Exhibit No.:	
Issue:	**Off-System Sales and Capacity Release Revenues**
Witness:	**Steven F. Mathews**
Type of Exhibit:	**Rebuttal Testimony**
Sponsoring Party:	**Laclede Gas Company**
Case No.:	**GR-2002-356**

LACLEDE GAS COMPANY

GR-2002-356

REBUTTAL TESTIMONY

OF

STEVEN F. MATHEWS

August 2002

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Tariff to Revise Natural Gas Rate Schedules.	)))	Case No. GR-2002-356

AFFIDAVIT

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

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

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

2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony, consisting of pages 1 to 14.

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

Steven F. Mathews

Subscribed and sworn to before me this 1st day of August, 2002.

Joyce L. Jansen

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

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STEVEN F. MATHEWS
LACLEDE GAS COMPANY
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REBUTTAL TESTIMONY OF STEVEN F. MATHEWS

Q. What is your name and business address?

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

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

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

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

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

Q. What is your educational background?

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

Q. Please describe your experience with Laclede.

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

Q. Have you previously submitted testimony before this Commission?

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

Purpose of Testimony

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to respond to the direct testimony by Staff witness David M. Sommerer and Public Counsel's witness James A. Busch regarding the appropriate treatment to be afforded off-system sales and capacity release revenues. Specifically, I will explain why their recommendations regarding the level of such revenues to impute in rates are unreasonable in light of the dramatic changes that have recently occurred in the natural gas market. I will also explain why these same considerations warrant a return to a straight sharing arrangement for these revenues under which the Company's customers would receive the lion's share of any revenues generated by the Company as a result of its efforts to market gas and capacity. Finally, I will discuss why Staff witness Sommerer's proposals to change the conditions and economic terms under which the Company makes off-system sales should be rejected.

Treatment of off-system sales and capacity release revenues

Q. Would you please summarize Staff's recommended treatment for the Company's off-system sales and capacity release revenues?

A. Yes. Staff's position is to include off-system sales and capacity release revenues as part of Laclede's non-gas costs and include such revenues in the cost of service for determining the Company's base rates.

Q. Does Staff recommend that specific amounts of off-system sales and capacity release revenues to be included into the Company's cost of service for determining base rates?

A. Yes. Staff recommends $2,645,000 and $1,628,000 annually for off-system sales and capacity release revenues respectively, for a total annual amount of $4,273,000.

Q. How did Staff arrive at these figures?

A. Staff developed these figures using the most recent three-year historical average for off-system sales and because of a declining trend, used the current period for capacity release revenues.

Q. Would you please summarize Public Counsel's recommended treatment for the Company's off-system sales and capacity release revenues?

A. Yes. Public Counsel recommends that a total of $4,000,000 in off-system sales and capacity release revenues be imputed when determining the Company's non-gas rates in this proceeding.

Q. Do you agree with either of Staff or Public Counsel's recommended treatment for off-system sales and capacity release?

A. No. I do not believe off-system sales and capacity release revenues should be included as part of Laclede's cost of service for determining the Company's base rates and certainly not at the levels recommended by these parties.

Q. Would you please explain?

A. Yes. Although the parties to the Stipulation and Agreement in Laclede's last rate case agreed to include off-system sales and capacity release revenues in the determination of the Company's rates, there have been dramatic changes in the natural gas market in the past few months that necessitate a change in the treatment of the Company's future off-system sales and capacity release revenues. The changes to which I am referring are the collapse or financial degradation of Enron and numerous other trading and marketing entities and pipelines with whom the Company buys, sells and transports natural gas. As a result of these changes, credit and counterparty risk within the natural gas market has reached unprecedented levels. Furthermore, as a result of the overall reduced focus or energy trading activities, liquidity, the ability to easily find multiple buyers and sellers willing to make a market, has declined dramatically. These fundamental changes have been so significant, that they will not only impact the Company's potential to make future off-system sales and capacity releases, but will also change the way the Company structures its gas supply contract portfolio.

Q. Why will these changes impact the Company's future off-system sales and capacity release revenues?

A. These changes will impact future off-system sales and capacity releases revenues because most of the Company's off-system sales and a significant amount of capacity releases were transacted between Laclede and the various entities that either no longer exist or have now become a significant potential default risk. Furthermore, many of these entities who have either filed for bankruptcy, like Enron, or who have decided to exit the trading business, such as Aquila Merchant Services, Inc., were significant marketmakers. As a result of their demise, it has now become much more difficult to find creditworthy buyers at various delivery locations where the Company has historically made off-system sales.

Q. How much off-system sales and capacity release business did the Company transact with these entities?

A. Since October 1998, the Company has generated approximately $100 Million in gross revenue as a result of making off-system sales. These sales have resulted in net revenues of approximately $8 Million, which has benefited both the Company and its customers. Of this $100 Million, approximately $69 Million or 69% were from companies that have either filed for bankruptcy, exited the trading and marketing business, or are currently a significant default risk. Of this $69 Million, approximately $47 Million or 47% of gross revenues were from Aquila, Columbia, TPC or Enron, companies who have either filed for bankruptcy or exited the trading and marketing business. Approximately $11 Million or 11% of gross revenues were from Dynegy or Williams, companies who are on the verge of bankruptcy and whose common stock prices have slid in the past year from over $45 and $30 respectively, to approximately $1. Finally, approximately $11 Million or 11% of these gross revenues were from Mirant, a company whose financial outlook is also uncertain and whose stock price has slid in the past year from over $30 to approximately $3.

