



Martha S. Hogerty
Public Counsel

State of Missouri

Bob Holden
Governor

Office of the Public Counsel
Governor's Office Building
200 Madison, Suite 650
P.O. Box 7800
Jefferson City, Missouri 65102

Telephone: 573-751-4857
Facsimile: 573-751-5562
Web: <http://www.mo-opc.org>
Relay Missouri
1-800-735-2966 TDD
1-800-735-2466 Voice

July 23, 2001

FILED³

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Mr. Dale H. Roberts
Secretary/Chief Regulatory Law Judge
Public Service Commission
P. O. Box 360
Jefferson City, MO 65102

Missouri Public
Service Commission

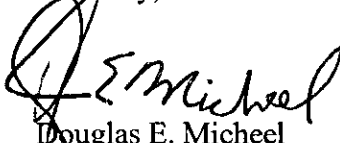
**RE: Laclede Gas Company,
Case No. GT-2001-329**

Dear Mr. Roberts:

Enclosed for filing in the above-referenced case please find the original and eight copies of **Initial Brief of the Office of the Public Counsel**. Please "file" stamp the extra-enclosed copy and return it to this office.

Thank you for your attention to this matter.

Sincerely,


Douglas E. Micheel
Senior Public Counsel

DEM:kh

cc: Counsel of Record

**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.)

Case No. GT-2001-329

INITIAL BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

OFFICE OF THE PUBLIC COUNSEL

Douglas E. Micheel MoBE# 38371
Senior Public Counsel
P.O. Box 7800
Jefferson City, MO 65102
(573) 751-5560
(573) 751-5562 FAX
dmicheel@mail.state.mo.us

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**INITIAL BRIEF OF THE
OFFICE OF THE PUBLIC COUNSEL**

I. INTRODUCTION

In this proceeding, Laclede Gas Company ("Laclede" or "LGC") has sought Commission approval of a new modified Gas Supply Incentive Plan ("GSIP") for an indefinite term. The Office of the Public Counsel ("Public Counsel") has critically analyzed LGC's new modified GSIP and offered its own proposal for a gas supply incentive plan for LGC on a going forward basis.

Before discussing the specific GSIP proposals proffered by LGC, Public Counsel and Staff it is important to understand the background of treatment of items denoted as "gas costs" in Missouri and how changes at both the state and federal level have impacted this Commission's regulatory treatment of such costs. From the enactment of Missouri's Public Service Law in 1913 to 1962, local distribution companies (LDC's") recovered gas costs in a general rate proceeding. The purchased gas adjustment ("PGA") clause was introduced into the regulatory framework in Missouri for LDCs in 1962 when the Commission approved the use of a PGA clause for Laclede. The Commission's adoption of the PGA clause was predicated on the premise that Laclede had "virtually no control" over the wholesale price of gas. In re Laclede Gas Company, 10 Mo P.S.C. (N.S.) 442, 452 (1962); 46 P.U.R. 3d 277, 285.

In the mid to late 1980's the Commission adopted the Actual Cost Adjustment (ACA) procedure. The goal of the ACA process was to ensure that ratepayers pay no more than the actual cost for the cost of gas. Thus, once a year, over or under recoveries for the estimated cost of gas included in the PGA rate were either returned to or charged to ratepayers on a going forward basis.

Also beginning in the 1980's, the Federal Energy Regulatory Commission ("FERC") via Orders 436 and 500 articulated an open access policy that enabled utilities and industrial customers to purchase gas directly from the interstate pipelines and upstream suppliers. In 1992, FERC entered Order 636 and its progeny. Under Order 636, which was implemented on Laclede's interstate pipelines in November 1993, interstate natural gas pipelines became common carriers of natural gas. Thus, interstate natural gas pipelines were effectively taken out of the gas procurement business.

These changes at the federal level placed much greater responsibility on local distribution companies, such as Laclede, to plan, procure and transport an adequate supply of natural gas. These changes at the federal level also gave Laclede much greater control over certain aspects of its gas supply portfolio.

Based in part on the changes at the federal level and the fact that LDC had more meaningful control over certain aspects of their gas supply portfolio and an apparent desire to move away from the traditional PGA/ACA process, the Commission determined it was appropriate to allow local distribution companies to implement incentive PGA rate plans on an experimental basis.

Laclede received its first experimental gas supply incentive plan ("GSIP") when the Commission approved a Stipulation and Agreement in GR-96-193. The Stipulation and Agreement in GR-96-193 provided "Public Counsel neither supports or opposes approval of the PGA incentive mechanism set forth in Attachment 2." At the expiration of the experimental GSIP approved in

GR-96-193, Laclede filed a proposal to continue the GSIP in a modified form. After hearing the Commission approved a modified GSIP in Case No. GT-99-303 for a term of one year. (Exhibit 1, p. 5, l. 15-22).¹ Subsequent to the approval of GT-99-303 Laclede, Public Counsel and the Staff entered into a Unanimous Stipulation and Agreement to continue the GSIP approved in GT-99-303 with certain modifications in Case No. GO-2000-395. (Ex. 1, p. 6, l. 2-5; Ex. 17, p. 5, l. 6-22). Those modifications included extending the GSIP another year and placing an earnings cap of \$9 million upon Laclede's profit ability under the GSIP among other things. (Ex. 1, p. 6, l. 7-15; Ex. 17, p. 5, l. 10-15).

In this proceeding Laclede seeks approval from the Commission to modify the current GSIP and extend its operation for an indefinite time into the future. Public Counsel believes that certain modifications to Laclede's current GSIP should be implemented and certain aspects of Laclede's GSIP should be eliminated.

II. ARGUMENT

A. Purpose and Expectations of the Gas Supply Incentive Plan

Public Counsel believes that the GSIP was established to provide Laclede an incentive to lower overall gas costs for customers and allow Laclede to be rewarded with a profit opportunity for lowering those gas costs. As this most recent winter heating season demonstrated the GSIP did little, if anything, to help reduce the cost of natural gas to the customers. As witness Meisenheimer pointed out in her rebuttal testimony, the gas procurement function of the GSIP only amounted to about 2¢ per dollar spent on gas for the 1999-2000 fiscal year. (Ex. 35, p. 10, l. 12-14). Apparently in recognition of the GSIP's failure to reduce customers gas costs in a perceptible manner, the

¹ Citations to the record will be abbreviated as follows: Tr. for Transcript and Ex. For Exhibit.

