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April 10, 2003

FILED[3]

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Missouri Public
Service Commission

Mr. Dale Hardy Roberts
Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102

Re: Case Nos. GR-2001-387 and GR-2000-622

Dear Mr. Roberts:

On behalf of Laclede Gas Company, I deliver herewith for filing with the Missouri Public Service Commission ("Commission") in the referenced matter an original and eight (8) copies of a Reply Brief and an original and eight (8) copies of Proposed Findings of Fact and Conclusions of Law.

Copies of this filing will be provided this date to all parties of record.

Would you please bring this filing to the attention of the appropriate Commission personnel.

Thank you very much for your assistance.

Very truly yours,

James C. Swearengen

James C. Swearengen

JCS/lar
Enclosures
cc: All parties of record

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Purchased Gas Tariff Revisions to Be Reviewed in Its 2000-2001 Actual Cost Adjustment	)))	Case No. GR-2001-387
In the Matter of Laclede Gas Company's Purchased Gas Adjustment Factors to Be Reviewed in Its 1999-2000 Actual Cost Adjustment	)))	Case No. GR-2000-622

REPLY BRIEF
OF LACLEDE GAS COMPANY

Pursuant to the briefing schedule established by the Commission in this case, Laclede Gas Company ("Laclede" or "Company") hereby submits its Reply Brief in response to the Initial Brief filed by the Commission Staff ("Staff") in this proceeding.

I. ARGUMENT

A. Staff has Failed to Provide any Legal Justification or Authority in its Initial Brief that would Sanction its Proposed Adjustment in this Case.

Even a cursory review of Staff's Initial Brief shows that Staff has not provided the kind of legal and evidentiary foundation required for the Commission to adopt its proposed adjustment in this case. The most significant omission in this regard concerns the complete absence of any legal justification or authority in Staff's Brief that would sanction its proposed adjustment to deprive the Company of its lawful share of the nearly $33.5 million in proceeds achieved by Laclede under its Price Stabilization Program ("PSP").

This deficiency is perhaps best illustrated by a comparison of the respective approaches taken by the Company and the Staff toward the two core issues that have been identified in this case. As those two issues indicate, the outcome of this case depends, as it must, on the legal effect of the controlling PSP tariff sheets and program terms that were approved and in effect at the time the transactions under consideration in this case took place. Indeed, the first issue simply asks what those controlling tariff sheets and program terms were, while the second issue asks whether those tariff sheets and program terms authorize the Company to retain $4.9 million of the $33.5 million in proceeds generated under the PSP.

Given this delineation of the core issues in this case, Laclede's Initial Brief discussed at length the specific wording of both the 1999 PSP tariff sheets and Program Description that were originally approved by the Commission in Case No. GO-98-484. (Laclede's Initial Brief, pp. 5-7, 15-16, 18-23). Laclede also discussed in detail the specific language of the September 1, 2000 Stipulation and Agreement and tariff approved by the Commission in Case No. GO-2000-324 -- language that, while altering one term of the PSP, explicitly stated that all other provisions would "remain in full force and effect." (Laclede's Initial Brief, pp. 8-9, 15-17, 27-29). And then, in a sentence-by-sentence analysis, Laclede explained how its treatment of the savings achieved under the PSP had been determined and calculated in strict compliance with these lawfully-approved and effective instruments. (Laclede's Initial Brief, pp. 18-24). Laclede also discussed at length how the entirely new method that Staff has proposed to retroactively apply for purposes of determining the treatment of these savings cannot be reconciled with the explicit provisions of these controlling documents. (Laclede's Initial Brief, pp. 24-29). Finally, Laclede cited court decisions from both Missouri as well as other jurisdictions to support its contention that such retroactive attempts to rewrite tariff provisions long after the transactions to which they apply had ended violated well-established legal principles. (*Id*).