Q. What would the Company's historical off-system sales net revenues have been if the off-system sales made to these entities had not materialized because they were no longer in business?

A. Assuming net revenues decline proportionately to these gross revenues, the $8 Million in net revenues that the Company has generated since October 1998 would have declined to approximately $2.5 Million. This equates to an annual average of $616,000. Obviously, this amount is significantly less than both Staff and Public Counsels' recommended amounts in this case.

Q. Is it possible that other companies will provide the services that these failed companies once provided?

A. This is very unlikely given the current climate in the financial community. The investment community is currently looking with disfavor on the energy trading business. Furthermore, these organizations we deal with were more than just physical buyers and sellers of energy. These companies were often marketmakers for various risk management products and tools in the over the counter market ("OTC") that other smaller traders and marketers relied upon in order manage their energy risk. Based on the lack of liquidity currently in these financial markets, it is obvious that new smaller companies will not likely be willing to accept the level of risk that is associated with providing these types of services.

Q. Are you saying that the Company will no longer be able to generate any off-system sales revenues?

A. Some limited off-system sales opportunities may be available but they will not begin to approach the levels recommended by Staff and Public Counsel. In fact, I have little confidence that the Company could even achieve the $616,000 annual level that I identified earlier. Moreover, as I will discuss in a moment, even these limited opportunities will be very difficult, if not impossible to achieve, should the Commission adopt the recommendations that Mr. Sommerer has proposed for changing the terms on which the Company may make such sales.

Q. Are there other reasons why the Company's ability to make off-system sales will be more limited in the future?

A. Yes. The changes in the market have been so significant, that in addition to eliminating most of the Company's primary trading partners, the Company may be forced to change the pricing structure of its gas supply agreements. In the event the Company changes to daily pricing instead of monthly pricing in its gas supply contracts, off-system sales for all practicable purposes will be eliminated.

Q. Please explain why changing to daily pricing for gas supply will eliminate off-system sales?

A. In the past, the Company's gas supply costs were generally based on a price that was established going into the month in which the gas supply was to be delivered, i.e. first of the month pricing. Off-system sales were possible during the month when the Company had gas supply that was no longer necessary for on-system sales customers and when the market price increased above the first of the month price. In the future, if the Company's gas supply costs are tied to a price that changes daily throughout the month, i.e. daily pricing, the gas supply that is no longer necessary for on-system sales customers will always be priced at the daily market price. As a result, it doesn't matter if prices increase during the month because the cost of the gas supply available for sale will also increase thereby eliminating any potential sales margins on such supply.

Q. Why has the Company traditionally priced its gas supply using first of the month prices?

A. Utilizing first of the month pricing reduces price spikes associated with short-term events such as a severe cold snap, wellhead freeze-offs, short-term transportation problems and other unusual events.

Q. Under what circumstances would the Company consider moving from monthly pricing to daily pricing?

A. The Company would consider daily pricing if it can not locate enough suppliers willing to provide volume flexibility under first of the month pricing structures or if such pricing structure becomes cost prohibitive. In the past, the Company has generally been successful acquiring, at a reasonable cost, natural gas supply contracts from various trading and marketing companies that provide volume flexibility under first of the month pricing structures. However, the Company has not been as successful acquiring these same types of contracts from producers. Generally, producers appear to be less willing to provide contracts with volume flexibility under first of the month pricing structures. Instead, they appear to prefer using daily pricing structures if the purchaser requires volume flexibility.

Q. Is volume flexibility important?

A. Yes. Volume flexibility is required due to the extremely weather sensitive demand requirements of the Company's on-system sales customers.

Q. Do you anticipate having problems finding suppliers willing to provide volume flexibility at first of the month pricing at a reasonable cost?

A. Yes. Because of the demise of so many trading companies that provided liquidity to the market, I anticipate that the Company will be forced to contract for a greater amount of gas supply directly with producers. In all likelihood, the cost for volume flexibility will increase substantially. Depending on the increase, the Company may decide daily pricing is the better alternative.

Q. Are you equally concerned about the Company's ability to achieve capacity release revenues?

A. Yes, I am concerned. I realize that the Company will undoubtedly achieve some level of capacity release revenues. However, I do not believe it is as great as Staff and Public Counsel are proposing. The Company released a significant amount of capacity over the years to the failed entities discussed above and to others that are now financially unstable. For this reason and because of the uncertainty surrounding potential turnback of MRT capacity held by National Steel, I believe it is inappropriate to assume that future capacity release revenues will remain at historical levels. Since October 1998, the Company received over $2.2 Million in capacity release revenues from Companies that have filed for bankruptcy or have exited the trading business. This equates to 30% of the Company's total capacity release revenues over the period. Furthermore, effective May 2002 Laclede shed approximately 6,000 MMBtu per day of MRT capacity that will no longer be available for future releases. In view of these developments, there is no basis for believing that the Company will be able to achieve the level of capacity release revenues that has been historically generated.

