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Service Commission

LACLEDE GAS COMPANY

GT-2001-329

SURREBUTTAL TESTIMONY

OF

KENNETH J. NEISES

May 30, 2001

1 **SURREBUTTAL TESTIMONY OF KENNETH J. NEISES**
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3

4 Q. What is your name and address?

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

7 Q. Are you the same Kenneth J. Neises who previously caused prepared direct
8 testimony to be filed in this proceeding?

9 A. Yes, I am.

10 **PURPOSE OF SURREBUTTAL TESTIMONY**

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

12 A. The purpose of my surrebuttal testimony is twofold. First, I want to describe the
13 further modifications that the Company is willing to make to its gas supply
14 incentive plan ("GSIP") in response to the concerns that have been raised by Staff
15 and Public Counsel in their rebuttal testimony. In doing so, I will also explain
16 why I believe our proposed plan, as modified, represents the only alternative
17 presented in this case that is both workable and consistent with the interests of
18 both the Company's customers and its shareholders. Second, I will address a
19 number of the claims that have been made by the witnesses for Staff and Public
20 Counsel in support of their proposals that I believe are either unwarranted or
21 inconsistent with the facts.

22 Q. Is surrebuttal testimony also being submitted by other Company witnesses?

23 A. Yes. Mr. John Moten, the Company's Vice President for Community Relations
24 will address one of the modifications that Laclede is proposing in response to
25 concerns that have been raised regarding the impact of rising gas prices on the

1 Company's customers. Specifically, he will address the need for, and impact of,
2 our proposal to contribute a significant share of the Company's earnings under the
3 GSIP to the Dollar-Help Program – an organization that has a long history of
4 providing energy assistance to our most vulnerable customers. Mr. Scott
5 Jaskowiak, who also presented direct testimony in this case, will address various
6 assertions that have been made regarding the structure of the GSIP and the level
7 of benefits that have been achieved by the Company under its auspices. Mr.
8 Glenn Buck, the Company's Manager of Financial Services, will respond to those
9 claims that have unfairly sought to portray the GSIP as a risk free mechanism that
10 allows Laclede to earn excess profits from its merchant function by providing the
11 Commission with a more balanced and more comprehensive perspective of the
12 risks and costs that the Company actually incurs in connection with its merchant
13 duties. Finally, Mr. Bruce Henning, a former economist with the American Gas
14 Association and a current member of Energy and Environmental Associates will
15 discuss why the proposal to raise the baseline associated with the pipeline
16 discount component of the GSIP is inappropriate in light of current market
17 conditions. He will also explain why Staff's proposed incentive plan, which relies
18 on a comparison of the relative changes in delivered gas costs experienced by
19 Missouri LDCs, is unworkable as a meaningful measure of management
20 performance and ill-designed to benefit consumers.

**PROPOSED MODIFICATIONS
DESIGNED TO ADDRESS PARTIES' CONCERNS**

Q. You indicated that the Company was willing to make a number of modifications to its GSIP proposal in order to address concerns that have been raised in the rebuttal testimony submitted by Staff and Public Counsel. Would you please summarize what those modifications are?

A. There are six major modifications that Laclede is prepared to make to its GSIP proposal in an effort to address the concerns or incorporate the recommendations set forth in the testimony of Staff and Public Counsel:

- First, the Company is willing to significantly reduce the overall share of GSIP benefits that it is permitted to retain under the plan and, in the process, equalize those percentages across all elements of the plan.
- Second, Laclede is proposing to devote a significant portion of its already reduced share of any benefits under the GSIP to funding energy assistance for its most vulnerable customers.
- Third, Laclede is willing to remove off-system sales revenues from base rates and once again include them in the GSIP.
- Fourth, Laclede is willing to reinstitute an overall cap on the amount it may retain under the GSIP – a cap that will also apply to off-system sales revenues.
- Fifth, the Company is proposing that language be added to the provisions of the GSIP that would explicitly permit further modifications to be made to the GSIP in the event the Commission ultimately adopts any

1 recommendations from its gas cost recovery task force that are
2 inconsistent with the Plan's provisions.

- 3 • Finally, and perhaps most importantly given the events of this past winter,
4 Laclede is willing to significantly alter that component of its GSIP
5 proposal which relates to the gas supply commodity component of its gas
6 costs in order to better ensure that fixed priced instruments can, in fact, be
7 used in coming winters to provide customers with additional protection
8 from any price spikes in wholesale gas supplies. Specifically, the
9 Company is willing to commit to obtaining a minimum level of fixed-
10 price instruments for this coming winter. For future periods, the Company
11 is also agreeable to implementing a modified version of Public Counsel's
12 proposal for procuring fixed price instruments, subject to the limitation
13 that the Company losses from the use of such instruments would be
14 limited to \$1 million in each annual period of the plan. In connection with
15 this proposal, the Company is also willing to subject its remaining
16 procurement decisions to a subsequent prudence review.

17 Q. Why is the Company willing to make these modifications?

18 A. For two reasons. First, it is abundantly clear, as the Commission itself has
19 recognized by its prior extensions of the GSIP, that the Plan has enabled the
20 Company to achieve significant net benefits for its customers. Although some of
21 the witnesses for Staff and Public Counsel have suggested, or simply assumed, a
22 lack of such benefit in their rebuttal testimony, they have offered no substantive
23 analysis in support of their views. Indeed, as Mr. Jaskowiak's surrebuttal

1 testimony demonstrates, these unsubstantiated claims simply ignore the evidence
2 from Case No. GT-99-303 which fully described and quantified at least \$45
3 million in net benefits that would not have been available in the absence of the
4 GSIP and the Company's superior performance thereunder during the first three
5 years of the program. Since then, these actions, as well as others, have generated
6 additional net benefits of at least \$19 million, and we are confident that the GSIP
7 will continue to benefit customers in the future if it is allowed to operate. In view
8 of these benefits, the Company believes it is critical for our customers that the
9 GSIP be allowed to continue and we are willing to make whatever reasonable
10 accommodations are necessary to permit that to happen.

11 Second, there is no denying the fact that the opportunity to achieve a
12 modest level of earnings under the GSIP has also become critical to the overall
13 financial health of the Company. As demonstrated by Mr. Buck, even with the
14 earnings realized by the Company under the GSIP, Laclede was still unable to
15 achieve its authorized rate of return in three out of the past four fiscal years. And
16 without those earnings, the Company would have not even had enough net
17 income in the last two years to cover its dividend payment to shareholders -- a
18 payment that has been consistently made by Laclede for more than fifty years. In
19 short, far from being "excess profits," as some have claimed in this proceeding,
20 Laclede's GSIP's earnings have done nothing more than give it the slimmest of
21 opportunities to achieve the returns that have, in fact, been authorized by the
22 Commission and to continue a dividend policy that has been critical to the
23 Company's financial structure for over half a century. Given these

1 considerations, continuation of a workable GSIP is also absolutely essential to the
2 Company's shareholders – a reality that we have acknowledged by proposing the
3 kind of reasonable modifications that should eliminate any concerns over whether
4 such a course of action is appropriate.

