BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's	)	
Purchase Gas Adjustment for 2005-2006	)	Case No. GR-2006-0288

STAFF'S RECOMMENDATION

COMES NOW the Staff of the Missouri Public Service Commission ("Staff") and files its Memorandum and recommendations in this case. The Staff requests that the Commission adopt the recommendations offered in Staff's Memorandum, establish the ACA balances set forth in its recommendations, and open an investigatory docket into the affiliate relationship between LER and LCG.

The Staff requests that the Commission order Laclede to respond within 30 days.

Respectfully submitted**,**

/s/ Steven C. Reed
Steven C. Reed
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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 31st day of December, 2007.

/s/ Steven C. Reed
Steven C. Reed

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MEMORANDUM

TO: Missouri Public Service Commission Official Case File,
Case No. GR-2006-0288, Laclede Gas Company

FROM: David Sommerer, Manager - Procurement Analysis Department
Anne Allee, Regulatory Auditor - Procurement Analysis Department
Lesa Jenkins, P.E., Regulatory Engineer - Procurement Analysis Department
Kwang Choe, Ph.D., Regulatory Economist - Procurement Analysis Department

/s/ David M. Sommerer 12/28/07	/s/ Steven C. Reed 12/28/07
Project Coordinator / Date	General Counsel's Office / Date

SUBJECT: Staff's Recommendation in Case No. GR-2006-0288, Laclede Gas Company's 2005-2006 Actual Cost Adjustment Filing

DATE: December 28, 2007

The Procurement Analysis Department (Staff) has reviewed Laclede Gas Company's (Company or Laclede or LCG) 2005-2006 Actual Cost Adjustment (ACA) filing. This filing was made on October 31, 2006, and is docketed as Case No. GR-2006-0288. The filing contains the Company's calculations of the ACA and Refund balances. The Staff's review included an analysis of billed revenues and actual gas costs for the period October 1, 2005 through September 30, 2006.

Laclede Gas Company serves approximately 631,000 residential, commercial and industrial customers in the St. Louis metropolitan area and the surrounding southeastern counties.

Staff conducted a reliability analysis for Laclede, including a review of estimated peak day requirements and the capacity levels to meet those requirements, peak day reserve margin and the rationale for this reserve margin, and a review of normal and cold weather requirements. The Staff also reviewed Laclede's gas purchasing practices to determine the prudence of the Company's purchasing and operating decisions. References to LGC refer to Laclede Gas Company while references to LER refer to the marketing affiliate Laclede Energy Resources.

RELIABILITY ANALYSIS AND GAS SUPPLY PLANNING

The Company is responsible for conducting reasonable long-range supply planning and the decisions resulting from that planning. One purpose of the ACA process is to examine the reliability of the Local Distribution Company's (LDC's) gas supply, transportation, and storage capabilities. For this analysis, Staff reviews the LDC's plans and decisions regarding estimated peak day requirements and the Company's capacity levels to meet those requirements, peak day reserve margin and the rationale for this reserve margin, and natural gas supply plans for various weather conditions.

Staff has the following comments and concerns regarding the Company's reliability and gas supply information:

1. <u>Pipeline Capacity Planning</u>

   a. Downstream Pipeline Capacity – the amount of space reserved on pipeline(s) to deliver natural gas into the LDC system

   The volumes from the downstream pipelines, ** ____________________ ** However, Laclede only provides estimates of peak day requirements for early and late winter for its entire system, not for each of the downstream pipelines. ** ____________________ **

   Laclede responses regarding the concerns for serving different parts of its system are as follows:

   (1) ** ____________________ ** (2004/2005 ACA, GR-2005-0203, Data Request No. 108-HC).

   (2) Laclede states, "Although the market requirements of Laclede's service territory have not increased on an aggregate basis in recent years, the pattern of consumption has changed dramatically. Demand in Laclede's western region has increased significantly, while demand in the eastern region near the MRT citygates has declined and the western region will continue to be Laclede's largest growth area based on information available at the current time." Laclede also states, it "requires additional deliveries in the western portion of its system, which at present can only be met by MoGas, because Laclede is fully utilizing the leg of the SSC that brings gas from Kansas City to St. Louis." (MoGas Pipeline FERC docket number CP07-450-000, *Motion for Leave to Answer and Answer of Laclede Gas Company to Protests* filed on November 26, 2007, dated December 11, 2007).

