BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company/Fidelity Natural Gas, Inc.'s Purchased Gas Adjustment for 2005-2006	)))	Case No. GR-2007-0179

RESPONSE OF LACLEDE GAS COMPANY
AND FIDELITY NATURAL GAS, INC.
TO STAFF RECOMMENDATION

COME NOW Laclede Gas Company ("Laclede") and Fidelity Natural Gas, Inc. ("Fidelity" or "FNG")(collectively "Laclede/FNG"), pursuant to 4 CSR 240-2.080 and the Commission's Order Directing Response issued on January 8, 2008, and state their response to the Staff's Recommendation filed on December 31, 2007, as follows:

1. On December 31, 2007, the Commission Staff filed its recommendations following the completion of the audit of the Actual Cost Adjustment ("ACA") rates for the 2005-2006 period for the service area previously served by Fidelity. As noted in the Staff Recommendation, the Commission approved Laclede's ownership of the natural gas assets of Fidelity, effective February 24, 2006. As a result, any Staff Recommendations in this 2005-2006 ACA case will be implemented by Laclede for customers previously served by FNG.

2. The Commission Staff reviewed Fidelity's calculations and made the following recommendations:

"1. The Staff recommends that Laclede Gas/Fidelity Natural Gas, Inc., adjust the ACA account balance in its next ACA filing to reflect the following Staff adjustments and to reflect the (over)/under-recovered ACA balance in the "Ending ACA Balance Per Staff" column of the following tables. Staff also recommends that the proposed adjustments apply to the former Fidelity Natural Gas customers only.

Using High End of Staff's Recommended Adjustment for Hedging			
Description	**Ending ACA Balance Per Filing**	**Staff Adjustments**	**Ending ACA Balance Per Staff**
2004-2005 ACA Ending Balance	($24,646)	$0	($24,646)
Cost of Gas/Transportation	$2,455,326	($17,451) (A) ($93,534) (B)	$2,344,341
Revenues	($2,519,147)	$9,874	($2,509,273)
ACA Approach for Interest Calculation	$2,879	$0	$2,879
Total (Over)/Under Recovery 2005-2006	($85,588)	($101,111)	($186,699)

Using Low End of Staff's Recommended Adjustment for Hedging			
Description	**Ending ACA Balance Per Filing**	**Staff Adjustments**	**Ending ACA Balance Per Staff**
2004-2005 ACA Ending Balance	($24,646)	$0	($24,646)
Cost of Gas/Transportation	$2,455,326	($17,451) (A) ($21,641) (B)	$2,416,234
Revenues	($2,519,147)	$9,874	($2,509,273)
ACA Approach for Interest Calculation	$2,879	$0	$2,879
Total (Over)/Under Recovery 2005-2006	($85,588)	($29,218)	($114,806)

(A) ($3,167) + ($14,284)
(B) Hedging

3. Respond to the comments/concerns in the Reliability Analysis and Gas Supply Planning section of this memorandum within 30 days.

4. File a written response to the above recommendations within 30 days."

Response to Staff Recommendation

3. After reviewing the Staff's Recommendation and Memorandum in this matter, Laclede/FNG agree to the following adjustments: (i) reduced revenue recovery of $9,874; and (ii) reduced transportation costs of $14,284. (See Staff Memorandum, p. 2). Laclede/FNG opposes Staff's proposed adjustment of $21,641-$93,534 related to FNG's hedging practices. (Staff Memorandum, p. 5 of 9). Laclede/FNG have not yet been able to gather sufficient information to make a determination with respect to Staff's proposed disallowance of $3,167 concerning fuel loss credits on the Panhandle pipeline. On that basis, Laclede/FNG opposes such disallowance pending further review.

4. With respect to the hedging issue, the Staff's proposed adjustment appears to be based solely on the use of hindsight, and is therefore an unlawful and unreasonable adjustment. In addition, FNG's hedging practices were not detrimental to customers.

<u>Legal Standard For Prudence Adjustments</u>

In *Re Missouri Gas Energy*, 11 Mo.P.S.C.3d 206, 222-224 (March 12, 2002), the Commission established the legal standard for reviewing the prudence of a natural gas corporation's purchases of natural gas. In this case, Staff had proposed to disallow approximately $3.5 million in natural gas costs incurred by Missouri Gas Energy in its 1996-1997 ACA period. In rejecting the Staff's proposed prudence adjustment, the Commission explained the application of the prudence standard in ACA cases as follows:

> The Commission established its prudence standard in a 1985 case involving the costs incurred by Union Electric Company in constructing its Callaway nuclear plant. In determining how much of those costs were to be included in Union Electric's rate base, the Commission adopted a standard for determining the prudence of costs that had been established by the United States

> Court of Appeals, District of Columbia, in a 1981 case. The standard adopted by the Commission recognizes that a utility's costs are presumed to be prudently incurred, and that a utility need not demonstrate in its case-in-chief that all expenditures are prudent. "However, where some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling those doubts and proving the questioned expenditures to have been prudent."
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> The Commission, in the Union Electric case, further established that the prudence standard was not based on hindsight, but upon a reasonableness standard. The Commission cited with approval a statement of the New York Public Service Commission that:
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> > . . . the company's conduct should be judged by asking whether the conduct was reasonable at the time, under all the circumstances, considering that the company had to solve its problem prospectively rather than in reliance on hindsight. In effect, our responsibility is to determine how reasonable people would have performed the tasks that confronted the company.
>
> (footnotes omitted).

