BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's Tariff to Revise Natural Gas Rate Schedules	))	Case No. GR-2007-0208

STAFF MEMORANDUM

IN SUPPORT OF STIPULATION AND AGREEMENT

COMES NOW the Staff of the Missouri Public Service Commission ("Staff") and submits its Memorandum in Support of the Unanimous Stipulation and Agreement ("Stipulation") executed by all Parties to this case and filed with the Commission on July 9, 2007. On December 1, 2006, Laclede Gas Company ("Laclede" or "Company") submitted revised tariff sheets proposing to increase rates for gas service to customers in its Missouri service area. These proposed tariff sheets were designed to produce an annual increase of approximately $52.9 million in permanent rates for regulated gas services.

On December 13, 2006, the Commission suspended the proposed tariff sheets and established a procedural schedule. In various orders, the Commission also granted the applications to intervene filed by the Missouri Energy Group ("MEG"); Missouri Industrial Energy Consumers ("MIEC"); USW Local 11-6, the Missouri School Boards Association ("MSBA"); and the Missouri Department of Natural Resources – Energy Center (DNR).

Laclede, Staff, the Office of the Public Counsel ("OPC"), DNR and MIEC appeared and participated at the prehearing conference. As a result of the prehearing conference and further negotiations, all Parties to the case reached agreement and filed a Unanimous Stipulation. As a consequence, the Stipulation reflects a resolution of all the issues in this case. There are two matters for which collaborative meetings will be scheduled to discuss implementation of programs specified in the Stipulation: (1) low income weatherization program and (2) an experimental low-income payment program.

The Stipulation is in the Public Interest

The Stipulation is consistent with Section 386.610 RSMo 2000, which states, in relevant part, that the provisions of the Public Service Commission Law "shall be liberally construed with a view to the public welfare, efficient facilities and substantial justice between patrons and public utilities." The settlement addresses the specific interests of the various Parties to this case including consumer representatives for the customers who pay these rates. The settlement will produce "just and reasonable rates," Sections 393.130.1 and 393.150.2 (RSMo 2000), which permit Laclede to provide "safe and adequate service" as well as earn a reasonable return on investment. Section 393.130.1. The Stipulation includes low-income customer assistance programs (funds for a weatherization program as well as funds for a low-income customer experimental payment program.) Additionally, the Stipulation includes a collaborative whose purpose is to design and implement conservation and energy efficiency programs. The intent of these programs will be to reduce demand for natural gas without jeopardizing the Company's ability to recover its costs.

Revenue Requirement

The revenue requirement in the Stipualtion is a "black box" settlement and, except where spelled out specifically in the Stipulation (e.g., pensions/OPEBS; ECWRA amortization; Fidelity Natural Gas net plant valuation). The contents of this memorandum reflect Staff'sperspective on these matters.

In this rate case filing, Laclede's proposal of increasing its rates by a total of $52.9 million, included a proposed increase in its PGA gas cost rates of approximately $9.8 million. This was due to Laclede's proposal of shifting a significant portion of its calculated bad debt expense from permanent margin (non-gas) rates to its PGA rates. In its direct testimony filing on May 4, 2007, Staff recommended a permanent margin rate increase of approximately $15.35 million (at the midpoint of its rate of return range), an amount which reflected continuation of the current practice of reflecting all of Laclede's bad debt expense in its margin rates.

Following the filing of Staff's Direct Testimony, certain errors and omissions in Staff's case were discovered, resulting in Staff making changes to its filed revenue requirement. These changes result in an approximate $8.65 million increase to Staff's filed revenue requirement. The largest errors were in Staff's customer growth and weather normalization adjustments, which increased Staff's case by approximately $5.75 million, and in Staff's tax depreciation calculations, which increased Staff's case by approximately $2.45 million.

Additionally, Staff's revenue requirement changed as a result of the receipt of additional information following the filing of Staff's Direct Testimony, receipt of more up-to-date numbers, and agreements among the Parties during the negotiation of this global Stipulation. These changes, which resulted in an approximate $3.05 million increase in Staff's calculation of revenue requirement, affected the following cost components: (1) Emergency Cold Weather Rule amortization; (2) medical/health costs; (3) home inspection fees; (4) bill redesign costs; (5) outside service expense; (6) capitalized depreciation; and (7) Fidelity Natural Gas (Fidelity) revenue annualization.

The impact of the updates in these revenue requirement areas, in conjunction with the errors and omissions previously discussed, was to increase Staff's recommended revenue requirement from the $15.35 million filed number to an approximate $27.1 million amount by the close of the settlement conference for this proceeding.

As a result of the settlement conference and subsequent negotiations of the Parties, Staff agrees that Laclede should be authorized to increase its annual non-gas, Missouri jurisdictional revenues by $38.6 million.

The net impact on an average customers' bills as a result of this Stipulation will be considerably less than the $38.6 million base rate increase provided for in the settlement. First, further described later in this document, ISRS revenues in the amount of $5.5 million are already reflected on customer bills, meaning that the net increase to customers as a result of this case is actually $33.1 million. In addition, as separately explained in this memorandum, off-system sales and capacity release margins are being moved from Laclede's base margin rates to its PGA/ACA rates. These margins, which once reduced Laclede's revenue requirement in general rate cases, now will have the impact of reducing Laclede's PGA and ACA rates. This Stipulation provides for a November 2007 crediting of $12 million to customer PGA/ACA rates due to off-system sales and capacity net revenues. Therefore, the net impact on customer bills from this agreement is $21.1 million, when the Stipulation's impacts on both margin rates and PGA/ACA rates are taken into account.