(3) Laclede states it has been concerned for some time over the impact on its citygate deliveries by MoGas' predecessors resulting from fluctuations in Panhandle Eastern Pipe Line Company's (PEPL) system pressures. It provides a list of eleven occurrences where MoGas was unable to deliver Laclede's contracted quantities "due primarily to the impact of weather on MoGas' predecessors' deliverability capability, due in turn to pressure reductions on PEPL", and six of these occurrences occurred prior to the 2005/2006 ACA. (MoGas Pipeline FERC docket number CP07-450-000, *Motion for Leave to Answer and Answer of Laclede Gas Company to Protests* filed on November 26, 2007, dated December 11, 2007). However, Laclede also states that there were no actual or potential low pressure problems for this ACA period. (Data Request No. 48)

Staff recommends that Laclede's Reliability Reports address how the pipeline capacity reliably meets the requirements of Laclede's system, including an explanation of how MoGas', or other pipeline capacity, may be earmarked to serve specific areas of Laclede's system, such as the western end of Laclede's service area, to assure that the available capacity is sufficient for a peak cold day.

b. Downstream Pipeline Capacity – Laclede's Exclusion of Contract from its 2005/2006 Reliability Report

Laclede does not include one of the SSC transportation contracts in its Reliability Report for capacity of 1,000 MMBtu/day beginning December 1, 2005. Laclede should assure that its Reliability Reports are updated to accurately reflect the available capacity for the months covered by the Reliability Report.

c. Upstream Pipeline Capacity (Pipeline delivering natural gas to another pipeline at an interconnection point where the second pipeline is closer to the LDC)

To support the quantity of upstream pipeline capacity needed, Laclede evaluated usage for a record cold day in March (Data Request No. 46) and also referred to its 2005/2006 Reliability Report. Because of constraints on the MRT's Unionville storage withdrawal and its on-system resources (Lange UGS and Propane), Laclede is concerned with late winter cold weather. Laclede's evaluation for the 2005/2006 ACA of a record cold day in March is consistent with this concern.

Staff does not agree with all of the assumptions in Laclede's analysis of upstream transportation capacity. However, Staff's review supports that the upstream capacity contracted by Laclede would be required for a cold winter. The analysis, however, does not support why Laclede chooses to split the capacity in the manner that it does between the various pipelines. The lack of information raises the question of how Laclede evaluated the cost of sourcing the supply on each pipeline. The lack of information makes evaluation of the Company's prudence much more difficult. Staff will pursue this in more detail in future ACA reviews.

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Staff continues to have concerns that ** __________________________________
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______________________ ** for the months of November through April. Staff will request this information through the data request process in the ACA review.

3. <u>Interruptible Services - these customers may be curtailed in times of peak demand or under certain circumstances</u>

It is important that interruptible customers curtail gas usage during times of peak demand so Laclede is able to serve its firm customers (primarily residential heating customers). The PGA charges for natural gas used during interruption for interruptible customers in effect during this ACA period were only $2.00 per therm ($20.00 per dekatherm or per MMBtu). The rate is not tied to a penalty above a daily rate that could be obtained in the daily market. During periods of interruptions, there is a potential that prices in the daily market may be higher than $2.00 per therm. Thus, interruptible customers could be using and paying for natural gas from Laclede during periods of interruption at lower cost than could be obtained in the daily market. To encourage interruptible customers to curtail usage in times of peak demand, Staff recommends that Laclede revise its tariff to tie the charge for natural gas used during curtailments to the higher of $20 or the daily NYMEX price plus an adder. This same concern and recommendation was expressed in the 2004/2005 ACA, GR-2005-0203.

4. Targets for Physical Supply

** ** The dates of the hedging is evaluated in Staff's hedging review.

The Company's reliability report does not contain targets for actually acquiring physical supply. ** ** This issue was also a concern in the 2004/2005 ACA, Case No. GR-2005-0203, and the 2003/2004 ACA, Case No. GR-2004-0273.

5. Laclede Actual Supply Compared to RFP and Study

a. ** ** Laclede's RFP (Data Request No. 86), defines such contracts as swing contracts, not combination contracts.

b. Laclede conducted a study of baseload, combination, and swing volumes (Data Request No. 106 and 106.1 – 106.5 responses in the 2003/2004 ACA, GR-2004-0273).

