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July 23, 2001

Mr. Dale Hardy Roberts
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RE: Case No. GT-2001-329

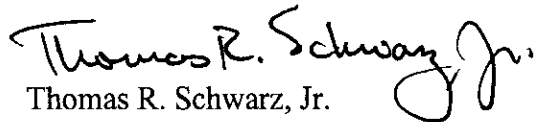
Dear Mr. Roberts:

Enclosed for filing in the above-captioned case are an original and eight (8) conformed copies of the **INITIAL BRIEF OF STAFF** in HC version and the original of the NP version.

This filing has been mailed or hand-delivered this date to all counsel of record.

Thank you for your attention to this matter.

Sincerely yours,


Thomas R. Schwarz, Jr.
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TRS:sw
Enclosures
cc: Counsel of Record

FILED²

JUL 23 2001

Missouri Public
Service Commission

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

FILED²

JUL 23 2001

Missouri Public
Service Commission

In the matter of Laclede Gas Company's
Tariff Filing to Implement an
Experimental Fixed Price Plan and Other
Modifications to Its Gas Supply
Incentive Plan.

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Case No. GT-2001-329

INITIAL BRIEF OF STAFF

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July 23, 2001

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

In the matter of Laclede Gas Company's)
Tariff Filing to Implement an)
Experimental Fixed Price Plan and Other)
Modification the to Its Gas Supply)
Incentive Plan.)

Case No. GT-2001-329

INITIAL BRIEF OF STAFF

I. INTRODUCTION

The Commission authorized Laclede Gas Company's initial Gas Supply Incentive Program ("GSIP") to provide financial incentives to minimize gas acquisition costs and "maximize the efficient management of [Laclede's] gas supply assets by . . . generating incremental net revenues from off-system sales for sharing with its regular service area utility customers." *In the Matter of Laclede Gas Company*, 5 Mo.P.S.C.3d 108, 114 (1996).

Laclede, however, has not viewed the GSIP in that light. Rather, Laclede views its GSIP as a means to bolster its bottom line in warm weather and to protect itself against low authorized rates of return by this Commission. As a consequence, Laclede has designed a program to assure earnings that it views as necessary to protect itself from the risks of the regulatory process, rather than one that will best protect ratepayers.

Laclede's approach to the GSIP is complicated by the current ACA/PGA process of after-the-fact review and adjustments that create a strong disincentive to Laclede to take actions it would otherwise deem prudent, reasonable, and in the interest of its customers. The Company repeatedly states that it cannot take these actions because it cannot risk a significant adjustment if

the results are adverse, and Staff or the Office of the Public Counsel proposes, and the Commission adopts, an adjustment that may amount to many millions of dollars.

The Commission must decide whether a new program should be put in place, whether the old program should be reemployed with modifications, or whether the incentive program premise should be eliminated completely. No party has asked that the GSIP in its current form be reenacted. To make its determination, the Commission must draw a reasonable conclusion based on competent and substantial evidence presented before it. *State ex rel. Util. Consumers Council of Missouri, Inc. v. Pub. Serv. Comm'n*, 585 S.W.2d 41, 47 (Mo. banc 1979).

Staff suggests that the Commission needs to do three things to resolve this case: first, eliminate the disincentives in the present system; second, focus attention on the delivered cost of gas, not its individual components; and finally, reward the LDCs with the best performance from year to year when ratepayer burdens justify additional rewards. Staff urges the Commission to adopt the reasonable and well-balanced approach outlined by Mr. Schallenberg – a plan to reward a company for obtaining better prices for its customers, rather than rewarding a company for performing activities it should and would do regardless of any incentive program.

II. SHOULD AN INCENTIVE MECHANISM SIMILAR IN STRUCTURE TO THE CURRENT GSIP, A DIFFERENT MECHANISM, OR NO INCENTIVE MECHANISM BE USED TO MANAGE LACLEDE'S GAS SUPPLY AND TRANSPORTATION?

