

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

SURREBUTTAL TESTIMONY

OF

KENNETH J. NEISES

LACLEDE GAS COMPANY

Case No. GO-98-484

FILED
AUG 5 1998
Missouri Public
Service Commission

St. Louis, Missouri

August, 1998

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's)
Tariff Sheets designed to extend for an)
additional year the experimental price)
stabilization fund.)

Case No. GO-98-484

A F F I D A V I T

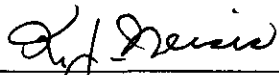
STATE OF MISSOURI)
) SS.
CITY OF ST. LOUIS)

Kenneth J. Neises, of lawful age, being first duly sworn, deposes and states:


1. My name is Kenneth J. Neises. My business address is 720 Olive Street, St. Louis, Missouri 63101; and I am Senior Vice President-Energy & Administrative Services of Laclede Gas Company.

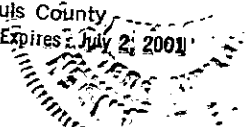
2. Attached hereto and made a part hereof for all purposes is my surrebuttal testimony, consisting of pages 1 to 19, inclusive.

3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.


Kenneth J. Neises

Subscribed and sworn to before me this 5th day of August, 1998.



JOYCE L. JANSEN
Notary Public - Notary Seal
STATE OF MISSOURI
St. Louis County
My Commission Expires July 2, 2001


SURREBUTTAL TESTIMONY OF KENNETH J. NEISES

1 Q. What is your name and address?

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

4 Q. Are you the same Kenneth J. Neises who previously
5 submitted direct testimony in this proceeding?

6 A. Yes, I am.

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PURPOSE OF TESTIMONY

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10 Q. What is the purpose of your surrebuttal testimony?

11 A. The purpose of my testimony is to respond to the concerns
12 raised in the rebuttal testimony of Staff witnesses David
13 Sommerer and James A. Busch regarding the structure,
14 effect and overall merits of the Incentive Price
15 Stabilization Program (Incentive PSP) proposed by the
16 Company in this proceeding. More specifically, I will
17 explain why I believe the Staff has greatly exaggerated
18 the measured risks associated with this program, while
19 substantially understating its potential benefits for
20 Laclede Gas Company's (Laclede or Company) customers. I
21 will also attempt to identify those concerns expressed by
22 the Staff which I believe are simply irrelevant to a fair
23 evaluation of the appropriateness of the Company's
24 proposal. Finally, in an effort to provide an effective
25 alternative to our original proposal should the Commission

1 share Staff's concerns, I will present several
2 modifications to the Company's proposed program designed
3 to address those concerns. These modifications were
4 previously developed and presented to Staff prior to the
5 filing of this testimony during discussions with the Staff
6 which were held in an effort to reach an agreement on a
7 hedging mechanism that would be acceptable to all
8 parties. While Laclede does not believe that these
9 modifications are truly necessary, they nevertheless
10 provide a simple, straightforward solution to Staff's
11 stated concerns.

12 Q. Are the concerns raised in Staff's rebuttal testimony
13 being addressed by any other Company witnesses?

14 A. Yes. John Snell of Risk Management Incorporated (RMI)
15 has submitted testimony explaining why Staff's notions of
16 a proper hedging program, and its criticisms of the
17 Company's proposal, are fundamentally at odds with the
18 financial techniques actually used by most firms to
19 measure and manage price risk. Given Mr. Snell's
20 extensive, hands-on experience in the procurement and use
21 of financial instruments, particularly natural gas
22 financial instruments, I urge the Commission to give
23 serious consideration to his views regarding the
24 appropriateness of the Company's proposed program. Some
25 of the more significant flaws in Staff's analysis are also
26 addressed in the surrebuttal testimony of Laclede witness
27 Scott Jaskowiak. Mr. Jaskowiak also provides additional

1 details on the program modifications which the Company is
2 willing to make in the event the Commission shares any of
3 Staff's concerns.
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5 RESPONSE TO STAFF'S CONCERNS
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7 Q. Do you have any general observations regarding the
8 criticisms which Staff has leveled against the Company's
9 proposed Incentive PSP?