5 **Reduction and Equalization of Company's Share of GSIP Benefits**

6 Q. Turning to the specific modifications you previously summarized, would you
7 please describe the Company's proposal to equalize the sharing percentages
8 applicable to what it may retain under the GSIP?

9 A. Yes. Under the current GSIP, the Company is permitted to retain 50% of the
10 savings achieved under the gas procurement component of the Plan and 30% of
11 the savings or revenues achieved under the other components of the Plan, with the
12 exception of the capacity release component which varies from 10% to 30%. In
13 addition, the Company is permitted to retain 100% of the off-system sales
14 revenues it achieves between rate cases once the \$900,000 baseline included in
15 rates is exceeded. Under our proposed modification, the sharing percentages for
16 all of these components would be equalized to 35%, with the exception of the
17 sharing percentage for the commodity portion of the gas procurement component
18 which would be reduced to zero.

19 Q. Compared to the retention percentages in the existing GSIP, does this represent a
20 reduction in the overall share of GSIP benefits that may be retained by the
21 Company?

22 A. Yes, adoption of these uniform sharing percentages, together with the complete
23 elimination of any sharing percentage for the gas procurement component, would

1 significantly reduce the Company's share of GSIP benefits. For example, had
2 these percentages been in effect during the 1999-2000 ACA period, the Company
3 would have received nearly \$3 million less than the approximately \$10 million in
4 savings and revenues it retained that year from both the GSIP and its off-system
5 sales. Expressed as a percentage, this is equivalent to an overall reduction of
6 approximately 30% in the share of GSIP and off-system sales benefits that may be
7 retained by the Company. I should add that this reduction in the Company's share
8 of GSIP benefits does not take into account the additional, financial impact of our
9 proposal to devote a significant portion of our remaining 35% share to
10 Dollar-Help. I will discuss that proposal later in my testimony.

11 Q. Why is the Company willing to reduce its share of GSIP benefits by such a
12 significant amount?

13 A. Both Mr. Sommerer for the Staff, as well as Mr. Busch for Public Counsel, have
14 proposed that the Commission establish new or increased baseline levels for all of
15 the components of the GSIP. Mr. Sommerer also proposes reductions in the
16 percentage share that the Company may retain in connection with most of these
17 components. The end result of both of these approaches is to virtually eliminate
18 any possibility that the Company will share in any savings under the GSIP and
19 increase the likelihood that it will lose money on its efforts to generate such
20 savings for its customers.

21 Q. Do you agree that such modifications are appropriate?

22 A. No. For reasons I will discuss later in my testimony, I believe it is fundamentally
23 inappropriate to "rebase" these items. And even if it were not, it is clear that the

1 baselines being proposed by Staff and Public Counsel are unreasonable given
2 current market conditions. I also believe that the same considerations argue
3 against any reduction in the sharing percentages applicable to these components.
4 Despite these fundamental differences, however, the Company has nevertheless
5 developed a proposal that gives substantial recognition to Staff's and Public
6 Counsel's position on this issue by permitting a significant reduction in the overall
7 share of benefits that may be retained by the Company under the GSIP. The
8 Company's proposal should accordingly be adopted by the Commission.

9 Q. Does the adoption of uniform sharing percentages serve any other purpose?

10 A. Yes. In the past, the GSIP has wrongly been criticized on the grounds that the
11 different retention percentages for its various components may give the Company
12 an inappropriate incentive to structure its transactions so as to take advantage of
13 the higher sharing opportunities afforded by some components. Indeed, it is clear
14 that Staff's and Public Counsel's respective proposals in this case to afford similar
15 sharing treatment to the Company's capacity release and off-systems sales
16 revenues has been prompted by this very kind of concern. Although Laclede
17 disagrees that the GSIP has actually had such an effect, adoption of the
18 Company's proposal to implement uniform sharing percentages should serve to
19 eliminate any such concerns in the future.

20 **Contribution of Company GSIP Earnings to Dollar- Help**

21
22 Q. In addition to reducing its overall share of GSIP benefits, you also indicated that

1 the Company was willing to contribute a significant portion of its GSIP earnings
2 to funding energy assistance for low-income customers. Please explain this
3 proposed modification and why the Company is making it.

4 A. In the event the Commission approves the 35% sharing retention percentages and
5 other modifications proposed by the Company in this proceeding, Laclede would
6 agree to contribute 5% or 1/7 of this retention amount to the Dollar-Help Program
7 in order to provide additional energy assistance to its most vulnerable customers.

8 Q. What impact would this proposal have on the level of energy assistance available
9 for low-income customers?

10 A. The amount of increased funding generated by this proposal would, of course,
11 ultimately depend on how successful the Company was in achieving savings and
12 revenues for all of its customers under the GSIP. For illustration purposes,
13 however, the analysis performed by Mr. Jaskowiak shows that had this
14 modification been in effect during the 1999-2000 ACA period, it would have
15 generated more than \$1 million in increased funding for low-income energy
16 assistance.

17 Q. Would implementation of this proposal also result in a further reduction in the
18 amount of earnings ultimately achieved by the Company as a result of the GSIP?

19 A. Yes. The Company's commitment to contribute 1/7 of its share of the benefits
20 achieved under the GSIP would obviously reduce by some additional amount the
21 level of earnings that could ultimately be realized by the Company pursuant to the
22 Plan. In fact, when combined with the reduction in the Company's overall share

1 of GSIP benefits, this further commitment would reduce the Company's earnings
2 potential under the GSIP by nearly 40% compared to the current structure.

3 Q. Why is the Company proposing to contribute a share of its GSIP earnings to help
4 fund the energy assistance efforts of Dollar-Help?

5 A. As discussed more fully in the surrebuttal testimony of Mr. John Moten, Laclede
6 has always been extremely active in supporting efforts aimed at obtaining public
7 and private sources of funding for low-income energy assistance. Laclede's
8 proposal in this case is therefore a natural extension of the Company's traditional
9 commitment in this area. As to why we chose Dollar-Help as the organization for
10 distributing these funds, we simply believe, for the reasons discussed by Mr.
11 Moten, that Dollar-Help has been an extremely successful and cost-effective
12 program for helping low-income customers with their energy bills as evidenced
13 by its success in raising over \$9 million for that purpose since the program was
14 first initiated.