No party suggests that the Commission should reinstate the GSIP as it currently exists. All parties concur that properly designed incentives have a place in the regulation of the current natural gas industry. Staff believes, however, that recent events and a full review of the facts before the Commission indicate a need to create a new type of incentive program, rather than persisting in making minor, annual modifications to an inadequate existing structure.

A. The piecemeal approach to incentives causes more problems than it solves.

Laclede's current GSIP, and Laclede's proposed solutions, are flawed. The current and proposed GSIPs propose rewards that are excessive; have benchmarks that do not require performance above that which customers can rightfully expect without additional incentives; do not put adequate emphasis on the commodity cost of the natural gas itself; and do not address the disincentives currently found in the ACA/PGA process.

1. The GSIP rewards are excessive.

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** (Ex. 45HC, Expected Business Results, pp. 2, 4). **

** (Tr. 234). Over time, Laclede has incorporated GSIP earnings into its overall earnings program, and although it believes the transportation discounts are derived from a different "profit center" than the traditional gas delivery profit center (Tr. 247), Missouri's statutes and the Commission have not drawn a distinction between these profit centers. The Commission has, and should continue to exercise, jurisdiction and review over Laclede's gas costs and how those costs are passed through to ratepayers, whether on the delivery side or the supply side. Indeed, the Commission is vested with the obligation under Section 393.140(5) RSMo. (2000) to "examine all persons and corporations under its supervision and keep informed as to the methods, practices, regulations and property employed by them in the transaction of their business."

In fiscal year 1997, GSIP earnings were 14% of Laclede's total net income, after taxes. In 2000, GSIP earnings comprised 22.9% of Laclede's total net income, after taxes. (Tr. 218-19). Mr. Neises readily admits that without the GSIP sharing process, Laclede would not have reached its "authorized return" in 2000. (Tr. 219). In "four out of five years," the only way

Laclede could "close the gap between its costs and its authorized level of earnings" is through GSIP earnings. (Tr. 330). The Commission would be justified in concluding that a significant amount of Laclede's income is tied to the GSIP, and that quite logically, the company would place great emphasis and effort on maintaining this source of income in the most profitable manner possible – and if resources were limited, the available resources would be routed toward this potential money-making enterprise rather than other areas that could benefit the consumer more and the company less. The Company has structured its plan to retain 30% – applied to a level of transportation discounts that Laclede has had since before the original GSIP, and which is already locked in place. Likewise, off-system sales, capacity release, pipeline mix, and gas supply demand premiums are at levels that virtually guarantee profits for Laclede, without providing additional benefits to consumers.

The Company complains that it faces substantial risk of losses from its merchant function. This claim, however, is not supported by even Laclede's own testimony. The "merchant-related function" originally estimated by Laclede in the surrebuttal phase to have a value of \$12.3 million not recovered through the PGA mechanism, dropped to \$10 million by hearing; correspondingly, the estimate of \$4.8 million being borne by shareholders dropped to \$4.1 million (Buck Surrebuttal, Ex. 8, p. 3; Tr. 499, 511-12). The amount actually borne by shareholders is actually even smaller – Mr. Buck did not take into account the concept that a shareholder does not absorb costs not reimbursed by ratepayers on a dollar-for-dollar basis. (Tr. 514). Rather, the company is able to offset its profits in other areas with the unreimbursed expenses from its "merchant function," reducing the ultimate liability passed on to shareholders by the amount of the saved taxes. In other words, Laclede is able to offset the increase in bad

debts, and the corresponding interest costs, against profits and does not have to pay the 40% in corporate income tax it otherwise would have had to pay on those profits. (Tr. 542-43).

Mr. Buck indicated his calculation of "merchant function" costs was not comprehensive, as he did not incorporate calculations for changes in customer consumption patterns due to high costs, additional collection tasks, and reallocations of resources to deal with customers during a period of high bills. (Tr. 572-74). For the most part, these additional expenses are related to the unusually high cost of gas or the unusually cold winter. (Tr. 573). Looking only at the cost side is misleading, however. Mr. Buck did not calculate the additional income from the higher consumption of gas during periods of cold weather, which compensates Laclede for the additional cold weather-related expenses. Admittedly, the estimated \$1.3 million in deferred gas costs is also an unusual cold weather expense (Tr. 581), and Laclede does not receive a direct reimbursement for these deferred costs, but ultimately these expenses are reimbursed through the additional profits that Laclede is able to receive for increased sales volumes -- and under its tariff, Laclede can recover deferred carrying costs from the ratepayer (Ex. 71; Tr. 611-12).

