

Exhibit No.:
Issues: Price Stabilization
Fund
Witness: James A. Busch
Sponsoring Party: MoPSC Staff
Type of Exhibit: Rebuttal Testimony
Case No.: GO-98-484

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

JAMES A. BUSCH

LACLEDE GAS COMPANY

CASE NO. GO-98-484

FILED

JUL 30 1998

Missouri Public
Service Commission

Jefferson City, Missouri
July 1998

Denotes Highly Confidential Information

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1 **REBUTTAL TESTIMONY**

2 **OF**

3 **JAMES A. BUSCH**

4
5 **LACLEDE GAS COMPANY**

6 **CASE NO. GO-98-484**

7
8 Q. Please state your name and business address.

9 A. James A. Busch, P.O. Box 360, Jefferson City,
10 Missouri 65102.

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

12 A. I am a Regulatory Economist with the Missouri Public
13 Service Commission (Commission).

14 Q. Please describe your educational and professional
15 background.

16 A. In June 1993, I received a Bachelor of Science
17 degree in Economics from Southern Illinois University at
18 Edwardsville (SIUE), Edwardsville, Illinois. In May 1995, I
19 received a Master of Science degree in Economics from SIUE.
20 While in Graduate school, I was the tutor for the Economics
21 Department for both undergraduate students and MBA candidates.
22 Upon graduation, I was co-recipient of the Outstanding
23 Graduate Student Award in Economics as determined by the
24 faculty of the Economics Department. In April 1996, I
25 accepted a position as a Research Analyst II at the Missouri

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1 Department of Economic Development. While there, my main
2 focus was to keep track of the economy of the state of
3 Missouri and to prepare the State of Missouri Quarterly
4 Economic Report. In April 1997, I accepted my current
5 position at the Commission. I am currently a member of the
6 American Economic Association and Omicron Delta Epsilon, an
7 economic honor society.

8 Q. What has been the nature of your duties at the
9 Commission?

10 A. The main nature of my duties at the Commission has
11 been to track the natural gas industry. This includes
12 following the futures and option markets for the natural gas
13 industry at both the New York Mercantile Exchange (NYMEX) and
14 the Kansas City Board of Trade (KCBT). I also am involved
15 with studying other forms of regulation. These include
16 incentive mechanisms and unbundling.

17 Q. Have you previously filed testimony before this
18 Commission?

19 A. Yes, I have previously filed testimony before this
20 Commission in Union Electric Company, Case No. GR-97-393, and
21 Missouri Gas Energy, A Division of Southern Union Company,
22 Case No. GR-98-140.

23 Q. What is the purpose of your rebuttal testimony?

1 A. The purpose of my rebuttal testimony is to respond
2 to the direct testimony filed by Laclede Gas Company (Laclede
3 or Company) witnesses Scott E. Jaskowiak and Kenneth J.
4 Neises. I will do this by first discussing Laclede's current
5 experimental price stabilization program (PSP). Then, I will
6 respond to Mr. Neises' direct testimony and Mr. Jaskowiak's
7 direct testimony. I will then summarize my testimony and give
8 Staff's opinion on hedging.

10 Q. What is the objective of Laclede's current program?

11 A. The objective of the current experimental price
12 stabilization program is to provide price protection to
13 Laclede's ratepayers against severe upward price spikes in
14 natural gas during the winter heating season, which is the
15 months of November through March.

16 Q. How does Laclede accomplish this objective?

17 A. Laclede accomplishes this objective by hedging

18 ** _____

19 **.

20 Q. What is hedging?

21 A. Hedging is the taking of a position, which is
22 purchasing or selling a financial instrument, in a financial
23 market to protect against adverse price movements in the cash
24 market.

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1 Q. How does hedging protect Laclede and its customers?

2 A. Currently, Laclede generally purchases gas which is
3 priced based on an index, which is determined on the first of
4 every month. This cost is then passed on to their customers.
5 There is no upper limit on the price. By hedging, Laclede can
6 purchase financial instruments that limit the exposure of
7 their ratepayers to this unlimited price increases. Staff
8 witness Sommerer discusses this concept in much greater detail
9 in his rebuttal testimony.

10 Q. How is price protection accomplished?

11 A. Laclede accomplishes this price protection as
12 follows. Laclede has been authorized to spend **_____
13 _____
14 _____
15 _____**. The purchase of
16 these instruments is solely at the discretion of Laclede, as
17 long as **_____. Laclede can make
18 these purchases at anytime after they received Commission
19 approval. They then hold these instruments until **_____
20 _____**. At that time, Laclede can
21 either **_____
22 _____
23 _____**.

