Missouri Public Service Commission

POST OFFICE BOX 360
JEFFERSON CITY, MISSOURI 65102
573-751-3234
573-751-1847 (Fax Number)
http://www.psc.state.mo.us

March 27, 2001

Mr. Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102

RE: Case No. GO-2000-394

Dear Mr. Roberts:

Enclosed for filing in the above-captioned case are an original and eight (8) conformed copies of a **STAFF RECOMMENDATION.**

This filing has been mailed or hand-delivered this date to all counsel of record.

Thank you for your attention to this matter.

Sincerely yours,

Thomas R. Schwarz, Jr.

Thomas R. Schwarz, Jr.
Deputy General Counsel
(573) 751-5239
(573) 751-9285 (Fax)

TRS:sw
Enclosure
cc: Counsel of Record

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's	)	
Experimental Price Stabilization Fund.	)	Case No. GO-2000-394

STAFF'S RECOMMENDATION TO SUSPEND

For the third time in ten months Laclede Gas Company (Laclede) has told the Missouri Public Service Commission (Commission) that its experimental Price Stabilization Program will not obtain satisfactory results, and for the second time in that period has said that preservation of customers' interest in stable gas prices requires a hurried consideration of its proposed fixes. This time, Laclede urges the Commission to adopt its fix, contained in tariff changes filed March 21, 2001, without benefit of any evidence supporting its claims that this fix will work, and without considering other possible solutions.

Staff recommends in detail in the attached memorandum the reasons that the Commission should suspend Laclede's proposed tariff. The memorandum recommends that the Commission direct Laclede to use its best judgment in the face of volatile market conditions to obtain reasonable and stable prices for its customers, without the restrictions of Commission-specified portfolios and without the distractions of gain. Staff's memorandum also makes recommendations for Commission consideration if the Commission is inclined to grant Laclede the peremptory relief it seeks.

63

WHEREFORE, the Staff respectfully urges the Commission to suspend Laclede's tariff and direct the parties to develop and file a procedural schedule that will promptly but thoroughly provide the Commission with the evidence to make its decision.

Respectfully submitted,

DANA K. JOYCE
General Counsel

Thomas R. Schwarz, Jr.

Thomas R. Schwarz, Jr.
Deputy General Counsel
Missouri Bar No. 29645

Attorney for the Staff of the
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102
(573) 751-5239 (Telephone)
(573) 751-9285 (Fax)

Certificate of Service

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record as shown on the attached service list this 27th day of March, 2001.

Thomas R. Schwarz, Jr.

Service List for
Case No. GO-2000-394
Revised: March 27, 2001 (SW)

Office of the Public Counsel
P.O. Box 7800
Jefferson City, MO 65102

Michael C. Pendergast
Laclede Gas Company
720 Olive Street, Room 1520
St. Louis, MO 63101

MEMORANDUM

TO: Missouri Public Service Commission Official Case File, Case No. GO-2000-394, File No. 200100962, Laclede Gas Company

FROM: TI ww
Thomas Imhoff, Gas Department - Tariffs/Rate Design
David Sommerer, Procurement Analysis Department

WW for Wess Henderson 3/27/01 Thomas R Schwarz Jr 3/22/01

Utility Operations Division/Date General Counsel's Office/Date

SUBJECT: Staff Recommendation On Laclede's Tariff Sheet Filed to Reduce the Required Price Protection Percentages in the Company's Price Stabilization Program for the 2001/2002 Winter from 70% to 40%

DATE: March 26, 2001

On March 21, 2001, Laclede Gas Company (Laclede or Company) filed a Motion for Expedited Treatment (Motion) to reduce its Required Price Protection Percentages in the Company's Price Stabilization Program for the 2001/2002 Winter from 70% to 40%.

By Motion for Expedited Treatment, Laclede requested an effective date of April 1, 2001, which is less than the standard 30-day period.

The Commission's Gas Department - Tariffs/Rate Design and Procurement Analysis Department (Staff) believes that Laclede's Motion should be denied and that the tariff filing should be suspended to enable the Staff time to examine the impact of this change on Laclede's ratepayers Laclede has requested to change the level of price protection as specified under the Price Stabilization Program (PSP) on an expedited basis. The Staff recommends that the Commission suspend this tariff and order the parties to file a procedural schedule. The Company's filing raises substantive as well as procedural issues that must be heard before the Commission can make an informed decision regarding the Company's request. The substantive and procedural issues will be discussed in the following paragraphs.

