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Rate Design

Kind/Rebuttal

Public Counsel

GR-2002-356

# **REBUTTAL TESTIMONY**

**OF**

**RYAN KIND**

**FILED**

**AUG 02 2002**

**Missouri Public  
Service Commission**

Submitted on Behalf of  
the Office of the Public Counsel

**LACLEDE GAS COMPANY**

**Case No. GR-2002-356**

✓

✓ August 2, 2001

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


In the matter of Laclede Gas Company's     )  
tariff to revise natural gas rate schedules.     )     Case No. GR-2002-356

**AFFIDAVIT OF RYAN KIND**

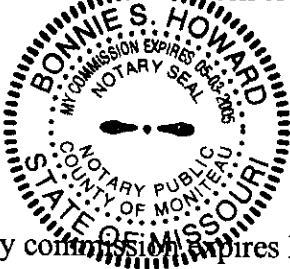
STATE OF MISSOURI     )  
   )     ss  
COUNTY OF COLE     )

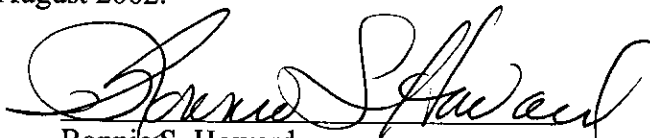
Ryan Kind, of lawful age and being first duly sworn, deposes and states:

1. My name is Ryan Kind. I am Chief Utility Economist for the Office of the Public Counsel.
2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony consisting of pages 1 through 32 and Attachments RK-1.
3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.

  
\_\_\_\_\_  
Ryan Kind

Subscribed and sworn to me this 2<sup>nd</sup> day of August 2002.



  
\_\_\_\_\_  
Bonnie S. Howard  
Notary Public

My commission expires May 3, 2005.

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**REBUTTAL TESTIMONY**

**OF**

**RYAN KIND**

**LACLEDE GAS COMPANY**

**CASE NO. GR-2002-356**

1       **Q.     PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.**

2       A.     Ryan Kind, Chief Energy Economist, Office of the Public Counsel, P.O. Box 7800,  
3             Jefferson City, Missouri 65102.

4       **Q.     PLEASE SUMMARIZE YOUR EDUCATIONAL AND EMPLOYMENT BACKGROUND.**

5       A.     I have a B.S.B.A. in Economics and a M.A. in Economics from the University of  
6             Missouri-Columbia (UMC). While I was a graduate student at UMC, I was employed as  
7             a Teaching Assistant with the Department of Economics, and taught classes in  
8             Introductory Economics, and Money and Banking, in which I served as a Lab Instructor  
9             for Discussion Sections.

10            My previous work experience includes several years of employment with the Missouri  
11            Division of Transportation as a Financial Analyst. My responsibilities at the Division of  
12            Transportation included preparing transportation rate proposals and testimony for rate  
13            cases involving various segments of the trucking industry. I have been employed as an  
14            economist at the Office of the Public Counsel (Public Counsel or OPC) since April 1991.

15       **Q.     HAVE YOU TESTIFIED PREVIOUSLY BEFORE THIS COMMISSION?**

Rebuttal Testimony of  
Ryan Kind

1 A. Yes, prior to this case I submitted written testimony in numerous gas rate cases, several  
2 electric rate design cases and rate cases, as well as other miscellaneous gas, water,  
3 electric, and telephone cases.

4 **Q. HAVE YOU PROVIDED COMMENTS OR TESTIMONY TO OTHER REGULATORY OR**  
5 **LEGISLATIVE BODIES ON THE SUBJECT OF UTILITY REGULATION AND**  
6 **RESTRUCTURING?**

7 A. Yes, I have provided comments and testimony to the Federal Energy Regulatory  
8 Commission (FERC), the Missouri House of Representatives Utility Regulation  
9 Committee, the Missouri Senate's Commerce & Environment Committee and the  
10 Missouri Legislature's Joint Interim Committee on Telecommunications and Energy.

11 **Q. HAVE YOU BEEN A MEMBER OF, OR PARTICIPANT IN, ANY WORK GROUPS,**  
12 **COMMITTEES, OR OTHER GROUPS THAT HAVE ADRESSED UTILITY REGULATION AND**  
13 **RESTRUCTURING ISSUES?**

14 A. Yes. I was a member of the Missouri Public Service Commission's (the Commission's)  
15 Stranded Cost Working Group and participated extensively in the Commission's Market  
16 Structure Work Group. I am currently a member of the Missouri Department of Natural  
17 Resources Weatherization Policy Advisory Committee, the Operating Committee of the  
18 North American Electric Reliability Council (NERC), and the National Association of  
19 State Consumer Advocates (NASUCA) Electric Committee. I have served as the public  
20 consumer group representative to the Midwest ISO's (MISO's) Advisory Committee and  
21 currently serve as the alternate consumer group representative to that committee. During  
22 the early 1990s, I served as a Staff Liaison to the Energy and Transportation Task Force  
23 of the President's Council on Sustainable Development.

**I. SUMMARY**

**Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

A. My testimony will provide Public Counsel's recommendations that are responsive to Laclede's assertions that the Company has a "weather problem" that should be "fixed" or "mitigated" through its two proposals for (1) a "weather mitigation clause" (WMC) and (2) shifting more cost recovery from the second rate block to the first rate block for residential customers. This testimony will also analyze those two proposals and the arguments that Laclede makes in its direct testimony in an effort to persuade the Commission to approve the proposals

**Q. PLEASE SUMMARIZE PUBLIC COUNSEL'S RECOMMENDATIONS REGARDING LACLEDE'S PROPOSALS FOR ADDRESSING THE "WEATHER PROBLEM" THAT THE COMPANY CLAIMS SHOULD BE ADDRESSED IN THIS CASE.**

A. Public Counsel recommends that the Commission not approve either of the Company's proposals for mitigating the effects of abnormal weather. If the Commission believes that the public interest will be served by making changes that will mitigate the effects of abnormal weather, then Public Counsel's alternative recommendation is for the Commission to approve our comprehensive and balanced proposal for mitigating the impacts that abnormal weather (and often related high commodity gas costs) have on both customers and the Company. Public Counsel's recommended alternative proposal is to:

- 1) Implement OPC's Gas Supply Incentive Plan (GSIP) proposal in this case as described in Barbara Meisenheimer's rebuttal testimony and;
- 2) Increase the proportion of costs (as specified in Hong Hu's rebuttal testimony) that are recovered in the first residential rate block (with a corresponding decrease in

1                   the second rate block) **if the Company agrees** to implement OPC's GSIP proposal  
2                   in this case.

