

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

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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

**LACLEDE GAS COMPANY'S
PROPOSED FINDINGS OF FACT AND CONCLUSIONS
OF LAW**

Issue Date:

Effective Date:

86

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Fixed Price Plan and Other Modifications	)	
To its Gas Supply Incentive Plan.	)	

APPEARANCES

Michael C. Pendergast, Associate General Counsel, Joseph T. Clennon, Associate Counsel-Regulatory, Laclede Gas Company, 720 Olive Street, St. Louis, Missouri 63101, and James M. Fischer, Fischer & Dority, P.C., 101 Madison Street, Suite 400, Jefferson City, Missouri 65101, for Laclede Gas Company.

Diana Vuysteke, Bryan Cave LLP, 211 North Broadway, Suite 3600, St. Louis, Missouri 63102-2750, for Adam's Mark Hotels, Alcoa Foil Products (Alumax, Inc.), Anheuser-Busch Cos., Inc., The Boeing Company, Ford Motor Company, General Motors Corporation, Hussmann Refrigeration, MEMC Electronic Materials, Inc., Monsanto Company, Paulo Products Company, Procter & Gamble Manufacturing Company, and Ralston Purina Company, collectively known as the "Missouri Industrial Energy Consumers" or "MIEC".

Thomas M. Byrne, Attorney at Law, 1901 Chouteau Avenue, St. Louis, Missouri 63103, for Union Electric Company d/b/a AmerenUE.

Douglas E. Micheel, Senior Public Counsel, Office of the Public Counsel, Post Office Box 7800, Jefferson City, Missouri 65102, for the Office of the Public Counsel and the public.

Thomas R. Schwarz, Jr., Deputy General Counsel, and David Meyer, Assistant General Counsel, Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102, for the staff of the Missouri Public Service Commission.

REGULATORY LAW JUDGE: Bill Hopkins.

REPORT AND ORDER

Procedural History

On November 17, 2000, Laclede Gas Company filed a tariff with the Missouri Public Service Commission to implement an experimental Fixed Price Plan and other modifications to its Gas Supply Incentive Plan ("GSIP"). By order of the Commission, these tariffs were suspended.

A hearing was held on June 18-22, 2001. Initial briefs were filed on July 23 and reply briefs were filed on August 1, 2001.

The primary issue before the Commission in this proceeding is whether Laclede's GSIP tariffs, with additional modifications, should be adopted, or whether the GSIP should be abandoned.

Background

A. Origins and Initial Structure of the GSIP

The initial GSIP originated as part of a stipulation and agreement that was approved by the Commission in the Company's 1996 rate case proceeding, Case No. GR-96-193. (Exh. 1, p. 3). At the time the GSIP was approved, the natural gas industry in Missouri and throughout the country had undergone a fundamental restructuring. In the past, LDCs like Laclede had purchased gas for all of their customers from interstate pipelines at rates that were regulated by the Federal Energy Regulatory Commission ("FERC"). (Exh. 24, p. 10). Under that structure, it was the pipelines, rather than the local gas utility, that had the responsibility to procure, finance and transport the gas supplies to the LDC's city gates, to ensure that such supplies were reasonably priced and adequate to meet their LDC customers' needs, and to basically oversee all of the other major elements associated with such functions. (*Id.*).

By 1996, however, this traditional structure had changed and changed dramatically. As a result of various initiatives at the federal level, including FERC Order No. 636, LDCs now had the obligation to procure their own gas supplies and transportation services. (Exh. 24, p. 10). They also had to undertake a myriad of other functions, ranging from nominating gas supply and transportation services on a daily basis to financing the cost of holding gas in storage and coordinating its dispatch with the Company's flowing gas supplies, in order to ensure that natural gas service was available when its customers needed it. (Exh. 24, pp. 10-11). In addition to these structural changes, LDCs also no longer had the exclusive right to sell the gas supplies required by all of their customers. Instead, many of their larger customers were now permitted to purchase their gas supplies and transportation services from unregulated marketers, brokers and integrated energy companies operating in the LDC's service territories. (See Exh. 14, pp. 56-60). These unregulated marketers and

brokers were, in turn, permitted to charge whatever the market would bear for their services and, in the process, profit from their successful efforts to obtain or sell gas supplies and transportation services. (*Id.*).

One significant aspect of natural gas service that had not changed by 1996, and that remains unchanged today, was the continuing obligation of Missouri LDCs to provide gas service to residential customers under special terms mandated by this Commission that are rarely, if ever, observed in a competitive marketplace. Among others, these include a continuing obligation to maintain natural gas service to customers, regardless of their ability to pay for such service, whenever temperatures are severe enough (i.e., predicted to drop below 30 degrees) to threaten their health or safety. 4 CSR 240.13.055(4)(A). They also include a continuing obligation to extend extremely favorable credit terms to customers that have difficulty paying for such services – terms that permit their payments for gas service to be spread over many months and even years at no additional cost to their customers. 4 CSR 240.13.055(5) and (8). In addition to these measures, LDCs also retained the obligation to follow special notice and service continuation requirements for registered handicapped and elderly customers and any customer with a medical emergency. See 4 CSR 240.13.055(3)(D) and 4 CSR 240.13.050(9). In other words, LDCs retained the obligation to provide a safety net for their customers that few if any other firms are ever obligated or expected to provide.

It was within this environment that the GSIP was developed and ultimately approved by the Commission. As originally approved, it had four components to govern the various activities that the Company must undertake to procure and manage its gas supply and transportation assets. The first was a gas procurement component to govern the Company's purchase of gas supplies. (Exh. 1, p. 3). In effect, this component permitted the Company to share, within prescribed limits, in any savings achieved as a result of the Company's successful efforts to reserve and purchase gas supplies below a predetermined benchmark. (*Id.*). At the same time, the procurement component also required that the Company absorb all or a portion of any increases above a predetermined benchmark. (*Id.*). The second component of the GSIP was designed to govern the Company's activities in negotiating what it pays for firm transportation and storage services from its pipeline suppliers. (*Id.*). It permitted the Company and its customers to share in savings generated as a result of the Company's efforts to negotiate discounts from the cost of service based transportation and storage tariff rates charged by those pipeline suppliers. The third and fourth components of the GSIP permitted Laclede to share with its customers revenues achieved by the Company through the temporary release of pipeline capacity held by Laclede or its sale of gas to customers located off of Laclede's distribution system. (*Id.*).

In addition to these incentive components, the Commission also approved other provisions in conjunction with the GSIP to ensure that Laclede would not sacrifice reliability in its efforts to achieve additional savings and revenues for its

customers. Finally, the Commission approved the GSIP for an initial term of three years.

During the ensuing three years, both the legality and reasonableness of the Commission's decision to implement the kind of incentive structure embodied in the GSIP were reaffirmed by Missouri courts. Following the Commission's approval of MGE's gas cost incentive plan, Public Counsel and an association of large industrial customers challenged the lawfulness and reasonableness of the Commission's determination that it was appropriate to use incentive provisions to govern a LDC's procurement and management of its gas supply assets. Based on their review of the extensive evidentiary record that had been produced during the proceeding in which the MGE incentive plan was approved, however, both the Circuit Court of Cole County and the Missouri Court of Appeals for the Western District ultimately determined that the Commission's use of such incentive provisions was reasonable and fully consistent with Missouri law. ***Midwest Gas Users' Association v. Public Service Commission***, 976 S.W.2d 470 (Mo.App. 1998). Indeed, the Court described the gas cost incentive plan approved for MGE as a "cost effective and beneficial" alternative to the traditional method for reviewing gas costs. *Id.* at 482.

B. 1999 Assessment and Continuation of the GSIP

In addition to withstanding judicial scrutiny, the effectiveness of the GSIP's incentive provisions as an instrument of sound public policy was also evaluated during this period. As the expiration of the initial three year term of the GSIP approached, Laclede filed tariffs in January of 1999 to continue the incentive plan with certain modifications. (Exh. 1, p. 3). During the ensuing proceeding that was established by the Commission to consider the Company's tariff -- Case No. GT-99-303 -- the Company, as well as all of the other parties, presented extensive evidence regarding the impact that the GSIP had had on the Company's management of its gas supply assets. (Exh. 1, p. 5). The evidence presented by the parties was the product of extensive discovery, including depositions, and was submitted through three separate rounds of testimony by all of the parties, and three full days of hearings. (*Id.*).