15 Q. Is this proposed modification also designed to address concerns raised by Staff
16 and Public Counsel in their rebuttal testimony?

17 A. Yes. Both Staff and, to a lesser extent, Public Counsel have raised concerns over
18 the appropriateness of permitting the Company to retain a share of the savings
19 achieved under the GSIP in those circumstances where there has been a
20 significant increase in customer bills because of rising wholesale gas prices or
21 colder than normal weather. This concern seems to be based, in part, on the
22 proposition that utility consumers may be offended or prejudiced by any incentive
23 mechanism that permits the Company to retain a share of GSIP benefits when

1 bills are high and that the Company should therefore be prohibited from doing so
2 under such circumstances.

3 Q. Do you agree with this concern?

4 A. While I have heard this concern voiced by Staff and Public Counsel, I have not
5 been able to confirm that it is actually shared by our customers. To the contrary,
6 the reports I have received regarding consumer reaction to what happened this
7 winter would suggest that they are far more open to the wisdom of using
8 incentives as a means of producing superior results in the gas cost area than either
9 Staff or Public Counsel. In fact, the only circumstances under which I could
10 foresee any adverse reaction of this nature would be in those situations where
11 consumers were misled into believing that they have not received significant net
12 benefits as a result of the Commission's innovative efforts in this area.
13 Nevertheless, I do agree that special measures need to be taken whenever sharp
14 increases in customer bills impose particularly difficult burdens on low-income
15 customers, the elderly and those customers living on a fixed income. In addition
16 to all of Laclede's other efforts in this regard, the proposal to contribute a
17 significant portion of the Company's GSIP earnings to Dollar-Help will further
18 that goal. In effect, it ensures that as the Company strives to save money for all of
19 its customers under the GSIP, it will be sharing any success it achieves on its own
20 behalf with its most vulnerable customers -- a result that should be particularly
21 helpful in the higher cost environment we face today.

Treatment of Off-System Sales Revenues

Q. Why is the Company proposing to remove off-system sales revenues from base rates and reincorporate them as a component of the GSIP?

A. As I previously mentioned, both Staff and Public Counsel have expressed concern that the varying treatment afforded these two items (i.e., one being dealt with in the PGA and the other in base rates with different sharing consequences for both) may provide the Company with an incentive to favor one kind of transaction over another. While I do not believe this has actually occurred, the Company understands why this differing treatment could engender such concerns.

Moreover, Laclede has always believed that PGA rather than rate case treatment is more appropriate for items like off-system sales revenues that are extremely volatile from one year to the next. The Company therefore supports Staff's recommendation, as set forth at page 18 of Staff witness Sommerer's rebuttal testimony, that off-system sales revenues be removed from base rates by temporarily increasing gas costs by the \$900,000 that was imputed for this item in Laclede's last rate case. However, for the reasons discussed elsewhere in my testimony and in the surrebuttal testimony of Mr. Jaskowiak, the Company does not agree that the Company's ability to retain a share of such revenues should be subject to a baseline, let alone the ones proposed by Staff and Public Counsel in their rebuttal testimony.

Preservation of Cap and Acceptance of MRT Proposal

Q. Please describe the fourth modification the Company is willing to make to its GSIP proposal in order to address the concerns raised by Staff and Public Counsel.

A. At the time it filed its tariffs and direct testimony in this proceeding, the Company proposed elimination of two temporary measures that had been added to the GSIP when it was extended by the Commission for a fifth year. These included elimination of the provision which imposed an overall \$9 million cap on the amounts that could be retained by the Company for the fifth year of the program and the provision which excluded from GSIP consideration any rate discounts that might be negotiated by the Company in the interim with its largest pipeline supplier, Mississippi River Transmission Corporation ("MRT").

Q. Has the Company reconsidered its position on these issues?

A. Yes. At page 18 of his rebuttal testimony, Staff witness Sommerer proposes that the current \$9 million cap be maintained for the GSIP. Mr. Busch also makes a similar recommendation at page 22 of his testimony. In response to these recommendations, the Company is willing to agree to the continuation of an overall cap on the amount it may retain under the GSIP. I should note, however, that at the time this cap was established, off-system sales revenues had been completely excluded from GSIP consideration. In light of Staff's recommendation that such revenues once again be included in the GSIP, I would recommend that the cap be raised from \$9 million to \$10 million to account for the addition of off-system sales.

1 Q. To put the amount of this earnings cap in perspective for the Commission, could
2 you please quantify what a \$10 million cap means as a percentage of the
3 Company's overall gas costs?

4 A. Based on current gas costs, a \$10 million cap would limit the Company's earnings
5 to an amount equivalent to about 2% of its overall gas costs.

6 Q. What is the Company's position regarding the exclusion of MRT discounts?

7 A. At page 16 of his rebuttal testimony, Staff witness Sommerer has presented a new
8 alternative for the treatment of MRT discounts. It is my understanding that under
9 the alternative approach recommended by Mr. Sommerer, the Company would be
10 permitted to retain a share of such discounts if the resulting rates are below the
11 contract rates that MRT is charging Laclede and the discounts achieved by
12 Laclede are not being made available by MRT on a system-wide basis. In my
13 view, Mr. Sommerer's alternative proposal for determining whether such
14 discounts should be recognized is not unreasonable and is clearly preferable to an
15 outright exclusion. The Company would therefore have no objection to
16 modifying the GSIP to incorporate this concept.

17 **Task Force Reopener**

18 Q. Please explain the fifth modification the Company is proposing to make to its
19 GSIP proposal.

20 A. At page 32 of his rebuttal testimony, Staff witness Schallenberg suggests that a
21 term of one year for the GSIP is appropriate due, in part, to the work that is being
22 done by the Commission's gas cost recovery task force and the potential impact of
23 that work on the GSIP. I certainly agree with Mr. Schallenberg that the work of

1 the gas cost recovery task force could ultimately have some bearing on the
2 structure and future of GSIP. However, I do not believe that this consideration
3 warrants the adoption of an artificial one-year term for the GSIP since there are
4 other, less-disruptive, ways to accommodate Mr. Schallenberg's concern and still
5 permit the implementation of a multi-year incentive plan.