There are several major considerations to Staff's agreement to increase its revenue requirement by approximately $11.5 million (from $27.1 million to $38.6

million) for settlement purposes; namely, return on equity, bad debts, prepaid pension asset amortization and true-up allowances and other (miscellaneous) items .

(1) **Return on Equity ("ROE")** – Staff recommended an ROE of 8.70% at the midpoint of its rate of return range in its direct filing. For settlement purposes, Staff was willing to accept a revenue requirement reflecting (from its perspective) a higher ROE . A significant portion of the movement from a 27.1 million revenue requirement to the higher stipulated reveneue requirement realtes to the ROE area. The reasons Staff was willing to accept this ROE valuation for settlement purposes include: 1) consideration of recent Commission decisions involving ROE, 2) the fact that an average of all ROE recommendations sponsored in this case (Laclede, Staff and MIEC) was approximately 10.08%, and 3) the fact that customer representatives participating in the case agreed to the revenue requirement.

(2) **Bad Debt Expense** – Laclede included a "factor-up" in its case to account for an estimated increase in its bad debts allegedly attributable to expected increased revenue levels from its regulated revenue sources (including PGA revenues in addition to margin revenues). Staff did not include any "factor-up" of bad debts in its recommended allowance for uncollectibles in its Direct filing. In light of a recent Kansas City Power & Light Company ("KCPL") rate proceeding (Case No. ER-2006-0314) Commission decision, Staff agreed as part of a total settlement to a revenue requirement which assumed a factor-up of Laclede's bad debt expense in this case for the stipulated increase in margin revenues (but not for projected PGA revenue increases).

(3) **Prepaid Pension Asset Amortization** – For settlement purposes, Staff agreed to increase the annual amortization to expense of Laclede's prepaid pension asset

by approximately $478,000. This item will be addressed further in the Pensions/OPEBs section of this memorandum.

(4) **True-up Allowance** – In its Direct filing, Staff indicated that the minimum result of its recommended true-up audit of Laclede, incorporating changes to its revenue requirement through June 30, 2007, as well as certain payroll increases scheduled for August 1, 2007, would be $1.5 million. As a result of this agreement, there will not be a true-up audit in this case. However, based upon updated information received from Laclede, Staff has determined that a conservative estimate of the value of a true-up audit to Laclede through August 1, 2007 would be $2.5 million.

(5) **Other** - Staff gave consideration to the positions of Laclede, OPC, and the intervenors and reflected a portion of the value of their positions in its quantification of the settlement revenue requirement.. on the issues of : dues and donations, Supplemental Executive Retirement Plan ("SERP") expense, overtime expense and automated meter reading expense.

The stipulated revenue requirement of $38.6 million includes approximately $5,500,000 in Infrastructure System Replacement Surcharge ("ISRS") revenues that currently appear on customers' bills as a line-item surcharge. As a result of moving the ISRS qualifying property into rate base, and in accord with 393.1009, 393.1012, and 393.1015, RSMo (Supp. 2003), Laclede's ISRS will be reset to zero ($0.00).

Rate Design

Staff recommended that the Straight-Fixed Variable rate design method be implemented for Laclede for the reasons set out in Anne Ross' direct testimony. The Company and OPC, however, agreed to a different rate design and the stipulated revenue requirement of $38,600,000 was allocated to each rate class in accordance with the amounts set forth on Attachment 1 to the Stipulation. The other rate components in each rate class shall be adjusted by a percentage determined by dividing the remainder of any rate increase by the non-gas revenues of such class excluding customer charges.

For settlement purposes only, Staff accepted OPC's and Laclede's agreement on rate design that calls for the first block of Laclede's General Service distribution and PGA rates be reduced to the therm levels set forth on Attachment 1 to the Stipulation. In addition, the rate differential between the first and second block of Laclede's General Service PGA rates will be reduced by 35%. This reduction helps to ensure low-use customers pay more of their gas costs in the fixed component of their bills and shift less of those costs to high-use customers.

As part of its next application for a general rate increase, Laclede agrees to furnish data and other information necessary to permit other parties to perform class cost of service and class infrastructure studies to be used in designing rates.

PGA/ACA Tariff Changes

The Parties agree that the following modifications and/or adjustments should be made to or through Laclede's PGA/ACA mechanism:

(a) Beginning with its November, 2007 PGA/ACA filing, Laclede shall reduce its ACA rates by an estimated $6,000,000 to reflect the one-time off-system sales and capacity release credits, including interest, due customers pursuant to the sharing mechanism set forth in paragraph 11 of the Stipulation and Agreement in Case No. GR-2005-0284 and further reduce its Current PGA rates by $6,000,000 to reflect an ongoing estimate of the customers' share of future off-system sales and capacity release revenues.

(b) Such one-time credits are based on the actual off-system sale/capacity release results from October 1, 2005 through September 30, 2007. Beginning with the Company's November 2008 PGA/ACA filing, the Company will also reduce its ACA rates by an annual level of $6,000,000, until modified in a general rate case proceeding.