The evidence presented by Laclede in Case No. GT-99-303 showed that the Company had achieved tens of millions of dollars in added savings and revenues as a result of the GSIP and the Company's superior performance thereunder. (*Id.*). A significant portion of these benefits were produced as a result of the Company's successful decisions to take moderate and informed strategic financial risks on behalf of itself and its customers. These successful risk-taking actions included, among others:

- (1) the Company's successful decisions to lock-in for a multi-year period the demand charges it was paying to reserve gas supplies (a strategy that saved \$5.9 million when the market cost to reserve

gas supplies subsequently rose as the Company had anticipated) (Exh. 6HC, Schedule 1);

- (2) the Company's successful decisions to lock-in for multi-month periods the amounts it was charging to release pipeline capacity (a strategy that produced additional capacity release revenues of \$1.3 million when, as the Company correctly anticipated, the market value of such capacity subsequently declined during the locked-in periods) (Exh. 6HC, p. 8; Schedule 1); and
- (3) the Company's successful strategy to lower its demand costs by significantly reducing the percentage of its firm gas supplies that had historically been taken by the Company under "swing" and "combination" supply contracts and increasing the percentage of such supplies taken by the Company under "baseload" contracts (a strategy that saved some \$2.6 million during the first three years of the GSIP).

The evidence presented by the Company in Case No. GT-99-303 also quantified other benefits produced during the first three years of the GSIP that were the result of its superior performance in acquiring gas supply and transportation services. These included, among others:

- (1) the Company's successful efforts to negotiate a number of unique and very beneficial supply arrangements under which Laclede was able to purchase significant quantities of gas supplies at below market prices during a time when other companies were paying higher costs for such services (efforts which resulted in millions of dollars in savings during the first three years of the GSIP) (Exh. 6HC, p. 7; Schedule 1);
- (2) the Company's successful efforts to convince Mississippi River Transmission Company ("MRT"), Laclede's largest pipeline supplier, to eliminate its Flexible Contract Demand service and transfer to Laclede a portion of the pipeline capacity that was not being effectively used to provide that service (an effort which permitted Laclede to achieve some \$700,000 in savings when the Company subsequently resold that capacity through the secondary market and immediately used the revenues to reduce overall transportation costs to the Company's customers) (Exh. 6HC, pp. 8-9, Schedule 1); and
- (3) the Company's superior efforts to negotiate and/or maintain discounts from the rates being charged by its pipeline suppliers for firm transportation services (discounts that were some \$20 million

in excess of the average level of discounts being achieved by other shippers on the same pipelines) (Exh. 6HC, Schedule 1).

Altogether, Laclede was able to specifically quantify at least \$45 million in additional savings and revenues as a result of these various initiatives. (Exh. 6HC, p. 4).

Based on this evidence, the Commission issued its Report and Order in Case No. GT-99-303 in which it determined that the GSIP should be continued, with certain modifications. These changes included, among others, several modifications that had been proposed by the Company in response to previous concerns raised or recommendations made by the Staff. Specifically, the Commission adopted the GSIP's current fixed price and mix of pipeline supplier components, the current fixed demand charge component of the gas procurement component, and the current \$13 million baseline for the firm transportation discount component of the GSIP. (Exh. 1, pp. 4-6). In issuing its Report and Order in Case No. GT-99-303, the Commission determined that, based on the extensive evidentiary record that had been compiled in that case, the modified GSIP was "in the public interest." See ***Re: Laclede Gas Company***, Case No. GT-99-303, *Report and Order*, p. 14 (September 9, 1999). Having made this fundamental policy determination, the Commission extended the term of the GSIP for another year, pending a review of any legislative developments that might lead to a further unbundling of LDC services.

C. The 2000 Extension of the GSIP and Events Relating to the Experience of Last Winter

The GSIP was once again extended with modifications in 2000 as the result of the Commission's approval of a Stipulation and Agreement that was filed in April of that year by the Company, Staff and Public Counsel in Case No. GO-2000-395. (Exh. 1, p. 6). These included the imposition of an overall \$9 million cap on the amounts that could be retained by the Company for the fifth year of the program and, at the request of the Commission Staff, the exclusion of any rate discounts that might be negotiated by the Company in the interim with its largest pipeline supplier, MRT. (*Id.*). Perhaps most significantly, the parties agreed in the Stipulation to participate in a "good faith effort to negotiate and implement a mandatory fixed rate trigger for gas supply commodity costs, with the understanding that the overall objective [would] be to develop a mutually-acceptable and workable multi-year incentive program." (*Id.*).

Obviously, an agreement on such an incentive plan was never reached. As a result, this matter was litigated before the Commission in evidentiary hearings which began on June 18, 2001. Before discussing the specific issues that need to be resolved, the Commission will briefly summarize the proposals of Laclede, Staff, and Public Counsel in this proceeding.

Laclede's Proposal

During the proceedings in this matter, Laclede proposed a number of modifications to the existing GSIP in addition to, or in place of, the Company's original proposals contained in the proposed tariffs. In particular, Laclede proposed modifications to the GSIP that are designed to address the concerns and recommendations that were presented in the testimony of Staff and Public Counsel. Specifically, Laclede proposed or agreed to:

- significantly reduce the overall share of GSIP benefits that it is permitted to retain under the plan and, in the process, equalize those percentages across all elements of the plan (Exh. 2, pp. 3, 6-8);
- contribute a significant portion of its already reduced share of any benefits under the GSIP to funding energy assistance for its most vulnerable customers (Exh. 2, pp. 8-11);
- remove off-system sales revenues from base rates and once again include them in the GSIP as proposed by Staff (Exh. 2, pp. 3, 12);
- maintain an overall cap on the amount the Company may retain under the GSIP – a cap that will also apply to off-system sales revenues (Exh. 2, pp. 3, 13-14);
- add language to the GSIP that would explicitly permit further modifications to be made to the GSIP in the event the Commission ultimately adopts any recommendations from its gas cost recovery task force that are inconsistent with the Plan's provisions (Exh. 2, pp. 3, 14-15); and
- significantly alter that component of its GSIP proposal which relates to the gas supply commodity component of its gas costs in order to better ensure that fixed priced instruments can, in fact, be used in coming winters to provide customers with additional protection from any price spikes in wholesale gas supplies. Specifically, the Company has proposed to obtain a minimum level of fixed-price instruments of at least 10 Bcf for this coming winter. For future periods, the Company has also proposed to implement a modified version of Public Counsel's proposal for procuring fixed price instruments, subject to the limitation that the Company losses from the use of such instruments would be limited to \$1 million in each annual period of the plan. (Exh. 2, pp. 3, 15-26).

Staff's Proposal

Staff recommended that no plan similar to the current GSIP should be put in place through this proceeding, and suggested that a "comprehensive gas purchasing plan" would better serve ratepayers. (Staff Position Statement, p. 2; Exh. 16). Staff also proposed a "possible" incentive plan that would permit Missouri LDCs to retain a small share of savings in their delivered cost of gas if:

(a) such costs declined below a historical level, (b) declined by a greater percentage on a volumetric basis than the percentage declines experienced by most other LDCs and (c) fell below a delivered cost of \$5.50 per MMBtu. Alternatively, Staff recommended modifications to the GSIP should the Commission desire to continue the plan.

Public Counsel's Proposal

Public Counsel recommended that the Commission discontinue Laclede's current GSIP. (Exh. 33, p. 5). Alternatively, Public Counsel recommended modifications to the GSIP, including the establishment of new or higher baselines, should the Commission desire to continue the plan. Public Counsel also proposed that capacity release revenues be removed from the GSIP and included in Laclede's base rates.

ISSUES TO BE RESOLVED

Having summarized the overall proposals of the parties, the Commission will next review the positions of the parties on the specific issues that need to be resolved in this matter:

- (A) Should an incentive mechanism similar in structure to the Company's current Gas Supply Incentive Plan ("GSIP"), an alternative incentive mechanism, or no incentive mechanism, be used in connection with the management of Laclede's gas supply and transportation assets on and after September 30, 2001?**

(1) Laclede's Position

Laclede believes that an incentive mechanism similar in structure to the Company's current GSIP, but with modifications designed to address the concerns of other parties, should continue to be used in connection with the management of its gas supply and transportation assets on and after September 30, 2001. (Exh. 2, pp. 1-26). As a result of the GSIP, and the Company's superior performance thereunder, the Company has achieved tens of millions of dollars in net benefits for its customers during the nearly five years that the Plan has been in effect. (Exh. 6HC, pp. 3-10). Continuation of the GSIP will enable the Company to continue to achieve such benefits for all of its customers as well as provide an additional source of energy assistance funding for the Company's most vulnerable customers. (Exh. 2, pp. 25-26; Exh. 7). As proposed and modified by Laclede, the GSIP will also ensure the Company's ability to use fixed price instruments for a portion of its customer's gas requirements this winter, thereby affording additional protection from potential price spikes in the wholesale cost of gas. (Exh. 2, pp. 25-26). Finally, continuation of the GSIP is both necessary and fair in light of the significant financial risks and unrecognized costs imposed on the Company as a result of its merchant function, including costs incurred to provide a safety net for the Company's most vulnerable customers and to allow customers to spread out their payments for natural gas

service over many months and its importance to the Company's financial health. (See Exh. 8, pp. 2-4). Laclede also asserts that its GSIP proposal is the only workable incentive plan that has been presented in this proceeding and opposes Staff's "possible" incentive plan on the grounds that it is not an incentive plan at all and is unworkable. (Exh. 2, pp. 27, 35-38).

