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**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of Laclede Gas Company's Purchased Gas Adjustment for 2007-2008	))	**Case No. GR-2008-0387**

RESPONSE TO STAFF RECOMMENDATIONS

COMES NOW Laclede Gas Company (hereinafter "Laclede" or "Company") and, pursuant to the Commission's January 28, 2010 procedural order in this case, submits its Response to Staff Recommendations. In support thereof, Laclede states as follows:

I. Introduction

On December 31, 2009, the Staff of the Missouri Public Service Commission (hereinafter the "Staff") submitted its Memorandum and Recommendation ("Memorandum") in Case No. GR-2008-0387 for the Company's 2007-2008 Actual Cost Adjustment ("ACA") period. In its filing, the Staff makes a number of recommendations, together with some analysis and comment. This Response addresses only those items expressly recommended by the Staff and certain comments related thereto. It should be noted that Laclede does not necessarily agree with, or acquiesce in, other comments in the Memorandum not specifically addressed in this Response.

II. Response to Staff's Recommendations on Reliability Analysis and Gas Supply Planning.

A. Upstream Pipeline Capacity Analysis

1. CEGT Capacity for Peak Day

Staff asserts that Laclede has less capacity than it thinks, because it is double counting capacity that is actually primary and secondary; that is, it is a case of either/or, and not both. In response Laclede states that Staff is mistaken. Whereas Staff believes that Laclede had **____** during the ACA Period, Laclede in fact had **____** So Laclede was not double counting capacity; it in fact had all the primary capacity listed in its analysis. Staff can confirm this information by reference to Laclede's Transportation Summary, a document routinely provided to Staff during the course of its audit.

Laclede believes that these types of errors can be cleared up prior to the Staff issuing its Recommendation. In the past the Company has suggested to Staff, to no avail, that Staff provide a copy of its recommendation to Laclede well in advance of the Staff's filing with the Commission so that Laclede could have a chance to review it and identify errors that can be rectified before filing. This process would enable the Commission to review a recommendation from Staff that contains more factually accurate information. Laclede renews this request for Staff's consideration.

2. Reserve Margin

Staff recommends the Company provide more justification of its reserve margin on upstream transportation. Staff appears to seek more of a statistical analysis to justify a reserve margin, but doesn't indicate a bias toward either increasing or decreasing the margin. In response, Laclede refers the Staff to the Company's 2007-08 Reliability Report, wherein Laclede has already performed a statistical analysis that would support a reserve margin in the vicinity of **________** (approximately **________** more than assumed in the past) which the Company would be prepared to use in any similar future justification of upstream capacity reserve margin.

B. Interruptible Customers Using Gas during Periods of Interruption

At Staff's request, Laclede filed proposed tariffs that adjusted the current charge of $2.00 per therm to the higher of $2.00 per therm or the daily NYMEX price plus commodity charges plus PGA charges. The proposed tariff has been filed in Laclede's rate case (GR-2010-0171) and will be administered therein.

C. Laclede's Gas Supply

1. Update Justification for Supply Plans for Cost and Volumes

Staff again recommends this year that Laclede routinely update its justification for its gas supply planning by showing how baseload, combo and swing supplies are structured to account for cost (e.g. reservation charges) while assuring that volumes are adequate to meet MRT storage tolerances, and warm and cold winter requirements.

As Staff recited on page 7 of its Recommendation, Staff had made a similar suggestion in the prior ACA case, to which Laclede responded as follows:

> Laclede does not believe it would be constructive to either update this study or try to pigeonhole in advance the relative amounts of baseload, combination and swing gas. Laclede cannot approach the RFP process with a preconceived intention of buying a certain amount of combination versus swing volumes. Instead, Laclede evaluates the state of the market each year by gauging the proposals made in the RFP process and applying its judgment to pursue the most cost effective combination of these products. The result of this approach is demonstrated in Staff's observation on page 9 of the Memorandum that contracted volumes of baseload, combination and swing gas diverged from Laclede's study. Hence, performing further baseload/combination/swing studies is not a useful exercise.