(c) The credits due to customers under the Stipulation And Agreement in Case No. GR-2005-0284 are booked to a "deferred account" (Account 182), and are being separately accounted for pursuant to the Stipulation and Agreement. The disposition of these credits has been determined in this rate case, and has been addressed in this Stipulation. Staff's understanding is that the actual historical amounts that are in the account as of September 30, 2007 will be used to reduce the ACA balances as of September 30, 2007. Then, the special "deferred account" will be closed. In October 2007, the Company will credit sales customers the amount in the deferred purchased gas account based on a calculation of the customers' share of actual off-system sales and capacity release margins and the actual amount of the one-time sharing mechanism set forth in Paragraph 11 of the Stipulation and Agreement in Case No. GR-2005-0284 (applicable to off-system sales and capacity release margins incurred by Laclede from October 1, 2005 through September 30, 2007).

Any difference between the PGA revenues and off-system sales and capacity release credits, negative or positive, shall be flowed through to customers in the subsequent ACA period. The allocation of such credits to customer classes will be the same as the allocation of off-system sales and capacity release margins set forth in paragraph 17 of this Stipulation;

(b) Any proceeds received by Laclede as a result of the NYMEX class action lawsuit addressed in Case No. GO-2006-0449 shall be flowed through to customers through a PGA/ACA credit to firm sales customers;

(c) Updated PGA volumes will be set forth on Tariff Sheet No. 28 (d) in the Company's November 2008 PGA filing.

Other Tariff Modifications

As part of this Stipulation, Laclede is no longer seeking approval of the tariff sheets and rate schedules that it filed in this case on December 1, 2006. Instead, the Parties agreed that tariffs in line with the specimen tariff sheets and rate schedules set forth in Attachment 2 to the Stipulation should be approved as replacements for the tariff sheets and rate schedules set forth in Laclede's December 1, 2006 filing. (The specimen tariffs included in Attachment 2 to the Stipulation are subject to change, and Staff expects the Company to make a compliance filing with final and agreed to tariffs prior to the effective date of new rates from this proceeding.) The specimen tariffs attached to the

Stipulation contain several modifications to Laclede's existing tariff, including the following:

(a) The reduced service initiation fees of $25 which reflects Laclede's cost of providing this service ; however, Laclede's tariff will retain the exception for rental property owners (Tariff Sheet Nos. 31-a and R-41);

(b) For settlement purposes only, Staff agreed to increase residential reconnection charges to $62 as agreed between Laclede and OPC. Staff's Direct testimony in this case indicated that a $72 reconnection charge reflected the true cost for this service. (Tariff Sheet No. 30-a);

(c) Staff, Laclede and OPC agreed that an experimental credit scoring basis should be used to determine whether Laclede will require a customer deposit, and Staff supports this approach. This tariff is subject to change based on the results of an upcoming Chapter 13 rulemaking and potential revision or termination in Laclede's next rate case proceeding. (Tariff Sheet No. R-5-a);

(d) Laclede also agrees the next time it files a general rate case, to submit to the Parties a credit scoring study using the same methods, sampling techniques, validation report score ranges and definitions as presented to Staff and OPC in this case.

(e) The Stipulation provides for elimination of the separate rate schedules, rules and regulations and other tariff provisions currently applicable to customers in the area previously served by Fidelity and application of the rate schedules, rules and regulations approved in this case for Laclede to the service provided to such customers. Staff expects that any Fidelity refunds recommended as result of Staff's next ACA audit will be refunded to Fidelity customers in subsequent ACA audits by Staff in accordance with the provisions of the Stipualtion and Agreement in Case No. GM-2006-0183, Laclede's Application to purchase the natural gas assets of Fidelity.

Pensions and Other Post-Employment Benefits

The terms of the Stipulation continue the provisions implemented in the Company's last two rate cases for pensions, with some modifications. These terms specify including pension expense in rates based upon Laclede's actual contributions to the pension fund and recognition of a regulatory asset/liability to account for the difference between pension expense in rates and the pension expense calculated for financial reporting. The terms also allow the Company to continue to recover the prepaid pension asset that accumulated under Staff's prior policy of recognizing pension expense in rates according to financial reporting standards, which often resulted in a negative pension expense. Since funds cannot be withdrawn from the pension fund to replace the lost cash resulting from inclusion of negative pension expense in rates, the Company was allowed to accumulate and recognize a prepaid pension asset in rate base. Including an amortization of the prepaid pension asset in expense for ratemaking purposes will eliminate the prepaid pension asset from rate base over time.

Staff has reviewed the current financial status of Laclede's pension plans and agrees that the rates established in this case for the Laclede Division and Missouri Natural Division pension plans include an allowance of $4,821,245, based on the fiscal

2007 ERISA Minimum Contribution of $942,550 as determined by the Company's actuary and a $3,878,695 amortization of the existing prepaid pension asset. (All amounts referenced in this section of the memorandum are stated prior to application of an O&M expense factor; i.e., they include both the capitalized and expensed piece of pension expense.) The amount of the prepaid pension asset amortization included in rates is an increase of almost $500,000 over the prior amount of $3.4 million. Increasing this amortization for settlement purposes will provide a future benefit to Laclede's customers in that it will reduce the Company's rate base in future proceedings, thereby reducing the required return element of Laclede's revenue requirement.