6 Q. Please explain what you mean.

7 A. The GSIP, as proposed by the Company, already contains a provision that permits
8 any party to recommend modifications to the GSIP in the event there is a
9 significant change in conditions. Laclede believes that this same provision can be
10 supplemented to explicitly provide that the GSIP may also be modified or even
11 terminated in the event the Commission decides, after an opportunity for hearing,
12 to adopt recommendations from the task force that are inconsistent with the GSIP
13 or its provisions. Such an approach will allow the work of the task force and its
14 inter-relationship to the GSIP to be fully considered and accommodated without
15 artificially limiting the term of the GSIP. The Company would accordingly
16 recommend that a modification incorporating such language in the GSIP be made
17 in response to the concerns raised by Mr. Schallenberg.

18 **Treatment of Gas Supply Commodity Costs**

19 Q. You previously indicated that the final modification proposed by the Company
20 relates to the treatment of gas supply commodity costs. Why is the Company
21 proposing a modification relating to this element of its GSIP proposal?

22 A. It is clear from a review of the testimony submitted by both Staff and Public
23 Counsel that concerns regarding the treatment of gas supply commodity costs is

1 driving many of their recommendations. And this is clearly one of the most
2 critical and perhaps most problematic issues facing market participants and the
3 Commission. Given the events of this past winter, the Company certainly
4 recognizes the need to develop a workable approach that will foster greater bill
5 stability through the use of fixed price instruments. Indeed, that is precisely why
6 the Company made its Fixed Price Plan the centerpiece of its GSIP renewal
7 request. Before a constructive solution in this area can be found, however, it is
8 very important that there be an accurate understanding of the circumstances and
9 reasons which actually contributed to the results experienced this winter. For if
10 we don't know what the problem is, we're very unlikely to find the correct
11 solution.

12 Q. Do you believe that Staff and Public Counsel have accurately explained why the
13 Company did not place a greater reliance on fixed price instruments this past
14 winter?

15 A. No, I do not. Both the witnesses for Staff and Public Counsel have suggested,
16 now that the winter is over and we all know what happened, that the Company did
17 not utilize fixed price instruments because of inherent flaws in the GSIP. In
18 particular, they cite the GSIP provision that shields the Company from prudence
19 reviews so long as it acquires gas supply costs at a benchmark level that changes
20 with monthly movements in the indexed price of gas. They wrongly suggest that
21 such a provision gave the Company a disincentive to obtain fixed price
22 instruments by creating the prospect that the Company would lose its protection
23 from a prudence disallowance if the fixed price turned out to be higher than this

1 benchmark. They also point to the fact that the purchase of fixed price
2 instruments was never triggered by the GSIP's existing fixed price component
3 since market prices never declined to the five year average price that the
4 component mandates before such purchases may be made. According to Staff
5 and Public Counsel, it was a combination of these so-called flaws in the GSIP that
6 led to the absence of fixed price protection. The historical record, however,
7 indicates something quite different.

8 Q. Please explain.

9 A. The chief reason that Laclede did not purchase fixed price instruments last winter
10 was because Staff and Public Counsel were, themselves, never willing to move
11 beyond a reliance on historical prices for purposes of determining whether and
12 when fixed price instruments should be purchased and endorse a more market-
13 responsive standard for making such determinations. It is true that the fixed price
14 component of the GSIP, which was proposed by Laclede in 1999, relied on an
15 historical, five-year average of gas prices to determine when fixed price financial
16 instruments should be purchased. Staff's "incentive proposal" at the time,
17 however, was also based on the use of historical gas prices. What matters though
18 is not what the parties may have used in 1999 to address the purchase of fixed
19 price instruments but how they reacted in 2000 when there was a radical increase
20 in the market price for both natural gas and financial instruments -- a change in
21 market conditions that made it increasingly unlikely that an historical price
22 benchmark would serve to trigger the purchase of such instruments.

1 Q. Did this change in market conditions cause Staff or Public Counsel to reevaluate
2 whether a more market responsive standard should be used to facilitate the
3 purchase of fixed price instruments instead of an average of historical prices?

4 A. Not from what I have been able to determine. To the contrary, at the very time
5 market prices were increasing to levels substantially above the historical averages,
6 Staff and Public Counsel entered into an incentive plan agreement with Missouri
7 Gas Energy ("MGE") that, once again, would have triggered the implementation
8 of a fixed price only if that price was at or below a historical average of gas
9 prices. And even though this agreement contained explicit provisions permitting
10 the parties to recommend increases in the trigger price in response to changing
11 market conditions, Staff and Public Counsel were apparently unwilling or unable
12 to ever make such a recommendation, notwithstanding the continuing escalation
13 in market prices.

14 Q. During this same time period, did Laclede make an effort to establish a more
15 market-responsive standard for the use of financial instruments?

16 A. Yes. As it became evident that there had been a fundamental shift in the market,
17 Laclede made a filing with the Commission in which it requested authorization to
18 take a number of steps that were designed to facilitate the effective use of
19 financial instruments in the changed market environment. Specifically, in
20 response to these market conditions, Laclede requested authority in July of last
21 year to increase the level of funding for the purchase of call options under its
22 Price Stabilization Program and to decrease the volumes covered by the Program.
23 Laclede also requested the authority to use costless collars and fixed priced

1 instruments that were more reflective of market prices. Ultimately, the parties
2 were only able to agree on an elimination of the volume requirement under the
3 Program.

4 Q. Are there other examples of Staff's reluctance to endorse standards that would
5 permit the use of market-responsive financial instruments?

6 A. Yes. Late last summer, Staff also opposed MGE's request to make adjustments to
7 its hedging program that were designed to permit the purchase of financial
8 instruments in the higher cost environment that existed in the market at that time.
9 Instead, Staff took the position that MGE should simply take whatever action it
10 believed was appropriate subject to a subsequent prudence review. In addition,
11 Staff opposed both a continuation of Laclede's Price Stabilization Program this
12 past winter as well as most of the adjustments that Laclede had proposed to make
13 to the Program in response to the higher cost environment for financial
14 instruments that exists now versus when the Program was originally approved.

15 Q. What conclusions do you believe should be drawn from these developments?

16 A. In light of this history, I think it is inappropriate and unfair to suggest that it was
17 the structure of the GSIP that was primarily responsible for the fact that the
18 Company did not rely on fixed price instruments this past winter. Instead, it was
19 tied far more closely to the Company's inability, despite its efforts, to obtain any
20 assurances, or even indications, that moving away from historical prices and using
21 market-responsive financial instruments would be deemed acceptable. To the
22 contrary, the message that was being repeatedly sent to the Company was that
23 historical prices remained the standard favored by both Staff and Public Counsel

1 and that any effort by the Company to utilize more market-responsive instruments
2 would have to be done at its own peril. Having sent that message, neither Staff
3 nor Public Counsel is in a tenable position to attribute the results of last winter to
4 the GSIP or any other factor that, as the historical record demonstrates, could
5 have been easily resolved by their simple endorsement of the measures that
6 Laclede was proposing in advance of the winter to permit the use of fixed price
7 instruments.

