

Exhibit No.:
Issue: Price Stabilization Program
Witness: David M. Sommerer
Sponsoring Party: MoPSC Staff
Type of Exhibit: Rebuttal Testimony
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

DAVID M. SOMMERER

LACLEDE GAS COMPANY

CASE NO. GR-2001-387

Jefferson City, Missouri
December 2002

****Denotes Highly Confidential Information****

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1 **REBUTTAL TESTIMONY**

2 **OF**

3 **DAVID M. SOMMERER**

4 **LACLEDE GAS COMPANY**

5 **CASE NO. GR-2001-387**

6
7 Q. Please state your name and business address.

8 A. David M. Sommerer, P.O. Box 360, Jefferson City, Mo. 65102.

9 Q. Are you the same David M. Sommerer that filed direct testimony in this
10 case?

11 A. Yes.

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

13 A. The purpose of my testimony is to rebut the direct testimony of Laclede
14 Gas Company (Laclede, Company) witness Steven F. Mathews.

15 Q. Do you agree with Mr. Mathews' statement on page 5, lines 14, through
16 17 that "...all proceeds from such intermediate activities were to be considered a savings
17 from the Maximum Recovery Amount ("MRA") as the result of intermediate option
18 liquidations?"

19 A. No. Because of the lack of clarity in the program description and in the
20 tariffs, the Company was forced to refer to the "record evidence" *In the Matter of Laclede*
21 *Gas Company's Tariff Sheets Designed to Extend for and Additional Period the*
22 *Experimental Price Stabilization Fund*, Case No. GO-98-484 (Mathews Direct page 5,
23 line 13). A term such as "proceeds" was never fully defined nor was the term "savings."

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1 The concept of savings implies a "reduction in expense" (Webster's New World
2 Dictionary, Second College Edition, 1978). Merely because there are "proceeds" does
3 not mean that there were savings.

4 Q. How does the Company interpret the word "savings?"

5 A. It appears that the Company's proposed interpretation is that anytime there
6 are proceeds from ** _____ **,
7 "savings" have been experienced. This kind of interpretation leads to nonsensical results
8 where the Company could have sold out of an option position and achieved "proceeds"
9 and yet left their gas supply unprotected and exposed. As the Staff pointed out in direct
10 testimony in this case, it becomes difficult to measure "savings" when the guarantee of
11 Price Stabilization is removed. The Staff's position is that a reasonable meaning of the
12 term "savings" is to hold the Company accountable to the very concept it stated in Case
13 No. GO-98-484. The idea was that the Company could achieve much better results by
14 ** _____ ** than by holding the
15 options until close to expiration.

16 Q. Do you agree with Mr. Mathews' characterization on page 6, lines 15
17 through 23, and page 7 lines 1 through 3 that the Staff's approach is somehow
18 inconsistent?

19 A. No. That the Company had "nearly \$9 million dollars" for the purchase of
20 options was because the customers had provided the entire funding of the program in the
21 first place. The only significant ways the Company could possibly have been at risk in
22 the PSP program was to either spend over the MRA without regard to gains being
23 received, or stand by its guarantee for price protection in the face of a rising gas market a

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1 guarantee that it eventually revoked. It is entirely consistent to evaluate savings based
2 upon whether real savings were achieved because of accurate judgments about the
3 eventual price of gas, or whether the proceeds generated by early sales fell far short of
4 continuing to hold the hedged position.

5 Q. Does Staff believe there is an inconsistency in the Company's approach?

6 A. Yes. When the Company opted out of the Price Protection Incentive
7 (PPI), there was a huge financial incentive for the Company to liquidate early, because it
8 no longer could share in savings under the PPI, by holding options ** _____
9 _____ **. Thus by its after-the-fact interpretation, the
10 Company had lucrative sharing possibilities if it liquidated the hedge early, rather than
11 holding the position to offset escalating gas prices reflected in the Company's ** _____
12 _____ **. Another very glaring inconsistency is the fact that the
13 Company seeks to share in savings that allegedly result from the cost reduction incentive.
14 The task that was given to the Company was to buy inexpensive price insurance. A
15 benchmark, the Maximum Recovery Amount (MRA), was established as quantification
16 of what a reasonable amount of insurance would cost at a predetermined level of
17 protection. How is it possible to measure whether the price insurance was inexpensive
18 and purchased at a cost savings when the level of coverage is no longer specified, and
19 includes the potential for zero coverage? The Staff has simply attempted to make sense
20 of provisions that Laclede never completely and clearly defined, and apply them to a
21 program to protect customers that was in complete disarray.

22 Q. Could you respond to Mr. Mathews' concern that "...Staff's proposed
23 standard for measuring savings based on what the value of an option would have been

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1 'near expiration' is also vague and indefinite" (Mathews Direct page 7, lines 5
2 through 7)?