Company has shifted its focus away from lowering gas costs to customers and asserts that the GSIP revenues are necessary to give Laclede the ability to earn its authorized returns on the non-gas portion of its business. (Ex. 2, p. 5, l. 11-15).

The record evidence demonstrates that the GSIP has not given any meaningful gas costs price reduction to consumers. The GSIP only serves as meaningful profit protection to the shareholders. Laclede's strategic plan (Ex. 45HC) appropriately recognizes the GSIP as a profit center with no mention of price protection to consumers. (Ex. 34, p. 7, l. 5-8). As demonstrated by Exhibit 44, GSIP income has resulted in a significant percentage of Laclede's net income:²

<u>Fiscal Year</u>	<u>(000)</u>		<u>%</u>
	<u>GSIP Income</u>	<u>Total Income</u>	
1997	4,542	32,369	14.0%
1998	3,908	27,795	14.1%
1999	3,320	25,965	12.8%
2000	5,917	25,872	22.9%

When the GSIP earnings are reviewed in terms of the Company's total net earnings, those earnings are significant. (Tr. p. 839, l. 3-5).

Laclede claims that pursuant to its GSIP it has "saved" millions of dollars on its gas costs. However, those "savings" levels are based upon a comparison with the Company's activity in the 1995/1996 fiscal year and the savings calculation never raises the bar for Laclede's actions. (Tr. p. 736, l. 7-8). Laclede engaged in the vast majority of activities it claims it utilized to "save" on gas costs prior to the implementation of the GSIP. For example, Laclede released capacity on a multi-

² Laclede attempts to obfuscate how much money it makes on gas costs via the GSIP by comparing the profits to total gas costs. (Ex. 2, p. 14, l. 1-5). The more meaningful percentage is the net income percent shown in Exhibit 44.

month basis (Tr. p. 641, l. 20-24); Laclede had previously locked in demand charges (Tr. p. 631, l. 19-24); and Laclede secured a level of transportation discounts. (Tr. p. 248, l. 12-18; Ex. 17, p. 8, l. 14-17). Staff or Public Counsel did not raise prudence challenges to these actions. (Tr. p. 632, l. 3-6; Tr. p. 642, l. 8-11).

Laclede claims that absent the GSIP it would not have taken any of the actions it has taken because it is afraid of a prudence disallowance. (Tr. p. 631, l. 2-4; p. 637, l. 15-25). Witness Jaskowiak testified that the following actions taken by Laclede were good business decisions and were prudent decisions: contracting for less flexibility in gas supply (Tr. p. 630, l. 8-11); locking in demand charges (Tr. p. 631, l. 5-15); purchasing gas supply below index (Tr. p. 633, l. 1-3); eliminating MRT's flexible contract demand (Tr. p. 636, l. 22-25; p. 637, l. 1-5); multi-month capacity release (Tr. p. 641, l. 15-25); negotiating firm transportation contracts with parties other than traditional pipelines (Tr. p. 642, l. 18-25; p. 643, l. 1); and reducing the level of combo and swing gas and increasing the level of base load gas. (Tr. p. 643, l. 2-10). The Company's actions discussed above, assuming supported by proper evidence, easily meets the Commission's prudence standard. The Commission's prudence standard states:

"The Commission will assess management decisions at the time they are made and ask the question, "given all the surrounding circumstances existing *at the time*, did management use due diligence to address all relevant facts and information known or available to it when it assessed the situation?" In accepting a reasonable care standard, the Commission does not adopt a standard of perfection. Perfection relies on *hindsight*. Under a reasonableness standard relevant factors to consider are the manner and timeliness in which problems were recognized and addressed." Re Union Electric 27 Mo. P.S.C. (N.S.) 183, 194 (1985) quoting Consolidated Edison Company of New York, Inc. 45 P.U.R. 4th 331, 1982.

The Company's irrational fear of prudence disallowances and its timid conduct of its gas supply activities should not justify this Commission giving Laclede the ability to earn up to \$9 million or

\$10 million on its gas supply activities and completely shielding the Company from any risk of prudence disallowances.

Perhaps the most disturbing claim Laclede has made in this proceeding is that the GSIP profits are necessary to help bolster Laclede's non-gas earnings. This should not even be an issue in this proceeding. As candidly admitted by witness Buck in response to a question from then Chair Lumpe, "the GSIP was setup as a – as a way to incentivize the company to lower gas costs for our customers. The original intent was never to cover costs that should under normal circumstances, be covered through base rates." (Tr. p. 589, l. 10-22). Unfortunately for Laclede's customers, the GSIP has become just another profit center for the Company to manage. Reducing gas costs to customers has become a secondary focus at best. In fact, this last winter customers saw the highest gas prices in history.

Contrary to Laclede's assertion, Public Counsel never asserted Laclede was making excess profits on its non-gas costs. Public Counsel witness Meisenheimer stated: "Laclede is permitted to retain a portion of the commodity cost discounts as excess profit. In other words, this mechanism provides a profit opportunity in excess of the normal profit opportunity afforded through a traditional rate case." (Ex. 35, p. 3, l. 18-20). A statement witness Buck agreed with. (Tr. p. 509, l. 2-13). Laclede's over or under earnings on its non-gas costs are not relevant to this proceeding and in no way should be considered when determining whether the GSIP should be extended for an indefinite period of time as requested by Laclede.

The GSIP, and the gas purchasing practices that it encourages, are not the best approach to natural gas purchasing in today's natural gas markets. (Ex. 16, l. 11-13). Public Counsel believes certain modifications and elimination of certain components of the GSIP are necessary to achieve a reasonable balance between ratepayer and shareholder interest. Absent these requested

modifications, Laclede's GSIP will continue to be a Company profit protection plan as opposed to a gas price protection plan for the Company's captive ratepayers.

B. Laclede Gas Company's Proposal

In its direct testimony in this proceeding filed in February 2001 Laclede proposed one significant modification to the currently effective GSIP – the addition of an Experimental Fixed Price Program (“EFPP”)³ – (Ex. 1, p. 7, l. 6-10); the elimination of the duration of the program (Ex. 1, p. 13, l. 15-20); the elimination of the \$9 million cap on the Company's ability to profit from the GSIP (Ex. 1, p. 16, l. 11-15) and the removal of the provision excluding from GSIP consideration any transportation rate discounts negotiated by the Company with Mississippi River Transmission Corporation (“MRT”). (Ex. 1, p. 16, l. 16-17).