Under this agreement, the Company will be allowed rate recovery for contributions it makes to its pension trust that exceed the ERISA minimum for the following reasons:

(a) the minimum required contribution is insufficient to avoid the benefit restrictions specified for at-risk plans pursuant to the Pension Protection Act of 2006, thereby causing an inability by Laclede to pay out pension benefits to recipients in its normal and customary manner; and

(b) to avoid incurrence of Pension Benefit Guarantee Corporation (PBGC) variable premiums.

The first circumstance listed above is new, and relates to the recent passage of the Pension Protection Act of 2006. Laclede has customarily paid out a portion of its pension benefits to recipients in lump-sum fashion, but may not be able to do in the future if its pension plans are considered to be "at risk," as defined under the law. (None of Laclede's pension plans are currently considered "at risk" under the Pension Protection

Act definition.) This provision is appropriate in that it will allow Laclede to continue to pay out benefits to recipients in the future in its normal and customary manner, even if its pension funds momentarily fall under the "at risk" category. Laclede is required to inform the Staff and OPC of contributions of additional amounts to its pension trust funds pursuant to Paragraph 6. of the Stipulation in a timely manner.

Recently, the Financial Accounting Standard Board (FASB) issued Financial Accounting Standard No. 158 (FAS 158), *Employers' Accounting for Defined Benefit Pension and Other Postretirement Benefit Plans* which, among other things, requires certain adjustments to the prepaid pension asset/ other post-employment benefit (OPEB) asset and/or accrued liability with a corresponding adjustment to equity (i.e., decreases/increases to Other Comprehensive Income) if a company's pension plans do not meet certain funding requirements. Staff believes that any funding shortfalls experienced by Laclede in relation to their pension plans will be temporary in nature as long as pension expense is recovered in rates, and that charges to income in this circumstance by utilities are not appropriate. Accordingly, under this agreement the Company will be allowed to set up a regulatory asset/liability to offset any adjustments that would otherwise be recorded to equity caused by applying the provisions of FAS 158 or any other FASB statement or procedure that requires accounting adjustments to equity due to the funded status or other attributes of the pension or OPEB plans. Regulatory assets/liabilities set up to avoid charges to income will not be included in rate base.

The Parties agree that the rates resulting from this case for OPEBs also continue the provisions implemented in Laclede's prior two rate cases, with some modifications. Laclede will continue to recover OPEBs expense as generally calculated under Financial

Accounting Standard No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions* (FAS 106). The parties agree that the rates established in this case as calculated under FAS 106 include an allowance of $7,572,662 (amount stated prior to application of O&M expense factor), based on the fiscal 2007 calculation of FAS 106 expense on a ratemaking basis for the qualified plans and payments basis for the non-qualified plans.

Anew provision included in this agreement is the difference between the amount of OPEB expense included in Laclede's rates and the amount funded by Laclede will be included in the Company's rate base in future rate proceedings. This provision is consistent with current regulatory treatment of pension expense for Laclede, and with treatment of OPEBs expense for other Missouri utilities.

Finally, in the event that FAS 106 expense becomes negative, the Company is authorized to set up a regulatory liability to offset the negative expense. In future years, when FAS 106 expense becomes positive again, the amount in rates will remain zero until the prepaid asset that was created by the negative expense is reduced to zero. The regulatory liability will be reduced by the same rate as the prepaid asset. This regulatory liability is a non-cash item and will be excluded from rate base in future years. This treatment of negative OPEB expenses is new to this case, and is appropriate to avoid potential problems in rate treatment of OPEBs that have been experienced in the past by Laclede and other Missouri utilities due to inclusion of negative pension expense in rates.

<u>Depreciation Issues</u>

The Parties agree that the Company's depreciation rates will remain unchanged, except for Account No. 391.02 related to data processing, mainframe and computer equipment which will have a depreciation rate of 20% (an average service life of five years; zero net salvage value assumed) and Account No. 391.04 related to data processing/other, which shall have a depreciation rate of 10% (an average service life of ten years; zero net salvage value assumed). These were the rates intended by the parties to be implemented for Laclede for these accounts in the Stipulation of the Company's last rate proceeding, but the numbers were transposed and the accounts were reversed in Attachment 3 to the 2005 rate case Stipulation and Agreement, and accordingly the wrong rates were authorized by the Commission for these accounts. Since the 2005 rate case, Laclede has appropriately booked its depreciation expense for data processing equipment and data processing-other in accordance with the authorized rates shown on Attachment 3 to the 2005 Stipulation And Agreement. In this case, the Parties agree that it is appropriate to implement the rates originally intended for these accounts on a prospective basis.

Also, beginning with the effective date of rates in this case, assets purchased from Fidelity on February 28, 2006 are to be depreciated using Laclede depreciation rates, not the prior authorized Fidelity rates.

Accounting Authorizations/Reservation of Rights

Paragraph 14 of the Stipulation includes language addressing the continued normalization treatment of income tax timing differences inherent in the recognition of pension costs, OPEB costs, and Account Authority Order recoveries.

Paragraph 15 states that nothing in the agreement shall be construed as prejudicing the Company's right to pursue revised tariff provisions relating to its liability for services provided to customers, though all Parties retain the right to oppose such provisions on any basis other than the grounds that such tariff provisions should have been disposed of in this proceeding.

Paragraph 15 also states anintent that the structure and contents of current Laclede's school aggregation tariff will be addressed through a separate tariff filing after the conclusion of this case.