5. Based upon the legal standard adopted by the Commission in the Missouri Gas Energy case, Laclede/FNG should not be subjected to any disallowance of its natural gas costs. FNG used its best judgment and acted reasonably under all the circumstances to make its gas purchasing and hedging decisions, using the information that was available at the time of the decisions. It is not reasonable for the Staff to Monday-morning-quarterback those decisions two years later when historic pricing information is now available.

6. FNG believed it was prudent to delay its decision to hedge its gas supply as natural gas prices soared to all-time high levels resulting from hurricanes and hedge fund activities in the summer of 2005. Gas futures prices for the 05-06 winter heating season were already at all-time highs during the spring of 2005, and then the hurricanes, Katrina and Rita, hit the gulf coast area and drove prices even higher for the summer and into the fall months. Under

these circumstances, and in the face of these unusual events, it was certainly prudent and reasonable for FNG to defer the purchase of fixed-price futures contracts while natural gas prices were at all-time highs.

7. In addition, FNG began negotiations to sell all of its gas operations to Laclede in early 2005. Negotiations and due diligence were in process throughout the spring and summer of 2005, until an Asset Purchase Agreement was finally signed in September 2005. Throughout the whole process, FNG was hesitant to enter into fixed-price futures contracts, knowing that FNG might be getting out of the natural gas distribution business, possibly before the winter heating season began, and not wanting to lock-in futures contracts.

8. Finally, FNG's gas supply contract with its gas marketer was due to expire on October 31, 2005. Therefore, FNG's gas marketer would not purchase fixed-price futures contracts on behalf of FNG for any months after October 31, 2005, until a contract renewal was signed. Renewal negotiations began in the spring of 2005, but FNG's gas marketer requested that FNG restructure the pricing contained in the contracts, and require FNG to commit to certain specified volumes. The revised contract with FNG's marketer was not executed until September 22, 2005. As a result, FNG could not have purchase fixed-priced futures contracts until that time.

9. It is unreasonable and unlawful to make a prudence disallowance based upon information (i.e. future natural gas prices later in the winter) that was not available at the time decisions were being made, as Staff is proposing. In fact, the Company acted reasonably using its best judgment, based upon the information that was available at the time, to determine the prudent purchasing and hedging practices for the 2005-2006 winter heating season.

10. In order to lawfully make a disallowance in this ACA proceeding, the Commission must also find that the public utility's actions had a detrimental impact upon customers. In *State ex rel. Associated Natural Gas v. Public Service Commission*, 954 S.W.2d 520, 530 (Mo.App. 1997), the Missouri Court of Appeals held that:

> Ultimately, the PSC's standards for the recoverability of ANG's costs arise from the statutory mandate that all charges made by a gas company be just and reasonable. Section 393.130.1. <u>It would be beyond this statutory authority for the PSC to make a decision on the recoverability of costs, based upon a prudency analysis of gas purchasing practices, without reference to any detrimental impact of those practices on ANG's charges to its customers, such as evidence that the costs which ANG is seeking to pass on to its customers are unjustifiably higher than if different purchasing practices had been employed.</u> Therefore, the PSC's decision denying recovery of half the premium of the SEECO contract must be deemed unlawful. (emphasis added)

11. With the benefit of complete hindsight, Staff has proposed four alternative adjustments based upon four alternative Scenarios. Staff's proposed adjustment(s) are based upon a comparison of what the cost of gas hypothetically would have been had FNG utilized the purchasing strategies assumed in the Scenarios, rather than using FNG's actual hedging and purchasing plan. However, the "damages" calculated by Staff are based upon the use of 20/20 hindsight, and not upon the information that was available at the time the purchasing decisions were being made by FNG. If, on the other hand, other assumptions (including other alternative dates for locking-in gas supplies) are utilized in this analysis, then it is possible to demonstrate that FNG's purchasing practices were not detrimental to FNG's customers at all. For these reasons, the Commission should reject Staff's proposed $21,641 to $93,534 disallowance related to FNG's purchasing practices.

12. The Staff Recommendation also contains a discussion of reliability and gas supply planning issues, and requests that FNG respond to the Staff's comments within thirty (30)

days. Since FNG no longer owns or operates the local distribution system in Sullivan, Missouri, Staff's comments and concerns related to FNG's reliability analysis and gas supply planning are now moot issues. Laclede will be responsible in the future for the reliability and gas supply planning related to the service area previously owned and operated by FNG.

WHEREFORE, Laclede Gas Company and Fidelity Natural Gas, Inc. respectfully request the Commission accept this Response.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been hand-delivered, emailed or mailed, First Class, postage prepaid, this 7th day of February, 2008, to:

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