Laclede has **

** Baseload contracts have little or no fixed costs.

** **

Laclede does not evaluate how the RFP structure should fit with its study of baseload, combination and swing supply volumes. Staff recommended in the 2004/2005 ACA, Case No. GR-2005-0203, that Laclede update the baseload/combination/swing study and Staff made recommendations to be considered for the update. Staff continues to recommend that the baseload/combination/swing study be updated on a routine basis and that Laclede evaluate how the RFP structure should fit with this study.

Laclede did not follow its study when setting the total supply volumes for October, November, February, March and April. However, the lower totals for February through April may be due to waiting to place baseload spot contracts until weather was known for earlier months and the winter was warmer than normal in November and January.

2005/2006 Contracted Volumes as % of Baseload/Combo/Swing Study				
	Baseload	Combo	Swing	Total
Oct	**			**
Nov	**			**
Dec	**			**
Jan	**			**
Feb	**			**
Mar	**			**
Apr	**			**

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Total Reservation Charges (Contract/Agreements, DR38 & 38.2)	Oct 05 - Sept 06	% of Total Charges	
Baseload	** ______	____ **	
Combo	** ______	____ **	
Swing	** ______	____ **	
			** ______ ______ **
Swing - Daily	** ______	____	____ **
Swing - FOM	** ______	____	____ **
Swing- Lower of Daily or FOM	** ______	____	____ **

Average Reservation Charges, $/MMBtu (Contract/Agreements, DR38 & 38.2)	Oct 05 - Sept 06
Baseload	** ______ **
Combo	** ______ **
Swing	** ______ **
Swing - Daily	** ______ **
Swing - FOM	** ______ **
Swing- Lower of Daily or FOM	** ______ **

6. Cost/Benefit Analysis for Producer Demand Charges

Staff recommended in the 2004/2005 ACA, Case No. GR-2005-0203, and the 2003/2004 ACA, Case No. GR-2004-0273, that Laclede conduct an annual cost/benefit analysis to evaluate whether the cost of obtaining ** ______ ** for Combination and Swing supply exceeds the benefits. Staff continues to recommend that Laclede conduct such a study. This study should include at least the following features:

- ** ______________________________ **
- ** ______________________________ **
- It should isolate and separately identify "off-system sales" so that costs and benefits related to on-system customers can be separately identified.

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The Company should also, maintain, and make available for review, in electronically readable format, all workpapers that support the study. These workpapers should maintain full functionality with readable cell formulas, macros, or other program add-ins that were used in the spreadsheet calculations. Finally, the study should be a before-the-fact study that is completed in time to help the Company assess the cost/benefits of ** ______________ **

** ______________ **

** ______________ **

OTHER AFFILIATE TRANSACTION CONCERNS REGARDING LER AND LGC

Given common management over LER and LGC, extensive affiliate transactions between LER and LGC, and the corresponding dramatic rise in the Net Income of LER, the Staff has concerns whether LER and LGC operations are conducted “separate and apart” and in compliance with the Commission’s affiliate transactions rules for natural gas companies. ** ______________

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In any off-system sales transaction, a question needs to be asked about whether LGC has derived the fair market value of the gas and/or transportation at the time, location, and given the nature of the transaction. The nature of the deal may vary depending upon unique market conditions at the time of sale. Is there a capacity constraint upstream, or downstream of the point of sale? Is the ultimate downstream market driving the value of the transaction?

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The FERC prohibition is found in Order 636, in which FERC described a buy/sell arrangement as, "An LDC will purchase gas in the production area from an end user or a merchant designated by an end user. The LDC will ship the gas on its own firm capacity and sell the gas to the end user at the retail delivery point." Order 636 goes on to state, "After a pipeline's capacity releasing mechanism goes into effect, no new buy/sell deals may be executed after that date and thereafter all allocations of interstate pipeline capacity must be done under the capacity releasing mechanism." Order 636 further explains buy/sell transactions should no longer be necessary because LDC's will have the ability to release its firm capacity. FERC designed the capacity release mechanism for the purpose of providing all potential shippers equal opportunity to bid on pipeline capacity. Buy/sell transactions avoid the FERC's capacity release mechanism. FERC also required prearranged capacity release deals to be posted to a pipeline's electronic bulletin board (EBB), "in order to keep all deals public so that discrimination can be detected and prevented." The transactions that concern the Staff were not made public by posting to the pipeline's EBB as a prearranged release of its capacity.