3                   This alternative OPC proposal is described in greater detail in Section IV of this  
4                   testimony.

5                   **Q.   HOW DOES LACLEDE ATTEMPT TO SUPPORT ITS TWO PROPOSALS FOR REDUCING THE**  
6                   **IMPACT THAT ABNORMAL WEATHER CAN HAVE ON ITS EARNINGS?**

7                   A.   The theme underlying Laclede's arguments that the Commission should approve its two  
8                   proposals for reducing the impact that abnormal weather can have on its earnings is that  
9                   the Company is "is entitled" to "adequate recovery of the fixed non-gas costs." Laclede  
10                  witness Michael Cline makes this statement regarding Laclede's "entitlement" to recover  
11                  its cost of service at line 13 on page 17 of his direct testimony. In addition to this  
12                  underlying theme, several statements in Laclede witness Douglas Yaeger's testimony  
13                  contain the implied threat that if the Commission does not let the Company get its way by  
14                  approving the major policy change (the proposed WNC) that Laclede seeks, then the  
15                  Company may choose not to fulfill its public service obligation to provide safe and  
16                  adequate service to its customers. (Yaeger direct: page 2 - line 2, page 7 - line 1, page 7  
17                  - line 7, page 10 - line 9, page 11 - line 3, page 18, lines 7 through 12)

18                  **Q.   WHAT DOES LACLEDE POINT TO AS SUPPORT FOR ITS BELIEF THAT THE COMPANY IS**  
19                  **"IS ENTITLED" TO GREATER ASSURANCE OF "ADEQUATE RECOVERY OF THE FIXED**  
20                  **NON-GAS COSTS?"**

21                  A.   Laclede has not pointed to any authoritative source to support this assertion. I thought  
22                  that most of our utilities recognize that the purpose of utility regulation is to set rates at a  
23                  "just and reasonable" level that allows the utility to have a **reasonable opportunity** to  
24                  recover its costs and earn a return that is deemed reasonable by the Commission.

Somewhere along the line, Laclede must have interpreted the phrase "reasonable opportunity" to mean "entitlement."

**Q. WOULD THE APPROVAL OF A WEATHER MITIGATION CLAUSE BE A MAJOR POLICY DECISION FOR THIS COMMISSION?**

A. Yes, it would be a major policy decision for at least a couple of reasons. First, to my knowledge, this Commission has never approved a pricing mechanism that would base the effective charges for service on the amount of usage that would occur under normal weather conditions, instead of basing the charges for service on the actual amount of usage. Second, I believe that if the Commission approves the proposed WMC, then it will find that other gas and electric utilities will also request approval of some form of a WMC.

**Q. IS THIS THE FIRST CASE WHERE THE COMMISSION HAS BEEN ASKED TO APPROVE A WEATHER MITIGATION CLAUSE?**

A. No. Missouri Gas Energy (MGE) asked this Commission to approve a WMC in Case No. GT-95-429 and its request was denied.

**Q. WHY DID THE COMMISSION DENY MGE'S REQUEST FOR A WEATHER NORMALIZATION CLAUSE?**

A. The Commission found that "the weather normalization clause tariff, as proposed, is unjust, unreasonable, and contrary to the law and should be rejected." (Order at p. 5)

## **II. LACLEDE'S WEATHER MITIGATION CLAUSE PROPOSAL**

**Q. PLEASE PROVIDE A BRIEF DESCRIPTION OF LACLEDE'S PROPOSED WEATHER MITIGATION CLAUSE (WMC).**

1 A. The WMC adjusts the rate that will be applicable to customers in future rate periods  
2 based on how much the margin revenues collected in the past have varied from the  
3 amount that would have been collected if the weather was "normal" as measured by  
4 heating degree days (HDDs). This adjustment of future rates to account for past revenue  
5 variations due to abnormal weather is made by adjusting the revenues collected from the  
6 PGA charge.

7 **Q. CAN YOU PROVIDE AN ANALOGY OF HOW SUCH A CHARGE MIGHT BE IMPLEMENTED**  
8 **BY A BUSINESS OUTSIDE OF THE UTILITY AREA?**

9 A. Yes. Suppose that a concert promoter is organizing an outdoor Jazz concert where the  
10 total costs (including a return for her entrepreneurial skills) are expected to be \$100,000.  
11 The promoter estimates that she will sell 10,000 tickets at \$10 each and recover all of her  
12 expenses so long as weather is normal and her August 10 concert attendance is not  
13 adversely impacted by excessive heat or rain. On August 10, the concert takes place  
14 during a day when the temperature reaches 105 degrees and as a result of the abnormal  
15 weather, attendance is only 5,000 people and the promoter is only able to recover  
16 \$50,000 of her total costs of \$100,000.

17 Now assume that the concert promoter has a franchise to be the only concert promoter in  
18 St. Louis and as part of this franchise, the promoter has a WMC that permits the promoter  
19 to charge higher prices at the next outdoor Jazz concert to recoup her losses at the last  
20 concert. The promoter again estimates that the costs for her upcoming concert will be  
21 \$100,000 and that 10,000 tickets will be sold if the weather is normal, but the promoter  
22 now can charge \$15 dollars per ticket since she is allowed to increase the ticket prices by  
23 \$5 to recover the costs that were not recovered in the last Jazz concert due to abnormal  
24 weather.

1       **Q.     WOULD THE PROPOSED WEATHER NORMALIZATION CLAUSE RESULT IN AN EFFECTIVE**  
2       **CHANGE IN THE RATES THAT ARE CHARGED DURING BILLING PERIODS WHEN THE**  
3       **WEATHER IS NOT PRECISELY NORMAL?**

4       A.     Yes, such effective changes in rates would occur in nearly every winter billing period for  
5       nearly every customer taking service under the RH (Residential Space Heating Service)  
6       and CG (Commercial and Industrial General Service) rate classes.

7       **Q.     CAN YOU PROVIDE AN EXAMPLE OF HOW THE EFFECTIVE RATE CHARGED PER THERM**  
8       **WILL DIFFER FROM THE TARIFFED RATE IN A MONTH WHERE ACTUAL WEATHER**  
9       **DIFFERS FROM NORMAL WEATHER?**

10      A.     Yes. Assume that customer Smith is a residential customer and that the tariffed margin  
11      rate for residential gas usage is .15 per therm. Next, assume that customer Smith actually  
12      used 100 second block therms (total therms used were 165 but the first 65 of these therms  
13      were billed at the first block rate and not subject to the WNC) in the January billing  
14      period so that without the WNC, the 2<sup>nd</sup> block commodity portion of this customer's bill  
15      for margin (non-gas) revenues will be \$15.00 (100 X .15). Now assume that the WNC is  
16      in effect and that actual weather is warmer than normal so the WNC adjusts the 2<sup>nd</sup> block  
17      margin portion of the customer's bill upwards towards the amount that the customer  
18      would be billed for if the weather was normal in the January billing period. The  
19      customer's usage is adjusted upward by 10 therms (the WNC volume adjustment) and  
20      this causes the PGA portion of customer Smith's future bills to increase by \$1.50 (10  
21      therms X .15).