24 Q. Why were **_____** chosen?

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1 A. Depending on the reason the hedge is needed, there
2 are three principal financial instruments that can be used for
3 hedging purposes. The first hedging tool is a futures
4 contract. This locks the price at the specific contract level
5 and is expensive. The second type is a call option. This
6 caps the price at the strike price purchased, but allows the
7 purchaser to participate in downward movements. The final
8 financial instrument is a put option. This is similar to a
9 call option except it protects against downward movements
10 while allowing the purchaser to participate in upward
11 movements. Therefore, **_____

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16 _____ **.

17 Q. What is a **_____**?

18 A. A **_____

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James A. Busch

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Q. How does this accomplish the objective?

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A. By purchasing **_____, the Company has

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guaranteed that **_____

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example, **_____

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Q. Has the current program been changed from the first

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year?

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A. Yes. The current program has two added changes as

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pointed out in Laclede witness Neises' testimony. The first

19

caveat added **_____**. The second

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change was **_____

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_____. **.

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Q. Based on this information, was the first year of the

23

Experimental Price Stabilization a success?

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1 A. Yes it was. The Company was able to procure **_____

2 _____

3 _____**.

4 Q. Do you agree with Mr. Neises' description of the
5 result of the program as answered on page 4, lines 4-6 of his
6 direct testimony when he states, **_____

7 _____**?

8 A. No, I disagree with Mr. Neises' viewpoint. **_____

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18 _____**.

19 LACLEDE'S PROPOSAL

20 Q. In Laclede's proposal, they ask for a three-year
21 program. Is this a good idea?

22 A. No, it is not. The program that Laclede has
23 proposed is very complex and vague. They have not
24 demonstrated how their proposed plan will work. **_____

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Q. What is paper trading?

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A. Basically, paper trading is where a hedger will look
at the current situation in the market and make paper or
simulated trades based upon the information available.

9

Q. Why does Staff feel paper trading was important?

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A. ** _____

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Q. ** _____

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A. ** _____

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Rebuttal Testimony of
James A. Busch

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Q. Are there any other reasons why the program should not be for three years?

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A. Yes. We do not know what the future will bring. The ability to review the program by both Staff and Laclede and make necessary alterations is a more prudent course of action. If either the Commission or Laclede determines after one year that the program operates unexpectedly, that party should have the ability to get out of the program or alter it. Staff lacks the confidence to commit to Laclede's new proposal for three years.

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Q. By buying low and selling high, would not the Company be able to make money which could ultimately lower the overall cost of the program, or allow for cheaper prices?

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A. In theory, yes, it does seem like a good idea. The problem arises when the Company gets out of their positions, or sells its profitable **_____**. At this time, the Company, and ultimately, the ratepayers, is unhedged and vulnerable to unlimited adverse price movements. This situations is exactly what the program was designed to avoid. No where in Laclede's testimony or any of their responses has the Company shown how they would be able to remain hedged

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1 while taking advantage of these potential money making
2 opportunities. They have only indicated that in theory they
3 would reenter the market at a later date if prices fall.

4 Q. What is wrong with that approach?

5 A. The problem with this approach is that the price may
6 not fall. If that happens, there will be one of two
7 scenarios. One, the ratepayers get nothing for their
8 **_____**. That is, Laclede spends all of the money, and
9 the ratepayers end up with no price protection. Or secondly,
10 the Company has to pay for their wrong guess and guarantee a
11 certain capped level for their ratepayers. This is the only
12 fair way.

13 Q. Does the Company's new proposal mitigate the
14 ratepayers' risk?

15 A. No. The way the company has set up their program
16 could increase the risk to the ratepayer. It is very
17 conceivable that the ratepayers could lose the **_____**
18 they initially gave to the Company to acquire protection, and
19 receive no protection.

20 Q. But if the Company accepts 50% of the
21 responsibility, doesn't that provide a risk free deal for the
22 ratepayers?

23 A. No. First of all, the Company has asked for a
24 90-day window of opportunity to avoid responsibility for price

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1 protection if the market moves against them. Second, 50% of
2 infinite upward price exposure is still infinity.

3 Q. Do you agree with Mr. Neises' answer on pages 9 and
4 10, lines 15-26, and 1-10, when he suggests that the current
5 program is speculative and the Company was force to utilize
6 only a single point-in-time decision to enter the market?

7 A. No, I do not. Mr. Neises claims on page 9 line 17
8 that there is inherent speculation in the current program.
9 There is less speculation, if any, in the current program than
10 in Laclede's proposal. Currently, the only "speculation"
11 involved is deciding when to enter, and that can hardly be
12 considered speculation. It is not considered speculation
13 because Laclede is simply establishing a position, they are
14 not trying to profit off any price movement. In contrast to
15 Mr. Neises statement on page 9, lines 20-25, the Company does
16 not have to, and did not, "rely on a single, point-in-time,
17 judgment of the relative economic merits of a particular"
18 purchase. **_____

19 _____
20 _____**. Their current
21 proposal requires a substantial amount of speculation and good
22 luck in order for it to work to the ratepayers advantage.