Staff asserts that Laclede's practice of entering into supply agreements for baseload, combo and swing supplies based on its judgment to pursue the most cost effective combination of these products does not explain the prudency of those costs or volumes. Laclede respectfully disagrees. The Company understands the auditor's desire to have something more mechanical to review. However, Laclede's supply decisions are based on the relative advantages the Company discerns from the various RFP responses it receives. There are too many variables to develop a practical formula in advance for acquiring these supplies. Rather, Laclede uses the RFP responses to enhance its understanding of current market conditions before responding. In essence, the formula sought by Staff is in the *approach* Laclede takes to the process; that is, issuing RFPs (as previously recommended by Staff) and then evaluating the responses with a goal of obtaining supplies that are both adequate and cost effective. Because the approach taken by Laclede is prudent (as are other approaches), unless the Company's execution is so egregiously poor as to be unreasonable, Staff has done its job and that should end the inquiry. Having said all this, Laclede is not opposed to developing a study if it believes doing so would be reasonably useful.

2. Target Dates for Physical Supply Volumes

Similar to deciding on the combination of supplies, Laclede has always approached the timing of acquisition of supply volumes on a flexible basis. Again, based on its reasonable judgment, Laclede may nail down gas contracts earlier in some years and later in others. Consistent with its view as auditors, Staff seeks to impose more structure on the process by recommending that Laclede designate target dates for acquiring supply.

Staff has raised this issue in the past, but this year, Staff added language to its Recommendation indicating that it is not looking for rigid targets, but that it believes some guidelines should be in place to assure reliability. In recognition of Staff's clarification and acknowledgment of the propriety of flexibility in this area, Laclede has reconsidered its position and will explore the feasibility of setting guidelines.

3. Gas Purchases for On-System and GSC Schedule Documentation

On page 9 of its Recommendation, Staff indicated some immaterial differences in Laclede's assignment of gas between system customers versus off-system sales. The Company has not previously been made aware of these alleged immaterial differences, but is willing to review Staff's data on this subject and address the matter. Laclede also agrees to revise its GSC or provide a separate schedule to aid Staff in matching contract identification numbers to the corresponding contracts.

III. Affiliate Transactions and Fair Market Value

A. Assessing Fair Market Value for Affiliated Transaction

Laclede has paraphrased, and will individually address below, three concepts expressed by Staff on page 10 of its Recommendation.

1. The nature and design of compensation and bonuses can have a bearing on LER's and LGC's common transactions.

Laclede generally agrees with this concept. Laclede Gas Company employees responsible for gas purchasing and sale transactions should not have any incentive inconsistent with their duty of maximizing off-system sale margins and minimizing gas costs, especially in transactions involving LER. The Staff has asked for and received bonus information on these employees, which information was also provided to the Commission during the two oral arguments held last year in the 2004-05 and 2005-06 ACA cases. This bonus information, which was also provided to Staff for the 2006-07 ACA case, conclusively demonstrated that Company employees are rewarded appropriately and that no improper incentive exists.

2. One way of assessing FMV is to look at the elements of the underlying supply used to fulfill LER's obligation to provide firm service.

Laclede agrees with Staff to the extent that the pricing standard in an affiliate transaction should revolve around fair market value (FMV), as dictated by the Affiliate Transaction Rule (the "Rule"). Having followed the Rule this far, however, Staff then swerves away from the common, intended meaning of FMV, and deliberately invents a fictitious definition of FMV to suit its wishes. As a result, Laclede strongly disagrees with the Staff's method of determining FMV.

This single concept embodies the heart of the ongoing dispute between Laclede and the Staff. First, it could not be clearer to Laclede that the pricing standards of the Affiliate Transaction Rule (the "Rule") must apply to the pricing of affiliate transactions. Why else would the Rule exist? For purchases of natural gas by Laclede from LER, the effective standard is the lower of Laclede's cost to acquire that gas or FMV. Take for example a situation in which Laclede buys gas from LER at point X on day Y. Since Laclede doesn't manufacture gas for itself, its cost would be the price it would pay a different, non-affiliated supplier for gas at point X on day Y. This amount would also be the FMV of that gas purchase, that is, the transaction price at which two unaffiliated, arms-length parties would agree to exchange gas at point X on day Y.