The amount was further overstated because Mr. Buck used an after-tax return on rate base of 7.79% to calculate Laclede's "merchant expense" on deferred gas costs rather than the more appropriate 6.31% called for by its tariff. (Tr. 523-24). The amount also is an estimate based on "an evaluation of where we expect uncollectible accounts to be," a component that admittedly is subject to change. (Tr. 530-31). The amount also included bad debt expense related to their current rate increase request that has not yet been granted by the Commission. (Tr. 530; Ex. 32, p. 26, lines 5-8). In calculating deferred gas costs, Mr. Buck did not normalize the costs for winter or high gas costs. (Tr. 522).

Finally, Laclede has included some of its "merchant function" expenses in its recently filed rate case (Tr. 589-90, 592), giving rise to the risk that the Commission would make a decision to allow Laclede to recover its "merchant function" costs twice over – once through the GSIP and again through the rate setting process. The GSIP is not intended, and should not be designed, to permit Laclede to recover its "merchant function" costs (Tr. 589), and the Commission's decision should not be based on this criteria. Laclede cannot claim it has no way to recover its expenses.

2. Current and proposed benchmarks do not require a performance that justifies rewards.

The benchmark concept has significant value, because it encourages a company to surpass the minimum level of a given activity it must do before savings result. Benefits should accrue to the company only if it performs above that minimum level. Laclede's witness, Mr. Henning, draws attention to the care needed in setting a benchmark. A benchmark should align the interests of the consumer and the utility, and optimize and maximize the benefits available from the resource. (Tr. 204). Mr. Henning observes that if a benchmark is too high, the company may have the incentive to shift discounts into other, less successful years to maximize its benefits under the system. (Tr. 142). The ratepayer will receive less in this case, because the entire discount is passed through to the ratepayer if the benchmark is not met.

If a company finds a benchmark difficult to obtain, the interests of the ratepayer and the company, rather than intersecting, become adverse. The company has an interest in obtaining as much over the benchmark as possible, and controls the contracting process that determines the degree of transportation discounts. If the company can shift discounts into a year where the benchmark is more difficult to meet, the ratepayer will lose the benefit of the share that otherwise would have gone towards reducing the rates.

Mr. Henning suggests that the Commission should retain the current "achievable" baseline for pipeline discounts -- relying on information provided by Laclede's personnel and without an independent investigation of Laclede's pipeline contracting practices (Henning Surrebuttal at 3; Tr. 76-77). Mr. Henning did not review Laclede's contracts. (Tr. 77). Those contracts reveal that Laclede receives discounts from MRT, Koch, Panhandle Eastern, and Missouri Pipeline Company. (Tr. 264). Laclede also receives discounts received from NGPL, Noram and Trunkline as well. These discounts antedate the GSIP, and have approached or exceeded \$20,000,000 every year. Because Mr. Henning did not analyze Laclede's transportation contracts, his analysis did not take into account customer mix; peak shaving abilities; Laclede's status as a captive LDC; and storage capabilities. (Tr. 78-80). Mr. Henning relied on historical data to develop his opinions, but not data specific to Laclede. (Tr. 94). His analysis was overly general, disregarding Laclede's average of ** _____

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(Tr. 101-102).