In surrebuttal testimony Laclede described “further modifications” that the Company was willing to make to its GSIP. (Ex. 2, p. 1, l. 12-13). Allegedly, these modifications were in response to concerns raised by Staff and Public Counsel in their rebuttal testimony. (Ex. 2, p. 1, l. 14-15).⁴ According to Laclede witness Neises, the GSIP proposal Laclede is requesting this Commission adopt is setout in the Company's surrebuttal testimony. (Tr. p. 267, l. 9-18; Tr. p. 446, l. 16-20). Thus, Laclede has completely abandoned its proposed EFPP setout in the direct testimony of witness Jaskowiak. (Tr. p. 286, l. 14-25; Tr. p. 795, l. 9-25).

Having abandoned its experimental fixed price proposal, for this winter heating season Laclede is willing to commit to purchasing fixed price instruments for a least 10 Bcf of its winter gas requirements for December, January and February, as long as Laclede can purchase these fixed

³ The EFPP was setout in detail in Mr. Jaskowiak's direct testimony Exhibit 4.

⁴ Suffice it to say, Laclede's proposed “modifications” do not in anyway alleviate Public Counsel's concerns. In effect, Laclede has offered an entirely new case in its surrebuttal testimony.

price instruments below a \$6.00 per MMBtu price in these months. (Ex. 2, p. 22, l. 3-7; Tr. p. 386, l. 3-10). Purchases for this winter (heating season 2001/2002) made within the above referenced guidelines would be immune from prudence reviews. (Ex. 2, p. 22, l. 7-9; Tr. p. 712, l. 1-5). After the winter heating season of 2001/2002 Laclede proposes to procure fixed price instruments to cover a range of natural gas volumes from a minimum of 10 Bcf to a maximum of 25 Bcf (Ex. 2, p. 23, l. 15-17). Pursuant to this proposal, Laclede would retain 10% of any gains from or absorb 10% of the losses associated with the use of the fixed price instrument, subject to the Laclede proposed overall GSIP price cap level of profits of \$10 million and a \$1 million limit on losses. (Ex. 2, p. 22, l. 13-22; p. 23, l. 1-13). Moreover, so long as Laclede purchases the fixed price instruments to cover the minimum 10 Bcf level and does not exceed the maximum 25 Bcf Laclede will be immune from a prudence review of the Company's actions. (Tr. p. 350, l. 25; p. 351, l. 1-2; p. 712 l. 11-19).

In its surrebuttal testimony, Laclede also proposed modifications to the other aspects of its proposed GSIP. Under the current GSIP, the Company is permitted to retain as profit 50% of the cost reductions achieved under the gas procurement portion of the GSIP. (Ex. 2, p. 6, l. 9-10). This portion of the current GSIP has two separate components that allow Laclede to profit – the gas supply demand cost component and the commodity component. (Ex. 35, p. 6, l. 1-17). Laclede proposes that the gas supply demand cost component of the GSIP remain in effect and that only its ability to profit from this component be reduced from the current 50% share to a 35% share with 5% of the profit going to Dollar-Help. (Ex. 2, p. 6, l. 1-16). Laclede proposes, consistent with the recommendations of Public Counsel and Staff that the commodity component of the gas procurement portion of the GSIP be eliminated. (Ex. 2, p. 6, l. 16-18).

With respect to the transportation discounts and the mix of pipeline services portion of the current GSIP Laclede has the ability to retain as profit 30% of the cost reductions in the mix of pipeline services (Ex. 34, p. 3, l. 16-24) and 30% of the transportation discounts above a \$13 million baseline. (Ex. 34, p. 4, l. 4-6). Laclede proposes the mix of pipeline services portion and the transportation discount portion of the GSIP remain intact, but that the sharing be increased from 30% to 35%, with 5% going to Dollar-Help and that the \$13 million benchmark be retained for the transportation discount portion of the GSIP. (Ex. 2, p. 2, l. 13-17; Tr. p. 254, l. 19-25; p. 255, l. 1-3).

Currently, Laclede receives profits from the release of pipeline capacity pursuant to the following Commission approved sharing grid:

<u>Capacity Release Revenues</u>	<u>Laclede's profit percentage</u>
First \$1,500,000	10%
\$1,500,000 to \$2,500,000	\$150,000 plus 20% of difference above \$1,500,000.
Amounts over \$2,500,000	\$350,000 plus 30% of amount of \$2,500,000.

(Laclede tariff P.S.C. MO. No. 5 Consolidated, Sixth Revised Sheet No. 23)

(Ex. 34, p. 3, l. 8-15). Laclede requests that the current sharing grid for capacity release be replaced and that Laclede be given an opportunity to extract as profit 35% of any capacity release revenues, with 5% going to Dollar-Help. (Ex. 2, p. 6, l. 15-18).

Finally, Laclede proposes that off-system sales revenues be removed from base rates and this item be placed back in the GSIP with Laclede being given an opportunity to extract as profit 35% of any off-system sales revenues, with 5% going to Dollar-Help. (Ex. 2, p. 3, l. 17-18). Currently off-system sales revenues are treated in a general rate case and Laclede is permitted to

retain 100% of the off-system sales revenues it achieves between general rate cases once the \$900,000 base line included in rates is exceeded. (Ex. 2, p. 6, l. 13-15).

Laclede also proposes that it will institute a \$10 million cap on its ability to profit from its proposed GSIP (Ex. 2, p. 13, l. 21-22) and that the proposed GSIP become a permanent fixture in its tariffs. However, Laclede did propose language that would permit the Commission to make further modifications to the proposed GSIP in the event the Commission ultimately adopts any recommendations from the Natural Gas Commodity Price Task Force that are "inconsistent" with the proposed GSIP provisions. (Ex. 2, p. 3, l. 22-24; p. 4, l. 1-2).

Public Counsel is opposed to most if not all of Laclede's proposed GSIP modifications. In Public Counsel's opinion, these proposed modifications fail to properly balance ratepayer and shareholder interests and merely set the stage for Laclede to extract additional profits from ratepayers without any risk on the part of shareholders. Public Counsel will discuss its specific problems with each part of the proposed GSIP. Public Counsel believes certain modifications and elimination of certain portions of Laclede's proposed GSIP are necessary to achieve a reasonable balance between shareholder and ratepayer interests.

