its Staff had also taken note of these developments as reflected in a letter that was sent to each Missouri LDC in the summer of 2003. In that letter, the Staff stated that the natural gas market currently had “very high prices” and that a number of groups had suggested that such prices might not go down before next spring, but instead might “go even higher.” Staff also noted that “few factors at this time provide much comfort in this market” citing figures showing that national, storage inventory levels were some 28% below the five year average. Staff also recognized in its letter that a continuation of current prices, even with normal winter weather, could put a tremendous burden on Missouri’s natural gas customers and requested that LDCs provide information regarding their storage and hedging situation. (Sommerer Deposition, pp. 68-70). Based on all of these factors, as well as its intimate, day-to-day knowledge of what was then happening and had happened in the natural gas markets, Laclede decided to continue its decade-old practice of **____

____**

Given the cost-effectiveness of this practice as a hedging tool, Staff’s long concurrence in its use over many years of ACA audits and other reviews, and the challenging circumstances that were prevailing at the time, one might reasonably expect that the Staff would have enthusiastically endorsed the practice rather than question its prudence when it filed its ACA recommendation in this case. Nevertheless, based on a retrospective and highly selective review of only a portion of the overall financial effects of this practice during the ACA proceeding, the Staff erroneously claims that Laclede was imprudent for paying demand charges on its swing supplies.

In support of that claim, Staff witness David Sommerer contends that since the level of demand charges paid by Laclede had nearly doubled since the previous ACA period, Laclede should have conducted a more recent study of the historical savings and costs of **____** before deciding to continue that long-standing practice. (Sommerer Direct, pp. 9-12). Staff's claim that such a study was necessary to establish the prudence of continuing this practice during the ACA period is a complete and utter canard.

First, the very reason given by Staff as to why such a study was necessary is premised on a grossly exaggerated and distorted depiction of the magnitude of the **____

_______** Although Mr. Sommerer asserted in his testimony that **_____________

_______________** during the ACA period, his own schedules show that they, in fact, had increased by about **____

____** Even with a charitable view towards the virtues of rounding, saying that something has "nearly doubled" (or nearly increased by 100%) when it has, in fact, increased by 70%, hardly provides an accurate or fair assessment.

Moreover, even saying that Laclede's **________________________________

__________** would only be true if one considers *all* of the **_____________** paid by Laclede on *all* of its contracts, including baseload, combo, and swing contracts. In both his pre-filed testimony and deposition, however, Mr. Sommerer himself insisted that the prudence **_______________________________________** should be based on a separate evaluation of each kind of contract and the specific levels of **______

______** paid in connection therewith. (Sommerer Direct, p. 14, lines 20-21; Sommerer Deposition , p. 18).

Disaggregating Laclede's contracts and demand charge payments in the manner recommended by Mr. Sommerer reveals that **____________________________________

____

____

____________________** (Godat Deposition Tr., pp. 21-22; see also Sommerer Direct, Schedule 2-11, which refers to a 28% increase in these charges). Accordingly, even if one were to accept the dubious proposition that a **____________________________** should have set off alarm bells (notwithstanding the huge price increases that were also being experienced in virtually every segment of the natural gas market), no such alarms were sounding when it came to the **__________________________** at issue in this case. As a result, Staff's entire claim of imprudence rests on a highly misleading and wildly exaggerated depiction of **____

_____________________ ** Indeed, because of this fundamental error, Staff finds itself proposing a disallowance ($2 million) that is **_________________________________

____

__________** -- a year in which Staff apparently believed such charges were both reasonable and prudent. Laclede respectfully submits that this gross flaw alone should lead the Commission to reject Staff's proposed disallowance.

As egregious as this flaw is, however, there is an even more fundamental problem with Staff's single-minded fixation on the fact that **______________** had increased as support for its assertion that Laclede should have performed a special study before continuing its practice of **______________________________________** That problem involves the total lack of perspective and context that Staff has brought to the discussion of these increases. To hear Staff tell it, one would think that **______________** were escalating in an unusual or unexpected way that set them apart from what was happening with other natural gas pricing mechanisms and instruments and therefore mandated some kind of special scrutiny. Nothing could be further from the truth.