Mr. Henning drew his conclusion that a \$20,000,000 benchmark is unreasonably high based on his view of future market conditions. (Tr. 108-109). He did not review Laclede's reasoning in arriving at the \$13,000,000 baseline. (Tr. 114). Evidence before the Commission suggests that pipelines currently serving the Laclede service area are not fully subscribed, including Panhandle Eastern, NGPL, Trunkline, and Koch (Tr. 164-67); and pipelines with significant available capacity are "more likely to offer discounts." (Tr. 168). Indeed, Laclede does receive discounts from these pipelines. (Tr. 264, 694-96). Laclede obtained "significant" discounts through its recently renegotiated contracts with Reliant and with the majority of its upstream portfolio, its Trunkline agreement, and a new contract with Gulf South. (Tr. 852-53).

Moreover, Laclede admits it "has in place long-term transportation discounts that significantly exceed in discounts the \$13 million baseline for the next two years," undercutting many of Laclede's claims. (Tr. 354).

Under Mr. Henning's reasoning, whether supply increases, as he suggests it will from the South (Ex. 3, Surrebuttal at 5); or decreases, as he suggests it will from the nearer western states and due to the conversion of the Trunkline pipeline (Ex. 3, Surrebuttal at 5, 7); obtaining transportation discounts will become more difficult. The only way obtaining transportation discounts could possibly become easier, or even stay the same, it seems, is for the supply to remain exactly at the level it is today. And in fact, despite the somewhat dire predictions in Mr. Henning's testimony, he admits that the Commission can expect transportation discounts to remain as a viable part of an incentive program for at least the next decade. (Tr. 193).

3. The current and proposed GSIP do not put adequate emphasis on the commodity cost of gas.

The commodity cost of gas represents between 70% and 80% of PGA costs, and 50% to 60% of customers' bills. The demand, or reservation charge for firm gas supply, represents less than 2% of those costs. Transportation costs represent only 25% of PGA costs. (Ex. 16, Schallenberg Rebuttal, Sched. 2). Laclede's current and proposed GSIP have not spurred any savings on the commodity cost of gas, yet have generated more than \$8,000,000 in some years in profit to Laclede. (Ex. 18HC, Sommerer Rebuttal, Sched. 2).

The current GSIP and Laclede's modifications still reward Laclede for tracking the highly volatile index cost of gas. During the 2000-2001 winter the index concept became even more harmful to the customer than in prior years. The index is one of the mechanisms that give Laclede an incentive NOT to hedge because even if it makes a reasonable hedging choice, Laclede could be penalized under the index benchmark. In fact, the benchmark tracks

catastrophic increases in short term gas prices, rewarding Laclede for buying decisions that adjust upward along with the index price.

As part of its fixed price instrument proposal, Laclede suggests that the Commission adopt a floor of 10 BCF and a ceiling of 25 BCF at any price below \$6 per MMBtu. (Tr. 338). This suggestion is made without any written analysis or documentation in support. (Tr. 338; Ex. 25). Quite simply, Laclede expects the Commission to "rely greatly on the expertise of management in these areas" to approve the purchase of gas that could be worth \$45,000,000 or more. (Tr. 340). Certainly, this lack of support is in keeping with the Laclede method of operation not to document decisions in the procurement process. (See Tr. 375-76; 383). Under Laclede's proposal, neither Staff nor the Commission will have the opportunity to review fixed price instrument purchases as long as the purchasing remains within the 10 to 25 BCF range at prices less than \$6.00. (Tr. 350-51; 367; 712-13). Laclede did not provide the Commission with evidence relative to these specific floor and ceiling determinations to enable it to consider the range of market factors, the range of supply basin factors, transportation constraints Laclede faces on MRT and other pipelines, and any other market factors in arriving at its proposals. (Tr. 345). In fact, a finding that 10 BCF at fixed prices is prudent almost implies the rest of the supply is prudent by default, even if a higher fixed percentage may be appropriate.

Laclede further proposes that the Commission institute the 10 BCF floor and 25 BCF ceiling for an open-ended period, until such time as Laclede moves to change them (Neises Surrebuttal, Ex. 2, p. 23). Nevertheless, merely in the time frame of this proceeding, Laclede has changed its proposal on how to treat fixed costs, either on a global level or merely the selection of floor and ceiling numbers, several times. (Tr. 384-85). Mr. Neises indicated that the range

was chosen based on Laclede's view of "this current marketplace in the near term" and that the minimum was based on Laclede's belief "at this point in time." (Tr. 440-41).

