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**

RESPONSE TO STAFF RECOMMENDATIONS

COMES NOW Laclede Gas Company (hereinafter "Laclede" or "Company") and, pursuant to the Commission's January 30, 2006 procedural order in this case, submits its Response to Staff Recommendations. In support thereof, Laclede states as follows:

I. Introduction

On December 29, 2005, the Staff of the Missouri Public Service Commission (hereinafter the "Staff") submitted its Recommendation in Case No. GR-2004-0273 for the Company's 2003-2004 Actual Cost Adjustment ("ACA") period. In its filing, the Staff makes a number of recommendations, along with analysis and comment. This Response addresses only those items expressly recommended by the Staff and certain comments related thereto. Laclede does not necessarily agree with or acquiesce in other comments in the Recommendation not specifically addressed in this Response. Although Laclede addresses a number of recommendations in this Response, the main issue is focussed on Staff's proposal to disallow approximately $3.3 million in gas supply costs.

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Staff's proposed disallowance should be rejected for a number of reasons. As discussed below, the Staff's disallowance is based on a demonstrably inaccurate and incomplete tabulation of the actual volumes that the Company purchased under its various contracts – an error which, by itself, results in a significant overstatement of the proposed disallowance. Aside from these plain factual errors, however, the Staff's proposed adjustment is also premised on a very basic misunderstanding of **__________

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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 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 could have easily been repeated during the ACA period in question 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. **____

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Had Staff done so, as the prevailing legal standard requires, such an offset would have totally negated its proposed disallowance.

Finally, Staff's attempt **____

_______________________________________** is fundamentally inconsistent with the Commission's own Natural Gas Price Volatility Mitigation rule. 4 CSR 240-40.018. As discussed below, that rule affirmatively encourages local distribution companies like

Laclede to use various contracting practices and financial instrument 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. By seeking to penalize the Company for using a price stabilization practice precisely because it may have 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.

II. <u>Staff's Proposed Adjustment</u>

As previously noted, Staff's proposed disallowance is based on two primary allegations. **

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III. Why Staff's Proposed Disallowance Should Be Rejected

As previously noted, there are a number of reasons why Staff's proposed disallowance should be rejected. As discussed below, while each of these reasons alone is sufficient to warrant such a result, Laclede would submit that such an outcome is affirmatively mandated once all of them are considered together.

Staff's proposed disallowance should be rejected because it erroneously excludes **

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C. Staff's proposed disallowance should be rejected because it is wholly inconsistent with the legal standards governing when a prudence disallowance may be made.

Both Missouri courts and the 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.* at 529. Second, the Commission must find that ratepayers have actually been harmed by the allegedly imprudent act. *Id.* at 529-30. Staff's proposed adjustment fails to satisfy either of these legal requirements.

1. <u>Failure to show imprudence</u>

In support of its apparent determination that Laclede acted imprudently, Staff relies on nothing more than an after-the-fact review of the actual results that were achieved under Laclede's gas supply contracts given the particular set of weather and pricing conditions that eventually prevailed during the ACA period. 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.

For example, Staff suggests that **

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None of these considerations come anywhere close to justifying a finding of imprudence. **

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2. Failure to show harm

Even if the Commission decides that **________________________** was somehow imprudent, it cannot order a disallowance without also finding that the strategy resulted in actual harm to ratepayers. *State ex rel. Associated Natural Gas Co. v. Pub. Serv. Comm'n*, 954 S.W.2d 520, 529-30 (Mo. App. W.D. 1997). In other words, Staff must show that Laclede's costs are higher than they would have been if not for **______ __________.**

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____.** In its 2002 rate case (Case No. GR-2002-356), a Stipulation and Agreement ("Stipulation") approved by the Commission (and in effect during the ACA period) provided that Laclede's annual revenue requirement included an imputed $3.8 million in off-system sales and capacity release revenues. In exchange for this imputation, the Company was permitted to retain all of the revenues realized from off-system sales and releases of pipeline capacity. 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 per year through lower rates. 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…" (Stipulation, p.10)

____, the Staff has completely ignored the revenues imputed to customers from these off-system sales. While the $3.8 million imputation discussed above is not expressly divided between off-system sales and capacity releases, Laclede can show that the majority of these revenues were derived from off-system sales. Thus, when the customer benefits from off-system sales are factored into Staff's calculation – as they should be – the result effectively negates Staff's proposed disallowance by eliminating any notion that the Company's ratepayers were somehow harmed **____.** On the other hand, the failure to reject Staff's proposed disallowance would 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. None of these impermissible results should be permitted by the Commission.

D. Staff's proposed disallowance should be rejected because it is wholly inconsistent with the Commission's Natural Gas Price Volatility Mitigation rule.

Finally, Staff's attempt **____** is fundamentally inconsistent with the Commission's own Natural Gas Price Volatility Mitigation rule. 4 CSR 240-40.018.

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 facilitate that objective, 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. By seeking to penalize the Company for using a hedging practice precisely because it may have 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, as well as those set forth above, the Commission should reject Staff's proposed disallowance.