8 Q. But couldn't the Company have simply locked in prices notwithstanding Staff's
9 and Public Counsel's reluctance to endorse such a course of action?

10 A. No. As both Staff and Public Counsel appear to recognize, had the Company
11 done so it would have faced the possibility of a significant disallowance had
12 November and December turned out to be warmer, rather than colder, than normal
13 and prices subsequently plummeted below the fixed price. And this is a risk that
14 the Company would have faced regardless of whether it had a GSIP or not. What
15 Staff and Public Counsel have not done, however, is give the Commission a sense
16 of the true magnitude of that risk. But as the price changes last winter and even
17 this spring continue to demonstrate, the dollar differences between a locked-in
18 price and the ultimate market price for any significant portion of an LDC's
19 requirements can be huge. Indeed, in the space of a few short months, the dollar
20 differences attributable to these price changes can easily exceed tens of millions
21 of dollars and ultimately dwarf, by two-fold or more, an LDC's net income for the
22 entire year. Under such circumstances, the risks associated with such activities
23 for a gas-only LDC, without reasonable assurances regarding prudence reviews,

1 are of a magnitude that could jeopardize the Company's very viability as a going
2 concern.

3 Q. But can't the Company rely on the prospect, as Public Counsel witness
4 Meisenheimer suggests at page 20 of her rebuttal testimony, that the prudence of
5 its actions will ultimately be judged based on whether it acted reasonably given
6 the circumstances that existed at the time such action was taken?

7 A. While I believe that the Commission would attempt to apply this standard in a fair
8 manner, as it has in the past, I know from past experience that parties, as well as
9 regulators, can have substantially different views on what is "reasonable" under
10 any given set of circumstances. And in light of some of the hindsight analysis
11 that Staff recently presented in support of its proposal to terminate our Price
12 Stabilization Program, I have serious reservations regarding whether all parties
13 will properly apply this standard. Indeed, Staff's analysis in that proceeding was
14 the very antithesis of the Commission's prudence standard in that it completely
15 ignored the information and circumstances that the Company was operating under
16 at the time it made its decision, focusing instead on what the outcome could have
17 been based on perfect hindsight.

18 Q. In light of these considerations, what approach would you recommend to address
19 gas commodity costs?

20 A. Certainly, the Experimental Fixed Price Plan ("EFPP") outlined in our tariff filing
21 and direct testimony would have established the kind of clear standards that I
22 believe are necessary to facilitate the use of fixed instruments. I also recognize,
23 however, that while the EFPP is more market-responsive than the current fixed

1 price component of the GSIP, there is some validity to Staff's and Public
2 Counsel's concern that it may not trigger for this winter. To address these
3 concerns and still provide the Company with reasonable assurances, Laclede is
4 willing, for this winter only, to commit to purchasing fixed price instruments for
5 at least 10 Bcf of its winter gas requirements for December, January and
6 February, as long as they can be purchased below a \$6.00 per MMBtu price in
7 these months. In the event, the Company makes such purchases within these
8 guidelines, any prudence reviews would be limited to matters other than the level
9 and cost of the financial instruments purchased by Company. In addition, for
10 periods after the completion of this winter season, Laclede proposes that the
11 Commission adopt a modified version of Public Counsel's fixed price proposal in
12 this case.

13 Q. How would this modified version work?

14 A. Like Public Counsel's proposal, the financial consequences associated with the
15 Company's use of fixed price financial instruments would be determined by
16 comparing whether, and to what extent, the fixed price instruments procured by
17 the Company actually resulted in gains and losses. For convenience and ease of
18 administration, however, the determination of gains and losses would be made by
19 reference to the NYMEX settlement price for the month that the futures contract
20 was purchased. In addition, the Company would absorb 10% of any losses
21 associated with the use of such instruments up to a total amount of \$1 million.

22 Q. Would the Company also be permitted to retain 10% of any gains?

1 A. Only to the extent such retention could be accommodated within the overall
2 earnings cap of \$10 million that I discussed earlier.

3 Q. Why is the Company proposing to limit the gains it could retain and the losses it
4 would be required to absorb in connection with this fixed-price mechanism?

5 A. To the extent Public Counsel's proposal envisions exposing Laclede to unlimited
6 gains and losses associated with the purchase of such instruments, it would make
7 it impossible for the Company to risk purchasing any meaningful level of these
8 instruments for its gas requirements. As I indicated earlier, absent some
9 limitation, purchasing any significant amount of these instruments could expose
10 the Company to losses of a magnitude sufficient to wipe out its entire net income
11 for a year or more. That is not a risk that the Company can or should be asked to
12 take.

13 Q. Would the Company be required to procure fixed price instruments for a specific
14 volume of its gas requirements?

15 A. No. Rather than impose a specific volume requirement, the Company proposes
16 that a range of required volumes be established with a minimum of 10 Bcf and a
17 maximum of 25 Bcf.

18 Q. Why is the Company proposing that a range be established for the required
19 volumes?

20 A. Given the concerns that have been expressed by the parties in this case regarding
21 the need for the kind of price protection that can be afforded by fixed price
22 instruments, the Company believes it is appropriate that it be required to fix a
23 minimum amount of its volume requirements. When combined with the 40% of

1 normal winter supplies covered by the financial instruments purchased under the
2 Company's Price Stabilization Program, a purchase of fixed contracts equal to the
3 10 Bcf of the Company's winter flowing requirements would ensure some form of
4 price protection for nearly 60% of the Company's normal winter purchases. And
5 if the Company purchased financial instruments for its winter flowing supplies
6 equal to the 25 Bcf maximum, the amount of normal winter purchases covered by
7 financial instruments would rise to 87%. Either of these scenarios, or any
8 scenario in between, would afford customers with significant price protection this
9 winter from any substantial spike in wholesale gas prices while still enabling them
10 to receive significant benefits from any large declines in the market price of gas.

11 Q. Is there any other reason why the Company has proposed a range?

12 A. Yes. Both Mr. Schallenberg for the Staff and Ms. Meisenheimer for Public
13 Counsel have discussed in their testimony the pros and cons of the Commission
14 pre-approving a specific course of action, such as the Company's EFPP proposal
15 to procure fixed instruments for a specific volume of its gas requirements if
16 certain triggers are reached. They have also noted, as have I, the risks faced by
17 the Company in the absence of any clear standards regarding the possible
18 financial consequences associated with using fixed price instruments. The
19 Company's proposal attempts to reconcile these potentially conflicting
20 considerations by having the Commission do nothing more than recognize that a
21 range of results is reasonable where any scenario within that range will bring
22 significant diversity to the Company's efforts to balance price and stability. At
23 the same time, such an approach gives the Company the flexibility to decide what

1 specific scenario is optimal, with the certain knowledge that it will be financially
2 responsible for how good a job it does in selecting that scenario.