Mr. Neises directed his staff, "you sit down and you quantify those benefits that would not have been achieved but for the GSIP," in both the prior GSIP case and the current one. (Tr. 422, 510); but the quantification was subjected to several qualifications over the course of this hearing. For example, the "request for proposals" (RFP) process that is used to establish the benchmark for purchased gas **

** (Tr. 684-86; 690).

Certainly, the RFP process, using unaccepted bids as a means to arrive at an average offering price, cannot establish a "market price" benchmark. (Tr. 777-78).

Customers deserve a utility provider that focuses its efforts on the single greatest cost that affects their bills. Neither Laclede's current GSIP, nor its proposed modifications, do so adequately.

4. The current and proposed GSIP do not address disincentives in the current ACA/PGA process.

Laclede's fear of prudence reviews casts a long shadow over its purchasing practices and entire frame of reference. In a non-GSIP world, according to Mr. Neises, "no matter how good a job we do, the shareholder gets nothing" but the risk of a disallowance. (Tr. 421). However, the shareholder certainly does get a share of the return from Laclede's sales; and this tradeoff of regulated profits in exchange for guaranteed markets is a fundamental part of the public utility sector. The shareholder is protected in many other areas of Laclede's activities: no possibility of losses exists with respect to transportation discounts, capacity releases, off-system sales, and pipeline services. (Tr. 463-64). The Company and shareholders trade the elimination of a

possibility of losses for a reduction in the amount of possible gains. Laclede alleges that if it uses market responsive instruments, and prices do not perform as expected and the company experiences a loss, Laclede will not be able to pass through its losses to the ratepayers. (Tr. 280, 282). Also, decisions of Laclede that are seen as "too conservative" are as subject to prudence reviews as decisions that expose Laclede to too much risk. (Tr. 638-39, 648). Under the hindsight review process that is intrinsic to the prudence review, Laclede is convinced that it faces significant potential disallowances, and as a result it has avoided market instruments -- leading to the problems besetting the State in the winter of 2000-2001. Yet, Laclede admits that as a practical matter the transportation discounts and capacity release and off-system sales are not subject to prudence reviews, either now or under Laclede's new proposals. (Tr. 288).

It is important to note that neither Staff nor the Office of the Public Counsel have used the prudence review process to challenge Laclede's actions to reduce supply reservation costs by contracting for less flexibility of its gas supply, to lock in levels of demand charges to reserve a majority of its gas supply portfolio over a multi-year period, to ** _____

_____ ** and to engage in multi-month capacity releases. (Tr. 630-33, 642).

Incentives can be either positive rewards or negative punishments. It is abundantly clear from the evidence that Laclede believes that the current ACA process imposes significant negative incentives. These disincentives must be reduced, and Laclede's proposed program does not do so. Only Staff's proposed comprehensive gas supply plan addresses the problem.

B. Staff's alternative is the best approach to providing incentives that benefit both ratepayer and shareholder.

Staff's plan is unquestionably the best experimental design of the three submitted to the Commission. It defines and measures how ratepayers will be better off; accommodates weather risk that Laclede will face due to the fixed charge pipeline rate structure; describes each element

contributing to the achievement of the desired result, and provides specific measures for each element; and avoids false signals and incentives. As one of Laclede's witnesses notes, from the consumer's perspective, "customers look at their total bill. They don't look at the gas company piece of it and they don't look at the . . . distribution cost piece of it, and they don't look at the gas cost piece of it . . . whether it's going to the gas company or whether it's going to some marketer down in Texas doesn't matter to [them]." (Tr. 608-09).