As Mr. Sommerer confirmed in his deposition, the Commission's own Natural Gas Commodity Price Task Force Report recognized that as far back as 2001, the amount of **____ ________________________** of their overall gas costs. (Sommerer Deposition, pp. 21-22)   Even with the increase in overall **______________** that Mr. Sommerer cites in his testimony, the amounts incurred by Laclede for such charges during the 2003/2004 ACA period still fell well within this historical range, totaling less than **______ ____ ______________________________________** (See Sommerer Deposition, pp. 23-24). Compared to Staff's myopic, out-of-context focus on a single cost element, this more complete assessment of how **______________** were performing relative to overall gas costs paints an entirely different, and far more meaningful, picture of the continuing reasonableness and efficacy of such charges. Of course they were increasing, but so was everything else! The important point is that based on overall market trends there was absolutely no reason to conclude in 2003 that there was something amiss or unusual about how **______________** were escalating, let alone something that should have prompted Laclede to conduct a special study of such charges or even consider abandoning its long-standing practice of using them to **________________** on its gas supplies.

To the contrary, an overall assessment of what was happening in the natural gas markets at the time strongly indicates that just the opposite was true. Indeed, all one needs to do to reach that conclusion is compare what was happening with **__________

____

____

____

____

____

____

____**

In comparison, Mr. Sommerer indicated in his deposition that the daily, intra-month price for natural gas during the preceding winter had spiked by as much as 20 *dollars* an MMBtu on certain days. (Sommerer Deposition, p. 30). Given these relative price movements, it is nothing short of astonishing that Staff would now claim that Laclede should have been wary of the **_____________________________________

_____________** and only continued its practice of paying them upon completion of some kind of formal study. It doesn't take a formal study – indeed, it takes little more than open eyes and the ability to distinguish between dollars and cents – to conclude that paying an additional **____

______________** was a reasonable thing to do.

In fact, if the marketplace events of 2003 raised any concerns at all regarding the need for additional study and analysis, those concerns would have been more properly focused on why it was appropriate and reasonable for LDCs to expose themselves to such huge intra-month price spikes when such exposure could have been avoided through the **____________________________________** Staff's insistence on formal studies as a means of establishing prudence, however, apparently only applies when the amounts being evaluated are relatively small, and such insistence inexplicably dissolves when the expenditures are far larger. Although Mr. Sommerer indicated during his deposition that Staff had informally asked other Missouri LDCs (who do not pay **________________ ____** to provide studies on whether such an approach had benefited their customers, he stated that no such studies had been provided. (Sommerer Deposition, pp. 42-44, 47). Despite the absence of such studies, however, Mr. Sommerer indicated that Staff had never questioned the prudence of an LDC's decision to pay **____ ____** (Sommerer Deposition, pp. 51-52). And since such studies have never been provided, Staff has apparently decided that the prudence of exposing customers to potentially massive increases in the **____** can be established (or perhaps just assumed) without the benefit of any historical analysis that quantifies whether such an approach has or has not worked to the benefit of those customers.

Laclede does not mean to imply that other LDCs may have been imprudent for not pursuing the same strategy as Laclede has on **______________________________ ____________** Different systems, storage capabilities, pipeline suppliers and other factors may very well justify different approaches. At the same time, Laclede believes it is highly inappropriate for the Staff to recommend that the Commission penalize Laclede for not performing a study often enough that Staff has *never* insisted that any other LDC perform *at all* and that Staff has never tried to perform itself. It is even more unseemly and inappropriate for the Staff to advocate that Laclede change such a practice when the Staff has absolutely no idea – no idea at all – as to whether its preferred alternative of **____ __________** has benefited or harmed the customers of those LDCs who have followed such an approach. Given these considerations, it is clear that if any party to this case has a problem with not having done the kind of homework or performed the kind of analysis necessary to support their position on the relative benefits and costs of **_____________ __________________________** it is Staff, not Laclede.