In Paragraph 16, the Parties agree that $5,033,655 in uncollectible expense and interest costs relating to compliance from January 1, 2006 through March 31, 2006 with the Emergency Cold Weather Rule Amendment (ECWRA) that was deferred by Laclede in accordance with the Commission's ruling in Case No. GX-2006-0434 should be amortized and recovered in rates by Laclede over a five-year period at a rate of $1,006,731 per year. An amortization in that amount is included in the stipulated revenue requirement. The total ECWRA cost amount referenced above includes $4,111,936 in uncollectible expense, and $921,719 in accumulated interest through the end of the amortization period.

<u>Off-System Sales and Capacity Release Revenues</u>

In recent Laclede rate proceedings, the rate treatment of off-system sales and capacity release revenues and costs has been to impute a level of revenues in the determination of margin rates. Once a level of revenue related to off-system sales and capacity release is determined, the cost of service is reduced by this imputed revenue level. Laclede then retains the revenues associated with off-system sales and capacity release until the next rate case when the revenue level is re-evaluated.

In Case No. GR-2005-0284, Staff believes a level of off-system sales and capacity release margins was imputed in the stipulated revenue requirement to reduce the rate increase amount that would otherwise have been allowed for the Company. The actual level of imputation was not spelled out in the 2005 rate case Stipulation and Agreement. The 2005 Stipulation and Agreement does state that 50% of the net revenues from off-system sales and capacity release transactions in excess of $12,000,000 were to be accumulated, with interest, and distributed to customers in the Company's next general rate case. Since the 2005 Stipulation and Agreement, the margins received by Laclede from off-system sales and capacity release transactions have exceeded $12,000,000 on an annual basis. The terms of this Stipulation follow on the provisions from the previous case's Stipulation and Agreement by providing for the distribution of the customers' share of off-system sales and capacity release margins to customers. The Company will adjust the ACA balances in its November 2007 PGA/ACA filing for this accumulated amount of off-system sales and capacity release revenue earned since the previous rate case. The reduction to customers' gas costs is estimated to be $6,000,000.

The terms of the Stipulation move the net revenues received from off-system sales and capacity release from margin rate inclusion to a sharing mechanism within the PGA/ACA clause, in accordance with the recommendations made in Staff's direct testimony. The sharing mechanism permits the Company to retain increasing percentages of off-system sales margins and capacity release credits up to 30% depending upon the annual achieved level. The sharing mechanism stipulated to by the parties is similar to the one approved for Missouri Gas Energy in Case No. GR-2004-0209. The Staff believes that the sharing mechanism recommended in this case will most likely reduce the Company's share of the net revenues from off-system sales and capacity release when compared with the previous case.

According to the terms of the Stipulation, the Company will reduce its PGA rate each year by $6,000,000 to reflect an on-going off-system sales and capacity release level. This amount will be trued-up to the actual level in the annual ACA process. The customer class allocation of the off-system sales and capacity release margins will follow the principle that those customers paying the fixed charges that made the off-system sale and capacity release opportunities possible should share the benefits based upon payment of those fixed charges. Generally, off-system sales and capacity release margins are facilitated by the payment of producer demand charges and capacity reservation charges. Moving the revenues received to the PGA/ACA rate mechanism ensures that, regardless of the level of off-system sales and capacity release, the majority of the benefits will flow through to the customers, thereby reducing their cost of gas. Moving the revenues received to the PGA/ACA will also provide a mechanism to track and to true-up the actual off-system sales and capacity release margins. It also aligns the revenues received with the recovery of costs for capacity reservation and producer demand charges which create the opportunity for these transactions. The prudence of the Company's gas procurement activities shall be reviewed within the relevant ACA proceeding.

Gas Supply Incentive Program

The Gas Supply Incentive Plan (GSIP) agreed to in this case is essentially a continuation of the currently effective GSIP that was proposed by OPC in Case No. GR-2002-0356 and extended in Case No. GR-2005-0284. The plan was implemented in November of 2002 pursuant to a Commission-approved Stipulation and Agreement and extended in October 2005. In this memorandum, the Staff will first describe the current

GSIP as it operates now, and then discuss the modifications to this mechanism agreed to in this Stipulation.

The current GSIP entails three tiers of natural gas costs. When natural gas costs are in the middle tier, Laclede receives an incentive. The ceiling price (top tier) is meant to reflect a price limit where gas costs are at such a high level, that it is inappropriate to reward the Company, given the overall environment of high gas prices. The floor price (bottom tier) is set to address a situation where prevailing prices in the market are considered generally low enough that rewards to the Company are unnecessary. The incentive portion of the plan provided Laclede with ten percent of any cost reductions, up to a $5,000,000 cap. Thereafter, the incentive drops to one percent of any further cost reductions.

Another of the major elements of the plan includes the comparison of the supply related portion of actual natural gas costs with a benchmark of various locations where the Company can source natural gas. That benchmark reflects so-called “first-of-month” (FOM) index pricing which in turn represents a monthly market-based benchmark.

The currently effective GSIP also integrates gains and losses from financial instruments (hedging). The GSIP applies to the total commodity cost of natural gas supplies purchased for on-system consumers, inclusive of the cost and price reductions associated with the Company's use of financial instruments. Therefore, results of hedging are incorporated into those costs that are compared to the FOM index based benchmark, although the benchmark itself is based solely on index based pricing.