Staff's plan forces the Local Distribution Companies ("LDCs") to deal explicitly and comprehensibly with the many factors that affect purchasing decisions, transportation availability, transportation costs, supply availability, supply costs, and the cost of hedging mechanisms. Under Staff's proposal, Staff can review Laclede's plans meaningfully, and at the appropriate time to maximize potential benefits to consumers – and avoids the hindsight review Laclede so vocally fears. In response to Staff's alternative on this topic, Mr. Neises indicates that "the Company doesn't have any choice but to do what the Staff recommends," because "once the Staff makes a recommendation and if we don't follow that recommendation, we are going to be subject to a prudence review in the event that it turns out the way Staff had thought or recommended." (Tr. 365). Mr. Neises believes the "potential for a disallowance" is effectively "like betting the farm." (Tr. 366). This perception is simply unfounded. Staff will do no more than it does in the remainder of the gas supply decision process – undertake a review that it performs for approximately two-thirds of Laclede's gas costs, and a review that it traditionally undertook for all Laclede gas supply decisions, regardless of the GSIP. (Ex. 24, Sched. 2, Chart 1; Tr. 370).

The Staff plan also avoids discouraging Laclede from buying fixed price instruments. Under the current GSIP, Laclede has the incentive to buy gas according to the index rather than

looking ahead, to prevent the possibility that the index could move below the fixed price instrument rates and affect the difference between the benchmark and the price of gas (in other words, Laclede's "savings"), as well as the possibility of a prudence review. (Tr. 1202-03).

Staff has suggested that the Commission could develop a comparison process, where each LDC's performance in a given year as far as the total delivered cost of gas is compared with that same LDC's performance on a total delivered cost of gas the prior year. With that comparison expressed as a percentage, the Missouri LDCs can be ranked to review relative performance for a given ACA year. Laclede has been outspoken in its objection to a comparison between LDC's; yet Laclede itself uses such comparisons when they illustrate Laclede's successes. (Ex. 24, p. 5). The accuracy of the information supplied to the Commission, and that would be relied upon in the comparison process, is undisputed. (Tr. 337).

Staff's proposal requires utilities to come in early in the year and provide Staff an integrated plan incorporating hedging, procurement plan analyses, transportation and storage prospects, etc., and obtain feedback from Staff on the appropriateness of the plan and thereby limit the likelihood of prudence reviews. (Tr. 935-36; 1146). Staff does not intend to provide a preapproval process -- rather, Staff would merely obtain information to improve the oversight process. Staff still intends that a company's management personnel, who have the best and most timely access to information, should make decisions about the particular gas supply portfolio. (Tr. 946). Under a coordinated gas purchase plan, Staff would consider the amount of gas supply covered by fixed price contracts, financial instruments, gas coming out of storage, or other hedging techniques; and make recommendations to the company about options or courses of action, and present them as possible choices. (Tr. 1128-29). Although some documentation would be created to establish Staff's views at any given time, Staff expects Laclede to make

choices based on its expertise in the gas markets and how its options relate to its goals in delivered cost of gas. Laclede would receive Staff's documentation within 60 to 75 days of Laclede's submission of its plan. (Ex. 16, Schallenberg Rebuttal, at 24). Staff would include comments on the relationship between financial hedge and physical purchase and usage of gas storage facilities. (Tr. 1139-40).

With regard to discount levels, to determine whether a prudence review should take place, Staff will attempt to obtain all documentation related to current, past and draft agreements, and all informational material the company relied on in making its decision; consider whether the company was captive on the system; examine the operations on a particular pipeline and try to determine whether or not it was fully subscribed; and review other discounts achieved within the state and discounts on the pipeline for other similarly situated entities. (Tr. 984-85). Staff's review would be based on the information the company had or could have had available at the time, and would look at the company's decisions from the perspective of what the best discount it could have achieved under circumstances that existed at the time. (Tr. 986-87). The prudence review would continue as part of the actual cost adjustment process. (Tr. 987).

It is commonplace that companies will compare earnings in one year to earnings in the next, revenues in one year to revenues in the next, and earnings per share in one year to earnings per share in the next. They compare those statistics to other companies, both within their field and in other fields as well, on a regular basis. Because the companies will not know in advance how they will rank, there is no need for concern that a company may intentionally perform at a lower level in one year in order to show major improvements and rank higher in subsequent years. This outcome is also unlikely because such actions could subject a company to a prudence review. (Tr. 1225-26).