The Staff's insistence that a more recent historical study of the relative costs and savings of an **____________________** approach was necessary to establish the prudence of continuing practice is also directly contrary to what the Staff and its own hedging expert have previously said is required to make such decisions. As Mr. Godat explained during his deposition, in deciding whether to **_________________________ ____** he followed the very kind of evaluation process that had been recommended by a hedging expert hired by the Commission in 2002. (Godat Deposition, pp. 18-19).

The expert referred to by Mr. Godat was John H. Herbert. After the price spikes of 2000/2001, Mr. Herbert was employed by the Commission to evaluate and make recommendations regarding the gas purchasing and hedging practices of the Missouri

LDCs regulated by the Commission. (Sommerer Deposition, pp. 62-64) His recommendations were formally submitted to both the Commission and the state's LDCs in March of 2002 in a document entitled "The General Report on Analysis of Gas Supply and Hedging Practice By Regulated Natural Gas Utilities in Missouri" (hereinafter "Herbert Report"). Notably, there is nothing in Mr. Herbert's report to suggest that a decision like the one Laclede made to continue its **____________________________ ____________** should be based primarily on the kind of historical cost/benefit analysis that Staff says Laclede should have done in this case. Instead, Mr. Herbert recommended that LDCs place most of their analytical efforts on evaluating current market fundamentals, such as national storage inventory levels, recent price volatility and other market factors in determining what contracting and hedging practices they should pursue. (Godat Deposition, pp. 18-19; Herbert Report, pp. 36). He also recognized that in deciding when to put on a hedge, LDC supply personnel must base their decisions on "market and price analyses, forecasts, judgment and years of experience." (Herbert Report, p. 40).

That is precisely what Laclede did in reaching its decision to continue the practice of **____** during the 2003/2004 ACA period. (Godat Deposition, pp. 18-19). Specifically, Laclede looked at the huge shortfall in storage inventories at the national level, took note of the extraordinary intra-month price spikes that had been experienced during the later part of the 2002/2003 ACA period, examined forward prices and, with a detailed knowledge of how cold weather and increased price volatility could have affected Laclede's gas costs, determined that it was reasonable to pay the **_________________________________

____** Unlike Mr. Sommerer, Laclede also took to heart Mr. Herbert's observation that **______________ __________________________________** and that the rising cost of obtaining this and other forms of hedging protection should not be used as an excuse for leaving customers exposed to monthly or daily price spikes, particularly in markets where there is great price volatility. (Herbert Report, pp. 9, 42; Sommerer Deposition, pp. 64-65.).

In addition to Mr. Herbert, Mr. Sommerer himself has also recognized the appropriateness of basing such decisions on judgment and a knowledge of prevailing market conditions, rather than on some kind of historical cost/benefit analysis. For example, when hedging programs were first approved for Laclede and Missouri Gas Energy after the price spikes that occurred in the 1995/96 winter heating season, Mr. Sommerer was actively involved in recommending what volumes of gas should be covered, what kind of hedging instruments should be used, and how much money should be spent in procuring such instruments. As Mr. Sommerer confirmed during his deposition, he did not believe at the time that any kind of formal cost/benefit analysis or study was necessary to make these determinations, nor did he attempt to perform any. (Sommerer Deposition, pp. 38-42). Instead, Mr. Sommerer believed it was perfectly reasonable and prudent to base such decisions – decisions that involved expenditures comparable to those at issue in this case – on the same kind of experience and knowledge of the natural gas markets that Mr. Godat relied on in making the decisions at issue in this case. (*Id.*). And to this day, Mr. Sommerer continues to believe that he acted reasonably and prudently in basing his decision on such informed judgment. (*Id.*, p. 73).

Finally, it is important for the Commission to recognize that **______________

____

____

____

____

____

______** (Godat Direct, pp. 8-9). Given the complete absence of any evidence suggesting that this competitive process was somehow flawed, there is no reason to believe that an historical study would have added anything of substance to the determination of whether Laclede's **_______________________________________

______** during the ACA period represented a reasonable expenditure.

In view of these considerations, there is absolutely no basis for Staff's assertion that Laclede was imprudent because it did not perform a more recent study of the relative costs and benefits of FOM versus non-FOM pricing before deciding to continue this long-standing practice of **____

_______** for the 2003/2004 winter heating season. Indeed, it is clear that Staff's claim that such a study was necessary is nothing more than a pretense to justify what is obviously an impermissible attempt to disallow costs based on a distorted hindsight view of how things turned out rather than a fair evaluation of what was known by Laclede at the time.

