

Exhibit No.:  
Witness: Kenneth J. Neises  
Issue: Price Stabilization  
Fund; Overview  
Type of Exhibit: Direct Testimony  
Sponsoring Party: Laclede Gas Company  
Case No.: GO-98-484

DIRECT TESTIMONY

OF

KENNETH J. NEISES

**FILED**

JUL 2 1998

Missouri Public  
Service Commission

LACLEDE GAS COMPANY

Case No. GO-98-484

St. Louis, Missouri

June, 1998

DIRECT TESTIMONY OF KENNETH J. NEISES

1 Q. What is your name and address?

2 A. My name is Kenneth J. Neises, and my business  
3 address is 720 Olive Street, St. Louis, Missouri 63101.

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

5 A. I am employed by Laclede Gas Company ("Laclede" or  
6 "Company") in the position of Senior Vice  
7 President-Energy & Administrative Services.

8 Q. Please state your qualifications and experience.

9 A. I graduated from Creighton University in 1967, where I  
10 received a jurist doctorate degree. In 1970, I received  
11 a LL.M. degree from Georgetown University Law Center.  
12 From 1967 to 1973, I was employed as a litigation and  
13 trial attorney for the Federal Power Commission (now the  
14 Federal Energy Regulatory Commission). I left the  
15 Commission in 1973 to accept an appointment by the U.S.  
16 Postal Rate Commission to represent the interests of the  
17 general public in proceedings before that Commission. I  
18 then served as a partner in the law firm of Debevoise and  
19 Liberman in Washington, D.C. until joining Laclede in  
20 1983 as an Associate General Counsel. I was elected to  
21 the position of Vice President in January 1987 and Senior  
22 Vice President in January 1994. Prior to assuming my  
23 current position, I was Senior Vice President-Gas Supply

1 and Regulatory Affairs. In that position I had overall  
2 management responsibility for the Company's gas  
3 procurement activities, its participation in proceedings  
4 before the Federal Energy Regulatory Commission ("FERC")  
5 on matters affecting Laclede and its customers, and  
6 Laclede's participation in various regulatory proceedings  
7 before this Commission. My current duties include these  
8 responsibilities, as well as overall responsibility for  
9 labor and community relations and corporate  
10 communications.

11 Q. Have you previously submitted testimony before this  
12 Commission?

13 A. Yes. I submitted testimony in the Company's last rate  
14 case proceeding, Case No. GR-96-193, and in its current  
15 Actual Cost Adjustment proceeding, Case No. GR-96-181.

16  
17 PURPOSE OF TESTIMONY

18 Q. What is the purpose of your testimony?

19 A. My testimony will provide a brief overview of the origins  
20 and current structure of the Company's experimental price  
21 stabilization program ("PSP"). I will also provide a  
22 brief overview of the Company's proposed modifications to  
23 the PSP and explain why the Commission's adoption of  
24 these modifications would be in the best interests of  
25 Laclede's customers.

1 Q. Are the Company's proposed revisions to the PSP addressed  
2 by any other Company witness?

3 A. Yes. I refer the Commission to the direct testimony of  
4 Scott E. Jaskowiak for a more detailed discussion of how  
5 these proposed modifications to the PSP would operate,  
6 and to the direct testimony of Michael T. Cline for a  
7 description of the tariff sheets that would be required  
8 to implement the Company's proposals.  
9

10 ORIGINS AND STRUCTURE OF CURRENT PSP

11 Q. How did the Company's current PSP originate?

12 A. The PSP was first approved by the Commission in Case No.  
13 GO-97-401 and took effect on August 1, 1997. As  
14 originally structured, the PSP authorized Laclede to  
15 purchase certain financial instruments on the New York  
16 Mercantile Exchange ("NYMEX") for the purpose of  
17 achieving price protection on \*\* \_\_\_\_\_  
18 \_\_\_\_\_  
19 \_\_\_\_\_

20 \_\_\_\_\_\*\*. The PSP was later modified and extended by the  
21 Commission for a second winter season, effective May 29,  
22 1998.

23 Q. What results were achieved by the Company during the  
24 first winter season in which the PSP was in effect?

25 A. Consistent with the goals of the PSP, Laclede was able to  
26 procure financial protection, in the form of \*\* \_\_\_\_\_

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Q. You mentioned that the PSP was modified and extended for a second winter season on May 29, 1998. What modifications were made to the PSP?