22      As a result of the \$1.50 adjustment to the customer Smith's future bills, the effective rate  
23      charged to this customer for his January usage is no longer the tariffed rate of .15 per  
24      therm. The customer's **actual** usage for the billing month of January has not changed as  
25      a result of the WNC. In this example, customer Smith's actual usage was 100 therms

1 before the bill was adjusted through application of the WNC, and this customer's actual  
2 usage remains 100 therms after the WNC is applied this customer's bill. The effective  
3 rate charged to Customer Smith has, however, changed from the legally tariffed rate of  
4 .15 per therm (\$15.00/100 therms) to .165 per therm ( (\$15.00 + \$1.50)/100 therms).

5 **Q. EARLIER IN THIS TESTIMONY, YOU DISCUSSED THE COMMISSION'S DENIAL OF MGE'S**  
6 **REQUEST FOR A WEATHER NORMALIZATION CLAUSE IN CASE NO. GT-95-249. DID**  
7 **THE COMMISSION FIND THAT MGE'S PROPOSAL IN THAT CASE WOULD RESULT IN AN**  
8 **EFFECTIVE CHANGE IN RATES?**

9 A. Yes, the Commission stated in its order that:

10 The Commission further finds that approval of the WNC tariff would  
11 result in a de facto change in MGE's rates. Under the weather  
12 normalization clause a customer would pay for more gas than he actually  
13 used in an unusually warm month. In that month, the customer would  
14 have paid an effective per unit rate for his usage greater than MGE's  
15 current tariffed rate. In an unusually cold month, the customer would  
16 have paid a lower unit rate for his actual usage than MGE's current  
17 tariffed rate. (Order at p. 4)

18 **Q. HAVE OTHERS FOUND THAT WEATHER NORMALIZATION CLAUSES LEAD INDIRECTLY TO**  
19 **AN ADJUSTMENT IN THE RATE THAT WOULD APPLY ABSENT THE CLAUSE?**

20 A. Yes, a December 1994 issue of a newsletter entitled *A.G.A. Financial Analysis*, published  
21 by the American Gas Association refers to WNCs as "rate adjustment mechanisms."  
22 This reference was included in a paragraph under the heading "UPDATE ON  
23 WEATHER NORMALIZATION CLAUSES" on page one (see Schedule RK-1) of the  
24 December 1994 issue of *A.G.A. Financial Analysis*. This same paragraph explains that  
25 WNCs are "an example of a regulatory mechanism known as an adjustment clause" and  
26 that these adjustment clauses are "[d]esigned to allow rates to fluctuate in response to  
27 certain specific criteria..."

1 **Q. PLEASE SUMMARIZE THE ARGUMENTS THAT LACLEDE MAKES IN ITS DIRECT**  
2 **TESTIMONY IN AN ATTEMPT TO PERSUADE THIS COMMISSION TO APPROVE THE**  
3 **COMPANY'S WEATHER MITIGATION CLAUSE PROPOSAL.**

4 A. Laclede's primary arguments can be distilled to the following three themes:

5 1) Laclede is "entitled" to recover its cost of service, not just a reasonable opportunity  
6 to recover its cost of service.

7 2) The implied threat that if the Commission does not let the Company get its way by  
8 approving the major policy change (the proposed WMC) that Laclede seeks, then  
9 the Company may choose not to fulfill its public service obligation to provide safe  
10 and adequate service to its customers.

11 3) The WMC will provide significant benefits to **both** the Company and its  
12 customers.

13 **Q. DOES PUBLIC COUNSEL BELIEVE THAT ANY OF THE ABOVE ARGUMENTS ARE VALID?**

14 A. No.

15 **Q. PLEASE EXPLAIN WHY PUBLIC COUNSEL DISAGREES WITH THE FIRST LACLEDE**  
16 **ARGUMENT LISTED ABOVE REGARDING LACLEDE'S ASSERTION THAT IT IS "ENTITLED"**  
17 **TO RECOVER ITS COST OF SERVICE.**

18 A. At line 13 on page 17 of his direct testimony Laclede witness Michael Cline states that  
19 the Company is "is entitled" to "adequate recovery of the fixed non-gas costs."  
20 Laclede's assertion that it is somehow "entitled" to recover costs and receive the return  
21 that the Commission determines to be reasonable when rates are set is just plain wrong.  
22 It is difficult to understand how Mr. Cline could have worked in the regulated utility

1 industry for 27 years without learning this fundamental concept of the utility regulation  
2 process.

3 The recognition that this assertion is clearly wrong should be one of the basic lessons that  
4 anyone could learn at one of the many "Intro to Utility Regulation 101" training seminars  
5 that are offered throughout the United States. If I were teaching at one of these seminars  
6 and one of my students left with the understanding that utilities are guaranteed a  
7 reasonable rate of return instead of only being guaranteed the **opportunity** to earn a  
8 reasonable rate of return, then I would be forced to acknowledge that my instructional  
9 abilities are wholly inadequate.

10 **Q. CAN YOU CITE ANY ANALYSIS BY A RECOGNIZED UTILITY INDUSTRY EXPERT THAT**  
11 **SUPPORTS YOUR BELIEF THAT UTILITY COMMISSIONS GENERALLY SET RATES AT A**  
12 **LEVEL WHICH ALLOWS UTILITIES THE OPPORTUNITY (AS OPPOSED TO A GUARANTEE)**  
13 **TO ATTAIN THEIR AUTHORIZED RETURN?**

14 A. Yes, the following quote from page 202 of A. J. G. Priest's *Principles of Public Utility*  
15 *Regulation* supports this widely recognized regulatory principle:

16 ...the utility's return allowance might be compared with a fishing or  
17 hunting license with a limit on the catch. Such a license does not  
18 guarantee that the holder will catch anything at all; it simply makes the  
19 catch legal (up to a specified limit) provided the holder is successful in  
20 his own efforts.