3 Q. With this modification, would the Company be subject to prudence reviews?

4 A. As I indicated previously, the Company is proposing to eliminate the commodity
5 portion of its gas procurement benchmark, together with the provision that
6 protects the Company from prudence reviews depending on how well it performs
7 in comparison with that benchmark. With that elimination, the Company would
8 be subject to prudence reviews relating to any issue involving its gas supply costs
9 other than the level and cost of the financial instruments procured by the
10 Company and the amount of demand costs incurred by the Company to reserve
11 gas supply. The latter would continue to be subject to the RFP-determined
12 benchmark, as modified to reduce the Company's sharing percentages of gain or
13 losses to 35%.

14 Q. Do you have any concluding comments regarding the Company's proposed
15 modifications?

16 A. As I indicated previously, the Company has made a serious effort to modify its
17 proposal in order to address, in a reasonable manner, the concerns and
18 recommendations made by Staff and Public Counsel in their rebuttal testimony. I
19 believe that the end result is a workable incentive plan that will permit the
20 Company to continue its successful efforts to achieve additional gas cost savings
21 and revenues for all of its customers, while affording the Company a meaningful
22 opportunity to enhance its historic support of programs designed to assist our
23 most vulnerable customers. Perhaps most importantly, given the events of last

1 winter, it provides a framework for the effective acquisition and use of the kind of
2 fixed price instruments that can help further stabilize our customers' bills.
3 Finally, for the reasons discussed below, I believe it represents the only workable
4 incentive plan that has been presented in this proceeding.

5 **RESPONSE TO PROPOSALS OF STAFF AND PUBLIC COUNSEL**

6 **General Comments**

7 Q. Do you have any general comments regarding the proposals submitted by Staff
8 and Public Counsel in their rebuttal testimony regarding an incentive plan for
9 Laclede?

10 A. Yes. Although the Company has made a concerted effort to adjust its GSIP in
11 order to address the concerns and recommendations that have been presented in
12 Staff's and Public Counsel's testimony, I have to say that I am disappointed by the
13 overall direction and nature of those recommendations. As I indicated in my
14 direct testimony, the parties agreed more than a year ago when they recommended
15 an extension of the GSIP that they would participate in a "good faith effort to
16 negotiate and implement a mandatory fixed rate trigger for gas supply commodity
17 costs, on the understanding that the overall objective will be to develop a mutually
18 acceptable and workable multi-year incentive program." While I recognize that
19 the parties were free to propose alternative courses of action in the event they
20 were unable to achieve this objective, it is disturbing how little relationship there
21 is between this goal and the approaches finally recommended by Staff and Public
22 Counsel.

23 Q. Please explain what you mean.

1 A. In contrast to the Company's proposal in this case, there is nothing in either Staff's
2 or Public Counsel's recommended approaches that would trigger any acquisition
3 of fixed price instruments for any portion of the Company's gas supply
4 requirements. In light of the events of last winter, and some of the assertions
5 made in their rebuttal testimony, it is amazing to me that neither Public Counsel
6 nor Staff have proposed any mechanism that would provide such a trigger for at
7 least some of the Company's requirements. Moreover, rather than propose a
8 workable, multi-year incentive program, Staff and Public Counsel have proposed
9 to either eliminate any workable incentive feature at all for various elements of
10 the Company's gas costs or to implement modifications that virtually ensure that
11 the Company can only lose money on its merchant function. In short, they have
12 failed to propose anything that could reasonably be deemed a workable incentive
13 program. And in addition to opposing the only workable incentive program that
14 has been presented in this proceeding, Staff has also proposed that such a program
15 be limited to only one year rather the multi-year arrangement originally
16 envisioned by the parties.

17 Q. What is the basis for your statement that Staff and Public Counsel have failed to
18 propose workable incentive plans in this proceeding?

19 A. Even in those instances where they have not opposed an incentive mechanism
20 outright for certain elements of the Company's gas supply costs, Staff and Public
21 Counsel have proposed to establish benchmarks or baselines that would
22 effectively deprive the Company of any opportunity to achieve earnings in
23 connection with its gas acquisition and management efforts. As shown by the

1 analysis presented by Mr. Jaskowiak in Schedule 2 to his rebuttal testimony,
2 application of the baselines proposed by Staff and Public Counsel to the non-gas
3 procurement components of the Company's existing GSIP would barely permit
4 the Company to break even on these components. And that assumes that the
5 Company was actually able to replicate all of the savings and revenue
6 enhancements that it has previously achieved in these areas. Moreover, Staff's
7 proposal goes one step further down the path of unworkability by proposing a
8 benchmark for the gas procurement component of the Company's GSIP that
9 would immediately require the Company to absorb more than \$3 million in gas
10 supply costs based on current market conditions.

11 Q. What would be the overall impact of these proposals on the Company were they
12 to ever be implemented?

13 A. There should be absolutely no misunderstanding regarding the cumulative effect
14 of these proposals on the Company. In addition to being unfair and unworkable,
15 they send the unmistakable message to the Company that, for the sake of its
16 shareholders and its customers, Laclede would have to seriously re-evaluate its
17 future merchant role should such proposals be adopted.

18 Q. Why do you say that?

19 A. As pointed out in the rebuttal testimony of Mr. Glenn Buck, the Company is
20 already incurring a significant level of unrecovered costs relating to its
21 performance of the merchant function under which it purchases, stores and sells
22 gas on behalf of its smaller customers. In the last year alone, these unrecovered
23 costs have been conservatively estimated at nearly \$5 million. Notably, a

1 substantial portion of these costs have been incurred by the Company in an effort
2 to provide its customers with a safety net which permits them to receive critical
3 natural gas service even when they cannot afford to pay for such services for
4 many months into the future, if at all. And it is on top of this already substantial
5 net cost, that Staff and Public Counsel have proposed to make the merchant
6 function even less economic for the Company by taking away any meaningful
7 opportunity to share in any gas costs savings achieved by the Company or, even
8 worse, by exposing the Company to over \$3 million in unrecovered costs. But it
9 doesn't even end there. In addition to having the Company absorb anywhere from
10 \$5 million to \$8 million in unrecovered gas costs from the start, both parties
11 would also propose that the Company be exposed to the risk of even greater losses
12 as a result of potential disallowances from future prudence reviews. I can't begin
13 to conceive of any business that would willingly submit to providing services
14 under these kind of punitive and patently uneconomic conditions.