A. There were two major modifications made to the PSP. First, a provision which had authorized Laclede to purchase financial instruments within a market adjustable range of \*\*\_\_\_\_\_\*\* was eliminated in favor of a specific \*\*\_\_\_\_\_\*\*. Second, a provision was added to prohibit the Company from selling  
\*\*\_\_\_\_\_\*\*  
\_\_\_\_\_\*\*.

PROPOSED REVISIONS TO PSP

Q. What additional modifications does Laclede propose be made to the PSP in this proceeding?

A. As described more fully in the direct testimony of Laclede witness Jaskowiak, the Company believes that the program's existing restrictions on when financial instruments may be sold should be eliminated in favor of an approach that gives the Company greater flexibility to

1 trade in and trade out of these instruments when market  
2 conditions warrant such actions. Second, to ensure that  
3 such flexibility is used in a manner that is most likely  
4 to produce tangible benefits for Laclede's customers, the  
5 Company is proposing the addition of an incentive feature  
6 to the program. Finally, the Company is proposing a  
7 three year term for the program.

8 Q. Please explain why the PSP's existing limitation on  
9 trading is inappropriate?

10 A. Once the Company purchases an \*\* \_\_\_\_\_ \*\* , it must hold  
11 that \*\* \_\_\_\_\_  
12 \_\_\_\_\_ \*\* . Due to the volatility of the natural  
13 gas financial market, however, the value of this  
14 \*\* \_\_\_\_\_ \*\* may change considerably between the time it is  
15 purchased and the time it expires. It's value could  
16 double or triple, return to one-half of its original  
17 value, and ultimately become worthless, all before the  
18 \*\* \_\_\_\_\_ \*\* . Having the ability to  
19 trade in and out of positions would permit Laclede to  
20 manage this volatility more effectively by allowing the  
21 Company to \*\* \_\_\_\_\_ \*\* when this  
22 highly volatile market is overbought (over-valued) and  
23 \*\* \_\_\_\_\_ \*\* when the market is oversold  
24 (under-valued).

25 Q. Do you believe the Company can purchase \*\* \_\_\_\_\_ \*\* at  
26 the lowest price and sell them at the highest price?

1 A. I am not implying that Laclede can always purchase  
2 \*\* \_\_\_\_\_ \*\* at the lowest price or always sell them at  
3 the highest price. Nor do I think that is necessary.  
4 The market is very volatile and price movements occur  
5 frequently. Once these movements begin, they often last  
6 for some time, thus creating price trends. Laclede  
7 believes that participation in these price trends, in  
8 whichever direction they may take at a particular time,  
9 will create opportunities to reduce the overall cost of  
10 acquiring price protection for the Company and its  
11 ratepayers.

12 Q. Why does Laclede propose to add an incentive feature to  
13 its program?

14 A. The Commission has previously recognized the constructive  
15 role that incentives can play in generating added savings  
16 and revenues in the gas supply area. The same  
17 considerations apply with equal or even greater force to  
18 efforts involving the procurement of financial  
19 instruments. If the program is approved, the Company  
20 would utilize its market expertise in an effort to  
21 increase the magnitude of price protection and/or reduce  
22 the total cost of such protection. If successful, the  
23 costs paid by Laclede's ratepayers will decrease, and  
24 Laclede will share in those savings.

25 Q. How would this incentive feature work?

1 A. The proposed program would have two incentive  
2 components. One component, which is referred to as the  
3 "Price Protection Incentive" in our specimen tariff  
4 sheets, would encourage the Company to obtain as low a  
5 \*\* \_\_\_\_\_ \*\* (consistent with achieving  
6 price protection for the prescribed volumes) so as to  
7 better the odds of realizing gains under the program. The  
8 second component, which is referred to as the "Overall  
9 Cost Reduction Incentive," would encourage the Company to  
10 buy \*\* \_\_\_\_\_ \*\* at the lowest reasonable cost so as to  
11 minimize the overall cost of the program.

12 Q. Please explain how the program would give the Company an  
13 incentive to obtain lower \*\* \_\_\_\_\_ \*\*.

14 A. Based on market data available at the beginning of each  
15 year of the program, a calculation would be made of the  
16 average or \*\* \_\_\_\_\_ \*\* ("TSP") that could be  
17 achieved by Laclede if it spent \*\* \_\_\_\_\_  
18 \_\_\_\_\_  
19 \_\_\_\_\_ \*\*. A Catastrophic Price Level ("CPL") equal to  
20 the TSP plus fifty cents per MMBtu would also be  
21 calculated. If, during the course of the program year,  
22 Laclede ultimately managed to \*\* \_\_\_\_\_  
23 \_\_\_\_\_ \*\* then the Company would be  
24 entitled to retain a 50% share of any realized gains up  
25 to the TSP. All other gains realized by the Company as a  
26 result of prices exceeding the TSP, or the Company's

1 purchase of \*\* \_\_\_\_\_, \*\*  
2 would be flowed through entirely to customers.