1. Laclede states that its immediate need for Commission approval is based on the fact that:

> The market price for natural gas, including the price of natural gas financial instrument, has been extremely volatile and any significant delay in the Company's ability to purchase financial instruments at the lower price levels proposed herein could be negatively affect Laclede's customers.

Volatility in the market makes natural gas prices unpredictable, and it is as likely that delay in the current volatile market will work to the customers' advantage as much as the customers' disadvantage. The volatility of the market is the fundamental reason that approval of mandated approaches for price protection for next winter is unlikely to produce the best result for Laclede's customers. Successful companies need to be flexible, to evaluate all available financial instruments, and to implement their decisions promptly when the conditions best suit their needs. The PSP does not provide these elements to Laclede or its customers. In fact, Laclede's interpretation of the PSP has actually encouraged the Company to engage in activities that were detrimental to its customers.

2. The PSP currently specifies that Laclede have a fixed amount, $4 million, to buy enough financial instruments to cover 70% of its flowing gas in a normal winter. The strike price is unknown until Laclede goes to the market to purchase this amount of financial instruments with $4 million. The strike price will be reduced if the amount of money paid increases, the amount of gas covered is reduced, or if the price of gas declines.

3. According to Laclede, increasing the premiums from $4 million to $8 million will reduce the guaranteed price from $12.45 to $9.50. Increasing the premiums to $8 million and reducing the volume of gas covered from 70% of flowing gas in a normal winter to 40% of flowing gas in a normal winter will reduce the guaranteed price from $9.50 to $7.60. It must be noted that the lower strike price is purchased at the price of protecting lesser volumes and increasing overall program cost.

4. The Company's proposal to provide price protection at a $7.60 strike price for 40% of flowing gas in a normal winter is not unquestionably the best option available. It should be noted that the $7.60 strike price is generally greater than the financial instruments that Laclede purchased for last winter. Staff and Public Counsel need to analyze whether lower strike prices for smaller volumes would produce a better overall strategy. This is one of the reasons Staff recommends that Laclede's tariff be suspended.

5. The company's request poses procedural difficulties. The Company's filing is another step to place the Commission in the position to pre-approve Laclede's plans without any 1) discussion of the benefits or disadvantages of the other available alternatives, 2) analysis or evaluation by the Commission Staff, the Office of the Public Counsel, and other interested parties, and 3) evidence that the reduction of the volumes of gas protected will produce the best result for customers. Laclede asks the Commission to make a significant decision regarding the price protection to be afforded St. Louis consumers and others without considering these relevant factors. Staff recommends that the tariffs be suspended to allow time for this information to be provided to the Commission. Staff urges the Commission not to take unto itself the responsibility for Laclede's decisions to modify the level of price-protected volumes. If the Commission chooses to take this responsibility, then the Commission should not do so without any evidence at all of the impact of its decision.

6. Staff notes that Laclede had no discussion with the Commission Staff before they filed this motion. Advance discussions are vital to the efficient and effective processing of requests for expedited treatment. Advance discussions allow the Staff to gain an understanding of the details of the request, determine the need for expedited treatment, and request any information required to evaluate the request. Advance discussions also allow the Staff opportunity to begin to adjust its workload to process the request. Additional time to make these adjustments is always beneficial given that time is a critical element in any request for expedited treatment. Laclede has chosen to take its issues directly to the Commission, bypassing the Staff and the Office of Public Counsel. Laclede worsens the situation by not allowing Staff and the Office of Public Counsel adequate time to provide adequate analysis or evaluation.

7. The Commission should specify the appropriate method to calculate cost savings under the price reduction portion of the PSP before further altering the program.

8. Financial instruments for a specific amount of gas have a strike price and an expiration date. A premium represents the cost to purchase the option. In the event that the price of natural gas is greater than the strike price at or prior to the time of expiration, the owner can liquidate his position for an amount of money equivalent to the difference between the price of natural gas and the strike price. This amount can then be used to offset the actual payment of the price of natural gas. These proceeds effectively reduce the price to be equal to the strike price in the financial instrument. For example, if a purchaser paid $.50 for a financial instrument for January purchase with a strike price of $5.00 and the price of natural gas is $5.80 at the end of December, then the owner would receive $.80 for each unit of gas covered by the financial instrument. When the owner actually purchases gas at $5.80 for January, the owner will have the $.80 to offset the $5.80 purchase price, effectively paying only $5.00 for gas in January. The owner paid $.50 for the protection of knowing the effective price of January gas would be no greater than $5.00. In the event that the January price of natural gas is less than the strike price at or prior to the time of expiration, the owner receives no money.