This pricing approach fulfills the stated goal of the Commission to make the utility indifferent to doing business with the affiliate or with a non-affiliate. ***Re Great Plains Energy, Inc. et al.,*** Case No. EM-2007-0374, 266 P.U.R.4th 1, 71 (Mo. PSC July 1, 2008). It protects the captive ratepayer from being charged a price above market. The logic behind the Affiliate Transaction Rule is simple and effective.

The Rule regulates affiliate transactions, but it also permits them. It does not prohibit these transactions. For this reason, Staff seeks to manipulate the Rule, because Staff does not like affiliate transactions. Since at least back to 1998, Staff has tried to discourage and prevent affiliate transactions. Why? Apparently, Staff does not believe that the Commission's Rule actually protects ratepayers. Staff believes that, somehow, paying a market price is acceptable in an unaffiliated transaction, but that same price is unacceptable in an affiliate transaction.

Therefore, Staff makes the incredible statement set forth above that it can assess the FMV of an affiliate transaction by looking at the seller's cost to purchase the goods sold. In other words, Staff believes that what LER paid for gas from its supplier at point W can determine what the FMV of that gas is at point X. However, in the interstate natural gas market as it is structured today, knowing the cost of goods sold at point W is not a way to assess the fair market value at point X. Rather, knowing the price of other comparable unaffiliated transactions at point X is the way to assess the fair market value at point X. Staff's view is akin to stating that the FMV of a house can be derived from the builder's cost to buy the lumber, rather than from assessing the sales prices of comparable homes.

Of course, by seeking LER's cost data in Laclede's other ACA cases, Staff is merely trying to do the same thing that it did in several other cases: force affiliates to sell at cost to utilities regulated by the Commission. If successful, this would effectively terminate affiliate transactions since no company stays in business selling at cost. However, at the same time, Staff will have eliminated a significant competitive alternative for Laclede's gas purchases and sales, which may very well raise the price of gas to Laclede's customers by depriving them of lower cost gas as well as some off-system sales revenues. Ironically, the Staff's efforts to eliminate affiliate transactions, supposedly to protect utility customers, are likely to have precisely the opposite effect.

Since the Affiliate Transaction Rule was adopted, Staff has either ignored or misused it, taking one unlawful position after another in Commission cases. In deciding these cases, the Commission has consistently rejected Staff's unlawful positions. The Commission has respected its Rule and relied on FMV as an adequate protection for ratepayers - until late 2009, when three commissioners inexplicably rewarded the Staff's patient defiance of the Rule and decided that the pricing standards of the Affiliate Transaction Rule don't apply to the pricing of affiliate transactions. Instead, under the guise of "prudence," the Commission has authorized the Staff, at least for discovery purposes, to pursue its unlawful, anti-affiliate standards. Laclede hopes that this Commission will be the one that steps forward and not only respects its own Affiliate Transaction Rule, but finally requires the Staff to do the same.

3. The Cost Allocation Manual narrowly defines what constitutes FMV. Paying an index price does not necessarily mean that Laclede paid FMV. LER should not be allowed to obtain interruptible supply and sell it to LGC as firm. In such case, FMV should be the price LER paid to acquire the supply. That is LER's fair market value and that should be LGC's fair market value. Or if LER is in an over-supplied position, LER might sell daily spot gas (presumably at fair market value) to LGC on an upstream pipeline that is convenient to LER, but is not in LGC's interest.

Staff's statements are consistent with its anti-affiliate bent and inconsistent with the pricing standards of the Affiliate Transactions Rule. In responding, Laclede first adopts its response to III.A.2 above. For a point X that is liquid enough to have a number of unaffiliated transactions within a relatively small range of pricing (the index price), what better indicator could there be than that index price itself?

Staff also claims that it needs to stop LER from selling interruptible supply to Laclede as firm. Although it is a common practice for marketers to aggregate multiple interruptible sources of supply to be re-sold as firm gas, apparently it only becomes a problem for Staff if LER does it. If Laclede agrees to buy gas from LER on a firm basis, then LER would be contractually committed to selling firm gas and Laclede would be contractually entitled to receive the gas. Like any marketer, LER's failure to deliver would come with financial consequences, which protects Laclede. There is no basis for Staff to get involved in how LER acquires its gas for sale to its customers. It has nothing to do with the fair market value of the deal, and is simply overreaching by a Staff determined to undermine affiliate transactions. In addition, Laclede would add that in the several years it has done business with LER, it has never had a problem with reliability.