(2) Staff's Position

As discussed above, Staff recommends that no plan similar to the current GSIP should be put in place through this proceeding, and suggested that a "comprehensive gas purchasing plan" and its "possible" incentive plan would better serve ratepayers.

(3) Public Counsel's Position

As discussed above, Public Counsel recommends that the Commission discontinue Laclede's current GSIP. Instead, Public Counsel recommended that gas costs be treated pursuant to the PGA/ACA procedures.

(4) AmerenUE's Position

AmerenUE strongly believes that properly designed incentives provide greater benefits to customers than prudence audits. AmerenUE also recommends that Staff's "possible" incentive feature not be adopted under any circumstances.

(B) If an incentive mechanism is used, what should be the terms of such a mechanism?

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

(a) Laclede's Position

Laclede recommends that no change be made to the existing treatment of gas supply demand costs under the GSIP, except for the modifications relating to the Company's proposal to adopt uniform sharing percentages that increase the customer's share of the overall benefits achieved under the GSIP and the elimination of the commodity benchmark. (Exh. 2, pp. 6, 15-26). Accordingly, consistent with its revised sharing proposal, Laclede should be permitted to retain or required to absorb 35% of any demand charge amounts that are less or more than the RFP benchmark amount. (Exh. 2, p. 6). Laclede does not object, however, to the proposals of other parties to terminate the commodity portion of the gas procurement component of the GSIP. (Exh. 2, p. 6). Laclede also is willing to subject its gas procurement actions to prudence reviews in the future, except for those actions covered by the demand cost benchmark and those

relating to the level and cost of financial instruments procured by the Company. (Exh. 2, p. 25).

(b) Staff's Position

Staff recommends that the demand cost benchmark to be set at 1 cent, and that sharing under this mechanism should be curtailed in months where the benchmark index price exceeds \$5.50. Also, Staff suggested that limitations on prudence reviews should be removed from current tariffs. (Exh. No. 17, p. 14-15)

(c) Public Counsel's Position

Public Counsel recommends that the Commission terminate the experimental benchmark gas procurement mechanism in the GSIP. (Exh. 35, p. 10). Alternatively, if the Commission decides to maintain the experimental benchmark mechanism, Public Counsel recommends that the Commission eliminate the commodity component of the benchmark and allow the Company 25% of any positive difference between the annual demand cost benchmark and the Company's actual annual demand charge costs. (Exh. 35, p. 11).

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

(a) Laclede's Position

In its initial tariff and direct testimony, the Company proposed that the Commission approve an Experimental Fixed Price Plan ("EFPP") that would have permitted the acquisition of financial instruments when they appeared to be favorably priced in comparison to recent historical trends or when the NYMEX strip price for such instruments declined to an average price of \$3.75 per MMBtu. Both Staff and Public Counsel expressed concerns that the Company's proposed mechanism would not trigger for this winter. To address these concerns and still provide the Company with reasonable assurances, Laclede proposes that, for this winter only, it be authorized to purchase fixed price instruments for at least 10 Bcf of its winter gas requirements for December, January and February, as long as they can be purchased below a \$6.00 per MMBtu price in these months. (Exh. 2, p. 22). In the event the Company makes such purchases within these guidelines, any prudence reviews would be limited to matters other than the level and cost of the financial instruments purchased by Company. (*Id.*).

In addition, for periods after the completion of this winter season, Laclede proposes that the Commission adopt a modified version of Public Counsel's fixed price proposal in this case. (*Id.*). Like Public Counsel's proposal, the financial consequences associated with the Company's use of fixed price financial instruments would be determined by comparing whether, and to what extent, the fixed price instruments procured by the Company actually resulted in gains and

losses. Specifically, the Company recommends that in the case of NYMEX and OTC futures contracts, that gains or losses will be measured as the price paid and the price sold for such contracts, while for fixed physical supply contracts such gains and losses will be measured as the difference between the fixed price associated with the commodity, excluding any premiums necessary to reserve such supply, and the index price applicable to the location of delivery. (Exh. 5, p. 24). Unlike Public Counsel's proposal, Laclede recommends specific limits on the level of reasonable losses or gains that the Company would absorb or retain under its recommended approach. Specifically, the Company would be required to absorb 10% of any losses associated with the use of such instruments up to a total amount of \$1 million, and be permitted to retain 10% of any gains, to the extent that such retention could be accommodated within the overall earnings cap of \$10 million that Laclede has recommended in this case. (Exh. 2, pp. 22-23). As part of its proposal, the Company has also recommended that the Commission establish a range of volumes, of between 10 Bcf and 25 Bcf, that the Company would be authorized to cover with fixed price instruments, rather than mandate that a specific level of volumes be protected. (Exh. 2, p. 23).

(b) Staff's Position

Staff believes that the fixed price mechanism should be eliminated from any incentive plan.

(c) Public Counsel's Position

Public Counsel recommends that the Commission reject Laclede's fixed price proposal. If the Commission were to approve a fixed price mechanism, Public Counsel believes it should adopt the proposal set out in Ms. Meisenheimer's Rebuttal at page 12.

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

(a) Laclede's Position

Laclede recommends that no changes be made to the firm transportation discount component of the GSIP, except for the modifications relating to: (a) the Company's proposals to adopt uniform sharing percentages that increase the customer's share of the overall benefits achieved under the GSIP and provide an additional source of energy assistance funding for low-income customers; and (b) the Staff's proposal that the Company should be permitted to retain a share of any discounts negotiated with MRT if the resulting rates are below the contract rates that MRT is charging Laclede and the discounts being achieved by Laclede are not being made available by MRT on a system wide basis. (Exh. 2, pp. 6-11, 13-14; Exh. 18HC, p. 16).

(b) Staff's Position

In the event the GSIP is continued, Staff recommends a rebasing above the current baseline of \$13 million and that the sharing percentage be set at 5% for discounts, other than those negotiated with MRT. Staff prefers that no sharing be allowed for MRT discounts. If sharing is allowed for MRT discounts, Staff recommends that they be subject to the 5% sharing percentage and limited to discounts that are less than current Laclede/MRT discounts and that are not available system wide. (Exh. 17, pp. 15-16).

(c) Public Counsel's Position

Public Counsel recommends that firm transportation discounts not be included in the GSIP but treated pursuant to normal purchased gas adjustment (PGA/ACA) procedures. (Exh. 33, p. 19). Alternatively, if the Commission decides to maintain the experimental transportation discount, a baseline of \$22 million should be established prior to any ability of Laclede to profit. (Exh. 33, p. 20). Public Counsel proposes that the currently approved sharing grid continue to be used.

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

(a) Laclede's Position

Laclede recommends that no change be made to the pipeline mix component of the GSIP, except for the modifications relating to the Company's proposals to adopt uniform sharing percentages that increase the customer's share of the overall benefits achieved under the GSIP, and to provide an additional source of energy assistance funding for low-income customers. (Exh. 2, pp. 6-11).

(b) Staff's Position

Staff recommends that the sharing percentage for pipeline mix should be 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. (Exh. 16-17).

(c) Public Counsel's Position

Public Counsel recommends that the mix of pipeline services component should not be included in the experimental GSIP but treated pursuant to normal PGA/ACA procedures. (Exh. 33, p. 19). Alternatively, if the Commission decides to maintain the experimental mix-of-pipeline services portion of the experimental GSIP, a benchmark of \$1.5 million should be established utilizing the currently approved sharing grids. (Exh. 33, p. 20).

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

(a) Laclede's Position

Laclede recommends that no change be made to the capacity release component of the GSIP, except for the modifications relating to the Company's proposals to adopt uniform sharing percentages that increase the customer's share of the overall benefits achieved under the GSIP, and to provide an additional source of energy assistance funding for low-income customers. (Exh. 2, pp. 6-11).

(b) Staff's Position

Staff recommends that a base-line level of \$1,750,000 be established before the Company is entitled to share in the capacity release revenues. Staff also proposes to change the sharing percentage to 10% for credits above the baseline. (Exh. 17, 18).

(c) Public Counsel's Position

Public Counsel asserts that capacity release revenues should not be included in the experimental GSIP, but placed in a rate case as a revenue stream along with off-system sales. (Exh. 33, p. 21). Alternatively, if the Commission decides to maintain the experimental capacity release mechanism, Public Counsel recommends that a baseline of \$1.9 million should be established utilizing the currently approved sharing grids. (Exh. 33, p. 21).

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

(a) Laclede's Position

Laclede has no objection to Staff's recommendation that off-system sales revenues be removed from base rates and addressed through the PGA, provided that: (a) such revenues are incorporated in the GSIP in accordance with the Company's recommendations regarding the sharing percentages that should be applied to this component of its GSIP and its position that no baseline is appropriate for these transactions and (b) that gas costs, as recommended by Staff are increased by \$900,000 to compensate the Company for the level of off-system sales revenues that were imputed in the Company's base rates. (Exh. 2, pp. 6-12).