15 Q. But isn't the Company compensated for these risks by the earnings it receives
16 from distributing gas to customers?

17 A. No. As I indicated previously, and as Mr. Buck's analysis also shows, even with
18 the income realized by the Company as a result of its efforts under the GSIP, it
19 has still not been able to earn its authorized returns in three out of the last four
20 fiscal years. And without that income, it would have been extremely difficult for
21 the Company to even cover the dividend it has been paying for more than fifty
22 years. The cold, hard reality is that Staff's approach to establishing base rates in
23 recent years has not even come close to providing the financial resources

1 necessary to fund the distribution side of our business. And now they have
2 proposed to eviscerate, in this proceeding, the only mechanism that has given the
3 Company at least a fighting chance to make up for some of the lost ground caused
4 by Staff's indifference to the Company's financial needs in these other areas.
5 Unfortunately, unlike utilities that have operations in other states or receive
6 substantial revenues from other lines of utility or non-utility business, Laclede has
7 no way to compensate for this continuing and, it seems, growing unwillingness on
8 the part of the Staff to provide the financial resources required to provide utility
9 service.

10 Q. You also indicated that the Company would have to re-evaluate its future
11 merchant role for the sake of its customers in the event the recommendations
12 made by Staff and Public Counsel were to be adopted. What did you mean by
13 that?

14 A. As the Commission may know, Laclede has on numerous occasions questioned
15 whether customers would receive any benefits from a further unbundling of our
16 natural gas services that would permit all customers to purchase their gas supplies
17 from alternative suppliers in a deregulated market. And we continue to believe
18 that the current structure, which authorizes and provides the Company with
19 incentives to pursue gas cost savings on behalf of all of its customers, still makes
20 the most economic sense for customers. Above all else, however, it is critical to
21 the health and welfare of our customers and the economic fabric of our state that
22 customers continue to receive natural gas service when they need it. Laclede has
23 always made that its highest priority and it has consistently delivered on its

1 commitment over the years to make certain that these critical services are
2 available. Given some of the proposals that have been submitted by Staff in the
3 past, and the proposals that have been presented in this case by both Staff and
4 Public Counsel, it is clear to me that they are unwilling to recognize the economic
5 realities of what it takes to perform this function. Accordingly, if their views
6 were to prevail, I have reluctantly concluded that consumers, as a whole, might be
7 better off under an unregulated market structure that would at least come closer to
8 eliciting the financial resources required to ensure the future availability of these
9 critical resources.

10 **Response to Baseline/Benchmark Recommendations**

11 Q. Aside from their adverse, financial impact on the Company, are there any other
12 reasons why the Commission should reject the proposals by Staff and Public
13 Counsel to establish new or higher baselines for various components of the GSIP?

14 A. Yes. While the Company has significantly modified its sharing percentages under
15 the GSIP in an effort to accommodate the concerns underlying these proposals,
16 and therefore believes no further adjustments are appropriate in any event, it also
17 has serious conceptual and factual objections to the propriety of these
18 recommendations. The factual ones, which demonstrate why these proposals are
19 unrealistic in light of current market conditions, are addressed by Mr. Henning
20 and Mr. Jaskowiak in their surrebuttal testimony. I will address why the
21 proposals are also conceptually inappropriate as a matter of policy and simple
22 fairness.

23 Q. Please continue.

1 A. At the core of both Staff's and Public Counsel's proposal is the assumption that
2 historically-derived baselines for the various components of the GSIP should be
3 established just as the Commission establishes discrete levels of expenses and
4 revenues in a general rate case proceeding. According to Public Counsel witness
5 Busch, this ensures that the Company will only be rewarded if it continues to
6 achieve ever greater levels of savings and ensures that the Company will not be
7 rewarded for "business as usual."

8 Q. What's wrong about such an approach?

9 A. To begin with, such an approach is really nothing more than a method for
10 ensuring that all incentive programs will inevitably be terminated. Contrary to
11 Public Counsel witness Busch's claim at page 20 of his rebuttal testimony, it is
12 simply not possible for Laclede or any other LDC to achieve ever greater levels of
13 savings and revenues through the management of their gas supply and
14 transportation assets. In fact, if carried to its logical but absurd conclusion, such a
15 view would suggest that to continue to operate under an incentive plan, an LDC
16 must eventually achieve a level of performance where suppliers and transporters
17 are giving away their services and products for free, or even paying the LDC to
18 take them. Since it is, of course, impossible to achieve such a result, the rebasing
19 approach suggested by Staff and Public Counsel would inevitably lead to a
20 situation where the so-called incentive becomes worthless because it will only
21 reward a level of performance that cannot be achieved.

22 Q. Why should the Commission conclude that the specific rebasing proposals made
23 by Staff and Public Counsel will produce such a result in this case?

1 A. Because if it was possible to achieve significantly higher levels of savings and
2 revenues than Laclede has in the past, the Company would have already done so
3 by now. Since it has operated under the GSIP for nearly five years now, Laclede
4 has had every incentive to achieve as significant a level of savings and revenues
5 through the management of its gas supply assets as it could without endangering
6 reliability or taking unwarranted risks. And I can assure the Commission that we
7 have done so. Indeed, when Mr. Busch notes that the overall level of savings and
8 revenues achieved under the GSIP have remained fairly constant (despite changes
9 in the amounts achieved under individual component), such an observation only
10 serves to confirm the point that the Company may have already extracted as much
11 in the way of additional savings and revenues as it is possible to achieve under
12 current conditions.

13 Q. But why then should the Company continue to be permitted to share in savings
14 and revenues at levels that are no greater than what it has been achieved under the
15 GSIP to date?

16 A. Because in an ever changing competitive marketplace, nothing is ever permanent
17 and nothing can ever be taken for granted. Savings and revenues achieved today,
18 can be gone tomorrow absent constant efforts to maintain them. Under such
19 circumstances, it is misguided in the extreme to suggest that management
20 performance can only be deemed superior and worthy of financial recognition if it
21 continues to produce an ever greater level of savings and revenues than it has in
22 the past. Under many circumstances, particularly in a tightening market like we
23 face today, the most exceptional manifestation of superior performance can be to

1 simply retain what you have already achieved. The Company's successful efforts
2 over the recent past to negotiate pipeline discounts at or below historical levels in
3 a tightening market are a good example of the kind of performance that merits
4 continued recognition. Indeed, to see the flaws in the approach recommended by
5 Staff and Public Counsel, one only has to consider whether any salesperson who
6 works on commission would be willing to do so if they had to constantly beat
7 their best historical performance to receive any compensation.