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INVESTIGATORY DOCKET

Given the expansive nature of the affiliate relationship between LER and LGC, the ever increasing scope and materiality of affiliate transactions, the common management of the gas supply functions, the dramatic rise in LER's net income that could in part be due to the affiliate relationship, the Staff recommends an investigation be opened to review the affiliate practices, and transactions between LER and LGC. This investigation should include an evaluation of the compliance with the Commission's affiliate transaction rule, any further adjustment necessary to the 2005-2006 sharing account for off-system sales and capacity release, and additional review of how fair market value is determined and shared between LGC and LER. This separate investigation is also necessary due to the likelihood that LER documents will need to be subpoenaed and examined. ** ____

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In addition, the table supplied as Schedule 4, in David M. Sommerer's Direct Testimony, filed in Laclede Gas Company Case No. GR-2007-0208, illustrates the increasing income figures of LER though the 2005-2006 timeframe.

VOLUME RECONCILIATION

Also during the course of the ACA review the Staff attempted to verify that the Company reconciled nominations to metered volumes. Although various reports and reconciliations were provided to Staff to help verify end-user volumes, it was not apparent to Staff that Laclede reconciled nominations with metered volumes. Due in part to the complex nature of Laclede's affiliate transactions with LER, the Staff has a continued concern in this area and will continue to attempt to verify the nominations that are confirmed at the citygate are being reconciled back to actual metered statements.

HEDGING

The Staff reviewed the Company's Risk Management Strategy and its hedging transactions applicable to the 2005-2006 ACA period. Weather during the winter period, November 2005 through March 2006, was warmer than normal. In particular, January 2006 was one of the warmest on record. Laclede's hedged coverage comes from financial instruments and from storage withdrawals.

The Staff also reviewed monthly hedged coverages. Because Laclede uses a combination of various option strategies that provide limited or partial hedging, Laclede should test their proposed hedges to evaluate the impact on customers of various gas price scenarios (scenarios that may occur during various winter conditions).

This should include a "stress test" evaluation of exposure to market prices to determine how different price increases will impact Laclede's gas portfolio and corresponding PGA rate.

The adequacy of the hedge coverage should be evaluated by Laclede to assess exposure to market prices when only the minimum time driven hedge volume has been obtained.

** **

Staff has the following comments regarding Laclede's hedging documentation:

> Although the Company provided a copy of its Risk Management Strategy along with some explanations of the workings of each financial instrument, the Staff did not find sufficient details regarding the rationale for each of its hedging transactions. For example, the

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Company evaluation of the market conditions that either support initiating the hedge or liquidating the hedge position were not provided. In particular, the Staff did not find any detailed explanation as to how the Company initiated liquidating the hedge position before expiration. This should include explanations on how these date specific transactions lower the cost of the initial hedge coverage. Several other examples illustrate a lack of sufficient hedge documentation detail. The Company has increasingly used various financial hedges that are not fully explained in the documentation provided to the Staff. For example, explanations of 3-way collar and 4-way collar, when placed, should be provided to support specifically how the agreement for the financial instruments at the time the agreement was made effectively hedges against possible rising natural gas prices. In addition, certain types of financial instruments were employed to synchronize hedge gains and losses to closely mimic liquidation on NYMEX closing. However, it is difficult with the information provided, to relate compound hedging strategies with the instruments that are used to build them. In addition, the type of reporting that would allow a straightforward assessment of how much of the Company's monthly hedge targets (expected volume component, price driven and time driven, etc.) are actually achieved for that month and cumulatively was not clearly provided as part of the hedge documentation. Furthermore, the Company should maintain some type of evaluation of the financial hedging performance. For example, an analysis of what factor(s) may have been attributable to the gains/losses from the financial instruments could provide a potentially effective hedging guidance on a going forward basis. The Company tariffs allow the pass-through of prudently incurred hedging costs. Therefore it should be obligated to provide justification and support for the reasonableness of those hedging expenditures.

Staff provided similar comments in the 2003/2004 ACA, GR-2004-0273, and also in the 2004/2005 ACA, GR-2005-0203. Laclede agreed to provide the information beginning with the 2005/2006 ACA. However, Staff has concern for the Company's failure to provide complete hedging documentation. Based on the previous ACA recommendations and the Laclede responses, Laclede should provide for the 2006-2007 ACA period forward, for each hedging transaction executed, its detailed rationale supporting its decision and a narrative of the interplay between the hedging purchase or liquidation and the Risk Management Strategy. The narrative should include but not limited to an explanation of how each hedging transaction and the Risk Management Strategy are specifically related. This should also include all reports that tie the Company's actual hedge results to the targets stated in the Company's Risk Management Strategy. In addition, the Company should continue to provide a specific identification of instruments that are used in conjunction to create a particular hedge strategy. The Staff further recommends this documentation should be maintained and be made available to the Staff at the start of each ACA review.