21 **Q. PLEASE EXPLAIN WHY PUBLIC COUNSEL DISAGREES WITH THE SECOND LACLEDE**  
22 **ARGUMENT LISTED ABOVE REGARDING LACLEDE'S ASSERTION THAT IT MAY NOT**  
23 **FULFILL ITS PUBLIC SERVICE OBLIGATION TO PROVIDE SAFE AND ADEQUATE SERVICE**  
24 **TO ITS CUSTOMERS UNLESS THE COMMISSION APPROVES ITS PROPOSED WMC.**

25 A. At line 3 on page 11 of his direct testimony, Laclede's Chief Executive Officer, Douglas  
26 Yaeger, states that:

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Ryan Kind

1                   No organization, be it a public utility, an unregulated business, or a state  
2                   agency, can long provide reasonable service if their ability to fund  
3                   services is subject to the whim and caprice of the weather.

4                   Mr. Yaeger's statement to this Commission in his testimony is not consistent with the  
5                   message that he recently delivered to Laclede's shareholders in the Laclede Group's 2001  
6                   annual report which came out a few months ago. In his CEO message to shareholders  
7                   and employees (see pages 4 – 6 of the Laclede Group Annual Report available at  
8                   www.lacledegas.com), Mr. Yaeger points to the new business diversification initiatives  
9                   that have accelerated at Laclede and its holding company subsequent to this  
10                  Commission's approval of Laclede's restructuring application in Case No. GM-2001-  
11                  342. He points out that:

12                   Our new strategic direction is designed to transition the company from  
13                   solely a traditional utility into an organization where [weather and  
14                   regulatory] risk is spread across a larger enterprise and in which we can  
15                   better manage our own future, operating a stable core utility along with  
16                   other non-regulated entities.

17                  When looking at the two quotes shown above from Mr. Yaeger, it is clear that he is  
18                  giving dramatically different messages to different audiences. In his position as the  
19                  Laclede Group's President and CEO, he is telling shareholders (see page 4 of the Laclede  
20                  Group Annual Report) that the Laclede Group is making progress on implementing a  
21                  strategic plan that allows it to "mitigate the impact of fluctuations in our core utility  
22                  operations, which can be impacted significantly by factors largely beyond our control,  
23                  such as weather cycles and regulatory decisions." In contrast, Mr. Yaeger has delivered a  
24                  message to this Commission in his direct testimony which implies that reductions in the  
25                  quality and reliability of service to Laclede's customers are likely to occur unless this  
26                  Commission approves all of the regulatory relief (including the WMC) that the Company  
27                  is seeking in this rate case.

1 **Q. DOES LACLEDE HAVE OTHER OPTIONS FOR MITIGATING THE IMPACT THAT WEATHER**  
2 **CAN HAVE ON ITS EARNINGS BESIDES THE GROWTH AND DIVERSIFICATION INITIATIVES**  
3 **THAT MR. YAEGER DISCUSSES IN HIS MESSAGE TO SHAREHOLDERS AND EMPLOYEES**  
4 **IN THE 2001 LACLEDE GROUP ANNUAL REPORT?**

5 A. Certainly. Such options would include:

- 6 • Offering customers a WMC option or a fixed bill option that would cover both the  
7 gas (PGA) and non-gas portions of a customer's bill.
- 8 • Obtaining weather insurance that would insulate the utility from some or all of the  
9 declines in margin revenues that are associated with warmer than normal weather.

10 **Q. HAS LACLEDE EVER FILED A PROPOSAL WITH THE COMMISSION FOR AN WMC**  
11 **OPTION THAT CUSTOMERS COULD CHOOSE AS AN ALTERNATIVE METHOD OF PRICING**  
12 **THEIR SERVICE?**

13 A. No.

14 **Q. HAS LACLEDE EVER FILED A PROPOSAL WITH THE COMMISSION FOR A FIXED BILL**  
15 **OPTION THAT CUSTOMERS COULD CHOOSE AS AN ALTERNATIVE METHOD OF PRICING**  
16 **THEIR SERVICE?**

17 A. No. Public Counsel has had discussions with the Company about such an option over the  
18 last couple years, but we have not been able to reach agreement with the Company about  
19 some of the basic parameters for offering this type of optional pricing.

20 **Q. HAS LACLEDE PRESENTED ANY EVIDENCE IN THIS CASE TO DEMONSTRATE THAT ITS**  
21 **LACK OF A WMC HAS EVER LED THE COMPANY TO BE ANYWHERE CLOSE TO THE**

**DIRE FINANCIAL SITUATION THAT COULD CAUSE IT TO BE UNABLE TO FULFILL ITS  
PUBLIC SERVICE OBLIGATION OF PROVIDING SAFE AND ADEQUATE SERVICE?**

A. No. Laclede has presented no such evidence to this Commission. There is no evidence to indicate that Laclede is unable to continue paying out dividends at the same level or unable to obtain adequate access to debt and equity markets. Therefore, the Company should be able to continue fulfilling its obligation to provide safe and adequate service.

**Q. HAS LACLEDE BEEN FORCED TO CUT ITS DIVIDEND IN RECENT YEARS DUE TO  
FINANCIAL PROBLEMS ASSOCIATED WITH THE LACK OF A WMC?**

A. No. The dividend history that the Company maintains on its web site indicates that the Company's dividend level has remained very steady (with a small upward trend) for over a decade.

**Q. SINCE LACLEDE HAS OPERATED FOR DECADES WITHOUT A WEATHER MITIGATION  
CLAUSE, WHAT COULD HAVE CHANGED IN THE LAST FEW YEARS TO EXPLAIN  
LACLEDE'S STRONG INTEREST IN MITIGATING THE EFFECTS OF WEATHER ON ITS  
EARNINGS?**

A. The only major change that I have noticed in Laclede's operations that could be related to its strong interest in proposals to control weather-related earnings volatility is the increased interest that Laclede and its new holding company, the Laclede Group, have shown in expanding the investments in non-regulated operations. Laclede's ability to raise the funds needed to rapidly diversify into non-regulated activities could probably be restrained to some degree by any earnings volatility at its core utility operations. This is because Laclede's ability to raise funds (either from debt and equity markets or from internal sources) for its non-regulated operations is largely dependant on its ability to leverage the earnings and cash flows at its core regulated utility operations.