Staff's last comment is a hypothetical situation in which Laclede bails out an oversupplied LER by purchasing gas from LER at an undesirable location for Laclede, albeit at fair market value. This raises two issues. First, the FMV pricing presumed by Staff represents compliance with the Affiliate Transaction Rule. Second, the supplier's status as an affiliated or non-affiliated entity, as well as the supplier's costs, should be completely irrelevant if, in fact, Laclede had purchased gas at an undesirable location. That is a question that can be answered, and answered conclusively, by simply looking at the price that was paid by Laclede at the location, how those prices compared to purchases Laclede made at other locations, and the merits of Laclede's reasoning for purchasing at that location rather than others. Delving into the costs paid by the supplier is completely unnecessary.

By describing hypothetical wrongdoing, it may be Staff's intention to raise the spectre that affiliate transactions are dangerous per se, with a goal of ultimately discouraging affiliate transactions. The Commission should not permit the Staff to employ these kinds of scare tactics. Without some indication of wrongdoing, Staff should not be allowed to go on a fishing expedition through affiliate files, as they are trying to do at present in Laclede's 2004-05 and 2005-06 ACA cases. As an analogy, it is hypothetically possible that Staff employee Mr. Z is embezzling from the Commission. Without any evidence other than a baseless suspicion, would it be reasonable for the Commission to demand that Mr. Z produce his checkbook, his financial records, and the financial records of other family members? If Mr. Z resisted this invasion of his privacy, would the Commission be justified in treating such resistance as confirmation of its groundless suspicion? Laclede anticipates that the Commission would answer both questions in the negative. The same rights should apply to Laclede.

B. Controls to Assure Affiliates are Not Receiving Preferential Treatment

Staff would like to make sure that controls are in place to assure that Laclede is not giving LER preferential treatment, and not transferring sales opportunities from the utility to the affiliate. As discussed above, there are two controls that can best insure proper behavior. First, Laclede's gas supply personnel should be rewarded for their performance on behalf of the utility, so that they have no incentive to act otherwise. Second, such personnel should be aware of and understand the rules for pricing affiliate transactions that were specifically established to prevent preferential treatment from being provided to an affiliate. Both controls are in place today.

IV. Purchasing Decisions that May Impact Customer Costs

A. Off-System Sales Location

Staff recommends that Laclede evaluate secondary delivery points and any associated costs because that flexibility allows Laclede to maximize its off-system profits, reducing gas costs for its customers. In response, Laclede states that the Company does, and will continue to, evaluate secondary delivery points and any associated costs to maximize off-system profits.

B. Supply Pricing for Marketing Companies at Lower Cost City Gates

Staff states that Laclede is now allowing marketing companies to nominate at lower cost city gates, and suggests that this may reduce the amount of cheaper supply available to sales customers. Staff indicates that it will further investigate this issue in the 2008-09 ACA. Laclede responds that, years ago, transportation customers delivered gas at their chosen location. Laclede has accommodated requests to do this again, subject to operational constraints. Absent such operational issues, Laclede questions its own authority to control where customers ship gas in the wholesale market.

V. FERC Reporting – Off-System Sales and Capacity release Transactions

In its 2007 Recommendation for the 2005-06 ACA period, Staff indicated that certain off-system sales and capacity release transactions possibly violated FERC regulations. Although the Company believed it had acted appropriately, Laclede conducted an internal review in 2008 and submitted a self-report to the FERC. After a long and expensive process, the FERC Enforcement Staff recently closed its review of the self-report without taking action against Laclede.

VI. Missouri Pipeline Company Charges

Laclede has placed MPC on notice that, based on the outcome of the pending appeal of the Commission's decision, Laclede may assert a credit due for past purchases.