A. Yes. The current uncertainty of trading partners impacts both off-system sales and capacity release. Furthermore, both Staff and Public Counsel agree that off-system sales and capacity release revenues should be treated in a similar manner.

Q. What kind of sharing does the Company recommend for off-system sales and capacity release revenues?

A. The Company recommends sharing off-system sales and capacity release revenues on a 70/30% split with 70% being retained by the customers.

Q. Why is this sharing appropriate?

A. This was the sharing level authorized by the Commission for off-system sales in 1996 and also represents the maximum sharing that was possible for capacity release revenues. Furthermore, the Company believes it provides reasonable compensation to the Company to focus adequate resources in this area in the event the marketplace overcomes the current obstacles.

Assignment of additional costs to off-system sales

Q. Has Staff recommended changes to the Company's tariff regarding off-system sales?

A. Yes.

Q. Could you please describe them?

A. Yes. Staff suggests changing the way gas costs are allocated to off-system sales and to begin allocating a portion of pipeline reservation costs to any sale that involves the use transportation capacity. Also, Staff proposes changes to the Company's tariff that requires the Company to account for off-system sales to its affiliate in accordance with the provisions contained within the tariff in lieu of allocating costs in accordance with the Company's Cost Allocation Manual, or if applicable, the Commission's affiliate transaction rules.

Q. Could you please explain the way gas costs have been allocated to off-system sales?

A. Yes. Generally, the Company allocates its highest cost of gas on the pipeline on which the sale is made unless such supply has been specifically hedged in a physical purchase agreement, i.e. bought under a fixed price contract or a contract that contains a price cap or price floor, etc... However under limited circumstances, the Company makes incremental gas supply purchases and then transports such supplies to a higher value market in order to make a sale and capture the transport value. Under these circumstances, the Company will assign the incremental supply cost to the sale.

Q. How does Staff recommend assigning gas costs in the future?

A. Staff is recommending assigning the highest cost of gas, regardless of whether or not it is flowing on the pipeline on which the sale is made. If for some reason the Company deviates from this methodology, Staff recommends that the Company document such occurrence and explain why.

Q. Do you believe this change is appropriate or necessary?

A. No. Typically when the Company has gas supply available for sale, the quantities that have been reserved under contracts must be sold quickly while market opportunities exist. Due to credit and liquidity obstacles previously discussed, markets for such gas supply are limited and are likely to become significantly more limited in the future. Limiting such sales to using the highest cost gas supply on all of the pipelines would likely reduce the Company's ability to unload such excess supply for low to moderate margin sales opportunities. This in turn would require the company to contract for greater volume flexibility, which is a costly proposition. Furthermore, in the macro sense, the customers have and will continue to benefit from assigning the highest cost of gas on the pipeline on which the sale is made because the customers are getting the major share of the profits from such sale. Whether off-system sales are included into base rates or shared in accordance with a sharing arrangement, over time, customers have received and continue to receive the lion's share of these net revenues. As a result of the high cost of acquiring flexible gas supplies, customers will probably be worse off under Staff's recommended methodology than they are under the current tariff provisions.

Q. Is Staff's recommendation to assign a portion of the pipelines' reservation costs to off-system sales appropriate?

A. No. For the same reasons that it is inappropriate to change the way gas costs are assigned to off-system sales, it is also inappropriate to assign pipeline reservation costs. Furthermore, pipeline reservation costs are usually a sunk-fixed cost and are not incurred or impacted as a result of making off-system sales, nor are they incurred for the purpose of making such sales. As such, it would not be appropriate to assign such costs to off-system sales. In fact, the only thing this proposal will do is limit such sales in the future and, in the process, deprive the Company's customers of what in any event already represents a contribution to these fixed costs.

Q. Are there other reasons to reject Staff's recommended tariff changes?

A. Yes. Staff recommends these tariff changes and appears to ignore their impact on Staff's recommended amount of off-system sales to be included in the Company's cost of service for determining base rates. In addition to overcoming an inordinate amount of historical off-system sales revenues, Staff would also require the Company to overcome significant additional costs in the form of pipeline reservation costs and higher gas costs. Staff's proposal to increase imputed revenues while simultaneously recommending changes that increase cost allocations by some unspecified amount simply isn't reasonable, nor is it supported with data. As such Staff's recommendations should not be adopted.

Q. Please summarize your testimony.

A. For the reasons previously discussed, the Commission should reject the recommendations made by Staff and Public Counsel regarding the level of off-system sales and capacity release revenues that should be imputed in this case and instead adopt a straight sharing of such revenues as recommended in my testimony. The Commission should also reject Staff's unfair and counterproductive proposals to change the basic terms under which off-system sales may be made.

Q. Does this conclude your rebuttal testimony?

A. Yes.