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August 1, 2001

FILED[3]
AUG 01 2001
Missouri Public Service Commission

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

**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 **Reply Brief of the Office of the Public Counsel** along with the original and eight copies of **highly confidential Attachment A** to Public Counsel's Reply Brief. Please "file" stamp the extra-enclosed copy and return it to this office.

Thank you for your attention to this matter.

Sincerely,

D.E. Micheel

Douglas E. Micheel
Senior Public Counsel

DEM:kh

cc: Counsel of Record

FILED[3]

AUG 0 1 2001

Missouri Public Service Commission

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 modifications to its Gas Supply incentive plan.	))))	Case No. GT-2001-329

REPLY BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

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August 1, 2001

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REPLY BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

I. INTRODUCTION

The Office of the Public Counsel ("Public Counsel") files this Reply Brief in response to the Initial Brief of Laclede Gas Company. Public Counsel believes that for the most part, it has anticipated the majority of arguments made in Laclede's Initial Brief. However, failure to reply to each specific argument does not indicate Public Counsel's agreement with that argument, merely that no response is necessary.

II. ARGUMENT

A. Purpose and Expectations of the Gas Supply Incentive Plan

A review of Laclede's Initial Brief in this proceeding further demonstrates the regulatory policy differences between Public Counsel and Laclede with respect to the purpose and operation of gas cost incentive plans. In attempting to explain why the current GSIP did little, if anything, to help reduce the cost of natural gas to customers during last winter's heating season, Laclede in numerous places in its brief points to the Staff and Public Counsel's alleged failure to allow

Laclede to modify its Price Stabilization Program ("PSP"). (Brief p. 3; p. 16 and p. 25).[1] According to Laclede, "it was Staff and Public Counsel's persistent refusal throughout the summer and fall of last year to provide the kind of regulatory assurances that would have permitted the acquisition of market-responsive instruments in advance of the winter heating season." (Brief p. 3)[2]

This attack on the Staff and Public Counsel misses the point. Public Counsel in this proceeding merely points to the fact that the GSIP did virtually nothing in preventing Laclede's customers from seeing the highest gas prices in its history. In fact, because customers were required to share some of the alleged savings with Laclede, their gas rates were increased to provide Laclede profit. Second, as the Commission is well aware the operations of the Laclede designed and Commission approved PSP are subject to review Case No. GO-2000-394.[3] The Commission in that proceeding will hear all the record evidence regarding the PSP's failure or success at producing lower gas costs for customers.

The Commission ought not allow Laclede to change the focus in this proceeding away from the utter failure of the GSIP to provide customers with a lower cost of gas. Finally, Laclede's assertions merely bolster Public Counsel and Staff's objections that the GSIP only encourages Laclede to be reactive and not respond to a market event until after its full impact has been realized. (Ex. 16, p. 8, l. 9-11). Nor do Laclede's claims regarding the PSP detract in anyway from the valid

[1] The ultimate decision to allow Laclede to modify its PSP rests with the Commission and not the Staff or Public Counsel. Laclede could have chosen to take its proposed PSP modifications to the Commission for a decision but declined to do so.

[2] The "regulatory assurances" to which Laclede speaks relate to blanket preapproval and the removal of this Commission's ability to review Laclede's actions.

[3] Obviously Public Counsel disagrees with Laclede's attempt to shift blame to Public Counsel for the failure of the Laclede designed PSP to provide price protection to customers. Public Counsel will address those claims in the appropriate forum GO-2000-394.

criticism raised by Staff and Public Counsel regarding the current and proposed structure of the GSIP.

Laclede also alleges that Public Counsel's proposed incentives would "destroy" Laclede's GSIP. (Brief p. 17). The record evidence demonstrates Laclede's claims are wholly incorrect with respect to Public Counsel's proposal. Public Counsel has recommended that the GSIP for Laclede on a going forward basis consists of three components: gas procurement; off-system sales and capacity release. Highly confidential exhibits 49 and 50 clearly demonstrate that if the Commission chooses to accept Public Counsel's primary recommendation to place capacity release revenues in base rates and retain off-system sales revenues in base rates based upon a four-year average, Laclede would have received nearly $2 million in profits and looking at each of the years on an individual basis Laclede would have received over $7.5 million in profit for a four-year period. (Attached at attachment 1 are Highly Confidential Exhibits 49 and 50). Such ability to profit hardly supports Laclede's assertions that Public Counsel's proposal "destroys" any incentive for Laclede.