Even more egregious in this case, however, is the fact that Staff has chosen to make this impermissible adjustment without any advance warning and after nearly a decade of ACA reviews, management audits, and other proceedings in which Staff had the opportunity to question the propriety of this practice, but did not. To the contrary, Staff sent just the opposite message in the years immediately preceding the ACA period, filled as they were with Staff letters and reports emphasizing the potential for higher and even more volatile gas prices and the need to pursue measures aimed at mitigating the impact of such prices on utility customers. Indeed, had Laclede suddenly abandoned, rather than continued, its practice of **____** in the face of such circumstances, it is quite likely that the Staff would have found *that* decision to be imprudent, especially if the weather had been even normal, rather than warmer than normal, or if prices had spiked that winter, as they had in two of the three preceding winters. For all of the reasons discussed above, however, Staff is decidedly wrong in proposing an adjustment in this case and the Commission should not hesitate to reject its proposed adjustment.

B. <u>If so, were Laclede's customers harmed by this action</u>?

Even if one were to erroneously assume that Staff was correct in asserting that Laclede was somehow imprudent for continuing its long-standing and successful practice of **____** Staff's proposed disallowance would still be impermissible because there is no evidence to suggest that Laclede's customers were harmed by such a practice. *See* <u>State ex rel. Associated Natural Gas Co. v. Pub. Serv. Comm'n</u>, 954 S.W.2d 520, 529-30 (Mo. App. W.D. 1997). In other words, Staff must show that Laclede was not only imprudent but also that its costs are higher than they would have been if not for the Company's decision to pay demand charges on its swing supplies.

Staff has failed to satisfy this requirement as well. As previously noted, the Staff has proposed to disallow approximately **______________________________ ____** during the ACA period. (Sommerer Deposition, p. 5). According to the Staff, the remaining **____ ____ ____ ** (Sommerer Deposition, pp. 7, 11).

In suggesting that $2 million of these costs should be disallowed, however, Staff has completely ignored the revenues that Laclede was able to generate for its customers as a result of being able to buy **_______** at a lower price than the market rate for a given day. (Godat Direct, p. 10). This pricing advantage, in turn, provided Laclede with an opportunity to realize a profit on the sale of gas to customers located off of Laclede's system when such supplies were temporarily not needed to serve its on-system customers (*Id.*).

As Mr. Godat explained in his testimony, Laclede has been making these off-system sales since the mid-1990s. And as Mr. Sommerer acknowledged during his deposition, the regulatory practice in effect during the ACA period under consideration in this case was to impute a representative level of such revenues into the Company's base rates – an approach that directly reduced what customers would otherwise have to pay for utility service. (Sommerer Deposition, pp. 14-15). Indeed, this very practice was followed in the Company's 2002 rate case proceeding in Case No. GR-2002-356. (Godat Direct, p. 10) As a result, the Commission approved a Stipulation and Agreement

("Stipulation") which expressly recognized that Laclede's annual revenue requirement had been reduced to reflect an imputed $3.8 million in off-system sales and capacity release revenues. (Godat Direct, p. 11). In effect, this means that regardless of the level of off-system sales or pipeline capacity release achieved by Laclede, its customers were *guaranteed* $3.8 million through lower rates. (*Id*.).

In his testimony, Mr. Sommerer acknowledged that the Company's **____** facilitated the Company's ability to make these off-system sales. (Sommerer Rebuttal, p.3, lines 2-5). He also had no problem identifying the specific off-system sales volumes that had actually been made with these **____________** (Sommerer Deposition, p. 12). Nevertheless, Mr. Sommerer completely ignored such revenues in calculating his proposed adjustment.

