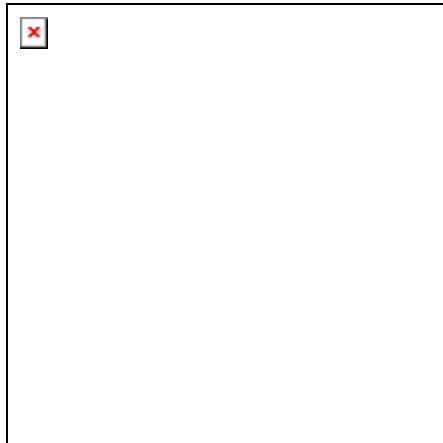


**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**



In the matter of Laclede Gas Company's Tariff)
Filing to Implement an Experimental Fixed) **Case No. GT-2001-329**
Price Plan and Other Modifications to Its Gas) Tariff No. 200100572
Supply Incentive Plan.)

REPORT AND ORDER

Issue Date: September 20, 2001

Effective Date: October 17, 2001

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OF THE STATE OF MISSOURI

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Filing to Implement an Experimental Fixed) **Case No. GT-2001-329**
Price Plan and Other Modifications to Its Gas) Tariff No. 200100572
Supply Incentive Plan)

APPEARANCES

Michael C. Pendergast, Assistant Vice President and Associate General Counsel, 720 Olive Street, Room 1520, St. Louis, Missouri 63101, and **James M. Fischer**, Attorney at Law, Fischer & Dority, P.C., 101 Madison Street, Suite 400, Jefferson City, Missouri 65101, for Laclede Gas Company.

Thomas M. Byrne, Associate General Counsel, One Ameren Plaza, 1901 Chouteau Avenue, P.O. Box 66149, St. Louis, Missouri 63166, for Union Electric Company d/b/a AmerenUE.

Diana M. Vuylsteke, Attorney at Law, Bryan Cave, LLP, 211 N. Broadway, Suite 3600, St. Louis, Missouri 63102, for Missouri Industrial Energy Consumers.

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

Thomas R. Schwarz, Jr., Deputy General Counsel, and **David A. Meyer**, Associate General Counsel, P.O. Box 360, Jefferson City, Missouri 65102, for Staff of the Missouri Public Service Commission.

SENIOR REGULATORY LAW JUDGE: Bill Hopkins

REPORT AND ORDER

This report and order allows the gas supply incentive program (GSIP) of Laclede Gas Company to expire.

Summary

Laclede Gas Company's current GSIP will expire of its own terms on October 17, 2001, unless the Commission extends it. Laclede filed new tariffs to maintain the program for the

future. The Commission determines that Laclede did not sustain its burden of proof that the GSIP strikes the proper balance between ratepayer and shareholder. Therefore, the GSIP will be allowed to expire. The goal of providing lower prices for the ratepayer has not been met.

Parties

The parties to this action are Laclede Gas Company, the Office of the Public Counsel, and the Staff of the Missouri Public Service Commission. At the time of the hearing, the Missouri Industrial Energy Consumers and Union Electric Company, d/b/a AmerenUE, remained as intervenors.

Brief Procedural History

On November 17, 2000, Laclede filed a tariff proposing modifications to and extending the duration of its GSIP, which would otherwise expire on October 17, 2001.

On December 11, 2000, Staff filed a motion to suspend Laclede's tariff filing. The Commission granted Staff's motion, suspended the effective date of the tariff until April 17, 2001, and established a case to address the GSIP provisions. On February 15, 2001, the Commission suspended the effective date of the tariff until October 17, 2001, and then conducted an evidentiary hearing from June 18 to 22, 2001.

Conclusions of Law

In making this decision, the Commission must first determine which party has the burden of proof.

Well-settled Missouri law is that, in a non-criminal case, the party asserting the affirmative of the issue bears the burden of proof.^[1] The *Gamble* case held that the proponent of an order in a contested case before an administrative tribunal has the burden of proof in sustaining the reasons for the order.^[2] The *Monsanto* case, where Laclede was a party, indicates that the proponent of a tariff has the burden of proof.^[3] The court stated:

Laclede filed the tariffs here in question using the existing rate design. In the suspension order and notice of proceedings dated January 18, 1983, the Commission noted that the Company bore the burden of proof before the Commission and ordered the Company "to provide evidence and argument sufficient for the Commission to determine... the

reasonableness of the Company's rate design.”

Thus, in this case, Laclede had the burden of proof but failed to sustain it because, upon examining the whole record, the Commission cannot find competent and substantial evidence presented by Laclede for its position.