Laclede continues to claim that it should be allowed to profit from its GSIP because it is the only mechanism that recognizes the risk of the merchant function Laclede provides to its customers. (Brief at p. 29). First, as pointed out by then Chair Lumpe the merchant function is not a new function for Laclede. (Tr. p. 588, l. 17-22) and as admitted by Laclede witness Buck the GSIP was not setup to offset merchant function costs. (Tr. p. 589, l. 10-16). Second, the risks of the merchant function are taken into account when the Commission authorizes an overall rate of return for Laclede. The GSIP was never intended to compensate Laclede for costs related to its merchant function.[4] Laclede witness Neises admitted the GSIP was implemented to provide an incentive for

[4] Staff's cross-examination of witness Buck clearly demonstrates that Laclede's merchant function claims are overblown and based on inaccurate assumptions.

the Company to reduce its overall gas supply costs. (Tr. p. 236, l. 5-14). The GSIP having failed in that task, Laclede is desperately seeking some justification for the GSIP's continued existence. Simply put, 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.

B. Laclede Gas Company's Proposal

No reply necessary

C. Fixed Price Proposal

At page 26 of it brief Laclede criticizes Public Counsel's fixed price proposal because Public Counsel's proposal requires a 50/50 sharing of any gains or losses in the purchase of the fixed price instruments. Laclede asserts it could lose tens of millions of dollars. What Laclede doesn't say is that Public Counsel's proposal does <u>not</u> require Laclede to purchase any fixed price instruments. Rather it gives Laclede the incentive to do so, if in Laclede's business judgment purchasing such instruments is the appropriate action to take based upon market conditions.

Laclede has testified that it believes it is appropriate to procure fixed price instruments to cover a range of volumes from a minimum of 10 BCF to a maximum of 25 BCF. If Laclede has confidence in these purchasing guidelines it should follow those guidelines without Commission preapproval.[5] The Commission ought not preapprove a specific level of use of fixed price instruments and allow Laclede safe harbor from this Commission's ability to review Laclede's actions and protect customers.

[5] Public Counsel can understand Laclede's apprehension in following these guidelines without Commission preapproval given the fact it has absolutely no written analysis to support these guidelines. (Tr. p. 388, l. 18-21).

D. Gas Procurement

At page 35 of its brief Laclede touts the alleged benefits of the demand cost component of its current GSIP and claims "no substantive arguments have been presented as to why the GSIP's existing Request for Proposal ("RFP") process should not be continued." Public Counsel and Staff have presented substantive arguments that demonstrate the demand cost component of Laclede's GSIP is not in the public interest and should be eliminated.

First, although Laclede has some ability to control reductions in the demand charges, Laclede pays the going market price at delivery for the commodity component. (Ex. 35, p. 8, l. 1-2). Since Laclede has no control over the commodity component, that constitutes at least 95% of the costs, the benchmark mechanism provides no meaningful price protection for customers. (Ex. 35, p. 8, l. 2-4). Second, the structure of the demand component virtually guarantees Laclede will profit. As described on Tariff Sheet 25 the demand benchmark component allows Laclede to take all of the bids it receives from its RFP for fixed gas supply and drops out the top 10% of the bids and then Laclede computes the unit average bid to determine the demand cost benchmark component. (Tr. p. 686, l. 5-16). The Company establishes the benchmark not on market price but based upon an average of failed bids. (Tr. p. 690, l. 22-25; p. 691, l. 8-13). In this process Laclede is able to choose all of the bids that are below the artificially created benchmark off failed offers and thus profit.[6] In fact, Laclede purchased considerable amounts of gas supply below the demand cost benchmark (Tr. p. 691, l. 1-5) and no gas above the benchmark. (Tr. p. 691, L. 6-7). In Public Counsel's opinion this "incentive" does not balance shareholders and ratepayers interests nor does

[6] In footnote 7 in its Initial Brief Laclede claims the RFP fixed cost demand charge benchmark was the idea of Public Counsel. Public Counsel has never supported this proposed benchmark. See Shaw Direct and Rebuttal GT-00-303, Ex. 25 and 26.

it result in a lower overall cost of gas being delivered to customers it merely provides Laclede with more profit.

E. Capacity Release

No reply necessary.

F. Off-System Sales

The Commission should reject Staff and Laclede's proposal to remove off-system revenues from base rates. Removal of these revenues from base rates and return to GSIP treatment would result in an asymmetrical sharing grid being created where Laclede is only provided the opportunity to profit. Such a proposal does not properly balance shareholder and ratepayer interests.