1       **Q.     PLEASE EXPLAIN WHY PUBLIC COUNSEL DISAGREES WITH THE THIRD LACLEDE**  
2       **ARGUMENT LISTED ABOVE REGARDING LACLEDE'S ASSERTION THAT THE WMC WILL**  
3       **PROVIDE SIGNIFICANT BENEFITS TO BOTH LACLEDE'S SHAREHOLDERS AND ITS**  
4       **CUSTOMERS.**

5       A.    At line 15 on page 8 of his testimony, Michael Cline states that "the WMC  
6       could...contribute to more stable bills by reducing the impact that weather would have on  
7       the magnitude of customer's bills." While OPC acknowledges that the proposed WNC  
8       could make a very minor contribution towards mitigating the impact that increased usage  
9       volumes associated with cold weather have on customer bills, we do not believe that the  
10      benefit is significant enough to merit strong consideration by the Commission in its  
11      determination of whether the proposed WMC is in the public interest. The potential  
12      earnings stabilization benefits for Laclede and its shareholders far outweigh any potential  
13      bill stabilization benefits that consumers could realize. Furthermore, Public Counsel  
14      believes that any minor beneficial impact that the WMC would have on stabilizing  
15      customer bills would be more than offset by the detrimental impacts that are discussed  
16      later in this testimony. Other portions of this testimony contain OPC's alternative  
17      proposal for a more balanced approach to addressing weather-related concerns of both the  
18      Company and its customers.

19      **Q.     IN ORDER TO PUT THIS ISSUE IN PERSPECTIVE, PLEASE DISCUSS THE PORTION OF A**  
20      **CUSTOMER'S AVERAGE WINTER BILL THAT IS ASSOCIATED WITH THE MARGIN**  
21      **REVENUES WHICH WOULD BE SUBJECT TO THE PROPOSED WMC.**

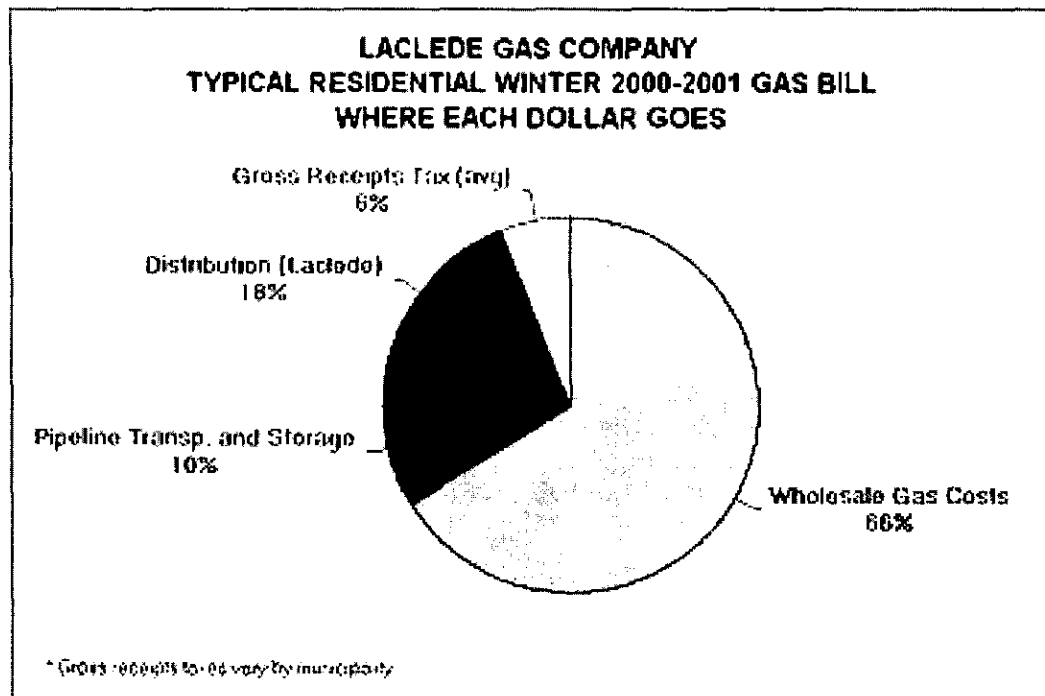
22      A.    Laclede issued a press release on May 18, 2001 when it filed its last request for a general  
23      rate increase in Case No. GR-2001-629 that stated:

24               The general rate increase applies only to the distribution cost portion of a  
25               Laclede customer's bill, which typically is about one-fifth of the total  
26               during the winter.

...

The remaining and by far the largest portion of a customer's bill involves the prices Laclede pays others to acquire natural gas supplies to meet its customers' needs and to store and transport those supplies from the production fields to Laclede's service area.

That same press release contained the following pie chart illustrating the proportion of each cost category that makes up the typical residential customer's winter gas bill.



As the above chart shows, only about 18% of a typical residential customer's winter bill comes from the "Distribution" charges that are the subject of this rate case. Thus, if the entire charge were based on volumes of gas consumed and if all of these volumes were weather sensitive, then the proposed WMC would only help mitigate the impacts that weather has on about one-fifth of a residential customer's typical winter bill. However, since a large part of this one-fifth of the bill is collected through the customer charge and through the initial block which includes non-weather sensitive usage such as water heating, the proportion of a residential customer's typical winter bill that would be subject to adjustment (and stabilization) by the WMC is far less than 18%.

1       **Q.     YOUR RESPONSE ABOVE SHOWED THAT ONLY 18% OF A RESIDENTIAL CUSTOMER'S**  
2       **TYPICAL WINTER BILL COMES FROM THE MARGIN COSTS THAT ARE AT ISSUE IN THIS**  
3       **CASE. CAN YOU PROVIDE AN ESTIMATE OF THE PROPORTION OF THESE MARGIN**  
4       **COSTS IN A RESIDENTIAL CUSTOMER'S TYPICAL WINTER BILL THAT WOULD ACTUALLY**  
5       **BE SUBJECT TO ADJUSTMENT BY THE WMC.**

6       A.     Yes. OPC witness Hong Hu has performed this calculation which is described in her  
7       rebuttal testimony. Her analysis indicates that out of the 18% of a residential customer's  
8       typical winter bill that comes from the margin costs, only about one-third of these costs  
9       are subject to adjustment by the WMC. Thus, Laclede's WMC proposal would only  
10      adjust about 6% of a residential customer's typical winter bill to the level that would be  
11      expected under normal weather conditions.

12      **Q.     DO YOU KNOW THE IMPACT THE WNC WOULD HAVE ON A CUSTOMER'S TYPICAL**  
13      **WINTER BILL DURING AN ABNORMALLY COLD WINTER?**

14      A.     Yes. On page 8 of his testimony Laclede witness Cline indicated that the proposed WNC  
15      would help reduce customer bill volatility. Since Mr. Cline's testimony did not contain  
16      any quantification of the amount that customer bill volatility could be reduced in an  
17      abnormally cold winter, Public Counsel requested that Laclede provide such a  
18      quantification in a Data Request (DR) response. Specifically, OPC DR No. 5012  
19      requested the Company to "please provide a calculation of the reduction in bill volatility  
20      a typical residential customer would have experienced during the 2000/2001 winter had  
21      Laclede's proposed WNC been in place."