(b) Staff's Position

Staff recommends the inclusion of off-system sales margins in an overall GSIP earnings cap. Staff also suggested that a base-line level should be developed for off-system sales, incorporating off-system sales in the GSIP. An adjustment would be made in the ACA process to reflect the \$900,000 already embedded in base rates. (Exh. 17, pp. 17-18)

(c) Public Counsel's Position

Public Counsel recommends that off-system sales revenue remain in base rates as ordered by the Commission in Case No. GT-99-303. If the Commission decides to maintain the capacity release mechanism in the GSIP, then Public Counsel recommends that the Commission remove off-system sales from base rates and establish a \$2.1 million baseline prior to permitting any sharing by Laclede. (Exh.33, p. 21)

(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?

(a) Laclede's Position

Laclede asserts that the Commission should reject the proposals of Staff and Public Counsel to establish new or increased baseline levels for all of the components of the GSIP. (Exh. 2, pp. 31-35). Laclede also recommends that the Commission reject the Staff's proposal to reduce the Company's sharing retention percentages to 5% or 10% for such components in favor of its uniform sharing proposal. (Exh. 2, pp. 6-8). Based on current market conditions, Laclede contends that the cumulative effect of Staff's and Public Counsel's proposals would be deprive the Company of any meaningful opportunity to share in any savings generated under the GSIP, and subject it to an immediate loss of approximately \$3 million. (Exh. 2, pp. 27-28). In view of the millions of dollars in unrecovered costs it is already incurring as a result of performing its merchant function (Exh. 8, p. 3), including gas supply-related costs associated with providing a Commission-mandated safety net for its customers, Laclede asserts that such a result would require it to seriously re-evaluate the feasibility of staying in the merchant function. (Exh. 2, pp. 29-30). Laclede also opposes Staff's and Public Counsel's recommendations on the grounds that by erroneously assuming that an ever greater level of savings can be achieved in the gas cost area, they will inevitably have the effect and, in this case do have the effect, of eliminating any meaningful incentives in these areas. (Exh. 2, pp. 32-34). Finally, Laclede asserts that Staff's and Public Counsel's position that these components should be rebased in a manner similar to how expenses and revenues are determined in a rate case is unfounded given the substantially lower percentage of savings and

revenues that Laclede is permitted to retain under the GSIP, the volatility of these items from year to year, and the risk of prudence disallowances that Laclede does not face in a rate case. (Exh. 2, pp. 34-35).

Despite these fundamental differences, however, the Company has nevertheless attempted to give substantial recognition to Staff's and Public Counsel's position on this issue by proposing to significantly reduce the overall share of benefits that may be retained by the Company under the GSIP and significantly increasing the share of such benefits received by the Company's customers. Under the current GSIP, the Company is permitted to retain 50% of the savings achieved under the gas procurement component of the Plan and 30% of the savings or revenues achieved under the other components of the Plan, with the exception of the capacity release component which varies from 10% to 30%. (Exh. 2, p. 6). In addition, the Company is permitted to retain 100% of the off-system sales revenues it achieves between rate cases once the \$900,000 baseline included in rates is exceeded. (*Id.*). Under the Company's proposed modification, the sharing percentages for all of these components would be equalized to 35%, with the exception of the sharing percentage for the commodity portion of the gas procurement component which would be reduced to zero. (*Id.*). Based on an analysis of the 1999-2000 ACA period, this proposed reduction in sharing percentages, together with the complete elimination of any sharing percentage for the commodity portion of the gas procurement component, would reduce Laclede's sharing retention opportunities by approximately \$3 million dollars or 30%. (Exh. 2, p. 7; Exh. 6HC, Schedule 3). Moreover, the amounts ultimately retained by Laclede under the GSIP would be reduced by another 10% in the event the Commission approves the Company's proposal to contribute 1/7 of its GSIP earnings to Dollar-Help. The adoption of uniform sharing percentages, as proposed by the Company, would also serve to address Staff's and Public Counsel's concern that applying different sharing percentages to capacity release and off-system sales revenues may give the Company an incentive to favor the latter over the former. (Exh. 2, p. 8).

(b) Staff's Position

The Staff's position on baselines was discussed in response to issues (3), (4), (5), and (6) above.

(c) Public Counsel's Position

Baselines should be established for firm transportation discounts, capacity release revenues, off-system sales system and the mix-of-pipeline discounts should the Commission decide to continue the GSIP.

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

(a) Laclede's Position

Laclede is agreeable to maintaining the earnings cap proposed by Staff and Public Counsel on the overall level of saving and revenues the Company may retain under the GSIP, subject to one modification. Specifically, Laclede points out the need to recognize that at the time the present cap was established, off-system sales revenues had been completely excluded from GSIP consideration through their inclusion in base rates. (Exh. 2, p. 13). As previously noted, however, Staff has proposed such that revenues once again be included in the GSIP, with a \$900,000 adjustment to the Company's gas costs. In view of this recommendation, Laclede recommends that the cap be raised from \$9 million to \$10 million to account for the fact that the cap will now apply to those revenues as well. (*Id.*). Laclede notes that even with this modest adjustment to \$10 million, the cap will still limit any potential earnings by Laclede to an amount that is only a few percentage points of its overall gas costs. (*Id.*).

(b) Staff's Position

Staff believes that an earnings cap is necessary to account for unexpected windfalls and recommends a \$9 million cap. (Exh. 16, p. 33; Exh. 17, p. 18).

(c) Public Counsel's Position

An earnings cap of \$9 million should be placed on the GSIP if it is continued. (Exh. 33, p. 22).

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

(a) Laclede's Position

Laclede does not believe it is necessary to establish a specific term for the incentive mechanism, since the GSIP, as filed, already contains a provision that permits any party to recommend modifications to the GSIP in the event there is a significant change in conditions. (Exh. 2, pp. 14-15). However, in response to concerns raised by Staff regarding the need to reflect recommendations made by the Commission gas cost recovery task force, Laclede recommends that this provision be supplemented to explicitly provide that the GSIP may also be modified or even terminated in the event the Commission decides, after hearing, to adopt any such recommendations that may be inconsistent with the GSIP or its provisions. (*Id.*). Such an approach will allow the work of the task force and its inter-relationship to the GSIP to be fully considered and accommodated without artificially limiting the term of the GSIP. The Company accordingly recommends

that a modification incorporating such language in the GSIP be made in response to the concerns raised by Staff.

(b) Staff's Position

Staff recommended that the term of any incentive plan established by this case should be one year.

(c) Public Counsel's Position

Public Counsel initially recommended a three year term for the GSIP should it be adopted by the Commission. In its surrebuttal testimony, however, Public Counsel took the position that the GSIP should be reviewed annually. (Exh. 35, p. 5).

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

(a) Laclede's Position

Although this was identified as an issue in this proceeding, Laclede points out that there is no specific recommendation in the testimony of either Staff or Public Counsel that purports to endorse or support some form of special treatment for bundled sales and transportation contracts. Accordingly, Laclede asserts that there is no evidence to support any new or special treatment for such contracts and that the Commission should therefore find that they will be accorded the same treatment that they have been given in the past.

(b) Staff's Position

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

(c) Public Counsel's Position

Public Counsel took no position on this issue.

(C) If an incentive mechanism is not used, what alternative can or should be implemented in its place?

(a) Laclede's Position

It is Laclede's position that neither Staff nor Public Counsel have proposed a workable incentive plan in this proceeding. Laclede also believes that they have failed to offer any reasonable or effective alternatives to the GSIP, as proposed by the Company.

In his rebuttal testimony, Staff did propose a new process for evaluating the gas procurement plans and strategies of Missouri LDCs. And as a general matter, Laclede stated that it is supportive of any effort that will help to expedite the ACA review process and potentially limit the magnitude and number of prudence issues that may have to be resolved through that process. In his surrebuttal testimony, however, Company witness Neises testified that Staff's proposal raises fundamental questions regarding how involved Staff or the Commission should be in the gas acquisition strategies of LDCs. (Exh. 2, p. 38). Laclede also expressed serious reservations regarding the feasibility of conducting such an elaborate review process within the time constraints suggested by Staff and does not, in any event, believe that such a review process is necessary for any portion of the Company's gas costs that are subject to incentives. (*Id.*). Laclede believes such a process could exacerbate rather than diminish concerns over prudence adjustments. (*Id.*). Nevertheless, the Company indicates that it will work with both the Staff and Public Counsel to implement improvements to the current process and will maintain an open mind on the form that those improvements should take. It does not believe, however, that Staff's proposal can or should be adopted as a substitute for the modified GSIP proposed by the Company in this proceeding. (*Id.*)

(b) Staff's Position

The Staff recommended a "comprehensive gas purchasing plan" in lieu of any incentive plan. Staff proposed three components: 1) a coordinated gas purchase plan; 2) documentation and reporting process; and 3) regulatory review procedures. (Exh. 16, pp. 18-30).

(c) Public Counsel's Position

If an incentive mechanism is not used, gas costs should be treated pursuant to the historical PGA/ACA procedures.

Findings of Fact

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact. The positions and arguments of all of the parties have been considered by the Commission in making this decision. Failure to specifically address a piece of evidence, position or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision.