This Stipulation preserves broad Commission review authority of Laclede’s natural gas purchasing practices.

Also in this Stipulation, the GSIP ceiling has been changed from the existing $7.50 per MMBtu to $8.00 per MMBtu (with a 6% escalator for years 2 and 3 of the program) to recognize that natural gas prices have been somewhat higher since the $7.50 ceiling was set. The GSIP floor remains at $4.00 per MMBtu. .

In this Stipulation, the FOM prices were updated to better reflect more current supply utilization. The hard cap placed upon the overall sharing that Laclede can achieve from this program was reduced to $3,000,000 per year.

Staff is generally supportive of incentive programs that actually provide strong incentives for gas utilities to reduce the overall delivered cost of gas to consumers. However, it is nearly impossible to design a gas cost incentive plan for Local Distribution Companies (LDC) that properly balances risk and reward between the LDC and its customers. As with many similar plans, in Staff's view, the only downside risk to the Company associated with the stipulated GSIP is the possibility of prudence disallowances. The risk for consumers is that Laclede may be able to obtain gas at costs set within the middle tier and benefit by increasing other types of costs, such as pipeline or producer demand charges, and attempt to pass those costs onto the consumer. This would mean that the Company would benefit but the consumer might actually be paying more for natural gas than if there had been no incentive mechanism at all. Scenarios that might lead to potential disallowances include, but are not limited to, situations where upstream pipeline costs or producer demand charges (these costs are not factored into the actual GSIP commodity cost but are flowed through 100% to customers via the PGA) increase without sufficient benefit to the customer to offset those additional costs. Increases in these costs could then enable Laclede to earn greater GSIP incentives and/or greater profits from off-system sales/capacity release revenues, but not result in an overall benefit for customers. If such a situation was found, the Staff would propose a disallowance.

Another example where the Company would benefit but the consumer might actually be paying more for natural gas than if there had been no incentive mechanism at all. might include situations where hedging efforts take on a speculative aspect that ultimately harms the customer. Again, the proposed GSIP provides that prudence reviews are applicable in all circumstances, and Staff will actively monitor the Company's activities that pertain to GSIP sharing levels.

Low-Income Energy Assistance Program

The Parties recommend that the following terms for Laclede's Low Income Energy Assistance Program be adopted:

(a) Interest at an annual rate equal to Laclede's average short-term debt cost as of March 31, 2007, shall be added by Laclede to the carry-over balance (estimated to be approximately $700,000) as of the effective date of rates in this case for existing programs. The interest referred to above shall be determined as the amount of interest that the carryover amount would have earned from the date of the effective date of rates in Laclede's last rate case until the effective date of rates in this case, based upon the average monthly carryover balances over that period (which balance shall assume Laclede collected the authorized funding for the program evenly in rates over the entire period). This combined amount will be used to fund a pilot low-income program that will terminate no later than three years after Commission approval of the Stipulation. The combined amount will be equally distributed to each of the three years of the pilot program. If the funds in any year of the pilot are not spent, the unspent fund will be applied to the regulatory asset account in the next year. Amounts for years two and three will accumulate additional interest until the funds are spent.

(b) Laclede shall invest up to $600,000 annually in a regulatory asset account to fund the low-income energy assistance program.

(c) Ongoing program review, analysis and revisions will be conducted by a Low-Income Program Review and Evaluation Team (PRET). The PRET shall consist of Laclede, Staff and OPC and USW Local 11-6, with input from the Community Action Agencies ("CAAs") administering the program. In addition, no later than 6 months after Commission approval of the Stipulation, a third party will be chosen by the PRET to offer assistance and perform a comprehensive program analysis at the end of the three year program period. If Laclede files a general rate case before three years has elapsed, the program evaluator will begin the evaluation at that point in time, with the evaluation to be furnished to all parties at least two weeks before the Staff and OPC file their direct testimony in the case.

(d) The PRET will meet every three months regarding this program. Before each meeting, Laclede will furnish written reports on program measurements to the PRET members. Supporting documentation will be supplied to PRET on request. Revisions to the program may be made on an annual basis provided the program measurements reflect a need for changes, with input from the affected CAAs and the third party chosen to evaluate the program.

(e) The CAAs and Laclede will file a written report to the Commission annually that summarizes, by month and by income grouping:

- number of participants in the bill credit program;
- number of participants in the arrearage matching program;
- amount of 'new' arrearages brought into the program by new participants during that month;
- arrearage amounts at beginning and end of month;
- number of new participants;
- number of participants who have defaulted;
- total dollars spent on bill credits;
- total dollars spent on arrearage matching;
- amount of funds contributed by Laclede; and
- total dollars contributed by customers for arrearage.

The report will also contain a narrative reporting the progress in meeting the program objectives, any problems identified by the PRET, changes to program parameters made during the year, and the reason for those changes.

(f) Beginning November 1, 2007, the program will be conducted in accordance with the general parameters set forth in Attachment 3 to the Stipulation.