To alleviate any ability of Laclede to game the incentive structure by giving Laclede a financial incentive to execute off-system sales transaction in place of capacity release transactions the Commission should adopt Public Counsel's proposal to place capacity release revenues in a base rate case. Such a proposal provides a reasonable balance between Company and ratepayer interests.

G. Firm Transportation Pipeline Discounts

In analyzing this issue the first question the Commission should ask is: Whether an incentive is necessary for Laclede to negotiate firm transportation pipeline discounts? The answer to that question is NO. The record evidence establishes the undisputed fact that Laclede negotiated pipeline discounts prior to the GSIP (Ex. 17, p. 8, l. 14-17) and Laclede will continue to negotiate firm transportation discounts absent the GSIP. (Tr. p. 248, l. 12-18). Laclede has not presented any persuasive record evidence that this portion of the GSIP should not be eliminated. Public Counsel witness Busch has demonstrated why Laclede does not need an incentive in this area to achieve the same or similar results. (Ex. 35, p. 16, l. 2-11). Public Counsel continues to recommend the Commission discontinue this component of the GSIP on a going forward basis.

Should the Commission wish to continue this portion of the GSIP, the Commission should establish baselines considerably higher than the current arbitrarily low level of $13 million requested by Laclede. Laclede bases its request on the analysis of witness Henning. According to Laclede witness Henning, "the ability to negotiate pipeline discounts, particularly at existing levels, was likely to decrease in the future in most regions in the country and along the pipeline corridors serving Laclede." (Brief at p. 46). However, the undisputed record evidence in this proceeding belies witness Henning's assertions.

The record evidence demonstrates that Laclede currently has in place long-term transportation discounts that significantly exceed the current and proposed $13 million baseline level. (Tr. p. 354, l. 11-16; p. 696, l. 20-25). If witness Henning were correct in his hypothesis that the ability to negotiate pipeline discounts in the future was likely to decrease, one must wonder why Laclede <u>already</u> has future pipeline discounts in place at levels wholly consistent with Laclede's pre and post GSIP discount level of over $19 million.

As pointed out by witness Henning, the macro-study he presented in this proceeding is most often used by pipelines for contracting purposes. (Tr. p. 81, l. 16-25; Tr. p. 113, l. 12-24). If the study were correct in relation to Laclede's specific situation, one must wonder why interstate pipelines serving Laclede are willing to give "significant" long-term discounts to Laclede knowing that pipeline capacity in the "Missouri corridor" is becoming constrained and thus more valuable. The answer to that questions is obvious. The pipeline capacity that currently serves Laclede is not constrained and will not be in the future.

Such a conclusion is not inconsistent with witness Henning's "study" because witness Henning conducted a macro-study of the value of transportation services between market centers throughout all of North America. (Tr. p. 81, l. 16-20). There was nothing specific in the EEA's study presented by witness Henning regarding Laclede or any other Missouri LDC. (Tr. p. 84, l. 16-25; p. 85, l. 1-13). Witness Henning candidly admitted he failed to study <u>any</u> specifics regarding Laclede's ability to obtain firm transportation discounts. (Tr. p. 76, l. 17-20; p. 77, l. 20-21; p. 82, l. 3-6; Ex. 40). In fact, witness Henning was unable to provide any level of firm transportation discounts Laclede could achieve in the future. (Tr. p. 114, l. 2-7). However, as witness Neises testified Laclede currently has in place long-term transportation agreements that "significantly exceed in discounts the $13 million baseline." (Tr. p. 354, l. 11-16).

If the Commission desires to continue the incentive for firm transportation discounts, it should not rely on the macro-study presented by witness Henning that is squarely at odds with the known current facts. At a minimum, the Commission should require Laclede to have a baseline amount of pipeline discounts based upon historic and current discount levels prior to any sharing between shareholders and ratepayers occurring.

H. Mix-of-Pipeline Services

No reply necessary.

I. Dollar-Help Proposal

No reply necessary.

J. Term/Earnings Cap

No reply necessary.

K. Staff Proposal

No reply necessary.

III. CONCLUSION

For all the reasons discussed in this Reply Brief and Public Counsel's Initial Brief, Public Counsel requests the Commission adopt the proposals in the testimony of Public Counsel witnesses Busch and Meisenheimer and reject the proposals requested by Laclede. Public Counsel believes its proposals are equally beneficial to Company shareholders and ratepayers.

Respectfully submitted,

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ATTACHMENT A

HAS BEEN DEEMED

HIGHLY CONFIDENTIAL

IN ITS ENTIRETY.

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 1st day of August, 2001:

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