C. Fixed Price Proposal

Having abandoned its Experimental Fixed Price Plan (Tr. p. 286, l. 14-25; Tr. p. 710, l. 11-14) Laclede has recommended that the Commission pre-approve a proposal that allows Laclede to procure fixed price instruments to cover a range of volumes from a minimum of 10 BCF to a maximum of 25 BCF for winter heating seasons after the 2001/2002 winter heating season, (Ex. 2, p. 23, l. 15-17). For the winter heating season 2001/2002 Laclede seeks pre-approval to purchase at least 10 BCF of its winter gas requirements, as long as Laclede can purchase these fixed price

instruments below a \$6.00 per MMBtu price. (Ex. 2, p. 22, l. 3-7; Tr. p. 386, l. 3-10). Public Counsel is opposed to the Commission pre-approving specific levels of fixed priced instruments.

Public Counsel has a number of concerns regarding Laclede's new proposal contained in its surrebuttal testimony. Most of Public Counsel's concerns are similar to the concerns Public Counsel had regarding pre-approval of EFPP. First, pre-approving a rigidly designed purchasing rule on a going forward basis could force Laclede to forego opportunities to secure fixed price contracts that would produce reasonable price protection for customers. (Ex. 35, p. 14, l. 20-21; p. 36, l. 1). Second, by pre-approving a specific level of volumes to be covered by fixed price instruments, the Commission will assume responsibility for mandating how much fixed price instruments Laclede can and cannot purchase. If levels higher or lower than the proposed 10 BCF to 25 BCF are more appropriate based upon market conditions, Laclede will be able to say "our hands were tied" the Commission only allows us to purchase a certain amount of fixed price instruments. Also, under Laclede's proposal, the Commission will have relinquished its ability to review the decisions that Laclede has made. (Tr. p. 712, l. -15; p. 713, l. 11-19). In essence, Laclede has invited this Commission to become a partner in its gas purchasing decisions. The Commission should decline the invitation. As noted by the Commission in Case No. GO-95-329 In the matter of the investigation of integrated gas resource planning rules by the Staff of the Missouri

Public Service Commission:

Decision-making should remain with utility managers, not the Commission. The Commission has not to this point, and has no intention, of assuming, either directly or in a *de facto* fashion, the management prerogatives and associated responsibilities for strategic decision-making. It is far wiser, particularly in a free market, economy, to allow utility managers the flexibility to make both overall strategic planning decisions and the more routine decisions in a relatively unencumbered fashion.

(Order Regarding Joint Motion to Determine the Need for Integrated Resource Planning Rules for Gas Utilities, p. 3, June 2, 1995).

Moreover, Laclede has failed to demonstrate that its proposal to subject 10 BCF to 25 BCF of its gas supply to protection by fixed price instruments is appropriate. Laclede failed to produce any documents or written analyses that supported this specific level, or any other level, of fixed price protection. (Ex. 25; Tr. p. 388, l. 18-21). When questioned why Laclede had absolutely no written analysis supporting its proposal Laclede witness Neises stated: "[i]t's not complicated. This is not rocket science, nor is it any kind of science. Essentially you're simply looking at - - it's very simple." (Tr. p. 351, l. 23-25). Inasmuch as determining the appropriate amount of gas supply is not "rocket science" and is "very simple" this Commission ought not give its imprimatur of approval to a specific mandated level of fixed price instruments. If Laclede has confidence in these purchasing guidelines, Laclede can certainly follow those guidelines without a specific Commission mandate. (Ex. 35, p. 19, l. 17-18). Absent a mandate to follow a rigid rule, Laclede would retain the flexibility to alter the volumes protected by fixed price instruments in response to changing market conditions.

However, Public Counsel has recommended an incentive if the Commission wishes to encourage Laclede to utilize fixed price contracts. The fixed price contract allows Laclede to lock-in a future price for natural gas when it appears favorable. The locked-in future price is not affected by future market conditions. The benefit of this pricing arrangement is to ensure gas costs do not exceed a specified maximum rate that appears favorable based upon prudent analyses of information known and available when the decision is made.

Public Counsel believes the fixed price benchmark should be based on Inside FERC Gas Market Report's (IFGMR) first-of-the-month spot market index for the transporting pipeline for the

month of delivery plus associated premium. If IFGMR does not report a spot market index for the transporting pipeline, a reasonable substitute could be the first-of-the-month spot market index published in Gas Daily or Natural Gas Intelligence. Public Counsel also believes it would be reasonable to include a \$0.055/MMBtu premium. This premium is intended to reflect the *firm* nature of service being provided by fixed price contracts while the spot market index generally represents *interruptible* (i.e. no guarantee of availability) purchases. (Ex. 35, p. 12, l. 1-14). The difference between the fixed price and benchmark (i.e. first-of-the-month spot market index plus \$0.055/MMBtu premium) would be determined and multiplied by the actual purchase volumes. When the fixed price is below the benchmark rate, a financial benefit would occur. Likewise, if the fixed price is above the benchmark rate, a financial detriment has been incurred. (Ex. 35, p. 12, l. 15-21).

Public Counsel proposes a 50/50 sharing of the financial benefits and detriments of using fixed price contracts. However, Public Counsel's proposal has no preset or predetermined limits or requirements. Laclede management would be wholly responsible for making any and all of the purchasing decisions.

The Commission should reject Laclede's rigid 10 BCF to 25 BCF proposal. The Commission should encourage Laclede to purchase fixed price instruments to protect customers from gas price fly-ups. However, the Commission should not pre-approve specific levels of purchasing practices, pre-approval is not necessary to ensure fair treatment of the Company and its customers. (Ex. 35, p. 20, l. 6-14).

D. Gas Procurement

Under the current GSIP, the Company is permitted to retain as profit 50% of the cost reductions achieved under the gas procurement portion of the GSIP. (Ex. 2, p. 6, l. 9-10). This

portion of the current GSIP has two separate components that allow Laclede to profit – the gas supply demand cost component and the commodity component. (Ex. 35, p. 6, l.1-17). In this proceeding, Laclede has sought to modify this component of the GSIP by recommending elimination of the commodity component of the gas procurement portion of the GSIP (Ex. 2, p. 6, l. 16-18) and recommending that the demand cost component remain in effect, but that Laclede's ability to profit from this component be reduced from 50% to a 35% share. (Ex. 2, p. 6, l. 1-16). Public Counsel opposes this modification and believes this portion of the GSIP should be eliminated in its entirety. (Ex. 35, p. 10, l. 8-11).