In contrast, the Staff makes little or no effort in its Initial Brief to address, analyze or even describe the specific wording of the foregoing tariff sheets and program terms, even though Staff recognizes them as the controlling instruments that govern the outcome of this case. (*See* Staff's Initial Brief, p. 5). Nor does the Staff attempt to explain how the explicit provisions of these instruments can be construed, either individually or in tandem, as requiring rejection of the Company's treatment of savings under the PSP (which was determined in strict compliance with the controlling tariff sheets and program description); or, conversely, adoption of Staff's proposed method (the terms of which, by Staff's own admission, are "flat out" nowhere to be found in the controlling instruments (Tr. 227)).[1] Indeed, except for a vague sentence or two, the Staff does not even describe how its own proposed method works, let alone explain how it can be reconciled with the language of the tariff sheets and program terms that Staff has acknowledged are controlling in this case.[2] Finally, in contrast to the Company, the Staff also fails to cite any legal authority for its position that the Commission may retroactively apply Staff's new method by effectively rewriting the tariffs and program terms that were in effect at the time these transactions took place.

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[1]Notably, the Staff does not present anything in its Initial Brief that would purport to show that the Company calculated its share of savings under the PSP in any way other than what was mandated by the controlling PSP Tariff Sheets and Program Description that were in effect at the time these transactions took place. Indeed, Staff does not cite a single error or discrepancy between how the Company determined and treated these savings and how these controlling instruments said such savings were to be treated and determined. Staff's inability to point to any discrepancy in the Company calculations is not surprising given the fact that Staff witness Sommerer arrived at the very same result as the Company did when he was asked during cross-examination to calculate the Company's share of savings under these PSP tariff provisions using the actual amounts achieved by the Company. (Tr. 62-65).

[2]*See* the first three sentences of the first full paragraph on page 6 of Staff's Initial Brief for the entirety of Staff's description of how its method works and the results that Staff says it produces.

In fact, it is abundantly clear from a reading of Staff's Initial Brief, that its proposed adjustment is premised on the notion that it may simply ***ignore*** these controlling tariff provisions and program terms and substitute an entirely new method for determining how savings under the PSP are to be treated. Accordingly to Staff, such an approach is appropriate because, in Staff's view, the terms of these controlling instruments "lost meaning" when Laclede opted out of the Price Protection Incentive and when the parties agreed in the September 1, 2000 Stipulation and Agreement to eliminate the PSP's 70% coverage requirement. (Staff's Initial Brief, pp. 5-6). As a result of these developments, Staff suggests that "a study" (in the form of its "buy and hold" method for determining savings) became necessary to assess whether savings were actually achieved under the Program. (Staff's Initial Brief, p. 6). Otherwise, Staff asserts that the Company would be able to claim savings based "solely on whether the proceeds achieved from the sale of call options exceeded costs." (*Id.*). According to Staff such a result would be inappropriate because these are presumably the kind of savings that one would associate with a "speculative" stand-alone "trading operation" rather than a program in which hedging activities were "to be directed toward price stabilization ...." (*See* Staff's Initial Brief, p. 8).[3]

[3]There is nothing in either the controlling PSP Tariff Sheets or Program Description to suggest that certain proceeds achieved by the Company do not count as "price stabilizaton" or "savings" simply because they were generated by a hedging practice that Staff deems to be speculative in nature. To the contrary, as Staff witness Sommerer acknowledged during cross-examination, the *only* way "price stabilization" is ever achieved under a program like the PSP is by generating proceeds from the sale of options and then using them to offset or "stabilize" the price being paid for natural gas. (Tr. 258-59). And that is true, regardless of whether the proceed is generated from the kind of intermediate trading activities that Staff would view as "speculative" or from a series of "buy and hold" purchases in which options were sold only during the last three business days of NYMEX trading. In other words, a proceed is a proceed no matter how it is realized, and all proceeds contribute to the goal of price stabilization. Accordingly, while the Staff can characterize Laclede's hedging activities any way it chooses, it cannot deny the fact that Laclede generated and distributed to its customers nearly $20 million in net cash proceeds as a result of its PSP activities during the ACA period. As Staff has repeatedly acknowledged, this was real cash money that was actually flowed through to the Company's customers in the form of reduced purchased gas expenses. (Tr. 65-66). As a