Should an incentive mechanism similar in structure to the Company's current Gas Supply Incentive Plan ("GSIP"), an alternative incentive mechanism, or no incentive mechanism, be used in connection with the management of Laclede's gas supply and transportation assets on and after September 30, 2001?

The Commission finds that the establishment of a modified Gas Supply Incentive Plan (referred to as the "GSIP III"), as modified by Laclede to address concerns raised by Staff and Public Counsel, is in the public interest. The Commission will approve the implementation of the GSIP III for an indefinite period, or until modified by a subsequent order of the Commission.

The Commission has recognized by its prior extensions of the GSIP that the GSIP has enabled the Company to achieve significant net benefits for its customers. Although some of the witnesses for Staff and Public Counsel suggested, or simply assumed, a lack of such benefits in their rebuttal testimony, they offered no substantive analysis in support of their views. As the testimony submitted by Laclede witness Jaskowiak's demonstrated, these unsubstantiated claims simply ignored the evidence from Case No. GT-99-303 which fully described and quantified at least \$45 million in net benefits that would not have been available in the absence of the GSIP and the Company's superior performance thereunder during the first three years of the program. Moreover, Mr. Jaskowiak's analysis also demonstrated that since the conclusion of Case No. GT-99-303, these actions, as well as others, had generated additional net benefits of at least \$19.3 million by the end of Laclede's fiscal year ending September 30, 2000. (Exh. 5, p. 4; Exh. 6HC, Schedule 1). Altogether, Laclede was able to identify and specifically quantify nearly \$65 million in added savings and revenues that had been made available for sharing with the Company's customers during the first four years of the GSIP's operation. (*Id.*). The Commission finds Laclede's evidence on these savings to be compelling in demonstrating that the GSIP has been in the public interest.

As Laclede witness Jaskowiak testified, these savings included some \$26.3 million in gas procurement related savings. (Exh. 5, p. 5). Of this amount, approximately \$9.5 million was associated with the Company's successful decision to lock-in over a multi-year period the amount of demand costs that it paid for reserving the majority of its gas supplies. (Exh. 5, p. 7). As a result of this initiative, the Company produced significant gas procurement savings when, as the Company had correctly anticipated, the market cost for reserving gas supplies significantly increased over the locked-in period. (*Id.*).

Another \$4.1 million in demand cost savings was achieved by the Company's successful decision to contract for less flexible firm gas supplies. (Exh. 5, pp. 4-7). In effect, the Company was able to achieve these savings by significantly reducing the percentage of its firm gas supplies that had historically been taken by the Company under more expensive "swing" and "combination" supply

contracts and increasing the percentage of such supplies taken by the Company under less expensive "baseload" contracts. As a result of the Company's efforts in this regard, the amount of firm baseload gas in the Company's portfolio increased from an average of 14% prior to the GSIP to an average of 24% during the GSIP. (Exh. 5, p. 6). Conversely, the amount of combination and swing in the Company's portfolio decreased from an average of 72% and 14% prior to the GSIP to an average of 66% and 10% respectively during the GSIP. (*Id.*). Unquestionably, in return for a share of the potential savings under the GSIP, the Company was willing to assume the risk of decreasing the flexibility in its supply portfolio in order to reduce costs. (*Id.*).

The remaining procurement savings reflect the Company successful efforts to purchase gas supplies at below market prices. (Exh. 6HC, p.7, Schedule 1).

As previously noted, the Company also took a number of initiatives under the GSIP in the pipeline capacity area – initiatives that produced approximately \$2.4 million in incremental revenues from the release or sale of pipeline capacity. (Exh. 5, pp. 7-9). The first of these initiatives relates to the Company's decision to enter into multi-month capacity release arrangements. (Exh. 5, p. 8). Although the Company had previously made a limited number of multi-month arrangements in years past, such a practice was not common for the Company. (*Id.*). Moreover, nearly all of the multi-month releases made by the Company before this period were at the pipelines' maximum applicable rates. (*Id.*). Since the maximum allowable amounts of revenues were being generated under these arrangements, the Company believed these multi-month release arrangements were easily supportable and not subject to being second-guessed. In contrast, the Company's multi-month arrangements during the GSIP were made at rates that were considerably below the maximum rates in effect at the time. (*Id.*) Because of the clear standards that were provided by the GSIP, and because the GSIP provided the Company an incentive to share in the benefits if its assessment of the market turned out to be correct, the Company has since made multi-month release arrangements a valuable tool to achieve savings for its customers. (*Id.*). The evidence shows that the incremental revenue that was produced as a result of the Company's decision to enter into multi-month release arrangements at below maximum rates was approximately \$1.3 million. (Exh. 5, pp. 8-9, Exh. 6HC, Schedule 1).

Another initiative that was thoroughly discussed in both this case and Case No. GT-99-303, relates to the Company's successful effort to minimize inefficiencies embedded in the services provided by its pipeline suppliers. As a result of this initiative, the Company determined that the under-utilized capacity associated with MRT's Flexible Contract Demand could be better utilized through the elimination of such service. (Exh. 5, pp. 8-9). Since MRT's firm shippers were essentially paying for the under-utilized capacity through straight-fixed variable rate design, the Company aggressively pursued having MRT eliminate such service and allocate such capacity to the shippers who pay for the capacity

anyway. (Id.). As a result of these efforts, the Company was allocated, without any overall increase in costs, an additional 12,480 MMBtu/D of contract demand, which it then released for approximately \$1.1 million in incremental revenue through the Company's most recent fiscal period ending September 2000. (Id.).

In addition, an incremental cost savings of \$28.9 million was achieved from the Company's successful efforts to negotiate pipeline discounts at levels greater than that established by the Commission in Case No. GT-99-303 which represented the average level of discounts being achieved by other shippers of capacity on the same pipeline systems. (Exh. 5, p. 5). The undisputed evidence presented by the Company also shows that the GSIP permitted the Company to flow through \$1.9 million from optimizing the Company's mix upstream transportation alternatives and over \$4.8 million in off-system sales revenues that would have otherwise gone entirely to the Company's shareholders. (Exh. 5, p. 5; 6HC, Schedule 1).

The Commission finds that this quantification of savings clearly demonstrates the value of the Company's GSIP and the need to continue it in the manner proposed by the Company. Contrary to the assertions made by Staff and Public Counsel, it is clear to the Commission that the GSIP, and the Company's management of its gas supply and transportation assets under that Plan, have produced substantial net benefits for Laclede customers. Moreover, by approving an extension of the GSIP and determining that it was in the public interest, the Commission has also recognized the beneficial role that the GSIP has played in this regard. In view of these prior determinations, the Commission believes it was incumbent on any party who disputes the beneficial role played by the GSIP in reducing gas costs and enhancing revenues for Laclede's customers to provide a sound analysis showing how the Company's quantification of these benefits is in error. Despite the fact that the vast bulk of the analysis and data underlying the Company's quantification of these benefits has been available for nearly two years (Exh. 5, p. 10), however, the Commission finds that there was nothing presented in the rebuttal testimony submitted by Staff and Public Counsel that would constitute such an analysis. In view of these considerations, the Commission finds that GSIP has significantly benefited the Company's customers and should be continued.

Since the Commission has determined that the GSIP should be continued, and in light of its other determinations set forth below, it does not need to address the arguments raised by the Company regarding the appropriateness of continuing the GSIP in light of its importance to the Company's financial health. The Commission would note, however, that the financial evidence presented by the Company on this subject, including its calculations of merchant related costs and its history of earning less than the Commission's authorized returns on equity, clearly negates any suggestion that the GSIP has enabled the Company to make excessive earnings or that it has resulted in unjust or unreasonable rates. Given its determination, the Commission also finds that Staff's "possible" incentive plan

should not be adopted. The Company provided persuasive evidence as to why such an approach was unworkable and unlikely to produce favorable results for consumers. (Exh. 2, pp. 35-38). In addition, the testimony by Staff's own witness on cross-examination clearly demonstrated that there are simply too many substantive and uncontrollable differences between the operational environments faced by Missouri LDC's that could influence the percentage change in their delivered gas costs from year to year, (Tr. 992-999) to conclude that Staff's comparative approach would produce fair or meaningful results.

How should Laclede's gas supply commodity and demand costs be incorporated in the structure?

Based upon the evidence presented in this case, the Commission finds that Laclede has achieved substantial savings in demand costs over the term of the GSIP as a result of its innovative efforts to lock-in demand charges, reduce contract flexibility and other measures. (Exh. 5, pp. 5-7). The Commission also finds that the RFP-determined fixed cost demand charge benchmark in the GSIP, which was initially implemented in response to concerns raised and recommendations made by the Staff, has functioned properly and that no credible evidence to the contrary has been presented in this case. (Exh. 1, p. 4, Exh. 6HC, pp. 14-16). The Commission accordingly finds that this feature of the gas procurement component should be retained.