Public Counsel believes that the current gas procurement portion of the GSIP has not resulted in mitigating gas costs for customers. Based on estimated GSIP Gas Supply cost reductions and gas supply cost for the 1999/2000 ACA Period, it appears that the impact of this mechanism amounted to just of 4¢ per dollar spent on natural gas. Of the 4¢, Laclede kept half reducing the consumer impact to about 2¢ per dollar spent on gas. Keep in mind that this "savings" was determined based on an assumption that the alternative was to basically pay the moving market price index. It does not reflect the "savings" that might be achieved under other procurement strategies. (Ex. 35, p. 7, l. 6-12). Laclede retained just over \$5 million from this mechanism under other procurement strategies. (Ex. 35, p. 7, l. 14-15).

The gas procurement mechanisms have been ineffective in reducing customers gas costs because the demand component of gas costs represents only a small fraction of the cost of gas, roughly 2-5%. (Ex. 35, p.7, l. 18-20). The lion's share of the cost, 95-98% are instead attributable to the commodity component. (Ex. 35, p.7, l. 20-21). Under the benchmark mechanism Laclede has some ability to control reductions in the demand charge. However, under this scenario Laclede pays the going market price at delivery for the commodity component. Since Laclede has no

control over the commodity component that constitutes the vast majority of costs, the benchmark mechanism provides no meaningful protection for customers. (Ex. 35, p. 8, l. 1-4). Moreover, the Commission has relinquished its ability to review the Company's purchasing practices.

Another reason the gas procurement mechanism have proven ineffective is the design of the incentive plans yields little incentive for Laclede to act in a manner that promotes consumers' best interests. (Ex. 35, p.8, l. 6-8). Economic theory suggest that when an "**incentive planner**" (the Commission) acting on behalf of the "**principal**" (the body of ratepayers) wants to design an incentive payment to induce an "**agent**" (Laclede) to take the best action from the point of the principle (ratepayers) the design of the incentive payment must be "**individually rational**" and "**incentive compatible**" for the agent. (Laclede) To be individually rational for the agent (Laclede) an incentive structure must offer at least the "**reservation price**" (minimum payment) that would cause the agent (Laclede) to be willing to participate. The more risk averse the agent (Laclede), the higher the reservation price they would demand. Conversely, the higher the reservation price, the less likely that the net benefit from the incentive plan will justify the cost to the principal (ratepayers). To be incentive compatible, the structure of the incentive payments must be designed in a way that causes the agent (Laclede), when acting in its own best interest, to act in a manner that produces the principal's (ratepayer's) desired outcome. Unfortunately, the design of portions of the current GSIP do not satisfy these constraints thus providing perverse incentives for Laclede to act in ways that do not achieve the desired outcomes for ratepayers. (Ex. 35, p. 8, l. 6-22). Recent natural gas price increases demonstrate that consumers would have been best served by a procurement strategy that included purchasing a reasonable measure of fixed price contracts, however, under the GSIP Laclede was not persuaded to do so. (Ex. 35, p. 8, l. 23-25; p. 9, l. 1-4).

Finally, and most importantly, when the Commission approved this mechanism it pre-approved various ranges around the Benchmark as being prudently incurred costs, eliminating any opportunity for parties such as Public Counsel to review Laclede's purchases. Further, since there are no volume limits on the Benchmark method it acts as a safe haven against prudence as long as actual cost are within the predetermined range around the Benchmark. Unfortunately, this rules out Public Counsel's ability to challenge a complete lack of fixed protection when markets are anticipated to rise. (Ex. 35, p. 10, l. 23-25; p. 11, l. 1-4). By terminating the gas procurement portion of the GSIP, the Commission would be reinstating Public Counsel's and this Commission's ability to protect consumers by conducting regular and thorough reviews of Laclede's natural gas commodity purchases.

Laclede's proposal to eliminate the commodity component of the gas procurement portion of the GSIP is a step in the right direction. However, Laclede's proposal to reduce the sharing on the demand component of the GSIP from 50% to 35% does not go far enough. Due to the ineffective nature of the demand component to reduce gas costs this component should be eliminated. However, if the Commission wishes to retain the demand component it should allow Laclede 25% of any positive difference between the annual demand cost benchmark and the Company's actual demand charge costs. (Ex. 35, p. 11, l. 9-11).

E. Capacity Release

Capacity release was implemented by the FERC as a result of FERC Order No. 636. Capacity release provides owners of interstate pipeline capacity, such as Laclede, the ability to release (i.e. market) unutilized capacity and receive revenues to mitigate interstate pipeline reservation charges. In this proceeding, Laclede seeks to retain 35% of the revenues it receives from releasing unutilized capacity on interstate pipelines. (Ex. 2, p. 6, l. 15-18; Tr. p. 716, l. 13-23).

Pursuant to Laclede's proposal the Company would share in the first dollar of capacity release revenue and no baseline would be established. (Tr. p. 716, l. 24-25; p. 717, l. 1-2). Thus on the first dollar of capacity release revenue achieved by Laclede, the Company would retain 35¢. This proposal by Laclede offers only upside benefit to the Company with absolutely no downside risk. (Tr. p. 463, l.8-13). Such an asymmetrical proposal is inappropriate and fails to appropriately balance the ratepayer and shareholder interests.

Public Counsel believes the proposed structure for the capacity release portion of the GSIP fails to appropriately recognize the fact that a certain level of capacity release revenues are inherent with Laclede's mix of pipeline services. (Tr. p. 264, l. 15-22; Tr. p. 717, l. 11-22). Recognizing that a certain level of capacity release revenues are inherent in the mix of pipeline services for Laclede, Public Counsel believes it is wholly inappropriate to allow the Company to earn revenues on the first dollar of capacity release revenues as requested by Laclede. Instead of modifying the current GSIP portion for capacity release and allowing Laclede to retain 35% of all capacity release revenues this portion of the GSIP should be eliminated and capacity release revenues should be treated as a revenue stream in Laclede's pending general rate case Case No. GR-2001-629.⁵ (Ex. 34, p. 21, l. 3-5). Public Counsel believes the level of capacity release revenues to be imputed for Laclede should be determined in Case No. GR-2001-629.