Once again, however, Staff points to nothing in the controlling PSP Tariff Sheets or Program Description Terms that would in any way substantiate its assertion that the provisions of the Overall Cost Reduction Incentive (under which Laclede has claimed savings in this case) were rendered meaningless as a result of these developments.[4] Nor does the Staff explain in its Initial Brief how such an assertion can possibly be reconciled with the explicit language of the September 1, 2000 Stipulation and Agreement and the implementing tariff that was approved by the Commission in Case No. GO-2000-394. As Staff itself has acknowledged, these controlling instruments, which were thoroughly reviewed by Staff prior to their approval by the Commission, explicitly recognized both of the developments that Staff now claims require the adoption of a new method for determining savings under the Overall Cost Reduction Incentive. (Tr. 85-93; Exh. 1, Schedule 4-4; Exh. 6HC, pp. 10-11, Schedule 1, p. 2). In fact, it was through the September 1, 2000 Stipulation and Agreement and implementing tariff that the elimination of the 70% coverage requirement was effectuated. (Exh. 1, Schedule 4-4). Despite its explicit recognition of these developments, however, neither the Stipulation and Agreement nor the implementing tariff made any changes whatsoever to the Overall Cost Reduction Incentive component of the PSP. To the contrary, the Stipulation and

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result, these proceeds constitute real "savings" and real "price stabilization" both within the meaning of the controlling PSP Tariff Sheets and Program Description and, as Staff witness Sommerer conceded during cross-examination, within the plain and ordinary meaning of "savings" as defined in the dictionary. (Tr. 60-61).

[4] The Staff also fails to identify anything in these controlling documents that would, in any event, authorize the kind of method that Staff has proposed to retroactively apply in this case for purposes of determining how savings are to be calculated under the Overall Cost Reduction Incentive of the PSP. Once again, Staff's failure to do so is not surprising given the fact that it acknowledged, time and time again during cross-examination, that there was nothing in the PSP Tariff Sheets and Program Description Terms approved by the Commission in Case No. GO-98-484 or the September 1, 2000 Stipulation and Agreement and implementing tariff approved by the Commission in Case No. GO-2000-394 that in any way referenced or authorized such a method. (Tr. 69-70, 85-93, 227).

Agreement stated, as clearly as anything can be stated, that all other remaining provisions of the PSP would remain "in full force and effect" -- a directive that Staff itself has acknowledged applied to the Overall Cost Reduction Incentive. (Exh. 1, Schedule 4-4; Exh. 6HC, p. 10; Tr. 85-93). Obviously, it is simply not possible to simultaneously concede, as Staff has in this case, that a Program provision was to remain unchanged and in full force and effect pursuant to a lawfully approved Stipulation and Agreement and tariff and then turn around and seek to retroactively change it, as Staff has also attempted to do in this case.

In view of these considerations, it is clear that Staff's failure to articulate any legal justification or authority for its proposed adjustment in its Initial Brief is not a matter of inadvertence but instead a direct and inescapable by-product of the fact that no such justification or authority exists. Either affirmatively or with its silence, Staff's Initial Brief simply confirms, as does the record in this case, that there is no genuine dispute in this proceeding regarding what the controlling PSP tariffs and Program Description terms were at the time these transactions took place or which treatment of PSP savings they mandate. The only issue is whether these controlling instruments, which have the same force and effect of law as a statute enacted by the General Assembly, are to be honored or ignored. ***Allstates Transworld Vanlines, Inc. v. Southwestern Bell Telephone Company,*** 937 S.W.2d 314, 317 (Mo. App. E.D. 1996). Consistent with long-standing principles of Missouri law, there can be only one answer to that question -- an answer that affirmatively mandates rejection of Staff's proposed adjustment.

B. **<u>Staff has Failed in its Initial Brief to Demonstrate that its Proposed Adjustment in this Case is Reasonable.</u>**

In addition to its failure to provide a legal justification for its proposed adjustment, the Staff also fails to explain in its Initial Brief why its proposed adjustment is reasonable. As previously discussed, Staff devotes only a few sentences in its Initial Brief to describing its proposed adjustment and the method for determining savings upon which it is based. Accordingly, there is virtually nothing in Staff's Initial Brief that responds in any substantive way to Laclede's contention that Staff's method contains numerous flaws that make it thoroughly unreasonable. (*See* Laclede's Initial Brief, pp. 31-38). The Staff does, however, raise several matters at pages 8 to 10 of its Initial Brief that, like the new method it developed for determining the treatment of savings in this case, present a highly selective and fundamentally misleading depiction of the PSP and the Company's performance thereunder.