There is simply no justification for ignoring the benefits of off-system sales in determining whether Laclede's customers were harmed by the Company's practice of **______________________** that made those sales possible. While the $3.8 million imputation discussed above was not expressly divided in the Stipulation and Agreement between off-system sales and capacity release revenues, Mr. Godat indicated that the data he had reviewed showed that as much as $2.7 million of these revenues were attributable to off-system sales. (Godat Deposition, p. 46). Moreover, those imputed amounts – and the corresponding offsets to rates -- have only increased in subsequent rate case proceedings. In view of these considerations, off-system sales revenues should have been factored into Staff's calculation of the costs and benefits associated with **____** When they are, the result more than negates Staff's proposed disallowance of $2 million by eliminating any notion that the Company's ratepayers were somehow harmed by this practice.

It is also important to note that in exchange for imputing $3.8 million of revenue, the Company was expressly permitted by the terms of the Stipulation to retain all of the revenues realized from off-system sales and releases of pipeline capacity. And to that end, the Stipulation further provided that "no other treatment of such revenues shall be implemented as the result of any action taken in another Commission case…" (Godat Direct, p. 11). In light of this clear language, the failure to reject Staff's proposed disallowance would effectively deprive Laclede of the value of what it bargained for in the Stipulation – and in the process violate that agreement – by taking away with an ACA adjustment what the Company was entitled to keep under the Stipulation. This impermissible action should not be condoned by the Commission.

Finally, Staff's proposed disallowance gives absolutely no recognition in this case to the intangible benefit that hedging instruments – and the protection they provide against price spikes – afford customers. Mr. Sommerer expressly recognized this value during his deposition and indicated that it should be recognized even in those instances where a particular hedging transaction loses money but nevertheless provides customers with protection while it is in effect. (Sommerer Deposition, pp. 105-107).

This intangible benefit is also reflected in the Commission's Natural Gas Price Volatility Mitigation rule which was adopted for the express purpose of encouraging LDCs, like Laclede, to use various contracting practices and financial instruments to achieve greater price stability on behalf of their customers. *See* 4 CSR 240-40.018. The rule promotes this objective by explicitly acknowledging and accepting the fact that prudent contracting and hedging practices aimed at promoting more stable prices may occasionally result in prices that are higher than spot market prices. (Godat Direct, p. 12). In other words, it recognizes that a more stable price is not always going to be the lowest price given the way market prices can decline as well as increase from what was assumed or prevailing at the time a hedging decision was made. (*Id.*). By providing this kind of assurance, the rule tells utilities that they will not be penalized with disallowances simply because their price mitigation practices result in higher rates in a given year than would have been the case had the utility simply relied on the spot market. (*Id.*).

By giving Laclede absolutely no credit for the intangible benefit provided by **____________________________** the Staff's proposed disallowance strikes at the heart of the rule and what it was intended to accomplish. **______________________

____

____

____

____** (Godat Direct, p. 13). As a result, Staff's proposed disallowance is directly contrary to the explicit wording and intent of the Commission's Price Volatility Rule and Staff's own acknowledgement that there is an intangible value to affording such protection to customers. If permitted to stand, it would actively discourage hedging by telling utilities that the practice is acceptable only if, and to the extent, it produces a favorable outcome in each and every ACA period. That would send exactly the wrong message at a singularly inappropriate time given the gas price environment faced by local distribution companies and their customers today. For all of these reasons, Staff's proposed adjustment should be rejected by the Commission.

C. **If customers were harmed, in what amount were they harmed, and what amount of gas costs, if any, should be disallowed to Laclede?**

Since Laclede was not imprudent and its customers were, in any event, benefited rather than harmed by Laclede's decision to **________________________________ ________** there is no basis for disallowing any amount in this proceeding. For all of these reasons, Laclede respectfully requests that the Commission reject Staff's proposed adjustment.

Respectfully submitted,

/s/ Michael C. Pendergast

Michael C. Pendergast, Mo. Bar #31763
Vice President and Associate General Counsel
Rick Zucker, Mo. Bar #49211
Assistant General Counsel - Regulatory

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

Certificate of Service

The undersigned certifies that a true and correct copy of the foregoing pleading was served on the General Counsel of the Staff of the Missouri Public Service Commission and the Office of Public Counsel on this 22nd day of January, 2007 by United States mail, hand-delivery, email, or facsimile.

/s/ Rick Zucker