The Commission must draw a reasonable conclusion based on competent and substantial evidence presented before it. The Commission's order has a presumption of validity, and the burden is on the party attacking it to prove its invalidity.

Judicial review of the Commission's order is conducted using a two-part test.

First, the reviewing court must determine whether the Commission's order is lawful. An order's lawfulness depends on whether the Commission's decision was statutorily authorized. When determining whether the order is lawful, a reviewing court exercises independent judgment and must correct erroneous interpretations of the law.

Second, a reviewing court must determine whether the Commission's order was reasonable. An order's reasonableness depends on whether it was supported by competent and substantial evidence on the whole record. A reviewing court must determine whether the decision was arbitrary, capricious, or unreasonable, or whether the Commission abused its discretion. “Substantial evidence” is competent evidence--i.e., evidence that is admissible, relevant, and material, which, if also true, has a probative force on the issues. If the Commission's decision is based on purely factual issues, a reviewing court may not substitute its judgment for that of the Commission. ^[4]

This order is prima facie lawful, reasonable, and authorized by statute. ^[5]

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. ^[6]

The GSIP was established to permit Laclede and its ratepayers to share in specified savings and revenues realized by Laclede in acquiring, utilizing, and managing its system gas supply assets. ^[7]

A decision to reinstitute or incorporate revisions to the GSIP is not supported by competent and substantial evidence before the Commission. It would be unlawful for the Commission to consider only a few non-gas-cost elements outside of a rate case.^[8]

The *MGUA* case implies that for the Commission to authorize a gas cost incentive program proposed by a gas company, the program must be of benefit both to the company and to the ratepayers. The court in that case stated: “The [Commission] found that the experimental gas cost incentive mechanism proposed by [the company], as modified by the [Commission] in its order, was authorized and was of benefit to [the company] and to ratepayers.”^[9]

As a whole, Laclede’s case is not supported by competent and substantial evidence before the Commission that would tend to show that its GSIP--admittedly beneficial to Laclede--is also beneficial to its ratepayers. Examples of Laclede’s failure to produce this type of competent and substantial evidence on three issues will suffice.

Merchant function: Laclede complained that without the GSIP, it faced substantial risk of losses from its merchant function. The claim, however, was not supported by Laclede Witness Glenn W. Buck’s testimony. The “merchant-related function,” originally estimated by Buck in the surrebuttal phase to have a value of \$12.3 million not recovered through the purchased gas adjustment mechanism, dropped to \$10 million by the time of the hearing; correspondingly, the estimate of \$4.8 million being borne by shareholders dropped to \$4.1 million. Staff persuasively argued that the amount borne by shareholders is actually smaller, since Laclede did not take into account the concept that a shareholder does not absorb costs not reimbursed by ratepayers on a dollar-for-dollar basis. Rather, according to Staff, Laclede is able to offset its profits in other areas, with the unreimbursed expenses from its “merchant function,” reducing the ultimate liability passed on to shareholders by the amount of the saved taxes. In other words, in Staff’s view, Laclede is able to offset the increase in bad debts, and the corresponding interest costs, against profits and does not have to pay the 40% in corporate income tax it otherwise would have had to pay on those profits. The Commission agrees with Staff on this point.

Benchmarks for pipeline discounts: Laclede Witness Bruce B. Henning suggested that the Commission should retain the current “achievable” baseline for pipeline discounts. The witness relied on information provided by Laclede’s personnel and did not do an independent investigation of Laclede’s pipeline contracting practices or review its contracts. According to Staff, those contracts revealed that Laclede receives discounts from several pipelines and these discounts antedate the GSIP. Staff pointed out that the discounts have generated large amounts of money for Laclede, but because the witness did not analyze Laclede’s transportation contracts, his analysis did not take into account customer mix; peak shaving abilities; Laclede’s status as a captive local distribution company; and storage capabilities. The witness, according to Staff, relied on historical data to develop his opinions, but not data specific to Laclede, thus making the witness’ analysis overly general and of little use. The Commission agrees with Staff on this point.

