BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Tariff Sheets Designed to Extend for an Additional Period the Experimental Price Stabilization Fund.	))))	**Case No. GO-98-484**

REPORT AND ORDER

Issue Date: June 15, 1999

Effective Date: June 25, 1999

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In the Matter of Laclede Gas Company's Tariff Sheets Designed to Extend for an Additional Period the Experimental Price Stabilization Fund.	))))	**Case No. GO-98-484**

APPEARANCES

Michael C. Pendergast, Associate General Counsel, and **Thomas M. Byrne**, Associate Counsel, Laclede Gas Company, 720 Olive Street, Suite 1530, St. Louis, Missouri 63101, for Laclede Gas 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, 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

Procedural History

The Commission initially approved Laclede Gas Company's (Laclede's) experimental Price Stabilization Program (PSP)[1] as part of the 1997 Stipulation and Agreement approved in Case No. GO-97-401. The tariff approved in that case provides that the PSP shall be terminated July 31, 1998, unless otherwise ordered by the Commission. The PSP was

[1] This program is referred to as both the Price Stabilization Program and the Price Stabilization Fund.

proposed in order to reduce the impact of natural gas price volatility on Laclede's customers during the 1997/1998 winter season.

On April 28, 1998, Laclede Gas Company (Laclede) filed a tariff sheet designed to extend the experimental PSP for an additional term, an Application to Extend Experimental Price Stabilization Fund and Request for Prehearing Conference, and a Motion for Protective Order.

Staff filed a memorandum on May 20, 1998, in which it recommended approval of the tariff sheet extending the PSP, with modifications proposed by Laclede, and requested a prehearing conference to permit the parties to discuss other program changes proposed by Laclede. On May 26, 1998, the Commission issued an order approving the tariffs with the changes jointly recommended by the parties. The tariffs extended the program for an additional year, provided that the Price Stabilization Charge shall end with the effective date of the 1999 summer PGA filing, and determined that any ending balance in the fund be charged to or returned to ratepayers through the ACA factors established in the winter PGA filing.

Pursuant to the Commission's May 26, 1998, order, the parties met on June 11, 1998, and submitted a proposed procedural schedule on June 22, 1998, in order to litigate the remaining modifications proposed by Laclede but opposed by Staff. The Commission issued a procedural schedule on July 7, 1998, and, at the parties' request, modified it on July 22, 1998. Laclede submitted direct testimony on July 2, 1998. Staff submitted rebuttal testimony on July 30, 1998. Laclede filed surrebuttal testimony on August 5, 1998.

A hearing was held on August 10, 1998. The parties filed simultaneous initial briefs on September 25, 1998, and reply briefs were filed on October 3, 1998. OPC filed a letter on the same date indicating that it would not file a reply brief.

Pending Motion

On February 19, 1999, Laclede filed a request for an on-the-record presentation involving Case No. TO-98-484, the present case, and Case No. GT-99-303, In the Matter of the Laclede Gas Company's Tariff Sheets to Extend and Revise the Company's Gas Supply Incentive Plan. Laclede notes that it has developed and submitted two incentive proposals relating to the procurement and management of its gas supply assets. The first proposal is the subject of the present case, and it establishes an incentive Price Stabilization Program to replace Laclede's current hedging program. The second proposal pertains to Case No. GT-99-303 and seeks to extend and revise certain elements of Laclede's Gas Supply Incentive Plan (GSIP), which is scheduled to terminate on September 30, 1999 (hereinafter referred to as the GSIP II Proposal). The GSIP II Proposal was filed on January 14, 1999, and is currently scheduled to be heard in August 1999.

Laclede requests an on-the-record presentation to address these issues and asks that the Commission thereafter approve Laclede's Incentive Hedging Proposal. Staff filed a reply on March 5, 1999, indicating that it believes that the evidence in this case has been

The Commission has reviewed Laclede's motion for an on-the-record presentation and the Staff's reply. The Commission appreciates both Laclede's willingness to provide the Commission with additional evidence and the patience of the parties; however, the Commission concludes that such a presentation is unnecessary in this case. The Commission addressed Laclede's request for an on-the-record presentation in Case No. GT-99-303 in an order issued April 13, 1999.

Discussion

As noted above, the objective of the current PSP is to mitigate the effects of sudden spikes in the price of natural gas. Laclede uses a common industry practice of pricing natural gas by reference to indices of spot market prices. The issue before the Commission is whether Laclede's request for modifications to the experimental PSP should be granted.