22             Most people will recall that the 2000/2001 winter was the heating season when customers  
23             experienced the "double whammy" of unusually high usage during November and  
24             December and unusually high wholesale gas costs (commodity costs) throughout the  
25             heating season. These two factors caused many consumers to receive gas bills that added

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up to seasonal heating costs that were several hundred dollars higher than those experienced in recent memory. Laclede's response to OPC DR No. 5012 revealed just how "modest" the relief was that customers could expect from a WMC during a time that customers would benefit the most from downward bill adjustments. Laclede's DR response indicated that the typical customer could only expect **\$8 of relief for the entire heating season** that could go to offset the huge bills that customers experienced during most months of the 2000/2001 heating season.

**Q. WERE YOU SURPRISED THAT A TYPICAL RESIDENTIAL CUSTOMER WOULD ONLY SEE \$8 OF RELIEF FROM THE WMC AT A TIME WHEN HEATING BILLS WERE SOARING BY HUNDREDS OF DOLLARS FOR MANY RESIDENTIAL CUSTOMERS?**

A. No. This is within the range that would be expected for a "weather solution" that only addresses 6% of the total gas bill that is paid by the typical residential customer during the winter season.

**R. DOES LACLEDE WITNESS CLINE ASSERT THAT THE COMPANY'S WMC PROPOSAL WOULD PROVIDE COMPARABLE BENEFITS TO BOTH THE COMPANY AND ITS CUSTOMERS?**

A. No. Laclede appears to recognize that the benefits that customers receive from some minor decrease in the weather sensitivity of their bills is dwarfed by the benefits that the Company receives in the form of greatly reduced earnings volatility related to abnormal weather conditions. Mr. Cline characterizes any bill stabilizing relief that customers might receive from the WNC as "modest" at line 20 on page 15 of his direct testimony. For customers, the main sources of bill volatility are: (1) changes in the level of consumption (e.g. volumes of therms consumed) during abnormal weather that is used to determine the PGA charges on the customer's bill and (2) the changes in gas commodity

1 costs that also impact the PGA charges on the customer's bill. Laclede's WMC proposal  
2 does nothing to mitigate the customer bill volatility that arises from these two sources.

3 As the pie chart above shows, about three-fourths (76%) of a customer's winter bill  
4 comes from the wholesale gas costs and pipeline transportation and storage costs that  
5 appear in the PGA charge. The proposed WNC does nothing to help consumers when the  
6 volumes of gas subject to the PGA charge are abnormally high in a cold winter. Perhaps  
7 the greatest shortfall of the Laclede WNC proposal is that it does nothing to address the  
8 large increases in wholesale gas costs (gas commodity costs) that tend to occur in  
9 abnormally cold winters. The large increases in customer bills that occurred during the  
10 winter of 2000-2001 were largely due to the enormous increases in wholesale gas costs  
11 that were passed on to consumers through the PGA charge.

12 **Q. DOES LACLEDE ALSO RECOGNIZE THAT THE LARGE INCREASES IN CUSTOMER BILLS**  
13 **THAT OCCURRED DURING THE WINTER OF 2000/2001 WERE LARGELY DUE TO THE**  
14 **ENORMOUS INCREASES IN WHOLESALE GAS COSTS THAT WERE PASSED ON TO**  
15 **CONSUMERS THROUGH THE PGA CHARGE?**

16 **A.** Yes. In the midst of the large "run ups" in the wholesale price of gas that occurred  
17 during the 2000/2001 heating season, Laclede issued "an open letter to customers of  
18 Laclede gas" wherein it explained that one of the major reasons for the increase in  
19 December heating bills was that "the wholesale cost of natural gas at the wellhead  
20 through December was significantly higher than it was last year or in the last decade." In  
21 the same "open letter" the company explained that "more than 75% of the portion of your  
22 current bill for gas service is going to wholesale suppliers and pipeline transportation  
23 providers."

1       **Q.    GIVEN THE UNBALANCED NATURE OF THE “WEATHER FIX” PROPOSED BY LACLEDE IN**  
2       **THIS CASE, DOES PUBLIC COUNSEL BELIEVE IT WOULD BE FAIR TO APPROVE THE**  
3       **WNC WITHOUT ADDRESSING THE PRIMARY SOURCES OF THE WEATHER-RELATED**  
4       **BILL FLUCTUATIONS THAT THREATEN THE HOUSEHOLD BUDGETS OF LACLEDE’S**  
5       **CUSTOMERS?**

6       A.    No. Public Counsel believes that it would be grossly unfair for the Commission to  
7       approve a WNC proposal that almost completely insulates the utility from potential  
8       adverse impacts of weather without addressing the needs of consumers for mechanisms  
9       that can help mitigate the enormous commodity price risk volatility that is borne solely  
10      by consumers through the operation of the PGA gas cost pass-through procedures. Since  
11      Public Counsel believes that Laclede’s WNC proposal is an unfair and one-sided  
12      approach to controlling the weather-related financial risks faced by both the Company  
13      and its customers, we have responded to this proposal with a balanced proposal for  
14      controlling weather-related financial risks. This alternative OPC proposal is discussed  
15      further in Section 4 of this testimony.

16      **Q.    PLEASE SUMMARIZE THE REASONS WHY PUBLIC COUNSEL OPPOSES LACLEDE’S**  
17      **WEATHER MITIGATION CLAUSE PROPOSAL.**

18      A.    This proposal would:

- 19           1) Virtually eliminate Laclede’s weather risk but it would not provide significant  
20           benefits to Laclede’s customers.
- 21           2) Not be consistent with the purposes of regulation.
- 22           3) Essentially charge customers in future periods for gas that was not consumed in  
23           prior periods. Just like all the other goods and services that consumers purchase,  
24           they like to pay for the amount of a good or service that they actually consumed.

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- 1           4) Dilute the price signal that now exists between the quantity of gas consumed and
- 2           the amount charged for this consumption.
- 3           5) Create radical changes in the manner in which customers are billed and PGA/ACA
- 4           rates are determined for the primary purpose of eliminating the risk that weather
- 5           may have an adverse impact on utility earnings.
- 6           6) Increase the complexity of the rate structure and make it more difficult for
- 7           customers to determine the basis for the charges on their monthly bills
- 8           7) Remove some of the risk of being in the gas utility business without giving explicit
- 9           recognition to this reduced risk in the determination of the appropriate rate of
- 10          return that should be used when rates are set.
- 11          8) Likely lead to additional costs such as an increase in billing system costs to
- 12          accommodate the new billing procedures but the Company has not provided any
- 13          estimate of these increased costs.
- 14          9) Create rates that discriminate between customers in different divisions of Laclede's
- 15          service territory and between customers within the different divisions of Laclede's
- 16          service territory.
- 17          10) Not be consistent with the customer views that OPC has seen in letters to the editor
- 18          which have opposed special ratemaking mechanisms that would compensate
- 19          Laclede for revenue decreases in warmer than normal weather.