Protection of gas supply by fixed price instruments: Laclede failed to demonstrate how its proposal to subject 10 BCF to 25 BCF of its gas supply to protection by fixed price instruments is appropriate. Laclede failed to produce any documents or written analyses that supported this specific level, or any other level, of fixed price protection. When questioned why Laclede had absolutely no written analysis supporting its proposal, Laclede Witness Kenneth J. Neises stated: “It’s not complicated. This is not rocket science, nor is it any kind of science. Essentially you’re simply looking at--it’s very simple.” Public Counsel maintained that, if determining the appropriate amount of gas supply is not “rocket science” and is “very simple,” the Commission ought not give its imprimatur to a specific mandated level of fixed price instruments. If Laclede has confidence in these purchasing guidelines, in Public Counsel’s view, then Laclede can certainly follow those guidelines without a specific Commission mandate. Public Counsel concludes that absent a mandate to follow a rigid rule, Laclede would retain the flexibility to alter the volumes protected by fixed price instruments in response to changing market conditions. The Commission agrees with Public Counsel on this point.

The Commission suspended the proposed tariff filing and held the evidentiary hearing

under the authority of Section 393.150(1). This statute requires that the Commission, whenever a gas corporation files a proposed tariff, hold a hearing to determine if the proposed tariff should be implemented. The Commission may suspend the effective date of the proposed new tariff during the pendency of the hearing. The statute states:

Whenever there shall be filed with the commission by any gas corporation...any schedule stating a new rate or charge, or any new form of contract or agreement, or any new rule, regulation or practice relating to any rate, charge or service or to any general privilege or facility, the commission shall have...a hearing concerning the propriety of such rate, charge, form of contract or agreement, rule, regulation or practice, and pending such hearing and the decision thereon, the commission...may suspend the operation of such schedule and defer the use of such rate, charge, form of contract or agreement, rule, regulation or practice, but not for a longer period than one hundred and twenty days beyond the time when such rate, charge, form of contract or agreement, rule, regulation or practice would otherwise go into effect; and after full hearing...the commission may make such order in reference to such rate, charge, form of contract or agreement, rule, regulation or practice as would be proper....

The Commission concludes that the proposed tariff is not proper in that it is not just and reasonable and not in the public interest.

Findings of Fact

The Missouri Public Service Commission makes its findings of fact having considered all of the competent and substantial evidence upon the whole record. 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. The Commission makes the following findings of fact:

(1) In fiscal years 1997 to 2000, GSIP earnings comprise between 14% and 22.9% of Laclede's total net income, after taxes. Laclede has incorporated the earnings into its overall earnings program, which was never its purpose. For example, Laclede Witness Kenneth J. Neises testified:

[I]t should be no secret to anybody that we strongly believe in the GSIP, and we are hopeful that this Commission will continue it and move it forward, and we have it in our planning process. If it isn't approved, this whole strategy goes down the drain, and I think, as the chart Mr. Pendergast used this morning demonstrates, GSIP earnings are as

important to shareholders as they are to customers....[W]e've come to the point that without them we can't make our authorized return. So we built it in. We're hopeful that the Commission will approve it as part of our plan, just as we built in a rate case and as we built in our weather normalization clause in this process. All of those elements are critical to the future financial health of this company.

(2) Discounts, such as transportation discounts, can be expected to remain a part of the purchasing process for some time to come. Laclede will continue to have the opportunity to make profits through off system sales and temporary releases of pipeline capacity. For example, Laclede Witness Bruce B. Henning testified: “[W]ithin the context of our particular view of the market, we're not going to be in a position where there will be no discounts over the next decade. And, as such, the role of maximizing potential discounts still has a role, in my opinion, in a GSIP.”

(3) Laclede calculated the unrecovered value of its merchant function, incorporating financing costs associated with underground storage and propane inventories, Cash Working Capital effects of natural gas purchases, the gas cost portion of customer deposits, carrying costs associated with deferred gas costs outside the GSIP and Price Stabilization Programs, gas cost related portion of payment plan arrangements under the Cold Weather Rule, and the gas cost component of uncollectable accounts. The calculation overstates the value because it disregards the effects of tax deductions for losses, recovery provisions contained in Laclede's tariff, and additional profits Laclede obtains through increased consumption, as well as the fact that Laclede may in fact recover some of its costs either from the ratepayer or through its pending rate case. For example, when Laclede Witness Glenn W. Buck was asked if Laclede had used the after-tax return on rate base for deferred gas costs instead of the short-term debt rate, he testified: “That's correct.” Buck went on to say:

Based on the prior three [actual cost adjustment] years, there's a level of deferred gas costs that essentially is, I don't want to use the term free, but there is...over- or under-recoveries up to that amount. No [deferred gas cost] interest is applied to above that amount [i.e., \$17 million; the amount of deferred gas cost that Laclede is incurring now], and that's the only incremental piece there would be interest charges associated there to either additional costs deferred for subsequent recovery from our customers or, conversely, deferred costs or deferred interest charges to be refunded to our customers in the subsequent period....