However, Staff and Public Counsel have recommended that the Commission terminate the commodity portion of the gas procurement component of the GSIP. Laclede is also willing to eliminate the commodity portion of the gas procurement component and is willing to subject its gas procurement actions to prudence reviews in the future, except for those actions covered by the demand cost benchmark and those relating to the level and cost of financial instruments procured by the Company. (Exh. 2, p. 25) The Commission finds this proposal to be reasonable and therefore will order that the GSIP be modified to eliminate the commodity portion of the gas procurement component from the GSIP and limit the incentive feature of this component to demand costs incurred to reserve gas supplies. Consistent with the Commission's decision regarding sharing percentages, the Company's retention of any gains or sharing of any losses in connection with its gas supply demand costs shall be limited to 35% of the amount by which the Company actual level of demand charges paid by the Company exceed or fall below the demand cost benchmark as determined in accordance with the GSIP's existing Request for Proposal Procedure.

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

As previously discussed, Laclede has proposed that, for this winter only, it be authorized to purchasing fixed price instruments for a minimum of 10 Bcf of its winter gas requirements for December, January and February, as long as they can be purchased below a \$6.00 per MMBtu price in these months. (Exh. 2, pp.

22, Exh. 5, 23). In the event, the Company makes such purchases within these guidelines, any prudence reviews would be limited to matters other than the level and cost of the financial instruments purchased by Company. (Exh. 2, p. 22). Given the fact that all of the parties to this case have either urged the Company to employ such fixed price instruments or urged the Commission to encourage the Company to take such action (See Public Counsel's Initial Brief, p. 13; Tr. 1060-1065, the Commission finds this proposal to be reasonable and in the public interest. The Commission also finds such approval to be consistent with the commonly-shared principle that diversity in the gas supply portfolios of LDCs should be clearly encouraged as a means of balancing price and price stability.

In addition, for periods after the completion of this winter season, Laclede proposes that the Commission adopt a modified version of Public Counsel's fixed price proposal in this case. (*Id.*). Like Public Counsel's proposal, the financial consequences associated with the Company's use of fixed price financial instruments would be determined by comparing whether, and to what extent, the fixed price instruments procured by the Company actually resulted in gains and losses. Specifically, the Company recommends that in the case of NYMEX and OTC futures contracts, that gains or losses will be measured as the price paid and the price sold for such contracts, while for fixed physical supply contracts such gains and losses will be measured as the difference between the fixed price associated with the commodity, excluding any premiums necessary to reserve such supply, and the index price applicable to the location of delivery. (Exh. 5, p. 24). Unlike Public Counsel's proposal, Laclede recommends specific limits on the level of reasonable losses or gains that the Company would absorb or retain under its recommended approach. Specifically, the Company would be required to absorb 10% of any losses associated with the use of such instruments up to a total amount of \$1 million, and be permitted to retain 10% of any gains, to the extent that such retention could be accommodated within the overall earnings cap of \$10 million that Laclede has recommended in this case. (Exh. 2, pp. 22-23). As part of its proposal, the Company has also recommended that the Commission establish a range of volumes, of between 10 Bcf and 25 Bcf, that the Company would be authorized to cover with fixed price instruments, rather than mandate that a specific level of volumes be protected. (Exh. 2, p. 23).

The Commission finds the Company's proposal for periods after this winter to be reasonable. As Mr. Neises testified, absent some limitation on gains and losses, purchasing any significant amount of these instruments could expose the Company to losses of a magnitude sufficient to wipe out its entire net income for a year or more. (Exh. 2, p. 23). The Commission finds that this is not a risk that the Company can or should be asked to take given the need to ensure the Company's continuing ability to meet its most fundamental obligation of providing natural gas service to its customers.

Commission also finds that it is reasonable to establish a range of volumes, of between 10 Bcf and 25 Bcf, that the Company would be authorized to cover with

fixed price instruments, rather than mandate that a specific level of volumes be protected. Given the concerns that have been expressed by the parties in this case regarding the need for the kind of price protection that can be afforded by fixed price instruments, it is certainly appropriate that Laclede be authorized to fix a minimum amount of its volume requirements. The Company presented evidence showing that when combined with the 40% of normal winter supplies covered by the financial instruments purchased under the Company's Price Stabilization Program, a purchase of fixed contracts equal to the 10 Bcf of the Company's winter flowing requirements would ensure some form of price protection for nearly 60% of the Company's normal winter purchases. (Exh. 2, pp. 22-24). If the Company purchased financial instruments for its winter flowing supplies equal to the 25 Bcf maximum, the evidence indicates that the amount of normal winter purchases covered by financial instruments would rise to 87%. (Exh. 2, p. 24). Under either scenario, the evidence shows that customers would be afforded with significant price protection from any substantial spike in wholesale gas prices while still being eligible to receive significant benefits from any large declines in the market price of gas. (Exh. 2, p. 24). The Commission finds this analysis and the diversity results it achieves to be reasonable.

The Company's proposal to establish a range rather than a specific volume requirement also addresses other concerns that have been raised in this proceeding. As Company witness Neises noted, both Staff witness Schallenberg and Public Counsel witness Meisenheimer discussed the pros and cons of the Commission pre-approving a specific course of action, such as the Company's EFPP proposal to procure fixed instruments for a specific volume of its gas requirements if certain triggers are reached. (Exh. 2, pp. 24). They also noted, however, the substantial risks faced by the Company in the absence of any clear standards regarding the possible financial consequences associated with using fixed price instruments. (*Id.*). The Commission finds that the Company's proposal to establish a range reconciles these potentially conflicting considerations by having the Commission do nothing more than recognize that a range of results is reasonable where any scenario within that range will bring significant diversity to the Company's efforts to balance price and stability. (*Id.*). At the same time, such an approach would give the Company the flexibility to decide what specific scenario is optimal, with the certain knowledge that it will be financially responsible for how good a job it does in selecting that scenario. (Exh. 2, pp. 24-25). In view of these considerations, the Commission finds Laclede's proposal to be reasonable and will therefore order that it be included in the modified GSIP.

How should firm transportation pipeline discounts be incorporated into the incentive mechanism?

Based upon the competent and substantial evidence in the record, the Commission finds that the firm transportation discount component of its GSIP should not be changed, except for the modifications relating to the Company's

proposals to adopt uniform sharing percentages that increase the customer's share of the overall benefits achieved under the GSIP, and to provide an additional source of energy assistance funding for low-income customers. The Commission believes that the Company's proposal to help fund low-income customers as a part of its GSIP is reasonable, and represents an innovative approach for helping customers who may be having difficulty meeting the costs of natural gas consumption.

The Commission also finds that the firm transportation discount component has worked well for the Company and its ratepayers, and that it should therefore be continued. Given the magnitude of the above average pipeline discount savings that the Company has been able to quantify in this case, the Commission finds that the Company's successful efforts in this area, particularly in a tightening market, are a good example of the kind of performance that merits continued recognition. Moreover, neither Staff nor Public Counsel have presented any credible evidence that would demonstrate that this component has not worked well for the Company's customers. (Exh. pp. 16-18). The Commission also finds that Staff's and Public Counsel's rebasing and sharing percentages proposal relating to this component are unreasonable and unrealistic. Although the Commission has general concerns regarding those proposal which will be addressed later in this Report and Order, it finds that such recommendations are particularly unsupported in this area.

As Laclede noted in its testimony, the Commission determined in Case No. GT-99-303 that a \$13 million baseline should be the firm transportation discount component of Laclede's GSIP based on Laclede's analysis that such a baseline represented the average level of discounts being achieved by other shippers on the same pipelines from which Laclede was receiving service. **Re: Laclede Gas Company**, Case No. GT-99-303, *supra*, at 11-12, 16-17 (Exh. 5, p. 18). Given that determination, Laclede asserts, and the Commission agrees, that a party seeking to change that baseline or reduce the related sharing percentage had an obligation to demonstrate that circumstances relating to the ability to negotiate such discounts have changed sufficiently to justify a modification in these parameters. Laclede contends that no such evidence has been presented in this case, however, by either Staff or Public Counsel. In fact, the Commission finds that the only substantive evidence presented on the issue was furnished by Laclede witness Bruce Henning, the Director of Regulatory and Market Analysis for Environmental Analysis, Inc. (Exh. 3, p. 1). Based on an analysis of all of the pipeline corridors serving Laclede, Mr. Henning found that 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. (Exh. 3, p. 4). According to Mr. Henning's analysis, the factors contributing to the tightening of capacity that would make negotiating such discounts more difficult were: (a) a substantial increase in demand for natural gas, which as a result of gas fueled electric generation and growth in other markets, would approach 30 trillion cubic feet by 2010; (b) a 30% increase in the

annual load factors for pipelines moving gas from Louisiana to Missouri by 2005; and (c) the abandonment of a major segment of the Trunkline pipeline as the result of its conversion to a products pipeline. (Exh. 3, pp. 4-5). In view of these factors, Mr. Henning concluded that Staff's and Public Counsel's rebasing proposals would result in unachievable baselines and, in the process, eliminate any effective incentive in this area. (*Id.*) He also noted that adoption of such proposals would be particularly inappropriate in that it would penalize the Company for its superior and recently concluded efforts to negotiate discounts with a number of its pipeline suppliers. (Exh. 3, p. 3). For all of these reasons, as well as those discussed later in this Report and Order, Commission finds that Staff's and Public Counsel's rebasing and sharing percentage recommendations are unreasonable and that the Company's sharing and baseline recommendations should therefore be adopted for this component.