3 A. Yes. The Staff's approach is reasonable given the lack of clarity in the
4 tariff and program description regarding the definitions of "savings" and
5 ** _____ **, and in the context of a
6 program designed to provide better protection for customers. The Staff took a fair
7 approach in estimating the value that options had during the ** _____
8 _____ **. Staff used the arithmetic mean of closing prices, which represents a
9 fair trading range to use for making a comparison as to whether true savings were
10 achieved. The Staff believes that the Company's own internal review shows that the
11 tariffs and program description lack clarity and are themselves vague and indefinite.

12 Q. Please explain.

13 A. Attached as Schedule 1 to my rebuttal testimony is an excerpt of the
14 Company's response to Staff Data Request No. 40. It contains a series of internal memos
15 (dated between August 2001 and October 2001) by Company employees discussing
16 ** _____ **. The memos
17 were dated long after the original approval of the PSP tariffs and the Company's decision
18 to opt out of price protection. Although the discussion in the internal audit memos
19 actually suggests that another ** _____
20 _____
21 _____ ** (See Schedule 1,
22 page 2). The Staff believes this series of memos clearly ** _____
23 _____ ** of this continually amended program.

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1 Q. What is the Staff's assessment of the "financial benefits" discussed by
2 Mr. Mathews on pages 8 and 9 of his rebuttal testimony?

3 A. Mr. Mathews goes beyond the analysis of the PSP provisions in the ACA
4 period of 2000-2001. He constructs a hypothetical example where he supposes that since
5 Laclede procured ** _____
6 _____ ** (a subsequent ACA period not the subject of this case) Laclede
7 theoretically saved an additional \$30 million by not locking into fixed prices. The fixed
8 prices Mr. Mathews "avoided" generally ranged between ** _____ ** per
9 MMBtu. Mr. Mathews appears to be saying that if the Commission finds that the tariff
10 and program description supports the Staff's calculation, then the Company will simply
11 construct scenarios in subsequent years that will show it saved money against an
12 unspecified alternative (the one suggested by the Company is to assume it would have
13 locked in supply at ** _____ **).

14 Q. Please comment on Mr. Mathews' statement on page 10, lines 16 through
15 18, that Staff's standard is neither objective nor reasonable, and it conflicts with the tariff
16 and Program Description.

17 A. The case that originally authorized the incentive PSP, Case No.
18 GO-98-484 is replete with indications of the critical nature of the price protection
19 guarantee, and how that guarantee supported the Company's claims to savings. These
20 savings were intended to drive the "net cost of price stabilization" (Actual Cost) below
21 the MRA. (See tariff sheet 28-f attached to Steven Mathews' Direct.)

22 Q. Could you provide an assessment of the Company's representations of
23 how the price protection guarantee was the foundation of the program?

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1 A. Public Counsel witness James Busch, *In the Matter of Laclede Gas*
2 *Company's Experimental Price Stabilization Fund*, Case No. GO-2000-394, provided an
3 excellent review of the Company's statements regarding price protection guarantees.
4 That assessment was summarized in Mr. Busch's direct testimony pages 14 through 17.
5 It is reproduced here, with Staff corrections in [brackets]:

6 Mr. Kenneth J. Neises, direct testimony, page 10, lines 5 - 8, "[...]
7 Laclede's ratepayers stand to receive a far greater level of price
8 protection than that enjoyed by customers of other LDCs which
9 have no hedging program in effect."

10 Mr. Scott E. Jaskowiak, direct testimony, page 2, lines 16 - 19,
11 "[...] the basic objective of the Incentive PSP is to ensure that
12 Laclede's customers receive the greatest amount of price
13 protection at the lowest possible cost...."

14 Mr. Scott E. Jaskowiak, direct testimony, page 2, lines 23 - 25,
15 "The Incentive PSP would require Laclede to obtain price
16 protection, in the form of natural gas ** _____ ** of
17 its gas supply requirements...."

18 Mr. Kenneth J. Neises, surrebuttal testimony, page 10, lines 15 -
19 23, "*** _____

20
21 _____* If it does not do so, the Company must assume
22 financial responsibility for the difference between the CPL and the
23 contract settlement price. By undertaking this risk, I believe the
24 Company has provided the Commission with the most powerful
25 type of assurance possible that the mandated volumes will be
26 protected."

27 Mr. Kenneth J. Neises, surrebuttal testimony, pages 13 and 14,
28 lines 9 - 27 and lines 1 - 18, Q. "*** _____
29 _____
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34 _____* A. ** _____
35 _____
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_____. ** Of course, if the Company believes market conditions have changed radically enough to warrant such actions, it does not believe it should continue to have an opportunity to profit under the program. Accordingly, if Laclede invokes this provision during the first 90 days, it agrees that the incentive aspects of the programs [program] should terminate for the [that] year."