(4) According to Laclede's Exhibit 18, the current GSIP has not created any significant savings on the demand cost of gas, but has generated large profits for Laclede last winter. The gas procurement mechanism's impact on consumers, according to Laclede's Exhibit 35, is approximately 2 cents per

dollar spent on gas. This amount is not significant.

(5) Allowing Laclede to shift discounts into years where benchmarks are more difficult to meet, at the expense of lowering customers' rates, is not in the ratepayers' interest. According to Laclede's Exhibit 18, ratepayers are worse off with

respect to transportation discounts under the GSIP than they would have been without the GSIP.

(6) Rewarding Laclede for merely tracking the highly volatile index cost of gas has not served the ratepayers' interest. Providing an incentive to Laclede to buy gas according to index, rather than taking a broader view and considering fixed price instruments, effectively limits Laclede's options, potentially causes ratepayers to pay higher costs than necessary, and is not in the public interest. For example, Staff Witness Robert Schallenberg testified:

[T]he current GSIP with the safe harbor that [it's] based on as long as gas is purchased within a benchmark that goes from the index, provides a safety net or definitely encourages a company to buy index-based price gas with the adders being within the parameters of the...adders that you have in the present GSIP. It definitely puts the company at risk if it were to buy any fixed price instrument, because the index could move below the fixed price and, therefore, it would be at risk....It would discourage Laclede [from buying] a fixed price instrument. So, by definition, if index-based gas is going to produce your best result in a given winter, then it will...be fine. If index-based gas produces a bad result, then it won't be. And last winter, riding the index was...not a good result for consumers.

(7) Laclede has failed to document its decisions in the procurement process. For example, Laclede Witness Kenneth J. Neises, when asked if anyone at Laclede ever issued a memorandum concerning procurement decisions, testified:

We do not have large staffs...churning out all kinds of documents because the principals, the people who are going to be carrying out [procurement] decisions, are the same people that are present in the room [when the procurements discussions take place].

(8) The Commission's finding year after year (e.g., in cases number GT-99-303, GO-2000-395, and GT-2001-329), that the GSIP principles must be

modified, does not serve or promote the public interest or permit Laclede to properly plan its commodity purchasing.

(9) The preapproval process is not appropriate. A company's management personnel, who have the best and most timely access to information, should make decisions about a particular gas supply portfolio, and can take into account unforeseeable circumstances and current market conditions, if not forced to abide by preset parameters. Preapproval could discourage Laclede from taking opportunities to secure fixed price contracts that would produce reasonable price protection for customers.

(10) The public will benefit more from a comprehensive purchasing program that focuses on the delivered cost of gas and reliability, rather than a program driven by individual, compartmentalized benchmarks. A comprehensive program defines and measures how ratepayers are benefited, incorporates weather risk into the purchasing provisions, and establishes measurements that encourage proper actions and discourage inaction or ineffective actions. A comprehensive program also incorporates the effects of purchasing decisions, transportation availability, transportation costs, supply availability, supply costs, and the costs of hedging mechanisms.

Thus, given the deficiencies of current GSIP, the Commission will allow it to expire. The Commission notes, however, that well-designed GSIPs--if guidelines for such designs can be determined--would be acceptable under Commission policy. The Commission, to ensure that such designs are well-designed, may await the results of its task force established for this purpose.

IT IS THEREFORE ORDERED:

1. That the Gas Supply Incentive Program of Laclede Gas Company will expire by its own terms on October 17, 2001.
2. That the proposed tariff filing on November 17, 2000, by Laclede Gas Company, under tariff number 200100572, is rejected. The rejected tariff sheets are:

P.S.C. Mo. No. 5 Consolidated
Fifth Revised Sheet No. 28-a
Third Revised Sheet No. 28-b
Original Sheet No. 28-b.1
Original Sheet No. 28-b.2

3. That competent and substantial evidence upon the record as a whole does not support an extension of Laclede Gas Company's Gas Supply Incentive Program.

4. That all motions not previously ruled upon by the Commission in this case are hereby denied, all objections not previously ruled upon are hereby overruled, and all evidence, the admission of which was not specifically denied, is admitted.

5. That this order will become effective on October 17, 2001.

6. That this case may be closed on October 18, 2001.

BY THE COMMISSION

**Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge**

(S E A L)

Simmons, Ch., Lumpe and Gaw, CC., concur;
Murray, C., dissents, with dissenting opinion attached;
certify compliance with the provisions of
Section 536.080, RSMo 2000.