Public Counsel believes including capacity release revenues in base rates provides a reasonable balance between Company and ratepayer interests. By imputing a reasonable level of capacity release revenues into Laclede's base rates, Public Counsel's proposal provides Laclede a

⁵ According to a proposed schedule Public Counsel will be filing its direct testimony in GR-2001-629 in October.

real incentive to improve its performance above and beyond the inherent levels resulting from its mix of pipeline services.

Moreover, such a proposal provides a level of symmetry between the risks and rewards relating to capacity release. If Laclede fails to achieve a level of capacity release at or above the imputed revenue level it will lose money. If Laclede achieves capacity release revenues greater than the imputed revenue amount Laclede retains 100% of the profits. Laclede witness Henning testified that incentives should be symmetrical. (Tr. p. 138, l. 15-25). As demonstrated by highly confidential exhibits 49 and 50 placing capacity revenues in a base rate case proceeding would have given Laclede the ability to earn millions of dollars from capacity release.⁶ (Tr. p. 660, l. 1-8; p. 665, l. 25; p. 666; p. 667, l. 1-4).

If, contrary to Public Counsel's primary recommendation, the Commission desires to maintain Laclede's current capacity release framework, Public Counsel recommends that a benchmark level of \$1.9 million be established and any amounts over this benchmark would then be subject to the sharing grid in Laclede's currently effective tariff MO No. 5 Consolidated, Sixth Revised Sheet No. 23. (Ex. 34, p. 21, l. 5-9). This recommendation still recognizes that certain capacity release revenues are inherent based on the Company's mix of pipeline services while providing financial benefit to Laclede not available under the traditional PGA/ACA process.

Public Counsel's proposed \$1.9 million baseline level is reasonable given the fact that in the 96/97, 97/98 and 98/99 this capacity release revenue level is well below Laclede's historical level. (Ex. 49 and 50). This level is only slightly above the level for 99/00 when it approached \$1.75 million. However, Laclede was able to achieve this level of revenues when capacity release had hit

⁶ Although Public Counsel does not agree with the claims made by Laclede regarding the adequacy of its non-gas rates, Public Counsel's proposal would help address this perceived problem.

“rock bottom.” (Tr. p. 720, l. 14-20). Both Laclede witnesses, Henning and Jaskowiak, testified that capacity release values will increase. (Tr. p. 118, l. 9-13; Tr. p. 718, l. 20-25). Even in the unlikely event that Laclede fails to achieve the benchmark level of capacity release revenues, Laclede still would not be at risk to lose money, it merely would not receive any profits from its capacity release transactions. Laclede and Public Counsel both agree that a certain level of capacity release revenue is inherent in Laclede’s mix of pipeline supplies. Thus, the Commission should not hesitate to utilize a baseline for determining when any revenue sharing occurs between ratepayers and shareholders with respect to capacity release revenues.

Public Counsel’s primary proposal to impute a reasonable level of capacity release revenues in Laclede’s pending rate case, GR-2001-629, appropriately balances the risks between the Company and the customers. Public Counsel’s proposal establishes a symmetrical incentive providing a penalty for poor performance and a substantial reward for performance above the threshold level established in rates.

F. Off-System Sales

In GT-99-303 the Commission accepted Public Counsel’s recommendation that off-system sales revenues be included in base rates when determining Laclede’s revenue requirement. (Report and Order GT-99-303, pp. 15-16 Sept. 1999). Subsequently in GR-96-193 the Commission determined that \$900,000 of off-system sales revenues should be imputed in Laclede’s revenue requirement. (Report and Order GR-96-193, p. 40 Dec. 1999). In this proceeding Laclede and the Staff seek to remove off-system sales revenues from base rates and return off-system sales to the

GSIP. (Ex. 2, p. 3, l. 17-18; Ex. 17, p. 18, l. 2-9). Public Counsel believes off-system sales revenues should remain in base rates.⁷

The Commission's decision to place off-system sales revenues in base rates resulted in the creation of a symmetrical incentive that allowed Laclede significant upside potential (in 99/00 Laclede realized approximately \$1.5 million in profit Ex. 49) with the potential to lose money. Witness Jaskowiak testified placing off-system sales in base rates did not destroy the Company's incentive to make off-system sales. (Tr. p. 842, l. 12-17). Removing off-system sales revenues from base rates and placing them back in the GSIP would result in the creation of an asymmetrical incentive where Laclede would only have upside profit potential. (Tr. p. 716, l. 7-12).

However, if the Commission decides not to place capacity release revenues in base rates, Public Counsel believes that off-system sales should be returned to the GSIP because capacity release and off-system sales are interdependent. (Ex. 34, p. 21, l. 12-13). Generally, when Laclede makes an off-system sale it bundles it with its own pipeline capacity. (Ex. 17, p. 17, l. 17-20; Tr. p. 670, l. 11-14). Thus, when Laclede is utilizing its interstate pipeline capacity to conduct an off-system sale it cannot simultaneously release pipeline capacity. (Tr. p. 672, l. 5-10). This fact is borne out in highly confidential schedule 2 to witness Jaskowiak's surrebuttal testimony Exhibit 4. This schedule shows historically when off-system sales numbers are higher, capacity release numbers are lower and vice versa. Thus, Public Counsel believes capacity release and off-system sales should be treated in a similar manner, either both in base rates or both in the GSIP.

If, contrary to Public Counsel's recommendation, the Commission determines off-system sales should be placed in the GSIP, Public Counsel recommends a baseline level of \$2.1 million be

⁷ Off system sales arise from the Company's practice of marketing additional gas commodity the Company has under contract in areas outside the boundaries of its service territory. (Ex. 17, p. 17, l. 8-9).

establish and that the sharing grid be identical to the sharing grid currently in effect for capacity release. (Ex. 34, p. 21, l. 16-20). This proposal recognizes the fact that a certain amount of off-system sales are inherent in Laclede's operations. (Tr. p. 266, l. 15-22).

Certainly, the Commission should reject Laclede's first dollar 35% sharing proposal for off-system sales revenues. Approval of this proposal would result in asymmetrical risk sharing and result in only profit potential for Laclede with no chance of loss. (Tr. p. 463, l. 3-25). Public Counsel believes allowing Laclede to share on the first dollar of off-system sales revenue without a baseline merely results in giving shareholders money and unnecessarily raising overall gas costs to Laclede customers.