Staff has designed its plan to remove any bias towards either fixed prices or index pricing. The proposal encourages Laclede to evaluate index and fixed pricing on an equal level and allocate its purchasing in the most appropriate manner and encourages diversity in the purchasing program. (Tr. 1021-22). By moving away from a trigger price, Laclede will not rely on a predetermined formula that removes the company's focus from examining the best price, the best mix of supplies, and the best diversification. (Tr. 1078).

Finally, Staff's plan does not require Laclede to perform any additional duties that a prepared company would not already do. Laclede should already be developing and evaluating detailed plans of its natural gas buying activities, revising those plans as market conditions change, and documenting those plans (and decisions made under them) to provide Staff and the Commission with a basis for review. (Tr. 1100-01). If Laclede does not already document its decisions, it would need to – it should already document its decisions, but now will need to take the additional step of incorporating responses to Staff's opinions. (Tr. 1164-65, 1175). Staff anticipates that as a result of its plan, the flow of information will be much more efficient than the current process, that increased and more timely flow will improve the regulatory process, that it will avoid the problems of hindsight review and eliminate some regulatory lag, and that Staff will be able to make more informed recommendations to the Commission and have more of an impact on the actual result than the current, after-the-fact process permits. (Tr. 1146, 1152, 1185-86, 1209-10).

III. IF AN INCENTIVE MECHANISM SIMILAR TO THE CURRENT GZIP IS USED, WHAT TERMS SHOULD IT CONTAIN?

If the Commission chooses to operate under the premise that rewarding individual components in the purchasing process is preferable to a review of a purchasing program's overall

results, then Staff urges a number of modifications to the plan that is currently in place. Staff's baseline proposals do not require unachievable goals; on average, in the past, Laclede has managed to achieve them. (Tr. 765-66). It might be noted that the enhanced Staff review process could also be incorporated into an update of the baselines and will simplify the ACA process because Staff will have better documentation and will know in advance what criteria Laclede used to set its purchasing practices and make specific purchasing decisions. (Tr. 1005-06).

- (1) How should Laclede's gas supply commodity and demand costs be incorporated into the structure?

Staff recommends the demand cost benchmark to be set at 1 cent multiplied by the actual purchase volumes, and that sharing under this mechanism should be curtailed in months where the benchmark index price exceeds \$5.50. Also, Staff suggests that limitations on prudence reviews should be removed from current tariffs. This removes the linkage between ever-increasing index prices and continuance of gas supply incentive "savings." It further offers a solution to Laclede's over-reliance on index pricing by subjecting the Company to a prudence review if it does not take appropriate steps to hedge. (Ex. 17, Sommerer Rebuttal, pp. 14-15).

- (2) What provision, if any, should be made for the use of fixed price contracts and/or instruments?

Staff believes that the fixed price mechanism should be eliminated from any incentive plan. It is a formulistic approach that failed severely last winter and has even been abandoned by Laclede. (Ex. 17, Sommerer Rebuttal, p. 8).

- (3) How should firm transportation pipeline discounts be incorporated into the incentive mechanism?

For discounts other than MRT, Staff recommends a rebasing above the current baseline of \$13,000,000 to a more reflective level of \$20,000,000 and that the sharing percentage be set at

5%. **

** As for the MRT agreement, Staff recommends that no sharing be allowed for this aspect **

** (Tr. 929). If sharing is allowed, the MRT discounts should also be limited to 5% sharing and restrictions that limit savings calculations to cost reductions greater than current contract levels and non-system wide discounts. (Ex. 17, Sommerer Rebuttal, pp. 15-16; Tr. 928-29). The **

** (Tr. 968-69). Failure to include this agreement in past RFP calculations has resulted in automatic "savings" in the RFP mechanism.

The Staff's baselines are predicated on analysis from actual previous GSIP results. The Company's \$13,000,000 transportation discount study is now over two years old. The Company witness who prepared the study was not available for cross-examination in this case. The study is full of self-contradicting flaws. It contains industrial and marketing company shippers that are not comparable to Laclede and may have no need for the services that Laclede claims it has uniquely negotiated. Major contracts have expiration dates that have already come to an end. In short, if it were ever reliable, it is certainly no longer reliable.