VII. Hedging

A. Limited or Partial Hedging

Staff is concerned that partial hedges could expose Laclede and its customers to unlimited upside price risk. Staff urges Laclede to "stress test" partial hedges to evaluate the impact at various pricing scenarios. Staff has overstated its point. Laclede and its customers are always exposed to unlimited price risk to the extent of gas purchases that aren't subject to a hedge. A complete hedge tends to be more expensive for customers but gives complete protection according to its terms. A partial hedge tends to be less expensive and correspondingly provides less than complete protection, according to its terms. Together, the complete and partial hedges provide a desired level of protection. Laclede is aware of the impact of its hedges on various price scenarios.

B. Time and Price Driven Hedging

Staff recommends that Laclede examine whether its price driven parameter is reasonable compared to historical prices. Staff recommends the Company's gas supply planning horizon incorporate a longer time horizon for hedging based on some reasonably realistic pricing formula when establishing the price driven parameter. In response, Laclede states that its hedging program is reviewed each Spring, when the Company determines whether to make any changes to the time and price parameters or the planning horizon. In fact, as Staff is aware, in March 2008, the Company **________

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Staff also recommends that Laclede create a report that would allow a "straightforward assessment" comparing the Company's actual hedges purchased to its monthly target. In response, Laclede states that, by providing its internal report on this topic, the Company has provided to Staff the information that the Company has. However, the Company is considering the prospect of revising its report. If and when this project is completed, the Company will share the new version of the report with Staff, and hopefully satisfy Staff's concern on this subject.

C. Hedge Documentation

Staff seeks more explanation from Laclede of the rationale for hedging transactions, such as how and why the Company initiated liquidating hedge positions before expiration, and why synchronizing hedge gains and losses to closely mimic liquidation on NYMEX closing is beneficial. Staff also recommends that Laclede provide greater detail on each financial hedging transaction executed, its rationale supporting its decision at the time of the specific transaction and a narrative of the interplay between the hedging purchase or liquidation, and the Risk Management Strategy.

Laclede has explained to Staff multiple times how and why the Company handles its futures positions so that it obtains the actual final NYMEX settlement price each month. Most recently, during discovery last year in this ACA case, Staff issued a handwritten question seeking another explanation on this matter. Laclede provided a narrative answer along with 7 pages of supporting documentation, meticulously annotated to help guide the reader. Laclede received no indication that Staff was unsatisfied with this explanation until it appeared in the Staff's December 31, 2009 Recommendation. While Laclede will be glad to respond to further questions on this subject, the Commission should be informed that, going back to 2005, Laclede has addressed this topic, and addressed it comprehensively, for the Staff.

Following the Staff's recommendation for the 2006-07 ACA period, Laclede provided Staff hedging explanations in a format that Staff indicated was acceptable. Again, Laclede was under the impression that Staff was satisfied until reading otherwise for the first time in the Staff Recommendation. Laclede will continue to provide this information, along with giving the Staff access to the market-based information available to Laclede, which illustrates for Staff the market conditions at the time of hedging purchases. Laclede does not believe, however, that it is either analytically useful or administratively feasible to provide further detail, including a minute-by-minute view of why each hedge position is initiated.

D. Performance Evaluation of Hedge Program

Staff recommends the Company develop an evaluation of the financial hedging performance after the close of the ACA period. Staff further suggests that Laclede consider using over-the-counter (OTC) instruments to control margin calls. As stated above, Laclede regularly reviews and evaluates its hedging program in deciding whether to make changes that may improve the program. Although up to now Laclede has considered the OTC market to be, among other things, less transparent and more risky than the established futures market, and less suited for LDC's that purchase a relatively low amount of baseload gas, Laclede will take Staff's suggestions into consideration, along with other Company objectives, in the course of the Company's regular re-evaluation of its hedging strategy.

WHEREFORE, for the foregoing reasons, Laclede respectfully requests that the Commission accept this Response.

Respectfully submitted,

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CERTIFICATE OF SERVICE

Gerry Lynch hereby certifies that the foregoing pleading has been duly served upon the General Counsel of the Staff of the Public Service Commission and the Office of the Public Counsel by hand delivery, email, fax, or United States mail, postage prepaid, on this 26th day of February, 2010.

/s/ Gerry Lynch
Gerry Lynch