10 A. What struck me the most about Staff's testimony was its
11 failure to provide a balanced assessment of the Company's
12 proposal and its potential impact on customers. In over
13 thirty years of practice before various regulatory bodies,
14 I have seen many proposals aimed at improving the way
15 utilities perform their public service obligations. I
16 have yet to see a perfect one, and I would be the last to
17 suggest that the Company's proposal in this proceeding
18 could not benefit from a constructive critique.
19 Unfortunately, Staff has failed to provide any guidance on
20 what it believes would be a mutually beneficial,
21 incentive-based hedging program. Staff apparently wants
22 the Commission to believe that Staff's **"_____" **
23 approach to hedging is the only approach worth considering.
24 Q. You previously indicated that Staff has interjected issues
25 that are irrelevant to a consideration of the Company's
26 proposal. Please explain.

1 A. Staff witness Sommerer devotes much of his testimony to
2 explaining why he believes the Company needs to
3 "diversify" the pricing of its physical gas supply
4 portfolio, and apparently rely less on indexed-based
5 contracts. In support of this proposition, Mr. Sommerer
6 even attaches an Statement of Policy from the New York
7 Public Service Commission which addresses this subject.
8 If the Company were to respond to this extraneous issue,
9 it would point out in some detail how anachronistic and
10 redundant the New York PSC's limited diversification
11 suggestions are in light of the strides already made by
12 this Commission and Laclede to use financial instruments
13 and other mechanisms to reduce price risk. The clear
14 purpose of this proceeding, however, is to discuss the
15 merits of the Company's hedging proposal -- a purpose that
16 is ill-served by Staff's obvious effort to change the
17 subject.

18 Q. Aside from introducing extraneous issues, has Staff
19 presented a balanced assessment of the Company's proposal?

20 A. No. I think it is fair to say that Staff has gone to
21 considerable lengths to paint the bleakest possible
22 picture of the intent and potential impact of each feature
23 of the proposed Incentive PSP. No matter how
24 inconsequential or unlikely a potential concern may be,
25 Staff takes great pains to convert it into an obstacle of
26 seemingly daunting proportions. At the same time, Staff
27 makes absolutely no effort to suggest what steps could be

1 taken, or what modifications could be made in the program,
2 to resolve its concerns. The end result is simply a
3 non-productive hodgepodge of obvious exaggerations
4 regarding supposed flaws in the program that are neither
5 internally consistent nor reflective of the actual
6 operation and intent of the program.

7 Q. One of the Staff's major criticisms is that the Company's
8 proposal may give Laclede an incentive to **_____

9 _____

10 _____

11 _____**. Why is this criticism invalid?

12 A. If it does anything, I think this criticism simply
13 demonstrates Staff's fundamental inability to make up its
14 collective mind on what kind of hedging program it really
15 wants.

16 Q. Please explain.

17 A. On the one hand, Staff witness Busch indicates, with
18 apparent favor, that the objective of the current PSP "is
19 to provide price protection to Laclede's ratepayers
20 against severe upward price spikes in natural gas during
21 the winter heating season..." (Busch Rebuttal, p.3;
22 emphasis supplied). If that is the case, then one of the
23 most economical and conservative ways to achieve this
24 objective is to **_____

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1 **_. Despite this rather obvious fact, however, both
2 Staff witness Busch and Staff witness Sommerer repeatedly
3 criticize Laclede's proposal on the grounds that it gives
4 the Company too great of an incentive to pursue this very
5 type of purchasing strategy, and too little of an
6 incentive to spend more ratepayer money on purchasing

7 ** _____

8 _____**.

9 (Busch Rebuttal, pp. 21-25; Sommerer Rebuttal, pp. 5-6)

10 Under this alternative view, the Staff appears to be
11 suggesting that the primary purpose of the hedging program
12 isn't to ** _____

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18 _____**.