8 Q. Isn't the rebasing approach recommended by Staff and Public Counsel consistent
9 with how revenues and expenses are determined in a general rate case
10 proceeding?

11 A. No. There is simply no way to analogize the two. For example, in a rate case,
12 once the level of revenues and expenses are determined, the utility is permitted to
13 keep 100% of any savings or increased revenues above or below the baseline
14 level. In sharp contrast, the most that the Company would be permitted to retain
15 in this proceeding, even under its own proposals, is 35% of any savings or
16 revenues. And the proposed retention percentages recommended by Staff are
17 significantly lower than that. I should note that this tradeoff between retention
18 percentages, and whether or how high a baseline should be set, has previously
19 been recognized by the Commission as well. In addition, the utility is not subject
20 to prudence reviews in a rate case that can retrospectively change the level of
21 costs or revenues that will be recognized in rates for a past period. Finally, unlike
22 most costs and revenues that are addressed in a rate case, the ones that are
23 addressed in the GSIP are, by and large, far more volatile in nature, a fact that

1 makes them particularly unsuited to the type of baseline approach recommended
2 by Staff and Public Counsel. For all of these reasons, I would urge the
3 Commission to reject their recommendations.

4 **Response to Staff's "Possible" Incentive Plan**

5 Q. Have you reviewed the "possible" incentive plan that Staff witness Schallenberg
6 has presented in his rebuttal testimony?

7 A. Yes, I have.

8 Q. Do you believe it provides a basis upon which the Commission could establish an
9 incentive plan in the future?

10 A. No. As it is currently structured, I would not even consider it an incentive plan.

11 Q. Why is that?

12 A. The entire justification for an incentive plan is to utilize financial incentives in a
13 way that encourages utility management to achieve superior results by rewarding
14 it depending on whether and to what extent it achieves such results with respect to
15 areas or transactions whose outcome it can influence. By tying its incentives to
16 how an LDC's per customer delivered cost of gas changes over time compared to
17 the relative change in the delivered cost experienced by other Missouri LDCs,
18 Staff's proposal defeats this fundamental purpose.

19 Q. How so?

20 A. It is clear that the per-customer delivered cost of gas achieved by one LDC
21 compared to another can vary over time based on factors that differ from one
22 LDC to the next and that are completely outside the control of the LDC. For
23 example, LDCs have different customer growth rates from year to year because of

1 demographic considerations that they cannot influence. Some LDCs are also
2 exposed to significantly greater variations in weather temperatures than other
3 LDCs. Each of these factors can have a significant impact on the magnitude of
4 the per customer change in those portions of the LDC's delivered gas costs that
5 are relatively fixed, such as the cost of transportation services and gas supply
6 demand charges. Staff's proposed mechanism completely fails to distinguish or
7 correct for these differences. Moreover, relative differences in the gas prices in
8 the different production fields that the LDC can access, as well as differences in
9 the terms and conditions under which they can access and utilize pipeline storage
10 and transportation services, can also affect year to year changes in their relative
11 performance. So too, of course, can differences in the manner in which each
12 LDC's tariffs at the state level permit customers with access to alternative
13 suppliers to purchase gas from the utility or use the LDC's facilities for balancing
14 purposes. Once again. Staff's proposal does nothing to account for these
15 differences.

16 Q. Can you determine how profound an impact these differences can have on the
17 degree to which one LDC's per-customer, delivered cost of gas may vary from
18 year to year compared to that experienced by another Missouri LDC?

19 A. While I believe it can be significant, there is no way to precisely answer that
20 question without full access to the procurement plans, operational characteristics
21 and results achieved by each LDC. And this again illustrates another major flaw
22 in Staff's approach. For it to ever be implemented in a fair and effective manner,
23 each LDC would have to have access to such information from every other LDC.

1 Unfortunately, the need for such access would potentially bring with it its own set
2 of adverse consequences by eroding any competitive advantage LDCs can achieve
3 by maintaining a certain degree of confidentiality regarding their gas procurement
4 strategies. Indeed, the practical difficulties inherent in such an approach have
5 already been demonstrated by Staff's need to withdraw certain LDC-specific
6 information upon which it based its proposal in this case because of Laclede's
7 inability to obtain access to the critical data, contracts and other material
8 underlying that information.

9 Q. Are there other reasons why you believe Staff's possible incentive plan is
10 unworkable?

11 A. Yes. According to Mr. Schallenberg the plan would only permit LDCs to retain a
12 share of the gas cost savings they achieve in those instances where the delivered
13 cost of gas has declined from the previous year. In effect, such a proposal would
14 completely eliminate any incentives when they are needed most, namely, in a
15 rising market. Moreover, it would create the very kind of "perverse incentives"
16 that Staff is always criticizing other incentive plans for. For example, consider
17 the impact of Staff's proposal in a rising market that each LDC knows, because of
18 the magnitude of the increase, will result in a delivered cost of gas higher than
19 that achieved the prior year. Under such circumstances, the only incentive
20 produced by Staff's recommended approach would be one that essentially tells the
21 LDC that the higher its cost of gas goes this year the better positioned it will be in
22 the next year to claim savings since its relative performance will then be
23 measured from a higher, less exacting base. By the same token, LDCs that did a

1 superior job in one year will be put at a distinct disadvantage versus others who
2 did not, since their performance would now be measured from a lower, more
3 daunting base for purposes of determining whether they will be rewarded in the
4 future. For all of these reasons, it is clear to me that Staff's possible incentive
5 plan is completely unworkable and far more likely to retard rather than promote
6 its asserted goals.

7 **Response to Staff's Recommendations on Gas Procurement Reviews**

8 Q. Have you also reviewed Mr. Schallenberg's proposals regarding a new process for
9 evaluating the gas procurement plans and strategies of Missouri LDCs?

10 A. Yes. And as a general matter, I am supportive of any effort that will help to
11 expedite the ACA review process and potentially limit the magnitude and number
12 of prudence issues that may have to be resolved through that process. However,
13 Staff's proposal raises fundamental questions regarding how involved Staff or the
14 Commission should be in the gas acquisition strategies of LDCs. Moreover, I
15 also have reservations regarding the feasibility of conducting such an elaborate
16 review process within the time constraints suggested by Mr. Schallenberg and do
17 not, in any event, believe such a review process is necessary for any portion of
18 the Company's gas costs that are subject to incentives. Nevertheless, the
19 Company will certainly work with both the Staff and Public Counsel to
20 implement improvements to the current process and will maintain an open mind
21 on the form that those improvements should take.

22 Q. Does this conclude your surrebuttal testimony?

23 A. Yes.