3 Q. How would the proposed program encourage the Company to  
4 minimize the cost of purchasing options?

5 A. The proposed program would permit the Company to share in  
6 any savings achieved by the Company in the event it is  
7 able to cover the prescribed volumes for a net cost of  
8 less than \*\* \_\_\_\_\_ \*\*.

9 Q. What are the sharing percentages that you propose?

10 A. The Company would be permitted to retain between 25% and  
11 75% of any such savings, with the percentage increasing  
12 in proportion to the magnitude and hence the difficulty  
13 of the achieved savings.

14 Q. Why should the Company share in any savings it achieves  
15 in the \*\* \_\_\_\_\_ \*\* cost of the program?

16 A. Once again, the Company is using its market expertise to  
17 reduce the overall cost of acquiring the prescribed price  
18 protection for its ratepayers. If the Company is  
19 successful, the ratepayers will benefit by paying less  
20 for this protection. Indeed, depending on how successful  
21 the Company is, ratepayers might conceivably pay nothing  
22 or even receive a credit.

23 Q. Does the Company also bear risks under this component of  
24 incentive mechanism?

25 A. Yes. As a general rule, the Company would absorb 50% of  
26 the costs incurred because of the failure to obtain price

1 protection at the CPL on 70% of its normal volumes. This  
2 assumes, of course, that the Company had a reasonable  
3 opportunity to obtain such protection at or below the  
4 CPL. If actual market conditions prove to be  
5 inconsistent with this assumption because of rapidly  
6 escalating gas prices during the first 90 days after the  
7 TSP is set, the Company would be authorized to purchase  
8 the \*\*\_\_\_\_\_\*\* without absorption exposure at whatever  
9 strike price it concluded was necessary to obtain the  
10 required protection. In such event, the Company would  
11 notify the Commission of its actions in this regard  
12 within 30 days of their occurrence.

13 Q. Will the proposed program result in greater risks to the  
14 ratepayers?

15 A. No. In fact, I believe our proposed modifications will  
16 actually tend to mitigate ratepayer risk by reducing the  
17 speculation inherent in the current program's requirement  
18 that all \*\*\_\_\_\_\_\*\* coverage be based on one-time  
19 purchases of these financial instruments. Instead of  
20 having to rely on a single, point-in-time, judgment of  
21 the relative economic merits of a particular \*\*\_\_\_\_\_\*\*  
22 purchase, the Company would have the flexibility to  
23 revisit such assessments, and perform additional  
24 transactions, if such action was warranted by changes in  
25 the marketplace. In my view, this more informed and  
26 adaptable approach represents a way of reducing risk. I

1 should also note that the program limits the potential  
2 liability of ratepayers to the \*\*\_\_\_\_\_\*\* cost of the  
3 program, plus transaction costs, an amount which is less  
4 than \*\*one percent\*\* of Laclede's overall costs. In  
5 exchange for this rather modest amount, Laclede's  
6 ratepayers stand to receive a far greater level of price  
7 protection than that enjoyed by customers of other LDCs  
8 which have no hedging program in effect. Accordingly, I  
9 do not believe our program is, in any sense, risky for  
10 the ratepayer.

11 Q. Why is Laclede proposing a three year term for the  
12 Incentive PSP?

13 A. Laclede believes a commitment to a longer term is  
14 necessary to properly test the merits of a program, the  
15 outcome of which depends on market conditions that  
16 typically change from year to year. The success or  
17 failure of this type of program should not be measured in  
18 one year alone because the outcome can be heavily  
19 influenced by uncontrollable factors such as extreme  
20 weather or gas supply disruptions in production areas. A  
21 three year term should be sufficient to properly evaluate  
22 the future parameters of this program.

23 Q. In the event a PSP with incentive features is approved by  
24 the Commission, when would Laclede propose to implement  
25 such a program?

1     A.   Laclede would propose to implement such a program as soon  
2         as possible.   The content of such a program and its  
3         implementation by Laclede will, however, be subject to  
4         final approval by Laclede's Board of Directors.

5     Q.   Does this conclude your testimony?

6     A.   Yes, it does.