The first concerns the two sentences of testimony from the evidentiary record in Case No. GO-98-484 that appear at page 8 of Staff's Brief, in which Laclede witness Kenneth Neises discusses the opt-out provision contained in the Price Protection Incentive and its relationship to the Company's right to profit under the program in the event it exercised that right. Since it is undisputed that the Company did not retain any profits under the Price Protection Incentive due to its exercise of the right to declare that incentive feature inoperable during the ACA period, it is difficult to understand why the Staff referenced this quotation in its Initial Brief. It certainly has no relevance to the Company's right to retain a share of the savings achieved under the Overall Cost Reduction Incentive.

To the contrary, the Staff has recognized throughout this proceeding, as it must, that the Company's exercise of its right to opt out of the Price Protection Incentive did not impair in any way its right to profit under the Overall Cost Reduction Incentive (Tr. 85-93). Indeed, the Staff continues to recognize that fact at page 9 of its Initial Brief by acknowledging that Laclede would be entitled to a share of savings under the Overall Cost Reduction Incentive if only Staff's standard were met. Moreover, such a conclusion was repeatedly demonstrated by the multiple documents that were presented in this case -- documents that conclusively showed that the Company's decision to opt out of the Price Protection Incentive only affected its right to retain a share of the gains realized under that incentive mechanism and had no impact on its right to retain savings achieved under the Overall Cost Reduction Incentive. As Staff witness Sommerer acknowledged during cross-examination, these documents included, among others, the Company's Brief in Case No. GO-98-484 (Tr. 264-65), the PSP Tariff Sheets and Program Description approved by the Commission in that case (Tr. 76-77), the notice filed by the Company in June of 2000 in which it declared the Price Protection Incentive inoperable (Tr. 78-79), and the September 1, 2000 Stipulation and Agreement and implementing tariff approved by the Commission in Case No. GO-2000-394. (Tr. 85). Given this historical record, any implication, whether intended or not, that the Company's decision to opt out of the Price Protection Incentive has some relevance to the Company's right to retain savings under the Overall Cost Reduction Incentive is simply unsustainable.[5]

[5]At page 10 of its Brief, Staff notes that one of Laclede's internal auditors had questions about how the PSP worked. Although Staff suggests that these questions demonstrate some ambiguity in the Program's terms, what they really show is an internal auditor doing what internal auditors are supposed to do -- aggressively check and ask questions to ensure that the financial procedures are being complied with. (Exh. 6HC, p. 7). The fact that the auditor concluded that the Company's current treatment of proceeds and costs under the PSP was both appropriate and advantageous to customers, only reconfirms the correctness of the Company's position.

In addition to citing these irrelevant matters in its Initial Brief, the Staff also seeks to support its position by casting a number of unwarranted and inaccurate aspersions on the Company's performance under the PSP. Beginning on page 9 of its Initial Brief, the Staff asserts that the evidence in this proceeding does not support the Company's claim that the principal reason that Laclede liquidated its option positions early was to provide funds for putting on additional hedges.[6] In support of this claim, the Staff first asserts that on November 28, 2000 Laclede had cash on hand from prior option sales of $6,912,350 – an amount that was almost twice as much as the $3,599,800 that Laclede spent to protect ratepayers for the balance of the heating season. What Staff does not say in its Brief, however, is that $4,747,500 of the $6,912,350 "cash in hand" on this date had been generated through the sale of options during the last three business days of NYMEX trading. (*See* Exh. 1HC, Schedules 9-1 and 9-2). Since this $4,747,500 in proceeds was generated through sales made during the last three business days of NYMEX trading, the Company had an ironclad obligation to flow through all of this money to its customers pursuant to the terms of its Price Protection Incentive. Given this obligation, there was no way that the Company could have used this cash to purchase additional call options, and it is highly misleading to suggest otherwise. As a result, the Company only had $2,164,850 in cash available on November 28, 2000 to make additional option purchases -- an amount that was significantly ***less*** than what the Company subsequently spent on purchasing call options.

[6] In fact, there is ample evidence to support the Company's claim. (Exh. 6, pp. 11-12; Tr. 303-308, 328). Moreover, the Company's focus on liquidating options early in order to generate proceeds to make additional option purchases was successful as evidenced by its early sale of November options under circumstances that generated over $1.1 million in proceeds. (*See* Exh. 1HC, Schedule 9-1). Notably, had the Company not sold these options, they would have expired virtually worthless. (*Id.*).