G. Firm Transportation Pipeline Discounts

Laclede's current GSIP allows the Company to retain 30% of the pipeline discounts above a \$13 million baseline as profit. (Ex. 34, p. 4, l. 1-6). Laclede proposes to increase the sharing percentage from 30% to 35% and maintain the current \$13 million baseline. (Ex. 2, p. 2, l. 13-17; p. 3, l. 11-13; Tr. p. 254, l. 19-25; p. 255, l. 1-3). A pipeline discount occurs when any interstate or intrastate pipeline provides transportation service, or transportation service bundled with gas at less than the FERC or PSC authorized maximum rate. Public Counsel recommends that this portion of the GSIP not be continued on a going forward basis.

Public Counsel does not believe Laclede should be given an incentive for pipeline discounts. Public Counsel makes this recommendation because it is reasonable to assume certain pipeline suppliers will charge less than maximum rates to acquire, maintain and increase market shared in the St. Louis area. (Ex. 34, p. 16, l. 2-8). Due to existing pipeline rate structures and the fact that numerous pipeline serve Laclede, it is in a strong negotiating position. (Ex. 34, p. 16, l. 8-11; Ex. 45HC). In fact, witness Neises admitted that the Company will continue to negotiate

pipeline discounts absent the GSIP. (Tr. p. 248, l. 12-18). Despite the fact that Laclede had negotiated significant pipeline discounts prior to the inception of the GSIP (Ex. 17, p. 8, l. 14-17) and would attempt to do so even if it did not have an incentive, Laclede believes it is appropriate to provide shareholders an incentive. Public Counsel does not believe Laclede or any other LDC should be given an incentive for undertaking activities the Company already has a public service obligation to undertake, i.e. providing safe and adequate service at just and reasonable rates.

If the Commission decides to maintain the incentive for firm transportation discounts the baseline of \$13 million should be raised substantially. Public Counsel recommends that the benchmark be established at \$22 million. (Ex. 34, p. 20, l. 1-2). This amount was determined by rounding down the average of discounts for 1999-2000 and the annualized total for 2000-2001. (Ex. 34, p. 20, l. 2-4). During the last four years Laclede has shown that ability to achieve an average of \$20 million in discounts. (Ex. 34, p. 14, l. 4-9). The current \$13 million benchmark level rewards Laclede for maintaining the status quo. (Ex. 34, p. 20, l. 9-10). Moreover, obtaining discounts from maximum FERC rates is not uncommon. (Ex. 17, p. 9, l. 10).

Empirically, the current and requested \$13 million baseline amount has consistently underestimated the pre and post GSIP level of transportation discounts Laclede has secured. This portion of the GSIP has been the "cash cow" for Laclede since the inception of the GSIP in the 1996-1997 ACA period to date accounting for 31.9%, 32.7%, 41.8%, 31.2% and 42.3% of Laclede's GSIP profits. (Ex. 34, p. 13, l. 13-18).

To support continuation of the artificially low \$13 million benchmark, Laclede offered the surrebuttal testimony of witness Henning (Ex. 3). Witness Henning's testimony does not support the continuation of the \$13 million baseline and such testimony should be rejected by this Commission. In arriving at his conclusion a \$13 million baseline was appropriate for Laclede

witness Henning wholly failed to explore any Laclede-specific information. (Tr. p. 84, l. 16-23; p. 85, l. 1-13). In fact, witness Henning did not conduct any investigation into Laclede's pipeline contracting practices. (Tr. p. 76, l. 17-20; Ex. 38); did not review the analysis Laclede prepared to arrive at the current \$13 million baseline (Tr. p. 114, l. 17-20) and did not make any determination regarding whether the \$13 million baseline level or some other baseline level is appropriate. (Tr. p. 108, l. 20-23). Witness Henning agreed that for the years 1996 to 2000 Laclede had achieved over \$19 million in discounts each year. (Tr. p. 109, l. 22-25; p. 110, l. 1-12).

The current \$13 million baseline level for discounts is based upon a "study" conducted by Laclede witness Cline in GT-99-303. (Tr. p. 256, l. 4-10). This "study" conducted 24 months ago compared certain shippers and certain pipelines with Laclede (Tr. p. 256, l. 11-16). This "study" was only related to three pipelines: Reliant, NGPL and Trunkline for the months April 1999 and March 1999. (Tr. p. 256, l. 14-25; p. 257, l. 1-5). However, the "study" did not review customers' load characteristics (Tr. p. 259, l. 1-25), did not review whether a shipper was captive (Tr. p. 260, l. 9-25). Nor did Laclede update this "study" in this proceeding. (Tr. p. 263, l. 1-11). The Commission should reject this outdated two-month "study" as the basis for supporting a \$13 million baseline or reaching a conclusion that Laclede has achieved superior pipeline discounts. In fact, witness Neises testified that the Company currently has in place long-term transportation agreements that "significantly exceed in discounts the \$13 million baseline." (Tr. p. 354, l. 11-16). Thus, Laclede already has discounts in place that exceed the proposed \$13 million baseline. At a minimum the Commission should require Laclede to have a baseline amount of pipeline discounts based upon historic discount levels prior to any revenue sharing between shareholders and ratepayers occurring.

Public Counsel recommends terminating Laclede's current pipeline discount portion of the GSIP when the term of the GSIP expires. Public Counsel recommends that prudently incurred pipeline service costs be passed-through dollar-for-dollar to ratepayers under the traditional PGA/ACA process.

H. Mix-of-Pipeline Services

Laclede has recommended the Commission continue the mix-of-pipeline service portion of the GSIP with the sharing grid increased to 35%. Laclede believes it should be given an incentive to ensure that it provides customers the most economical mix-of-pipeline services. Public Counsel believes the Commission should eliminate this portion of Laclede's GSIP.

Laclede does not need an incentive to perform these activities. Reducing pipeline capacity because too much is under contract is a job that should be conducted on a regular basis. (Ex. 34, p. 17, l. 10-11). Ratepayers are already compensating Laclede employees to conduct this activity. (Ex. 34, p. 17, l. 14). Ratepayers should not have to provide increased profits to Laclede shareholders to incent Laclede employees to do a job they should already be doing. (Ex. 34, p. 17, l. 14-16).