I. Laclede's Position

Laclede's proposal would allow it to trade in and out of financial instruments once a hedge position has been established. The parties disagree as to how Laclede should be permitted to acquire and use financial instruments for the winter of 1999/2000. Laclede's original proposal recommends that three major changes be made to the PSP. First, Laclede proposes to eliminate the program's existing restriction on when financial instruments may be sold and adopt an approach that gives Laclede greater flexibility to trade in and out of these instruments when market conditions warrant. This would allow Laclede to more effectively manage the volatility of the market. Laclede alleges that this will create opportunity to reduce the overall cost of acquiring price protection for Laclede and its ratepayers. Second, Laclede proposes to incorporate an "incentive feature" into its PSP. Laclede argues that in exchange for undertaking the risks inherent in guaranteeing price protection, it should have a corresponding opportunity to benefit from it if achieves positive results. Third, Laclede proposes a three-year term for the program. Laclede contends that the longer authorization period would provide the Commission with sufficient experience with the operation of the program under varying conditions and permit a fair assessment of its effectiveness, and that this would reduce the expense of the annual review which is costly to both the Commission and to Laclede.

Laclede also proposes to modify the tariff approved in Case No. GO-97-401 in order to clarify the procedures to be followed at the end of the experiment.

However, in response to concerns raised by Staff, Laclede made modifications to its original proposal, resulting in its Alternative B plan. Under the Alternative B plan, Laclede withdrew its request to use certain types of instruments and adjusted the percentage which Laclede would pay of the increased costs for the volumes which are required to be covered under the program, thus providing an absolute cap on the cost to the ratepayers of these volumes. In exchange for assuming this additional risk, the Alternative B plan increases the percentage of gains which Laclede would receive in specified instances. Laclede also indicates that it is willing to further modify its program to address certain concerns which were expressed by Commissioners at the hearing. For example, Laclede additional risk, the Alternative B plan increases the percentage of gains which Laclede would receive in specified instances. Laclede also indicates that it is willing to further modify its program to address certain concerns which were expressed by Commissioners at the hearing. For example, Laclede proposes to revise its method of calculating the TSP[2], and to adjust the sharing mechanism in the Overall Cost Reduction Incentive. In addition, Laclede offered to modify the proposal to give the Commission the right, but not the obligation, to review the program annually and, if necessary, revise it to correct any major deficiencies on or before February 15 of each year of the program.

II. Staff's Position

Staff argues that the current program provides substantial benefit to Laclede's ratepayers by potentially obtaining effective price protection from spikes in natural gas prices for the company's heating gas supply. Staff notes that the current program is funded by a surcharge on ratepayers, which Laclede uses to secure financial instruments as a hedge against high gas prices. The Staff emphasizes that although the current hedging program acknowledges the possibility of financial gain to ratepayers, the actual purpose of the program is the protection of ratepayers from high gas prices during the period of the customers' greatest consumption. Staff alleges that Laclede's proposal modifies the program objective to include the pursuit of financial gain,

[2] The term TSP is not defined here because it was designated by Laclede as highly confidential.

and that these modifications increase the potential risk to the ratepayers.

Staff notes that Laclede proposes to liquidate hedge positions when doing so would result in gain and rehedging at a later time. However, Staff argues that Laclede proposes to move from protection to speculation and that Laclede has not provided the Commission with adequate assurances that the ratepayers will be protected. A major flaw in Laclede's proposal, according to the Staff, is that it denies the speculative nature of the market which requires a loss to match every gain. Staff is particularly concerned that Laclede refuses to openly acknowledge the speculative aspects of its proposals and has failed to suggest discrete limits to ratepayer exposure in specific trading situations.

Staff also alleges that there is an incentive for Laclede to act in the interest of the shareholders at the expense of ratepayers, and that the plan imposes additional costs on ratepayers. Furthermore, the Staff states that there is an inability to terminate the plan if the results are unfavorable.

Staff argues that the record does not establish adequate details on critical elements of Laclede's plan. Staff contends that Laclede has indicated that the detailed analysis necessary to support this type of program does not exist. Staff alleges that it is unacceptable that Laclede failed to generate adequate documentation for the proposal. Staff targets several other problems with Laclede's proposal, including

Laclede's provision that ratepayers bear all the transaction costs for the program.

III. Office of Public Counsel's Position

The Office of the Public Counsel (OPC) opposes Laclede's proposal to modify its current PSP program. OPC argues that the current program is designed to provide price protection to Laclede's ratepayers and that Laclede is attempting to modify it to a program that makes the purchasing of financial instruments another "profit center" for Laclede. OPC contends that Laclede's new program is very complex and vague. OPC also argues that the new program allows Laclede to speculate with ratepayers' money but it does not help Laclede achieve the program goal of providing price protection for its ratepayers.

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, or that specifics of the evidence are not discussed herein because of their designation as "Highly Confidential" material.

The Commission finds that Laclede's request to extend or modify the experimental PSP should be granted. The Commission will approve Laclede's Alternative B plan with the additional modifications Laclede agreed to during the hearing and in its posthearing briefs. These additional modifications include a provision regarding non-winter month transactions, how the TSP will be calculated in specific situations, adjustments to the sharing mechanism in the overall cost reduction, and a provision giving the Commission the right, but not the obligation, to review the program annually and, if necessary, revise it to correct any major deficiencies on or before February 15 of each year of the program.