IV. <u>Response to Other Staff Recommendations</u>

In Recommendation No. 2, Staff requests a response to its comments in section 3 of the Reliability Analysis portion of the Recommendation concerning School Aggregation. Staff appears to have two concerns. First, because the level of capacity released to the schools is not adequate to meet their requirements on an expected historical peak cold day of minus 8 degrees, Staff appears concerned that other firm customers are subsidizing schools for the schools' peak day capacity shortfall. Staff's second concern is that Laclede's nominating factors are flawed, because the daily nominations for the schools appear to differ significantly from the schools' actual usage.

Regarding Staff's first concern, the School Aggregation program is authorized by statute (393.310 RSMo), and the specific terms of the program were established by the Commission in Case No. GT-2003-0032, and are reflected in the Company's Tariff Sheet

Nos. 41-45. Notably, Tariff Sheet Nos. 42-43 set forth the specific terms of capacity release between Laclede and the schools. Accordingly, while the Staff has expressed concerns about those capacity arrangements, the fact that Laclede is simply following the terms of its tariff in this regard has led Staff to properly conclude that no adjustment should be made in connection with this issue.

With regard to Staff's second concern, Staff's chart on page 4 of its Recommendation compares nominated volumes, which are based on a calendar month, to actual usage volumes, which are based on a meter read cycle month. Differences occur because meter read cycle usage tends to lag behind nominations by about 15 to 20 calendar days. Accordingly, in the early winter months as it gets progressively colder, the nominations based on calendar days are much higher than the usage based on meter read cycles. The opposite occurs in the spring when it gets continuously warmer each month. Staff's chart essentially compares ripe apples to overripe apples. When the dates of the nominations are matched to the meter read cycle usage, the differences between the two are actually very small as a percentage of the total gas nominated.

Recommendation No. 3 addresses upstream pipeline capacity, interruptible customer volumes, **_____________,** and physical supply targets. The Company believes that it already provides the Staff information sufficient to meet Staff's requirements. However, the Company agrees to organize such information in a manner that the Staff may find to be more useful.

In Recommendation No. 6, Staff seeks a cost/benefit analysis **_______________ ____** by June 1, 2006. Laclede will perform an analysis of the benefits **____

____________________________________.** Laclede will set the parameters for the analysis, and will make such analysis available to Staff during the 2006-07 ACA review process.

In Recommendation No. 7, Staff requests certain documentation applying to each hedging transaction for the 2004-05 ACA period forward. Laclede believes that Staff may have mistakenly referenced the 2004-05 ACA period, and actually meant the 2005-06 ACA period. Laclede believes this to be the case, because in the prior ACA case, GR-2003-0224, Staff requested hedging documentation for the 2004-05 ACA period in virtually the same format as listed in paragraph 7a of the current Recommendation, and Laclede delivered these materials for the 2004-05 ACA period on or about November 1, 2005. Since Staff already has the 2004-05 hedging documentation, it would make more sense for Staff's request to apply to the current period. Regardless, Laclede will continue to deliver hedging documentation in the format identified in recommendation 7a.

Regarding Recommendation No. 7b, as Staff is well aware, Laclede's Risk Management Strategy requires **____

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Laclede also provides the Staff access to the market-based information Laclede reviews to stay informed of market activities. However, because market prices can move either direction at any time, it is neither analytically useful nor administratively feasible to provided a minute-by-minute view of why a hedge position is or is not established.

With respect to Recommendation No. 7c, Laclede has provided in the past, and agrees to again provide, an explanation of the various option and spreading strategies it uses. **____

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With respect to Recommendation No. 7d, as previously discussed with Staff, **__

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____.** Laclede agrees to further explain this concept to Staff.

Regarding Recommendation No. 7e, Laclede does provide a monthly and cumulative hedging report to Staff, and agrees to continue to do so. As a final note of clarification on this topic, while subparts c, d and e are listed under paragraph 7, which calls for per transaction documentation, Laclede intends to treat the requested explanations in subparts c and d as one time events, and to provide the requested reports in subpart e on a monthly basis.

In Recommendation No. 8, Staff requests that Laclede test and document its hedges in accordance with Statement of Financial Accounting Standard (SFAS) 133. Laclede does not perform hedge effectiveness testing and is not required to do so under SFAS 133. Moreover, given the structure of the Company's Risk Management Strategy, and the voluminous information provided to Staff on the Company's hedging program, there is no reason to believe that further analysis would be useful.

WHEREFORE, for the foregoing reasons, Laclede respectfully requests that the Commission reject Staff's proposed disallowance and establish a procedural conference in this case so that a suitable procedural schedule can be developed and proposed by the parties.

Respectfully submitted,

/s/ Michael C. Pendergast

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CERTIFICATE OF SERVICE

Rick Zucker hereby certifies that the foregoing pleading has been duly served upon the General Counsel of the Staff of the Public Service Commission and the Office of the Public Counsel by hand delivery, email, fax, or United States mail, postage prepaid, on this 27th day of February, 2006.

/s/ Rick Zucker

Rick Zucker