Dated at Jefferson City, Missouri
on this 20th day of September, 2001.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of Laclede Gas Company's Tariff)
Filing to Implement an Experimental Fixed) **Case No. GT-2001-329**
Price Plan and Other Modifications to Its Gas) Tariff No. 200100572
Supply Incentive Plan.)

DISSENTING OPINION OF COMMISSIONER CONNIE MURRAY

In order to stabilize natural gas prices for ratepayers it is appropriate for the Commission to give natural gas companies incentives to find lower prices and use alternative purchasing methods. I must dissent from the majority's decision to reject the proposed extension of Laclede's gas supply incentive plan.

The gas supply incentive plan that the Commission first approved for Laclede in 1996 for a three-year term and extended, with modifications, for two additional years has provided significant benefits to both Laclede's ratepayers and shareholders. Contrary to the arguments of Staff and the Public Counsel, benefits to shareholders do not equate to detriments to ratepayers. Financial integrity of the utility is necessary to provide safe and reliable service, and an incentive plan that improves the company's bottom line may also be a plan that increases benefits to ratepayers. Indeed, Laclede's was such an incentive plan. The Commission has in the past approved Laclede's gas supply incentive plan in order to serve the public interest. The incentive program has been a win/win situation.

The modifications that Laclede proposes to the plan in this case are in response to concerns raised by Staff or the Public Counsel, and make the benefits of the plan apportion even more favorably to the ratepayers. Those modifications include significant reduction of the share of benefits that Laclede is permitted to retain; commitment to contribute a portion of Laclede's retained benefits to funding energy assistance for low-income customers; removal of off-system sales revenues from base rates for inclusion in the gas supply incentive plan; retention of a capped amount by Laclede; explicit permission of further modifications in the event the Commission ultimately adopts any recommendations from its Gas Cost Recovery

Task Force that are inconsistent with the gas supply incentive plan provisions; and, significant alteration of the gas supply commodity component in order to provide additional customer price protection.

I do not dispute that it may be possible to devise incentive mechanisms that would be superior to the one proposed here. The one proposed by Laclede, however, is a reasonable, workable plan that the evidence shows to be in the public interest. No other reasonable, workable incentive plan is before us in this case. While I applaud the majority's desire to encourage a collaborative set of incentive guidelines that all local distribution companies can employ, I am concerned that such guidelines will not be established in time for application to this winter season. Furthermore, language that would explicitly permit further modifications of Laclede's gas supply incentive plan to conform to any Commission adoption of the Gas Recovery Task Force recommendations, should remove any concern that approval of this plan will result in inconsistencies between the Commission's ultimate policy determinations and this plan.

Laclede's September 18, 2001 request that the Commission receive into evidence the Final Report of the Missouri Public Service Commission's Natural Gas Commodity Price Task Force states that a number of the recommendations and sections of the Task Force Report are relevant and material to the issues raised in this proceeding. Particularly, Laclede cites the Task Force's strong preference for use of financial incentives. Laclede points out that it would be consistent with the Task Force's recommendation for the Commission to authorize Laclede's proposed GSIP, as a bridge to any final incentive structure that might be ultimately adopted by the Commission as a result of the Task Force Report. Approval, therefore, of extending the gas supply incentive plan with the modifications proposed by Laclede would be in the public interest.

For these reasons, I respectfully dissent.

Respectfully submitted,

Connie Murray, Commissioner

Dated at Jefferson City, Missouri,
on this 20th day of September, 2001.

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- [1] *Michaelson v. Wolf*, 364 Mo. 356, 261 S.W.2d 918, 924[5] (1953).
- [2] *Gamble v. Hoffman*, 695 S.W.2d 503 (MoApp 1985).
- [3] *State ex rel. Monsanto, et al. v. Public Service Com'n of Missouri*, 716 S.W.2d 791 (Mo.banc 1986) at 795.
- [4] See *State ex rel. Midwest Gas Users' Association v. Public Service Commission of the State of Missouri*, 976 S.W.2d 470 (MoApp 1998).
- [5] Section 286.270, RSMo 2000. (References to Sections of the Revised Statutes of Missouri, unless otherwise specified, are to the revision of the year 2000.)
- [6] Sections 393.130 and 393.140.
- [7] *In the matter of Laclede Gas Company*, 5 Mo.P.S.C. 3d 108, 130 (1996).
- [8] *Utility Consumers Council of Missouri v. Public Service Commission*, 585 S.W. 2d 41 (Mo. 1979); *Midwest Gas Users' Association, supra*.
- [9] *Midwest Gas Users' Association*, at 475.