RECOMMENDATIONS

It is Staff's opinion that Laclede should do the following:

1. Establish the following account balances in its next ACA filing to reflect the (over)/under recovery of ACA and Refund balances to be (refunded)/collected from the ratepayers as of September 30, 2006:

	Firm Sales non-LVTSS	Firm Sales LVTSS	Interruptible Sales	LP Sales	Firm Transportation	Vehicular Fuel
Company Filed ACA Balance	$38,941,232	$721,415	$ (124,748)	$(8,721)	$ 954,361	$ 19,410
Prior ACA Adjustment: LER Supply Contract	$(1,677,493)	$(4,265)	$(13,455)			
Current Staff Adjustments:						
LER Supply Contract	$(2,775,024)	$(9,100)	$(25,459)			
Under-statement of Off-System Sales Margin	$(35,375)	$(116)	$(325)			
Ending ACA Balance	**$ 34,453,340**	**$707,934**	**$ (163,986)**	**$(8,721)**	**$ 954,361**	**$ 19,410**

2. Respond within thirty days to the comments made by Staff in the Reliability Analysis and Gas Supply section regarding pipeline capacity planning, including downstream pipeline capacity and upstream pipeline capacity, continuation of winter month data for Laclede's Lange underground storage resource, charges for natural gas used by interruptible customers during period of interruption, targets for physical supply, updating its baseload/combination/swing study and evaluating how the RFP structure should fit with this study, and update its cost/benefit analysis for producer demand charges.

3. Adjust the ACA balance by $2,809,583 for Laclede's decisions related to its supply contract with Laclede Energy Resources.

4. Adjust the ACA balance by $35,815 for the under-statement of Laclede's off-system margin on sales made to Laclede Energy Resources.

5. Respond within thirty days to the comments made by Staff in the Hedging section.

6. Document and provide to the Staff by March 31, 2008, for each hedging transaction executed, the following information for the 2006-2007 ACA period forward:

   a. For each hedging transaction executed, Laclede's 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 in greater detail. This should include all reports that tie the Company's actual hedge results to the targets stated in the Company's Risk Management Strategy and a specific identification of instruments that are used in conjunction to create a particular hedge strategy.

b. Laclede's evaluation of the market conditions at the time of specific transactions that either support initiating the hedge or liquidating the hedge position.

c. A written explanation of workings of the various option and spreading strategies utilized by Laclede contained in its hedging reports to management, the hedging committee, and/or the board of directors, especially as to what specific financial instruments are utilized by the strategies, how they work, and why they are used and when the strategies are employed.

d. A written explanation of any swaps that are acquired to synchronizing hedge gains and losses to more closely mimic liquidation an NYMEX closing, including an explanation of how this reduces exposure to upward price volatility. Specific transactions that Laclede actually executed must be utilized to explain the concept.

e. A report of how much of the Company's monthly hedge targets (price driven and time driven) are actually achieved for that month and cumulatively.

f. An evaluation of the financial hedging performance in order to identify factor(s) attributable to the gains /losses from the financial instruments for each winter month.

7. Respond to the recommendations herein within 30 days.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the matter of the Purchased Gas Adjustment filing of Laclede Gas Company	))	Case No. GR-2006-0288

AFFIDAVIT OF DAVID M. SOMMERER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

David M. Sommerer, being of lawful age, on his oath states: that as a Utility Regulatory Manager in the Procurement Analysis Department of the Utility Services Division, he has participated in the preparation of the foregoing report, consisting of 14 pages to be presented in the above case; that he has verified that the following Staff Memorandum was prepared by himself and Staff of the Commission that have knowledge of the matters set forth as described below; that he has verified with each of the Staff members listed below that the matters set forth in the Staff Memorandum are true and correct to the best of his knowledge and belief,

Anne M. Allee:	Billed Revenue and Actual Gas Costs
Lesa Jenkins:	Reliability Analysis and Gas Supply Planning
Kwang Y. Choe:	Hedging

that he has knowledge of the matters set forth in such report and that such matters are true to the best of his knowledge and belief.

David M. Sommerer

Subscribed and sworn to before me this 28th day of December 2007.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
County of Cole
My Commission Exp. 07/01/2008

Notary Public