How should pipeline mix be incorporated into the incentive mechanism?

Based upon the competent and substantial evidence in the record, the Commission finds that the pipeline mix component of the GSIP should not be changed, except for the modifications relating to the Company's proposals to adopt uniform sharing percentages that increase the customer's share of the overall benefits achieved under the GSIP, and to provide an additional source of energy assistance funding for low-income customers. Laclede identified specific savings of \$1.9 million that it had achieved under this new component since it was added in Case No. GT-99-303. (Exh. 5, p. 9). Moreover, the Staff and Public Counsel have not presented credible evidence that the pipeline mix component of the GSIP has failed to provide the Company with proper incentives. (Exh. 5, pp. 18-19). In addition, the Commission believes that the proposals of Staff and Public Counsel to eliminate this component is particularly inadvisable given the evidence on the record which indicates that this component was added to the GSIP for the express purpose of addressing Staff's concern that utilities might have a perverse incentive to increase transportation costs uneconomically in order to procure less expensive gas supplies. (Exh. 1, pp. 4-5). The Commission finds no legitimate reason to modify this component of the GSIP other than as proposed by the Company.

What treatment should be afforded to capacity release credits or revenues?

Based upon the competent and substantial evidence in the record, the Commission finds that the capacity release component of the GSIP should not be changed, except for the modifications relating to the Company's proposals to adopt uniform sharing percentages that increase the customer's share of the overall benefits achieved under the GSIP, and to provide an additional source of energy assistance funding for low-income customers. The Staff and Public Counsel have not presented credible evidence that the capacity release component of the GSIP has failed to provide the Company with proper incentives. (Exh. 5, pp. 19-21). Nor has Public Counsel demonstrated why it

would benefit customers to remove capacity release revenues from the GSIP and put them in base rates. In contrast, the Company has presented substantial evidence demonstrating the positive impact of this component on the Company's ability to generate financial benefits for its customers, such as its strategy of entering into multi-month capacity release arrangements at less than maximum rates. (Exh. 5, pp. 8-9). The Commission therefore finds no legitimate reason to modify this aspect of the GSIP other than as proposed by the Company.

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

Both Staff and Public Counsel have expressed a concern in this proceeding that the varying treatment afforded capacity release revenues versus off-system sales revenues (i.e., with the former being dealt with in the PGA and the other in base rates with different sharing consequences for both) may provide the Company with an incentive to favor one kind of transaction over another. To address this concern, Staff has proposed that the Company's off-system sales revenues be removed from base rates and reincorporated in the PGA. Laclede testified that it has no objection to Staff's proposal to reincorporate off-system sales in the PGA, provided that: (a) such revenues are incorporated in the GSIP in accordance with the Company's recommendations regarding the sharing percentages that should be applied to this component of its GSIP and its position that no baseline is appropriate for these transactions and (b) that gas costs are increased, as suggested by Staff, by \$900,000 to compensate the Company for the level of off-system sales revenues that was imputed in the Company's base rates. (Exh. 2, p. 12).

The Commission finds that Staff proposal, as implemented in accordance with the Company's recommendations, is reasonable and will order that the GSIP be modified accordingly.

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?

Both Staff and Public Counsel proposed that the Commission establish new or increased baseline levels for all of the components of the GSIP. Staff witness Sommerer also proposed reductions in the percentage share that the Company may retain in connection with most of these components. Laclede testified that these proposals should be rejected for a number of reasons. (Exh. 2, pp. 26-34). However, the Commission finds that the Company has submitted a proposal that gives substantial recognition to Staff's and Public Counsel's position on this issue by permitting a significant reduction in the overall share of benefits that may be retained by the Company under the GSIP.

As previously discussed, under the current GSIP, the Company is permitted to retain 50% of the savings achieved under the gas procurement component of the Plan and 30% of the savings or revenues achieved under the other components of the Plan, with the exception of the capacity release component which varies

from 10% to 30%. In addition, the Company is permitted to retain 100% of the off-system sales revenues it achieves between rate cases once the \$900,000 baseline included in rates is exceeded. (Exh. 2, p. 6). Under the Company's proposed modification, however, the sharing percentages for all of these components would be equalized to 35%, with the exception of the sharing percentage for the commodity portion of the gas procurement component which would be reduced to zero. (*Id.*).

Compared to the retention percentages in the existing GSIP, the Commission believes that the adoption of these uniform sharing percentages, together with the complete elimination of any sharing percentage for the commodity portion of the gas procurement component, would significantly reduce the Company's share of GSIP benefits and, conversely, increase the share received by its customers. (Exh. 6, p. 7; Exh. 5, p. 11). The evidence demonstrates that, had these percentages been in effect during the 1999-2000 ACA period, the Company would have received nearly \$3 million less than the approximately \$10 million in savings and revenues it retained that year from both the GSIP and its off-system sales. (*Id.*). Expressed as a percentage, this is equivalent to an overall reduction of approximately 30% in the share of GSIP and off-system sales benefits that may be retained by the Company.

The Commission finds that adoption of uniform sharing percentages, as proposed by the Company, would also serve another purpose. In the past, the Staff and Public Counsel have criticized the GSIP, as well as other incentive programs, on the grounds that by providing different sharing retention percentages for its various components, the incentive program may give the Company an inappropriate incentive to structure its transactions so as to take advantage of the higher sharing opportunities afforded by some components. (Exh. 2, p. 8). Indeed, it appears to the Commission that Staff's and Public Counsel's respective proposals in this case to afford similar sharing treatment to the Company's capacity release and off-systems sales revenues has been prompted by this very kind of concern. (*Id.*). The Commission believes that the adoption of the Company's proposal to implement uniform sharing percentages should serve to eliminate any such concerns in the future.

The Company has also stated that, in the event the Commission approves the 35% sharing retention percentages and other modifications proposed by the Company in this proceeding, Laclede would agree to contribute 5% or 1/7 of this retention amount to the Dollar-Help Program in order to provide additional energy assistance to its most vulnerable customers. (Exh. 2, pp. 8-11; Exh. 7). As noted by the Company, the amount of increased funding generated by this proposal would ultimately depend on how successful the Company was in achieving savings and revenues for all of its customers under the GSIP. For illustration purposes, however, an analysis performed by Mr. Jaskowiak showed that had this proposal been in effect during the 1999-2000 ACA period, it would have generated more than \$1 million in increased funding for low-income energy

assistance. (Exh. 5, p. 11). Of course, this would also result in a further reduction in the amount of earnings ultimately retained by the Company as a result of the GSIP. (Exh. 2, pp. 9-10). In fact, when combined with the reduction in the Company's overall share of GSIP benefits, the evidence shows that this further commitment would reduce the Company's earnings potential under the GSIP by nearly 40% compared to the current structure. (*Id.*).

Because it adequately addresses the concerns underlying Staff's and Public Counsel's rebasing and sharing retention proposals, and because it will provide the Company's most vulnerable customers with an added source of low-income energy assistance to the extent the Company can achieve savings for all its customers, the Commission finds that the Company's proposals on this issue are reasonable and should be adopted.

In contrast, it is clear from the evidence in this case that Staff's and Public Counsel's rebasing and sharing retention proposals would effectively deprive the Company of any meaningful opportunity to achieve earnings in connection with its gas acquisition and management efforts. In Schedule 2 to his surrebuttal testimony, Laclede witness Jaskowiak showed that application of the baselines proposed by Staff and Public Counsel to the non-gas procurement components of the Company's existing GSIP would barely permit the Company to break even on these components, under current market conditions. (Exh. 6HC, Schedule 2). And that assumes that the Company was actually able to replicate all of the savings and revenue enhancements that it has previously achieved in these areas. (Exh. 2, p. 28). In addition, the Company points out that Staff's proposal for the gas procurement component of the Company's GSIP would require it to immediately absorb another \$3 million in gas supply costs based on current market conditions. (Exh. 2, p. 28). Laclede claims that in addition to being unfair and unworkable, these proposals send the unmistakable message to the Company that, for the sake of its shareholders and its customers, Laclede would have to seriously re-evaluate its future merchant role should such proposals be adopted. (*Id.*).

In addition to having the Company absorb millions of dollars in unrecovered gas costs, it is also clear from the evidence that both parties' proposals would also expose the Company to the risk of even greater losses as a result of potential disallowances from future prudence reviews. (Exh. 2, p. 29). Laclede asserts that it is difficult to conceive of any business that would willingly submit to selling gas under these kinds of punitive and patently uneconomic conditions and Public Counsel's own witness admitted that he could think of no unregulated gas marketing firm that would voluntarily agree to provide services under such a one-sided arrangement. (Exh. 10, pp. 61-62).