In the interests of clarity, Laclede is directed to file a revised Price Stabilization Program which clearly embodies the modifications found in the Alternative B plan and includes the changes proposed by Laclede in its posthearing briefs. The Commission finds that the Alternative B plan with these additional modifications provides benefits to ratepayers regarding guaranteed catastrophic price protection and provides the potential for ratepayers to share in gains and cost savings, while also providing Laclede a financial incentive to optimize price protection in a prudent manner.

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.

Orders of the Commission must be based upon competent and substantial evidence on the record. § 536.140, RSMo 1994. Based upon the complete record, the Commission concludes that Laclede's proposed modifications to the PSP are justified by substantial and competent evidence and shall be approved. Accordingly, the Commission shall approve Laclede's proposed modifications.

IT IS THEREFORE ORDERED:

1. That Laclede's application for modifications to the Price Stabilization Program, as amended by Alternative Plan B and the additional changes proposed in Laclede's posthearing briefs, is granted.

2. That the tariff filed by Laclede Gas Company on April 28, 1998, is rejected. However, Laclede Gas Company is directed to file a revised tariff sheet, and a new program description, incorporating the modifications approved in Ordered Paragraph 1, by June 30, 1999. The tariff rejected is as follows:

P.S.C. Mo. No. 5 Consolidated
First Revised Sheet No. 28-e Cancelling Original Sheet No. 28-e

3. That Staff shall file a report by July 12, 1999, which states whether Laclede Gas Company's new program description and tariff complies with this Report and Order.

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

5. That this Report and Order shall become effective on June 25, 1999.

BY THE COMMISSION

Dale Hardy Roberts

Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge

(S E A L)

Crumpton, Drainer, and Murray,
CC., concur;
Lumpe, Ch., and Schemenauer, C.,
dissent, with separate dissenting
opinion;
certify compliance with the
provisions of Section 536.080,
RSMo 1994.

Dated at Jefferson City, Missouri,
on this 15th day of June, 1999.

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In the Matter of Laclede Gas Company's Tariff Sheets Designed to Extend for an Additional Period the Experimental Price Stabilization Fund.	))))	Case No. GO-98-484

DISSENTING OPINION OF CHAIR SHEILA LUMPE AND COMMISSIONER ROBERT SCHEMENAUER

We respectfully disagree with the majority in case number GO-98-484. The Report and Order approved by the majority will allow Laclede Gas Company to modify the currently approved Experimental Price Stabilization Fund. The changes will permit Laclede to trade in and out of financial instruments once a hedge position has been established. Laclede argues that these changes will permit it to respond more efficiently to changes in the market to improve the position of both the company and its ratepayers. We fear that the changes will instead allow Laclede to speculate in the market while putting its ratepayers at risk.

The purpose of the Experimental Price Stabilization Fund is to permit Laclede to purchase and hold financial instruments in its efforts to reduce the volatility of its cost of natural gas. Laclede's ratepayers would thus be protected from the volatility of the natural gas market. The changes proposed by Laclede and approved by the majority will allow Laclede to stray from that basic objective by permitting Laclede to buy and sell financial instruments after establishing its hedge position, if it believes that it can make a profit by doing so. Thus the purpose of the Price Stabilization Fund is changed from protecting ratepayers from radical price fluctuations, to attempting to make a speculative profit for Laclede's shareholders through the trading of financial instruments. Laclede proposes to share a portion of these profits with its ratepayers, presupposing that there will be profits. In the meantime the ratepayers are endangered by the downside risks associated with the financial speculation proposed by Laclede.

For all its willingness to speculate with the money of the ratepayers, Laclede's proposal is remarkably short on details. Critical terms are ill-defined; critical processes are undescribed; insufficient evidence was presented to support the belief that Laclede's gas supply personnel are able to foretell natural gas market movements so as to ensure a profit. Laclede asks that its proposal be approved for a period of three years. But it does not provide any definite criteria to permit the termination of the program before that time if that becomes necessary. The ratepayers will bear all transaction costs while Laclede's shareholders will share in the benefits. The proposal does not contain adequate assurances of how ratepayers will be protected.

It seems that Laclede is asking the Commission to simply trust it to do the right thing, suggesting that its ratepayers will ultimately benefit from its financial dealings. Laclede's ratepayers are perfectly capable of speculating in the financial markets if they choose to do so. Those ratepayers do not, however, expect Laclede to use the ratepayers' money to engage in such speculation.

The majority would permit Laclede to speculate in the financial market to the possible detriment of its ratepayers. For that reason we dissent.

Respectfully submitted,

Sheila Lumpe

Sheila Lumpe, Chair

Robert Schemenauer

Robert Schemenauer, Commissioner

Dated at Jefferson City, Missouri
On this 15th day of June, 1999