Public Counsel recommends that the Commission deny Laclede's request to continue the mix-of-pipeline services portion of the GSIP. Public Counsel believes the traditional PGA/ACA process is essential to addressing the prudence of changes in Laclede's mix-of-pipeline supplies and services. All parties should have the opportunity to fully investigate the necessity and prudence of any changes in pipeline transportation or storage services based upon information known and available when the decision was made. Laclede's mix-of-pipeline services GSIP does not ensure that Laclede will take actions, it merely ensures that Laclede will take actions to enhance

shareholder returns and relieves the Company of making prudent decisions. Simply put, actual pipeline charges should be addressed via the traditional PGA/ACA process.

I. Dollar-Help Proposal

In its surrebuttal testimony, Laclede proposes to donate 5% of its GSIP profits to the Dollar-Help Program in order to provide energy assistance to low-income customers of Laclede and customers of other utility companies. (Ex. 2, p. 9, 1.1-9). In order to achieve this goal Laclede requests that its ability to profit from the GSIP be increased from a 30% share to a 35% share.⁸ (Ex. 2, p. 9, 1. 1-9). Public Counsel certainly supports helping Laclede's low-income customers; however, Public Counsel questions whether this particular proposal is the appropriate way to help low-income customers.

First, Laclede already has ample opportunity to funnel any amount of its profits it sees fit to the Dollar-Help Program. However, for the last few years, Laclede has only given \$88,000. (Ex. 47). Second, Laclede doesn't need Commission approval to contribute any share of its earnings to the Dollar-Help Program. (Tr. p. 481, 1. 22-25). Moreover, the Commission lacks authority to require Laclede to contribute 5% of its earnings to the Dollar-Help Program. (See: State ex rel. Public Service Commission v. Bonecker, 906 S.W.2d 896, 899 (Mo. App. 1995) “. . . the Commission's authority to regulate does not include the right to dictate the manner in which the company shall conduct its business.”). The Commission ought not give its approval to a proposal that the Commission would be powerless to enforce. Finally, increasing the sharing percentage 5%

⁸ Apparently any level of sharing below the requested 35% would result in Laclede's withdrawal of this proposal. (Ex. 75).

means that all customers will be paying 5% more for their natural gas. Such an increase just further increases the burden on all customers and low-income customers in particular.⁹

J. Term/Earnings Cap

Laclede has requested the Commission authorize the GSIP continue for an indefinite period and that an earnings cap be placed upon the GSIP of \$10 million. (Ex. 2, p. 13, 1.21-23). Public Counsel opposes both of these requests.

Public Counsel believes that there should be a specific term for the operation of the GSIP so that the Commission may periodically review its operation. In light of the Natural Gas Commodity Price Task Force Public Counsel believes if the Commission is inclined to continue the GSIP, the Commission should only allow the GSIP for a term of one year. (Ex. 36, 1. 1-5).

Laclede's offer for a "task force reopener" is too open-ended. (Ex. 2, p. 14, 1. 17-23). Specifically, the parties may or may not agree that the task force report is inconsistent with the GSIP or its provisions. Moreover, due to changing market conditions, periodic review of the GSIP is wholly appropriate.

Assuming the Commission approves continued use of the GSIP, Public Counsel believes the current earning cap of \$9 million should remain in place. (Ex. 34, p. 22, 1. 8-10). This earnings cap will allow Laclede a more than sufficient opportunity to profit from the GSIP.

K. Staff Proposal

The Staff in the rebuttal testimony of witness Schallenberg (Ex. 16) recommends that the Commission approve a comprehensive gas purchasing approach that would require Laclede to develop and submit a purchasing plan and supporting documentation in advance of purchases.(Ex.

⁹ Laclede asserts the 5% level is significant. (Tr. p. 487, 1. 23-24). This further demonstrates that Laclede's proposed 30% profit opportunity is excessive.

16, p. 23, l. 13-24; p. 24). Staff proposes that Staff and Public Counsel have an opportunity to voice concerns and recommend modifications to the plans. (Ex. 16, p. 25, l. 1-12). The Staff's proposal regarding incentives would reward the top 20% of district performances provided that the cost of gas provided to customers is below the prior three-year average. (Ex. 16, p. 27, l. 18-21).

Public Counsel was initially concerned that the Staff proposal would foreclose Public Counsel's ability to raise issues during an ACA review that were not previously raised during the initial review of a company's purchase plan. (Ex. 36, p. 3, l. 15-18). Based upon discussions with Staff and Staff's responses to Public Counsel data requests, it became clear Staff is no way attempting to prevent Public Counsel's ability to conduct an ACA review. (Ex. 36, p. 4, l. 9-12).

Public Counsel certainly supports the Staff proposal as a better alternative to the modified GSIP proposed by Laclede in this proceeding. Public Counsel supports improved documentation and a more proactive review of Missouri LDCs gas purchasing activities provided that there is recognition that such a process does not limit a party's right to discovery and full participation in the ACA review process. (Ex. 36, p. 4, l. 15-18).

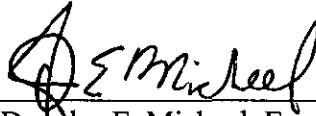
III. CONCLUSION

For the reasons setout above, Public Counsel requests the Commission adopt the proposals in the testimony of Public Counsel witnesses Busch and Meisenheimer and reject the proposals setout in Laclede witness Neises' surrebuttal testimony. Public Counsel's proposal represents a reasonable balance between ratepayer and shareholder interests.

Respectfully submitted,

OFFICE OF THE PUBLIC COUNSEL

BY:



Douglas E. Micheel, Esq. (Bar No. 38371)

Senior Public Counsel

P. O. Box 7800, Suite 650

Jefferson City, MO 65102

Telephone : (573) 751-5560

Fax: (573) 751-5562

dmicheel@mail.state.mo.us

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing has been faxed, mailed or hand-delivered to the following counsel of record on this 23rd day of July, 2001:

Thomas R. Schwarz, Jr.
Deputy General Counsel
Missouri Public Service Commission
P. O. Box 360
Jefferson City MO 65102

Thomas M. Bryne
Ameren Services Company
1901 Chouteau Avenue
P. O. Box 66149
St. Louis, MO 63166-0149

Michael C. Pendergast
Laclede Gas Company
720 Olive Street, Room 1520
St. Louis MO 63101

Diana M. Vuylsteke
Bryan Cave, LLP
211 N. Broadway, Suite 3600
St. Louis, MO 63102