It is also clear from the undisputed evidence in this case that the Company is not being compensated for these risks by the earnings it receives from distributing gas to customers. According to Company witness Buck, even with the income

realized by the Company as a result of its efforts under the GSIP, Laclede has still not been able to earn its authorized returns in three out of the last four fiscal years. (Exh. 8, p. 4). And without that income, it would have been extremely difficult for the Company to even cover the dividend it has been paying for more than fifty years. (Exh. 2, p. 29).

Aside from their adverse, financial impact on the Company, there are a variety of reasons why the Commission does not believe that the proposals by Staff and Public Counsel to establish new or higher baselines for various components of the GSIP are in the public interest. At the core of both Staff's and Public Counsel's proposal is the assumption that historically-derived baselines for the various components of the GSIP should be established just as the Commission establishes discrete levels of expenses and revenues in a general rate case proceeding. (Exh. 2, p. 32). As explained by Company witness Neises, however, such an approach is really nothing more than a method for ensuring that all incentive programs will inevitably be terminated. (*Id.*). Contrary to the assumption underlying Staff's and Public Counsel's position on this issue, the Commission finds that it is simply not possible for Laclede or any other LDC to achieve ever greater levels of savings and revenues through the management of their gas supply and transportation assets. (*Id.*). In fact, if carried to its logical conclusion, such a view would suggest that to continue to operate under an incentive plan, an LDC must eventually achieve a level of performance where suppliers and transporters are giving away their services and products for free, or even paying the LDC to take them. (*Id.*). Since it is, of course, impossible to achieve such a result, the rebasing approach suggested by Staff and Public Counsel would inevitably lead to a situation where the so-called incentive becomes worthless because it will only reward a level of performance that cannot be achieved. The Commission therefore finds the Staff and Public Counsel proposals to rebase the benchmarks to be unrealistic.

The Commission also finds that the position taken by Staff and Public Counsel fail to recognize that in an ever changing competitive marketplace, savings and revenues achieved today, can be gone tomorrow absent constant efforts to maintain them. (Exh. 2, pp. 33). Under such circumstances, it is incorrect to suggest that management performance can only be deemed superior and worthy of financial recognition if it continues to produce an ever greater level of savings and revenues than it has in the past. (*Id.*). Under many circumstances, particularly in a tightening market like the Company faces today, the most exceptional manifestation of superior performance can be to simply retain the savings it has already achieved. (Exh. 2, pp. 33-34). The Company's successful efforts over the recent past to negotiate pipeline discounts at or below historical levels in a tightening market are a good example of the kind of performance that merits continued recognition. (Exh. 2, pp. 33-34; Exh. 3). Moreover, if it were, in fact, possible for the Company to achieve a greater level of savings or revenues in these areas as Staff and Public Counsel suggest, the Commission believes it

is likely that the Company would have done so by now since it has had every financial incentive to do so as a result of the GSIP.

The Commission is also not persuaded by Staff's and Public Counsel's suggestion that their rebasing proposals are consistent with how revenues and expenses are determined in a general rate case proceeding. As Company witness Neises testified, once the level of revenues and expenses are determined in a rate case, the utility is permitted to keep 100% of any savings or increased revenues above or below the baseline level. (Exh. 2, p. 34). In contrast, the most that the Company would be permitted to retain in this proceeding, even under its own proposals, is 35% of any savings or revenues. (*Id.*). Moreover, this tradeoff between retention percentages, and whether or how high a baseline should be set, has previously been recognized by the Commission as well. (*Id.*). In addition, as Mr. Neises testified, a utility is not subject to prudence reviews in a rate case that can retrospectively change the level of costs or revenues that will be recognized in rates for a past period. (Exh. 2, p. 34). Finally, unlike most costs and revenues that are addressed in a rate case, the ones that are addressed in the GSIP are, by and large, far more volatile in nature, a factor that makes them particularly unsuited to the type of baseline approach recommended by Staff and Public Counsel. (Exh. 2, pp. 34-35).

In view of these considerations, the Commission finds that Staff's and Public Counsel's proposals on this issue should not be adopted. The Commission does believe, however, that it is appropriate to give some recognition to the concerns underlying these proposals and finds that the Company sharing percentage proposal does that in a meaningful way. The Commission will therefore adopt the Company's sharing percentage proposal in this case.

Should an earnings cap be placed on the savings and revenues retained by Laclede?

In their rebuttal testimony, both Staff witness Sommerer and Public Counsel witness Busch proposed that an overall cap of \$9 million be maintained on the level of earnings that the Company may retain under the GSIP. In the Company's surrebuttal testimony, Laclede indicated that it does not object to the continuation of such a cap on the amount it may retain under the GSIP, provided that it is increased by \$1 million dollars to accommodate the reincorporation of off-system sales revenues in the GSIP. (Exh. 2, pp. 13-14). The Commission finds that retention of the cap, as modified by the Company's proposal, is appropriate in that it provides the Company with an opportunity to retain a reasonable share of the benefits produced under the GSIP that is limited to a very small percentage of the Company's overall gas costs.

Should a specific term for the incentive mechanism be established?

Staff recommends that a term of one year for the GSIP is appropriate due, in part, to the work that is being done by the Commission's gas cost recovery task force and the potential impact of that work on the GSIP. Public Counsel, on the other hand, initially proposed that the GSIP be authorized for a term of three years but, based on its surrebuttal testimony, now recommends a term of one year.

For its part, the Company recognized that the work of the gas cost recovery task force could ultimately have some bearing on the structure and future of GSIP. (Exh. 2, pp. 14-15). However, Laclede does not believe that this consideration warrants the adoption of an artificial one-year term for the GSIP since there are other, less-disruptive, ways to accommodate Staff's concern and still permit the implementation of a multi-year incentive plan. (Exh. 2, pp. 14-15).

Specifically, the Commission notes that the GSIP already contains a provision that permits any party to recommend modifications to the GSIP in the event there is a significant change in conditions. (*Id.*). Laclede also indicated that this same provision can be supplemented to explicitly provide that the GSIP may also be modified or even terminated in the event the Commission decides, after an opportunity for hearing, to adopt recommendations from the task force that are inconsistent with the GSIP or its provisions. (*Id.*).

The Commission finds that the approach proposed by the Company will allow the work of the task force and its inter-relationship to the GSIP to be fully considered and accommodated without artificially limiting the term of the GSIP. The Commission therefore finds that a modification incorporating such language in the GSIP be made in response to the concerns raised by the Staff. In view of this proposed modification, the Commission does not believe it is necessary to establish a specific term for the incentive mechanism.

How should bundled sales and transportation contracts be treated?

Based upon a review of the evidence in the record and the positions of the parties, the Commission finds that there is no evidence to support any new or special treatment for such contracts and that no party has proposed such treatment. The Commission therefore finds bundled sales and transportation contracts will be accorded the same treatment that they have been given in the past under the Company's existing tariff.

If an incentive mechanism is not used, what alternative can or should be implemented in its place?

Since the Commission has found that the GSIP, as modified herein, should be continued, it is not necessary to address this issue.

Conclusions of Law

The Missouri Public Service Commission has arrived at the following conclusions of law.

Laclede is a regulated public utility over which the Commission has jurisdiction in accordance with Chapters 386 and 393, RSMo 1994. The Commission must protect the public interest, ensure that Laclede's rates are just and reasonable, and ensure that Laclede provides safe and adequate service to the public. §§ 393.130 and 393.140, RSMo 1994.

Orders of the Commission must be based upon competent and substantial evidence on the record. § 536.140, RSMo 1994. Based upon its findings of fact, the Commission concludes that a GSIP modified to comply with this order would be in the public interest.

IT IS THEREFORE ORDERED:

1. That the proposed tariff filed by Laclede Gas Company on November 17, 2000, is rejected.
2. That Laclede Gas Company is authorized to implement a modified Gas Supply Incentive Plan (GSIP III) which is consistent with the modifications directed by the Commission in this order. This plan shall be effective until modified by order of the Commission.
3. That Laclede Gas Company shall file, by _____, 2001 either (a) a revised tariff implementing a modified Gas Supply Incentive Plan (GSIP III) which is consistent with this order; or (b) a notice that Laclede elects to return to the traditional PGA/ACA process once the current experimental Gas Supply Incentive Plan expires on September 30, 2001.
4. That if Laclede Gas Company files revised tariff sheets implementing a modified Gas Supply Incentive Plan (GSIP III), Staff shall file, by _____, 2001 a report which states whether or not the company's revised tariff complies with this Report and Order.
5. That any pending motions or objections not specifically ruled on in this order are hereby denied or overruled.
6. That this Report and Order shall become effective on _____, 2001.

BY THE COMMISSION

Dale Hardy Roberts

Secretary/Chief Regulatory Law Judge

(S E A L)

Dated at Jefferson City, Missouri,

on this ____ day of _____, 2001.