Next, the Staff cites a single example on page 8 and then again on page 10 of its Initial Brief of an instance in which the Company sold 100 options contracts on the day prior to the last three business days of NYMEX trading. In doing so, the Staff implies, without any evidentiary support, that Laclede sold these options for the sole purpose of being able to retain a share of $4,500,000 (sic)[7] in proceeds that were generated as a result of selling the options. What the Staff does not cite in its Initial Brief, however, are the numerous other instances in which Laclede did not sell options until the last three business days – instances which were significant enough to generate $11.5 million in proceeds, *all* of which were attributed to the Price Protection Incentive and subsequently flowed through in their entirety to the Company's customers. (Exh. 1HC, Schedule 9; Exh. 4HC, pp. 3-4). If the Staff wishes to question the Company's motives it should be required to make at least some rudimentary effort at providing the Commission with a more complete and balanced account of what the Company actually did. By mentioning only one transaction that allegedly supports its claim, while ignoring a multitude of others that contradict it, the Staff has obviously failed to offer such an account in this instance.

Finally, on page 10 of its Initial Brief, the Staff asserts that it is "astounding" that Laclede did not add a single December or January call option after October 31, 2000 and only spent $357,000 on call options after December 19, 2000. As discussed below, this is not astounding at all. What is astounding, however, is the lengths to which Staff will go to provide the Commission with a distorted and ill-informed assessment of the Company's hedging activities. What the Staff does not tell the Commission in its Initial Brief is that the Company did not purchase additional December and January call options

[7]The $4,500,000 figure cited by Staff apparently contains a transposition error. It should be $4,050,000. (Exh. 1HC, Schedule 9-3, option proceeds for 12/20 option sales).

after October 31, 2000 because it had already purchased significant quantities for those months (as shown by Staff's own Schedules 9-2 and 9-3 to Exhibit 1HC), and was therefore turning its attention to procuring options for February and March which were virtually barren of any protection. Given Staff witness Sommerer's testimony in this case that he would have concerns about any hedging strategy that left a utility uncovered during February and March (Tr. 104-106), Staff's attempt to mischaracterize this prudent allocation of resources is truly remarkable.

Unfortunately, the same thing is equally true of Staff's attempt to create the erroneous impression that there was something wrong or untoward about the Company's actions in not spending more than $357,000 (sic) on options after December 19, 2000.[8] Since February and March were the only remaining winter months for which the Company could have purchased additional options, Staff's criticism effectively implies that by the time late December rolled around the Company should have been purchasing more options for those months. However, because the Company had already made significant option purchases for those months by late December (*see* Exh. 1HC, Schedule 9) and because it was not convinced that further purchases were advisable, it saw no need to make additional purchases. And as Staff's own analysis shows, this turned out to be a decision that greatly benefited Laclede's customers since prices in February and March ultimately declined to a point that Laclede actually had to sell its February and March options early in order to realize any gains from them. (*See* Exh. 1HC, Schedule 9-4 and 9-5). Accordingly, Staff's expression of concern that Laclede did not spend more money on options after December 19, 2000 is tantamount to a suggestion that the Company

[8] Staff's calculation of $357,000 appears to be incorrect. As Staff's Schedule 9-4 and 9-5 to its Exhibit 1HC shows, Laclede spent $559,800 on February and March options after December 19, 2000.

should have dissipated the financial benefits that it had accrued for its customers by that time by using them to purchase options that did nothing but lose value. Such a strategy did not seem appropriate at the time and with the benefit of hindsight it is downright ludicrous to suggest that the Company should have done something different than what it did.

It is important to note that despite the availability of three rounds of testimony, the Staff never made any of the foregoing assertions in its testimony before the Commission. And given how indefensible those assertions are, it is understandable why Staff did not. These assertions, like Staff's adjustment in this case, are deeply flawed and should accordingly be rejected by the Commission.

II. CONCLUSION

For the foregoing reasons, as well as those set forth in the Company's Initial Brief, Laclede Gas Company respectfully requests that the Commission issue its Order approving the Actual Cost Adjustment balances submitted by the Company in this case and denying Staff's proposed adjustment.

Respectfully submitted,

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Certificate of Service

The undersigned certifies that a true and correct copy of the foregoing Reply Brief was served on all counsel of record in this case on this 10th day of April, 2003 by hand-delivery, email, fax, or by placing a copy of such Reply Brief, postage prepaid, in the United States mail.