19 Q. What is the Company's position on which strategy is
20 appropriate?

21 A. Generally, the Company agrees with the overall objective
22 of the existing program to provide for ** _____

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4 _____ ** . Given
5 its failure to even clarify which of these objectives it
6 believes is most important, the Staff is hardly in a
7 position to question the manner in which that balance has
8 been struck by the Company. This is particularly true
9 given Staff's corresponding failure to offer any
10 alternative to the Company's proposal.
11 Q. Do you agree with Staff that there is, in fact, an
12 inappropriate incentive under the Company's program that
13 would bias it towards ** _____
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15 _____ **?
16 A. ** _____
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Q. What about Staff's claim that the Company's proposed program would expose ratepayers to additional risk from rising gas prices?

A. Here again, Staff relies on exaggeration and inconsistent reasoning, rather than solid analysis. For example, both Mr. Sommerer and Mr. Busch claim that the program would result in additional risk for the ratepayer because any

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Q. Are there other reasons why you believe Staff's concerns regarding the program's risk are misplaced or exaggerated?

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A. Yes. Although Staff repeatedly warns of the risk of unlimited increases in gas costs, even its own proposal for hedging, as reflected in the existing program, does not require that more **

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3 _____**. I think Staff's concerns over unlimited
4 increases in the cost of gas also have to be taken with a
5 grain of salt in light of Mr. Busch's comments, in
6 criticizing another aspect of the Company's proposal, that
7 since 1990, the closing contract price for natural gas on
8 the NYMEX market has never been above \$4.00 per MMBtu at
9 expiration (Busch rebuttal, p. 25).

10 Q. But isn't it possible, as Staff suggests, that the Company
11 might leave a substantial portion of its gas supply
12 volumes unprotected because of **trading activities**
13 that, in hindsight, turn out to have been ill-advised?

14 A. The Company has no intention of **_____

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18 _____**. If it does not do so, the Company must assume
19 financial responsibility for the difference between the
20 CPL and the contract settlement price. By undertaking
21 this risk, I believe the Company has provided the
22 Commission with the most powerful type of assurance
23 possible that the mandated volumes will be protected.
24 Laclede management simply has no intention of exposing
25 either its shareholders or its customers to the
26 potentially significant financial consequences which could
27 arise in the event there was a material failure by the

1 Company to obtain the mandated level of price protection.
2 While it is true that the Company would not be required to
3 compensate the customer for any "losses" that might occur
4 because it did not buy **

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9 **.

10 Q. **

11 _____
12 _____
13 **?

14 A. No. The current program merely authorizes Laclede to
15 procure financial instruments. Of course, if the Company
16 decided not to purchase any price protection, it would be
17 subject to a prudence review. But prudence reviews do not
18 necessarily result in an adjustment and do not provide
19 immediate compensation. Laclede's customers would have to
20 wait for some future prudence disallowance which, as Staff
21 witness Sommerer states at page 4 of his rebuttal
22 testimony, "are typically delayed many months after the
23 harm has already been done and are always difficult to
24 prove."

25 Q. Do you think that the Staff seriously believes that
26 Laclede would undertake unreasonable risks?

1 A. No. Staff repeatedly asserts in its testimony that
2 Laclede is far more likely under the proposed program to
3 take the "safe" route of **

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9 (Busch Rebuttal, pp. 21-25; Sommerer Rebuttal pp. 5-6)
10 While I do not necessarily agree with much of Staff's
11 analysis on this point, the fact remains that Staff can't
12 have it both ways. If Staff truly believes the Company is
13 risk averse enough to always opt for the "bird in the
14 hand", as asserted by Mr. Sommerer at page 6 of his
15 rebuttal testimony, Staff can't simultaneously believe
16 that Laclede is reckless enough to risk huge losses
17 because of a material failure to obtain the mandated
18 levels of price protection.