23 Q. What do you mean by a "substantial amount of
24 speculation?" Isn't this supposed to be a hedging program?

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1 A. Yes, it is supposed to be a hedging program.
2 Speculation is the essence of their proposal. They now will
3 not only have to speculate on when would be the right time to
4 initially enter the market, but they will also have to
5 speculate on when would be the best time to exit the market,
6 and speculate again as to the best time to reenter the market.
7 This is a lot of speculation, and much harder to do than a buy
8 and hold strategy. If their guess is wrong, and guess is all
9 they can do, they could harm both the ratepayers and
10 themselves. Under the current program, the ratepayers are
11 paying **_____** for price protection. If that
12 protection is lost due to the Company's attempt to profit, the
13 Company should be held responsible.

14 Q. But on page 9, line 26, Mr. Neises claims their
15 "approach represents a way of reducing risk."

16 A. I do not agree with Mr. Neises' statement . Their
17 proposal imposes much greater risk on the ratepayer. It
18 increases the number of times the ratepayers are exposed to
19 adverse price movements, as well as the risks of losing the
20 previous level of price protections. Paying **_____**
21 and having no protection is a real possibility. This is far
22 greater risk for Laclede's ratepayers than it is to any other
23 LDCs ratepayers.

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1 Q. In Company witness Jaskowiak's direct testimony, he
2 mentions on page 3, lines 11 and 12, that "It would also be
3 permitted to purchase **_____** for other months." What
4 exactly is he saying?

5 A. Mr. Jaskowiak is stating that Laclede should be
6 allowed to purchase **_____** for the months April -
7 October.

8 Q. Why does Laclede want to purchase **_____** for
9 those months?

10 A. Laclede feels that they might be able to profit from
11 price movements in months that are not included in the winter
12 heating season.

13 Q. How does purchasing **_____** for the summer
14 months help the Company hedge its winter flowing supplies?

15 A. It does not help the Company hedge its winter
16 flowing supplies. It is purely a speculative entry into the
17 market. They would be betting with ratepayer money that they
18 will guess right on summer price movements.

19 Q. Where would Laclede get the money for such
20 purchases?

21 A. They would simply use some of the **_____**
22 _____**.

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1 Q. If Laclede uses some of the **_____

3 _____**?

4 A. Yes, they will have less money available to purchase
5 the protection outlined in the objectives. Therefore, the
6 ratepayers may end up losing some of their **_____** and
7 having less protection.

8 Q. Later in Mr. Jaskowiak's testimony he discusses the
9 Company's ability to be able to purchase **_____**?
10 Why?

11 A. Again, the Company is asking to be allowed to use
12 ratepayer money to speculate in the market. They are hoping
13 to make money on **_____** in the market.
14 The problem here is twofold. The first problem is exactly as
15 described above with the **_____

24 _____**.

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1 Q. So, do these two added wrinkles help the Company
2 achieve their objective of providing price protection for
3 their ratepayers?

4 A. No, they do not. They only allow the Company to
5 speculate with the ratepayers money. Keep in mind that if the
6 Company wishes to risk shareholder money to buy these
7 instruments, they have that right. Then the potential loss
8 remains where it should.

9 Q. The Company's testimony uses the terms "TSP" and
10 "CPL." What exactly are these and what do they represent?

11 A. The TSP is the **_____

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Q. Why did Laclede choose 50 cents to add to the TSP?

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A. I do not know. No support has been provided to show Staff why 50 cents was chosen.

6

Q. Does the Company intend to add the transaction costs to the total cost of the program?

8

A. Yes, they are. On page 3, line 18, of Mr. Jaskowiak's testimony, he states, that Laclede will recover " . . . **_____**."

10

11

Q. Wouldn't that raise the overall cost of the program to the ratepayers?

12

13

A. Yes, it would. As noted in Mr. Jaskowiak's testimony on page 10, line 3, of his testimony, commissions and transactions fees totaled **_____**. This amount should be recognized, however, as the transaction cost for only one round of **_____**.

17

18

If the Company is allowed to trade in and out of its positions throughout the year, these costs would rise dramatically. It is very conceivable that if the Company gets its initial coverage, gets out, and then gets back in, that, the transaction costs would be closer to **_____**.

22

23

Laclede proposes to add this to the **_____** already spent by the ratepayers.

24

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1 Q. Would you give an example?