(g) Any expenditures made for the program (minus one half of the actual summer margin revenues, or a reasonable estimate thereof as agreed upon by the PRET, paid by participating customers who comply with the terms of the program and $31 in avoided disconnection/reconnection costs for each complying customer), shall be placed in a regulatory asset account during the term of this Stipulation. This includes expenses for the administration, implementation and the third party evaluator. Compensation to the CAA for administration of the program shall be limited to no more than 10% of the program funds. All costs shall be reviewed for implementation prudence in Laclede's next rate case. Subject to such review, such investments will be reflected in Laclede's rate base in its next general rate case in the same manner as other rate base items, and amortized over a ten-year period. Any monies advanced in rates by customers or by Laclede prior to rate base inclusion for such programs shall accumulate interest at Laclede's average short term debt cost as of March 31, 2007.

Staff believes that the benefits of the low-income program provided for in this Stipulation to the participants and to Laclede are obvious. It is Staff's goal to use the data collected in the program to determine what benefits such a program provides to ratepayers who are not participants in the program. For this reason, the collection of data and the evaluation of this program by an independent third party is very important.

Energy Efficiency and Alternative Energy Programs

Low-income Weatherization

The current low-income weatherization program for eligible Laclede residential customers is enhanced by increasing the funding from $500,000 annually to $950,000 annually. This funding level for weatherization of homes of low-income customers in Laclede's service area is more consistent with the funding levels of other Missouri LDCs, as shown in the table attached to this memorandum (Attachment 1). The program is streamlined by transferring the funds and administration to DNR, to be operated in conjunction with DNR's funding for the federal Low-Income Weatherization Assistance Program (LIWAP).

Other Energy Efficiency Programs

The existing program for rebates to residential customers, commercial customers, and rental units for installation of high efficiency appliance and HVAC equipment will continue. No new funds will be collected, but the existing funds for the rebates, allowed in rates in the prior rate case, Case No. GR-2005-0284, are combined so that Laclede has the flexibility to continue the rebates where demand exists. The rebate program will continue until the Energy Efficiency Collaborative (EEC), described below, makes its recommendations on continuing, modifying, adding to or terminating the rebate program on a going forward basis.

The rates recommended herein include an allowance of $150,000 annually. An additional amount of funding from Laclede of up to $3,500,000 over the next three years will be accumulated in a regulatory asset account to fund conservation and energy efficiency programs that are developed as a result of an EEC process. The $3,500,000 funding level by Laclede can be increased if the charter members unanimously agree to request that the Commission approve a greater expenditure during the three years following approval of this Stipulation. The majority of the funding for the non-LIWAP energy efficiency programs is in a regulatory asset account, rather than a specific annual funding level, because the programs would be recommended by a collaborative and those programs are not yet defined. Under a collaborative approach, it will take time to develop the programs, the implementation may be ramped up over time, and the programs could be modified over time to improve deployment. Finally, use of a regulatory asset approach is justified because experience with Laclede's existing rebate and loan programs shows that the funds previously stipulated to in existing Laclede rates have not been fully expended by the Company.

The EEC includes Laclede, DNR, Staff, OPC, and USW Local 11-6, and electric utilities that have a significant presence in Laclede's service area and desire to participate, as well as other appropriate parties may participate in the process. Stipulation provisions are included for tracking/reporting, objectives development, consultant selection, design, pre-implementation evaluations, and post-implementation evaluation of energy efficiency programs.

A comparison of the proposed energy efficiency funding for Laclede compared to that of other Missouri LDCs is shown in the table in Attachment 1 to this memorandum.

Alternative Energy Programs

Laclede will provide quarterly updates of its progress in evaluating landfill gas from Fred Weber, Inc. as a potential alternative source of system supply.

Fixed Gas Price Option

Staff believes the concept of offering customers an option of obtaining the gas commodity at a fixed price for a period of time has merit, and should be considered further. Within 90 days of the effective date of the Report and Order in this case, Laclede, Staff and the OPC agree to begin discussions the development of an experimental program that would offer a fixed-price gas cost option to a maximum of 25,000 Laclede customers. Given the limited time available prior to next winter, and the complexity of such issues as the allocation of excess supply due to under subscription, the program implementation will likely be applicable for next summer if an agreement can be reached. The program will be offered as a regulated service and be subject to Commission oversight. Any program agreed to should not have any detrimental effects to Laclede's remaining customers.

Infrastructure System Replacement Surcharge

As required by Commission rules and state statutes, the Company's current ISRS rates shall be reset to zero upon the effective date of new rates in this proceeding. The overall rate of return and capital structure calculations as set forth in Attachment 5 to the Stipulation shall be used. The plant in service additions for inclusion in any future ISRS filings will be limited to additions subsequent to March 31, 2007. The Parties agree to continue their resolution of the past ISRS issue regarding income tax by reducing the Company's filed amount by one-half of the value of Staff's tax adjustment. Staff will work towards implementation of the ISRS as soon as reasonably possible, but the implementation is contingent on the Company's timely provision of data and information, including response to discovery, and the availability of the parties' resources to process the surcharge. This section of the Stipulation is consistent with the provisions of the Stipulation and Agreement for Case No. GR-2005-0284 regarding ISRS filings.