20       **Q.   YOUR EARLIER TESTIMONY ALREADY EXPLAINED THE BASIS FOR THE FIRST REASON**  
21       **LISTED ABOVE. PLEASE PROCEED TO DISCUSS THE SECOND REASON LISTED ABOVE.**

22       **A.**   The WNC is not consistent with the purposes of utility regulation. As I explained earlier,  
23       utility regulation does not create an "entitlement" for the utility to earn a Commission

1 determined return that fully compensates the utility for its cost of service. If that were the  
2 case, there would be no reason to determine an appropriate level of a risk adjusted return  
3 that should be included in a utility's rates.

4 Instead, utility regulation is intended to mimic the outcomes and market environment that  
5 is faced by competitive firms. The use of utility regulation to simulate a competitive  
6 environment and encourage the benefits that would accrue if the industry were suitable  
7 for a competitive structure has been referred to as the competitive market paradigm. This  
8 paradigm was described by Dr. James Bonbright on page 93 of *Principles of Public*  
9 *Utility Rates* in the following manner:

10 Regulation, it is said, is a substitute for competition. Hence its objective  
11 should be to compel a regulated enterprise, despite its possession of  
12 complete or partial monopoly, to charge rates approximating those which  
13 it would charge if free from regulation but subject to market forces of  
14 competition. In short, regulation should be not only a substitute for  
15 competition, but a closely imitative substitute.

16 Its difficult to imagine a competitive firm imposing a mandatory pricing structure on its  
17 customers that included post consumption adjustments to prices in order to ensure that  
18 adverse weather did not have a negative impact on the firm's earnings and cash flows.

19 **Q. PLEASE DISCUSS THE THIRD REASON LISTED ABOVE.**

20 A. Customer generally like to know prior to the time of consumption, the charges that will  
21 be associated with each additional unit of consumption. How would most consumers  
22 react if they pulled into a gas station and no prices were listed on the pumps? I do not  
23 think customers would be receptive to the attendant telling them that prices are in flux  
24 due to recent weather conditions and we will send you a bill later, once we figure out  
25 what the prices are.

26 **Q. PLEASE DISCUSS THE FOURTH REASON LISTED ABOVE.**

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1 A. Since the WNC will make it virtually impossible for customers to know the margin rate  
2 that they are effectively being charged prior to consumption, it will be more difficult for  
3 consumers to make both long-run and short-run choices regarding the amount of gas that  
4 they will consume. The long run decisions that consumers make about the size and level  
5 of energy efficiency of the structure that they will inhabit and the efficiency level of gas  
6 furnaces and other gas-fueled appliances will not be based on readily available prices for  
7 utility service. Likewise, the lack of readily available prices for utility service will make  
8 it more difficult to make decisions regarding short-run decisions like where to set the  
9 furnace thermostat.

10 **Q. PLEASE DISCUSS THE FIFTH REASON LISTED ABOVE.**

11 A. As discussed earlier in this testimony, the WNC clause will only have a minimal impact  
12 on the weather related volumes risk of customers since it will only be applied to about  
13 6% of the typical customer's winter bill. It will, however, have an enormous impact on  
14 the utility's weather-related volumes risk. At the same time, the WNC will greatly  
15 complicate the rate structure and the PGA/ACA process. Its not at all clear that the  
16 purported dire need for virtual elimination of the utility's weather-related earnings  
17 volatility even exists. Such a need would have to be demonstrated much more  
18 convincingly than Laclede has done thus far in order to justify the radical rate structure  
19 changes being proposed.

20 **Q. PLEASE DISCUSS THE SIXTH REASON LISTED ABOVE.**

21 A. Currently, it is fairly simple for a residential customer to calculate the charges that will  
22 apply for the margin portion of their bill. The customer only needs to know the customer  
23 charge and the block rates that apply for the current season. Public Counsel sometimes  
24 gets inquiries from customers about how to calculate the margin rates that appear on their

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1 monthly bills and we post these rates for all of the Missouri investor owned gas utilities  
2 on our web site (<http://www.mo-opc.org/gas/gasbill.htm>) in order to help customers  
3 understand how their monthly bills are calculated. If the WNC is approved, customers  
4 could calculate the margin charges that would appear on their monthly bill, but these  
5 charges would be subject to future true-ups to account for weather variations. These true-  
6 ups of margin costs would then appear on a later customer bill, buried in the PGA costs  
7 that were formerly (prior to the WMC) related only to gas procurement costs.

8 **Q. PLEASE DISCUSS THE SEVENTH REASON LISTED ABOVE.**

9 A. The WMC would undoubtedly reduce Laclede's risk of being in the regulated gas  
10 business. However, Laclede's testimony in this case contains no recognition of the  
11 impact that its WNC proposal should have on the return that the Commission determines  
12 to be reasonable for inclusion in the rates that result from this case. OPC witness Mark  
13 Burdette's rebuttal testimony addresses this issue.

14 **Q. PLEASE DISCUSS THE EIGHTH REASON LISTED ABOVE.**

15 A. The Company's testimony does not provide any information regarding cost increases that  
16 are likely to be associated with the implementation of its WNC proposal. Wouldn't  
17 significant modifications to Laclede's billing system be necessary to accommodate a  
18 WNC? Would Laclede's customer service department need additional service  
19 representatives to respond to customer complaints and inquiries regarding the new  
20 pricing structure? These are just examples of questions about the cost impacts of the  
21 WMC that Laclede failed to address in its testimony where this proposal was presented.

22 **Q. PLEASE DISCUSS THE NINTH REASON LISTED ABOVE.**

1 A. On pages 7 through 9 of his direct testimony, PSC Staff witness James Russo explains  
2 why the Staff believes that the WNC as proposed by Laclede, create rates that  
3 discriminate between customers in different divisions of Laclede's service territory and  
4 between customers within the different divisions of Laclede's service territory

5 **Q. PLEASE DISCUSS THE TENTH REASON LISTED ABOVE.**

6 A. I do not believe that most consumers would support the one-sided approach to mitigating  
7 weather-related risk that has been proposed by Laclede in this case. I have seen letters to  
8 the editor in the St. Louis Post Dispatch where Laclede's customers expressed their  
9 "outrage" at Laclede's request to be allowed to seek compensation for its decline in  
10 earnings during the 2001/2002 heating season. Customers appear to perceive proposals  
11 like this as blatant attempts obtain a "corporate bailout" from the utility regulatory  
12 process that would come at the expense of captive ratepayers. I think most customers are  
13 offended by profitable corporations seeking this type of assistance when they themselves  
14 are struggling to make ends meet.