9. Laclede has construed its PSP in a manner inconsistent with the above principles. Laclede asserts that if it sells a financial instrument prior to the last three business days before the expiration of the financial instrument, that it can claim 50% of the proceeds regardless of the fact the proceeds are less than or equal to the actual cost of gas purchased. This encourages Laclede to engage in activity detrimental to its customers in two ways by providing Laclede the incentive to sell its financial instruments prior to the last three business days before the expiration of the financial instrument regardless of whether the sale is beneficial to its customers.

10. Assume a $5.00 strike price and a $5.80 actual price for January gas. If Laclede sells the financial instrument prior to the last three business days before the expiration of the financial instrument, then Laclede would receive $.80 for each unit of natural gas covered by the option. Laclede claims that it can retain $.40, thereby leaving only $.40 to offset the $5.80 price of January natural gas. The customers' effective $5.00 price of gas is increased to $5.40 because Laclede has diverted $.40 to its own profits.

11. A second example using a $5.00 strike price and a $5.80 actual price for January gas will illustrate the Staff's second concern. When Laclede sells the financial instrument prior to the last three business days before expiration, the price of January natural gas could be different than the $5.80 expiration price. Laclede is justified in selling a financial instrument early if it had a legitimate reason to believe that the expiration price would be less than the current market. If Laclede guesses right and sells its financial instruments when the current market price is $6.00 and the expiration price is $5.80, then Laclede would have generated an additional $.20 (assume $.20 is actual sale proceeds) for each unit of natural gas sold early. Under the PSP, this would be a favorable trade and Laclede would be entitled retain approximately 50% or $.10 while consumers actually see the price of their January gas reduced to $4.90 or $.10 below the effective price of $5.00. Staff agrees that the PSP would allow Laclede to retain the $.10. If Laclede guesses wrong and sells when the current market price is $5.60 and the expiration price is $5.80, then Laclede would have generated a loss of $.20 (assume proceeds at time of sale generate $.60 but would gave generated $.80 proceeds if held till expiration) for each unit of natural gas sold early. Under the PSP, this would be not be a favorable trade and Laclede would be entitled to retain no monies as the consumer will actually see the price of their January gas increased to $5.20 or $.20 above the effective price of $5.00. Staff's current evaluation indicates that Laclede's early cashing of its financial instruments resulted in a loss of approximately $5 million that otherwise would have been available for its consumers to realize the effective price of gas reflected in its financial instrument. In other words, Laclede traded early when the market price of gas was less than the cost of gas that Laclede later actually paid. Laclede's consumers will pay $5 million in additional gas costs as a result of Laclede's early trading. Laclede had the incentive to engage in this activity because the Company asserts that it can only make money through early trading, and cannot lose money if its early trading results in additional costs to consumers. Staff does not agree that the PSP allows Laclede to divert financial instrument monies from its customers when its early trading activities in the aggregate are at prices less than or equal to the actual price of natural gas.

12. The Staff believes its previous position of 1) elimination of the PSP and 2) providing Laclede clear direction that the Company is to make its best efforts to purchase gas on the most favorable terms for its consumers continues to be the best course of action for the Company's natural gas customers. Staff recognizes that the Commission has not embraced the Staff position. The Staff's recommendations are designed to improve

customer protection from price spikes. If the Commission decides that it does not want to suspend the tariff, then the Staff offers several alternatives to improve the current PSP situation short of the plan's demise.

13. Laclede will be allowed to include in its winter Purchase Gas Adjustment (PGA) up to $8 million for the price protection vehicles. Laclede should evaluate all available alternatives, such as fixed price contracts and costless collars that will produce the best overall price for its consumers. The profit-making aspects of the PSP are to be eliminated so that the Company will have no distractions from its objective to produce the best overall result for its customers. Laclede will file monthly reports with the Commission Staff and the Office of Public Counsel describing its current gas purchasing activities, including the use of the $8 million allowance. If the Commission believes that it must maintain Laclede's profit-making potential, then the Commission should make it clear that Laclede cannot make any profits unless it sells its financial instruments at a price greater than the ultimate closing price and the Company will be responsible for all losses when it sells its financial instruments at prices less than the ultimate closing price.

The Staff has reviewed the Motion and the accompanying tariff sheet filed by Laclede on March 21, 2001 and is of the opinion that this sheet will require time for the Staff to fully analyze the impact of this change. Therefore, Staff recommends that the Motion for expedited treatment be denied and that the following tariff sheet filed on March 21, 2001 be suspended:

P.S.C. MO. No. 5

1st Revised SHEET No. 28-g Cancelling Original SHEET No. 28-g