19 Q. The Staff appears to object to the ratepayers sharing 50%
20 of the "losses" resulting from the Company acquiring

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23 A. **
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12 _____**. Of course, if the Company believes
13 market conditions have changed radically enough to warrant
14 such actions, it does not believe it should continue to
15 have an opportunity to profit under the program.
16 Accordingly, if Laclede invokes this provision during the
17 first 90 days, it agrees that the incentive aspects of the
18 program should terminate for that year.

19 Q. What is your reaction to Mr. Busch's suggestion at pages
20 8-9 of his rebuttal testimony that the Company implement a
21 ** _____

22 _____**?

23 A. ** _____

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26 _____**. First, it is unreasonable to expect that
27 management would devote the same level of resources and

1 attention to an exercise which has no financial
2 consequences for either the Company or its shareholders.
3 The Company's resources are not unlimited and they must be
4 focused on activities that actually make a difference in
5 terms of the cost and reliability of the services we
6 provide. Accordingly, the results of such an effort would
7 not be reflective of those likely to be experienced under
8 a real program. Second, it has to be recognized that
9 market conditions in the natural gas industry, including
10 trends in the cost of financial instruments, can vary
11 significantly from year to year, based on changes in
12 weather and other factors. Under such circumstances,
13 there is no reason to believe that the results obtained in
14 one year would be reflective of the results that are
15 likely to be experienced in the next year. Indeed, it is
16 for this reason, among others, that the Company believe it
17 is imperative to have a three year program, notwith-
18 standing Staff's concerns.

19
20 POSSIBLE MODIFICATIONS TO INCENTIVE PSP

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22 Q. Please explain why the Company has developed several
23 additional modifications to its proposed Incentive PSP.
24 A. In an effort to develop an effective Incentive PSP that
25 would be acceptable to all parties, the Company prepared
26 and presented to Staff several modifications to its
27 proposal that were designed to address Staff's stated

1 concerns. Although Laclede is not convinced that such
2 modifications are truly necessary, it nevertheless remains
3 willing to make them in the event the Commission shares
4 any of the concerns expressed in Staff's rebuttal
5 testimony.

6 Q. Please describe these modifications.

7 A. The modifications which the Company is willing to make to
8 its proposed Incentive PSP are discussed in somewhat
9 greater detail in the surrebuttal testimony of Scott
10 Jaskowiak, where they are presented as Alternative B. The
11 modifications are relatively simple, however, and can be
12 summarized as follows. First, the Company is willing to
13 modify its proposed 50% sharing of financial consequences
14 associated with failing to obtain the required level of
15 price protection. In its place, the Company would agree
16 to absorb 100% of the financial consequences arising from
17 such a failure, subject to the 90 day window period which
18 I previously discussed. In exchange for undertaking this
19 additional risk, and in an effort to address Staff's
20 concerns regarding the program's supposed bias against

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Q. How do these additional modifications address Staff's concerns?

A. 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. While I believe this additional incentive is unnecessary, it is certainly responsive to Staff's stated desire to have a **_____** on the customer's exposure to price risk. Indeed, by agreeing to absorb amounts in excess of the CPL, the Company's proposal provides far more protection from such risk than does the existing program.

Q. **_____

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A. **_____

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_____. **. Of course,
as I stated previously, such a change is also warranted by
the Company's assumption of greater risk under the
program, as described above.

Q. Please summarize your testimony.

A. The Incentive PSP has been designed by the Company to
impose only very limited risk on Laclede's ratepayers.
Because Laclede will only ** _____

_____. **.

Given the proposed program's limited risks to

1 ratepayers and substantial potential benefits, it is
2 difficult to understand why Staff has failed to suggest
3 modifications to accommodate its concerns. The Commission
4 should not permit such a failure to prevent the
5 implementation of an innovative program that offers
6 substantially more benefits to Laclede and its customers
7 than those afforded by continuing the inflexible, **_____
8 _____** to hedging that Staff advocates.

9 For all of these reasons, I would urge the Commission to
10 approve the Company's initial proposal or, if it is so
11 inclined, the revised proposal which has been developed by
12 the Company to address Staff's stated concerns.

13 Q. Does this conclude your surrebuttal testimony.

14 A. Yes, it does.