Cost Allocation Manual/Affiliate Transactions

In the direct testimony of Staff witnesses David M. Sommerer, Paul R. Harrison and Mark L. Oligschlaeger in this proceeding, the Staff identified several concerns with

Laclede's current practices involving entering into and accounting for affiliated transactions between the regulated utility, Laclede Gas Company, and various non-regulated affiliates. These concerns included the current methods used by Laclede Group employees for charging their time between Laclede Gas Company and its unregulated affiliates. This agreement requires that within 90 days of the effective date of the Commission's Report and Order in this case, Laclede, Staff and OPC shall begin meeting to discuss the issues or concerns they may have relating to Laclede's Cost Allocation Manual ("CAM"), the compliance of the CAM with the Commission's affiliate transactions rules, and transactions between Laclede and its affiliates. This agreement, and such future meetings, is not to be construed as placing any restrictions on Staff's or OPC's ability to investigate and file complaints concerning affiliated transaction matters following the conclusion of this proceeding.

Fidelity Natural Gas

On February 21, 2006, in Case No. GM-2006-0183,the Commission approved Laclede's purchase of the natural gas assets of Fidelity Natural Gas ("Fidelity") for approximately $2.177 million less than the net book value of the Fidelity assets as recorded on Fidelity's books on that date. Staff does not think that at the time of the purchase Fidelity's rates were sufficient to cover Fidelity's full cost of operation. As a result, if the net book value of Fidelity's assets were to be used to set Laclede's rates, Laclede's general body of ratepayers would have subsidized the Fidelity operations. This agreement requires Laclede to value the former Fidelity assets at its purchased price value in this and subsequent rate proceedings.

The fact that a condition of the certification of Fidelity as a gas utility by the Commission in Case No. GA-91-299 was that ratepayers would not be asked to bear the economic risk of viability of the natural gas service is another reason the purchase price should be used to value these assets for rate purposes.. This condition of holding the ratepayers harmless in case Fidelity's gas business failed should apply equally under Laclede's ownership as it did to Fidelity's prior ownership. In fact, Lacledes' burden in future rate proceedings to justify any attempted inclusion in Laclede's rate base of the Fidelity assets at any amount in excess of the purchase price was agreed to in the Stipulation of Case No. GM-2006-0183.

The ratemaking treatment afforded to the Fidelity assets in this Stipulation is warranted based upon the specific facts and circumstances surrounding the 2006 Laclede-Fidelity purchase transaction, and does not constitute a general Staff position on appropriate rate valuation of acquired utility assets.

WHEREFORE Staff submits this memorandum in response to the Commission's Order directing such filing.

Respectfully submitted,

/s/ Lera Shemwell
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Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, or transmitted by facsimile or electronic mail to all counsel of record this 11th day of July 2007.

/s/ Lera L. Shemwell

Laclede Gas Company, Case No. GR-2007-0208
Attachment 1

Energy Efficiency Programs - MO Local Distribution Companies

LDC	Case Number	Non-LIWAP EE Funding Total	LIWAP	Total Annual Funding (excludes financing)	Comments	No. of Customers	Funding Per Customer		
							Non-LIWAP EE	LIWAP	Total
Atmos	GR-2006-0387	$65,000	$100,000	$165,000	Annual Funding is 1% of annual gross revenues, includes LIWAP. The dollar amount for annual funding shown here is for the first year. For the non-LIWAP, $5,000 in year one is for education and $60,000 in year one is for high efficiency furnace and boiler rebates ($250 for Energy Star rated furnace unit or boiler; $450 for Energy Star rated combination space heating and water heating system) . $100,000/yr LIWAP	60,800	$1.07	$1.64	$2.71
AmerenUE	GR-2007-0003	$100,000	$263,000	$363,000	Annual contribution of $100,000 to fund programs to promote customer use of energy-efficient gas equipment. May also have DSM programs with funding in a regulatory asset account. $263,000/Yr LIWAP	120,700	$0.83	$2.18	$3.01
		$0	$90,319	$90,319	Funds remaining from the experimental programs developed for Stoddard and Scott Counties in GR-2003-0517. ($270,958 If spread over a 3-yr period, annual amount is $90,319. How it will be used not yet decided.		$0.00	$0.75	
Empire District Gas	GR-2004-0072	$7,500	$102,500	$110,000	$78,500 annually LIWAP plus $24,000 annually in the Sedalia area; $7,500 annually for experimental commercial energy audits	48,700	$0.15	$2.10	$2.26
MGE	GR-2006-0422	$750,000	$750,000	$1,500,000	Water heater rebate program $705,000/year; $45,000/year for education. $750,000/yr LIWAP.	490,900	$1.53	$1.53	$3.06
Laclede - current tariffs		$300,000	$500,000	$800,000	Appliance and HVAC Rebate Program, funding $300,000 annually. Financing Programs: Insulation Financing; Energy Wise Dealer Program for HVAC financing; Eligibility Expansion for EnergyWise Program to include rental property for low-income households. LIWAP: $500,000 annually; includes energy education.	648,000	$0.46	$0.77	$1.23
Laclede – Proposed Stipulation & Agreement	GR-2007-0208	$1,316,667 $150,000/yr + $3.5 MM regulatory asset account over 3 years	$950,000	$2,266,667	An allowance of $150,000 annually and up $3,500,000 in a regulatory asset account for energy efficiency programs developed from energy efficiency collaborative (EEC) process over the next three years, unless request that the Commission approve a greater (regulatory asset account to be amortized over a ten-year period). LIWAP $950,000.	648,000	$2.03 If regulatory asset account fully utilized	$1.47	$3.50
		$295,250 (Year 1)	$0	$295,250	Carry over funds from the existing energy efficiency rebate programs into one fund for rebates until Collaborative recommends other energy efficiency measures.		$ 0.46		