2 A. Certainly. Let's assume that by trading in and out
3 of their positions, Laclede is able to reduce the overall cost
4 of the program by \$1 million. ** _____

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20 _____ **.

21 Q. The ratepayers have their price protection and still
22 ended up paying less. What is wrong with that?

23 A. A number of things. ** _____

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Q. Please explain the two additional factors.

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A. Certainly. **

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1 Q. The Company says the most the ratepayers will pay is
2 **_____**? Why do you claim it will cost them more?

3 A. According to the program, the most the ratepayers
4 will pay for **_____**. That is correct.
5 The problem is that the ratepayers could end up paying more
6 for gas than what the original protection was bought for.
7 This could cause real losses to the ratepayers in the millions
8 to tens of millions of dollars, exactly what the program is
9 supposed to prevent.

10 Q. Isn't the Company guaranteeing a **_____**?

11 A. No, they are not guaranteeing a **_____**.

12 **_____
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15 _____
16 _____
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19 _____
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Q. What does this 90-day window mean?

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A. It means that if Laclede is not hedged 90 days after the TSP is set, and current market prices are above this level, Laclede will not be responsible if high prices ensue. This means that the protection, or **____**, that was the main focus of the program is gone.

9

Q. ** _____

10

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_____. **?

12

A. ** _____

13

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_____. **.

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Q. Doesn't the Company claim that obtaining low **_____** is one of the major components of their proposal?

19

20

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A. It is one of their claims, but under the sharing mechanisms described, it is counterintuitive for the company to do anything but try to lower the overall cost of the program by **_____

23

_____. **.

24

Q. Please explain.

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A. **

— * * *

Q. Could you please provide an illustrative example?

A. **

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Q. Could you give a numerical example?

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A. **. .

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SUMMARY

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Q. Are there any positives to any hedging program?

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A. Yes there are. As noted above, a simple hedging program of buy and hold is very beneficial to the ratepayers and the Company. It **_____** at some level, protecting against adverse price spikes.

20

21

Q. Are you suggesting that the only hedging program should be buy and hold?

22

23

A. No. There may be alternatives that could be utilized that may be better than buy and hold. Unfortunately,

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1 Laclede's new proposal does not qualify as one of those
2 programs. Therefore, a buy and hold strategy is the best plan
3 available at this time.

4 Q. Under this buy and hold strategy, should the Company
5 simply, upon approval, acquire all the protection needed at
6 the going market rate?

7 A. No. To help Laclede gain more market expertise,
8 they would be better served by entering the market in a more
9 piecemeal manner.

10 Q. What do you mean by piecemeal?

11 A. What I mean, is that they should enter throughout
12 the year, trying to take advantage of dips in the market.
13 This would benefit both the ratepayers and the Company. The
14 ratepayers would receive lower strike prices. The Company
15 will gain market experience and the positive image benefit of
16 acquiring lower priced gas for the ratepayers. They would be
17 able to show how they were able to protect the interests of
18 the ratepayers without exposing them to all the risks
19 associated with the Company's new proposal.

20 Q. Could you please briefly summarize your testimony?

21 A. The Company has asked the Commission to give them
22 permission to **_____**. This
23 would allow the Company to profit from the use of ratepayers'
24 money. At this time, the Company has not proven with any

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1 amount of certainty that their new proposal can work, or
2 benefit the ratepayers. Staff has serious concerns with their
3 logic. Some of their proposals are clearly defined to benefit
4 the Company at the expense of the ratepayer. No program
5 should be approved that is not fair to both the Company and
6 the ratepayers.

7 Q. What is Staff's opinion of hedging and hedging
8 programs in general?

9 A. Staff strongly favors hedging programs, and
10 believes it is necessary in the ever changing natural gas
11 industry. Staff is also aware that there is the potential to
12 make profit in the financial markets, but warns that any
13 attempt at making money is fraught with vast amounts of risk,
14 not only to the ratepayers, but to the Company as well. These
15 risks need to be considered carefully. Staff is always open
16 to new ideas and will gladly work with any Company attempt to
17 find better ways to protect ratepayers from abnormally high
18 gas prices.

19 Q. Does this conclude your rebuttal testimony?

20 A. Yes it does.

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

AFFIDAVIT OF JAMES A. BUSCH

STATE OF MISSOURI)
)
COUNTY OF COLE) ss.

James A. Busch, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 27 pages to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.



James A. Busch
JAMES A. BUSCH

Subscribed and sworn to before me this 30th day of July, 1998.

Randall Z. Wright
Notary Public

My Commission Expires: Randall Z. Wright
Notary Public, State of Missouri
County of Cole
My Commission Exp. 01/02/2001