Mr. Kenneth J. Neises, surrebuttal testimony, page 17, lines 6 - 11, "To the extent there is any lingering concern over the Company's commitment to actually obtain the required level of price protection on ** _____ **, it should be completely eliminated by the Company's agreement to absorb 100% of the financial consequences associated with its failure to do so."

Mr. Kenneth J. Neises, surrebuttal testimony, page 18, lines 13 - 20, "Because Laclede will only ** _____

_____. **."

Mr. John B. Snell, surrebuttal testimony, page 4, lines 24 - 27, "*** _____

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Mr. John B. Snell, surrebuttal testimony, page 7, lines 1 - 9,
"Laclede would be absolutely required to **

_____, **, no matter
what. Laclede would also be required to guarantee a certain level
of price protection to its ratepayers regardless of **
_____ ** it purchases to provide the required
protection."

From Laclede's Initial Brief, page 6, "[...] Laclede proposed to
provide its customers with a firm guarantee that such price
protection would, in fact, be provided on at least **
_____ **." "... should be no
question regarding the substantial value to ratepayers of an actual
guarantee that such protection will, in fact, be provided."

From Laclede's Initial Brief, page 8, "As Mr. Jaskowiak explained,
Laclede would be required to obtain **

_____ ***" [...] "Laclede would be permitted to recover a
maximum of ** _____ ** each year for
the program through the existing surcharge in the PGA. Any
additional costs required to obtain the specified levels of price
protection would be borne by Laclede's shareholders. (Exh. No.
6HC, p. 3)"

From Laclede's Initial Brief, page 10, "If, during the 90 days
immediately following the establishment of the TSP, market
conditions change radically and Laclede determines it is necessary
to purchase ** _____ **,
Laclede would notify the Commission in writing, and the Price
Protection Incentive would not be operational for that year. This
feature was designed to insure that ratepayers would receive price
protection, and Laclede would not suffer from catastrophic losses,
if a radical change in the market occurs early in the program.
(Exh. 3HC, p. 9; Exh. No. 6HC, pp. 7 - 8)."

From Laclede's Initial Brief, pages 11 - 12 [12 -13], "Laclede's
Alternative B guarantees Laclede's payment of 100% of such
increased costs for the volumes which are required to be covered

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1 under the program. This provides an absolute cap on the cost of
2 those volumes – a feature which represents a significant
3 enhancement to the price protection Laclede has provided in the
4 past. (Exh. No. 4HC, p. 16 – 17)."

5 From Laclede's Initial Brief, page 17, "Under the plan, Laclede's
6 customers will receive an absolute guarantee of price protection for
7 **

8 _____ **."

9 From Laclede's Initial Brief, page 18, "First, with regard to the
10 issue of cost, it is clear that the maximum amount that ratepayers
11 will be required to pay for price protection under any
12 circumstances is **

13 _____ **. This cost can, and almost certainly
14 will, decrease as Laclede generates **
15 _____ **, but it can never increase under any
16 circumstances."

17 From Laclede's Initial Brief, page 19, "At the same time,
18 ratepayers will be guaranteed a substantial level of price protection
19 under any scenario. Even in the unlikely event that Laclede was to
20 leave itself 'completely unhedged,' ratepayers would still have
21 price protection, paid for by Laclede, above the CPL."

22 From Laclede's Reply Brief, page 2, "b) guaranteeing, for the first
23 time, catastrophic price protection for ratepayers under virtually all
24 circumstances."

25 Q. What does Staff find significant about the above references?

26 A. First, the overall view of these comments indicates that the guarantee was
27 presented to the Commission as virtually ironclad. Secondly, the Company's key policy
28 witness in Case No. GO-98-484 adds his view of incentive savings if the price guarantee
29 is revoked. In his surrebuttal testimony, page 14, lines 12 through 18 Company witness
30 Kenneth Neises stated "...Of course, if the Company believes market conditions have
31 changed radically enough to warrant such actions, it does not believe it should continue
32 to have an opportunity to profit under the program. Accordingly, if Laclede invokes this

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1 *provision during the first 90 days, it agrees that the incentive aspects of the program*
2 *should terminate for that year.” (emphasis added)*

3 Q. Please summarize your testimony.

4 A. The Staff believes that its savings calculation is consistent with the PSP
5 tariffs, PSP program description and the record in Case No. GO-98-484. The Company’s
6 calculation assumes that any sort of option activity ** _____
7 _____ ** that creates proceeds must create savings, which is not consistent
8 with the program design and not found in the general tariff references and program
9 description. Although the program generated millions in “proceeds,” the Company’s
10 method failed to recognize that early trading actually resulted in greater expenses for its
11 customers.

12 Q. Does this conclude your rebuttal testimony?

13 A. Yes, it does.

SCHEDULE 1
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HIGHLY CONFIDENTIAL
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