(4) How should pipeline mix be incorporated into the incentive mechanism?

Staff recommends the sharing percentage for pipeline mix should be set at 5%, and that no sharing should begin until Laclede has achieved a baseline of \$1,917,000 in savings within the pipeline mix incentive framework. (Ex. 17, Sommerer Rebuttal, pp. 16-17).

- (5) What treatment should be afforded to capacity release credits or revenues?

Staff believes Laclede should achieve a base-line level of \$1,750,000 before it is entitled to share in the capacity release revenues. Staff also proposes to change the sharing percentage to 10% for credits above the baseline. (Ex. 17, Sommerer Rebuttal, pp. 17-18).

- (6) What treatment should be afforded to revenues from off-system sales?

Staff recommends the inclusion of off-system sales margins in an overall GSIP earnings cap. Staff also suggests that a base-line level should be developed for off-system sales, and recommends an amount of \$1,800,000, incorporating off-system sales in the GSIP (Ex. 17, Sommerer Rebuttal, p. 18). Staff suggests a 10% sharing over its proposed baseline to make it consistent with capacity release. (*Id.*). An adjustment would be made in the ACA process to reflect the \$900,000 already embedded in base rates (Ex. 17, Sommerer Rebuttal, pp. 17-18; Tr. 1000). Laclede is not requesting a baseline for off-system sales and has asked for a 35% share in the savings. (Tr. 715). Since off-system sales will take place by virtue of the nature of the gas business, Laclede has guaranteed itself 35 cents of every dollar made on off-system sales unless a baseline is enacted. (Tr. 717).

- (7) How should any savings or revenues associated with these components be determined and allocated between Laclede and its customers and what role, if any, should baselines play in that process?

See the responses to issues (3), (4), (5), and (6), which discuss baselines for each relevant component.

- (8) Should an earnings cap be placed on the savings and revenues retained by Laclede?

Staff believes an earnings cap is necessary to account for unexpected windfalls and recommends a \$9,000,000 cap. (Ex. 16, Schallenberg Rebuttal, p. 33; Ex. 17, Sommerer Rebuttal, p. 18).

(9) Should a specific term for the incentive mechanism be established?

Staff recommends that the term of any incentive plan established by this case should be one year, in order to permit modifications needed due to market, management philosophy, and gas supply options, and in order to allow the incorporation of recommendations from the Commission's Natural Gas Commodity Price Task Force established in Case No. GW-2001-398. (Ex. 16, Schallenberg Rebuttal, p. 32). Incentive plans without termination create the possibility of programs out of date and out of touch with current market realities; targets could be set too low, or not be rebased on current data; studies serving as a basis for the program become outdated; and rewards may stem from events unassociated with the incentive program. (Tr. 1017, 1183-84).

(10) How should bundled sales and transportation contracts be treated?

Staff suggests that the existing tariff addresses this issue for the limited purposes of this case, and has not filed testimony to address the issue.

IV. IF AN INCENTIVE MECHANISM IS NOT USED, WHAT ALTERNATIVE SHOULD BE IMPLEMENTED IN ITS PLACE?

Staff has adequately discussed this point in paragraph II.B., above.

V. CONCLUSION

Staff has proposed a new incentive plan, one which takes into account the full range of factors and focuses on what will be the best outcome for the ratepayer, while still ensuring the company a reasonable profit. Staff's plan addresses the disincentives in the current ACA process, and that element alone will improve results for customers. The Commission should adopt Staff's proposal.

Respectfully submitted,

DANA K. JOYCE
General Counsel



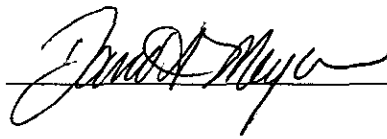
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Certificate of Service

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record as shown on the attached service list this 23rd day of July, 2001.



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