15 **Q. IN THE FIRST SECTION OF THIS TESTIMONY, YOU EXPLAINED WHY PUBLIC COUNSEL**  
16 **BELIEVES THAT THE COMMISSION WOULD BE MAKING A MAJOR POLICY DECISION IF IT**  
17 **DECIDED TO APPROVE THE PROPOSED WEATHER NORMALIZATION CLAUSE. IS THE**  
18 **IMPORTANCE OF THAT POLICY DECISION HEIGHTENED BY THE FACT THAT LACLEDE**  
19 **HAS NOT PROPOSED THAT THIS CLAUSE BE IMPLEMENTED AS AN EXPERIMENT WITH**  
20 **LIMITED DURATION?**

21 A. Yes. Public Counsel believes that the decision to implement a WNC would be such an  
22 important policy change that it should only be approved on an experimental basis if the  
23 Commission decides to approve it, despite OPC's recommendation to the contrary. The

1 decision to approve the WNC could be revisited after the expiration of a two year  
2 experimental time period.

3 **Q. DOES PUBLIC COUNSEL BELIEVE THAT LACLEDE'S WNC TARIFF SHOULD INCLUDE A**  
4 **PROVISION THAT REQUIRES THE COMPANY TO RETAIN INFORMATION REGARDING**  
5 **CUSTOMER FEEDBACK ABOUT THIS EXPERIMENTAL RIDER?**

6 A. Yes, if this proposal is approved contrary to OPC's' recommendation, Laclede's tariff  
7 should be modified to include requirements for the Company to track customer feedback  
8 regarding this rider (including the retention of all written and verbal customer inquiries  
9 and comments about the rider). If approved, Laclede's WNC tariff should also include a  
10 plan to evaluate the tariff that includes surveying customers about their views on the  
11 experimental WNC after customers have experienced two heating seasons of billing  
12 under the WNC.

13 **III. LACLEDE'S REVISED RESIDENTIAL BLOCK RATES PROPOSAL**

14 **Q. PLEASE PROVIDE A BRIEF DESCRIPTION OF LACLEDE'S PROPOSAL TO PARTIALLY**  
15 **MITIGATE THE AFFECTS OF WEATHER BY INCREASING THE FIRST BLOCK RATE AND**  
16 **DECREASING THE SECOND BLOCK RATE FOR THE RESIDENTIAL CLASS.**

17 A. This is essentially the second prong of Laclede's initiative in this case to seek changes in  
18 its rate structure that will reduce or eliminate the weather-related risk that could have  
19 adverse impacts on the Company's earnings and cash flows. Of the 18% of Laclede's  
20 revenues that come from residential customers during the winter season from its margin  
21 rates, the Company is seeking to move a larger portion into the portions of its winter rate  
22 structure that have little or no sensitivity to weather variations. According to calculations  
23 performed by OPC witness Hong Hu, Laclede's winter margin revenues from residential  
24 customers are derived in the following manner:

- 1           • 31.2% come from the \$12.00 per month customer charge.
- 2           • 34.1 percent come from the first block of the volumetric charge.
- 3           • 34.7 percent come from the second block of the volumetric charge.

4           Laclede's customer charge and first block charge provide revenues with little or no  
5           weather sensitivity during the winter season. Together, these two sources of revenue  
6           provide 65.3% of the winter season margin revenues that come from the residential class.  
7           With its proposal to move additional cost recovery from the second winter block to the  
8           first winter block, Laclede is seeking to increase the proportion of its residential winter  
9           margin revenues with little or no weather sensitivity above the current percentage of  
10          65.3%.

11          **Q.    WHY MIGHT LACLEDE BE MAKING THIS PROPOSAL IN ADDITION TO THE WNC**  
12          **PROPOSAL? WOULDN'T THE DECLINE IN WEATHER SENSITIVITY AFFORDED BY THIS**  
13          **PROPOSAL ALSO BE CAPTURED BY THE WNC?**

14          A.    Yes. These proposals seems to be duplicative with respect to the impact that they would  
15          have on the weather sensitivity of Laclede's earnings. Laclede has presented multiple  
16          weather risk reduction proposals in at least one previous case but it generally offered such  
17          proposals as "either, or" proposals where it was asking the Commission to choose just  
18          one of the proposals offered. I see this proposal as chiefly being part of a "fall back"  
19          strategy that would allow the Company to make some progress on its goal of eliminating  
20          the weather risk associated with its earnings and cash flows but Laclede may see this  
21          proposal as furthering some additional strategic goals of which I am not aware.

22          **Q.    WHAT SUPPORT FOR THIS PROPOSAL IS PROVIDED IN LACLEDE' TESTIMONY?**

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1 A. Mr. Cline discusses this proposal very briefly on pages 16 and 17 of his direct testimony  
2 where he states that:

3 The Company has developed a revised rate structure for customers billed  
4 under its RG rate schedule that, if approved, would represent an  
5 improvement over the existing rate structure in terms of recovery of the  
6 Company's relatively fixed non-gas costs.

7 **Q. DOES MR. CLINE PROVIDE ANY SUPPORT FOR HIS ASSERTION THAT LACLEDE'S NON-**  
8 **GAS COSTS ARE "RELATIVELY FIXED."**

9 A. No. In fact the Company did not even perform the type of class cost of service study for  
10 this case where costs are categorized by function and then classified as customer, demand  
11 and commodity-related costs. Absent such a current study, Mr. Cline's assertion that  
12 Laclede's non-gas costs are "relatively fixed" is nothing more than informed conjecture.

13 **Q. DOES MR. CLINE IDENTIFY THE IMPACT THAT THE COMPANY'S BLOCKING PROPOSAL**  
14 **WOULD HAVE ON THE WEATHER SENSITIVITY OF LACLEDE'S EARNINGS OR**  
15 **CUSTOMER'S BILLS?**

16 Yes. He states that his proposal would "only adjust for approximately one-third of the  
17 Company's weather variation from normal for residential customers." No quantitative  
18 analysis is provided in his testimony to support this assertion that the proposal would  
19 remove one-third of the weather volatility that remains in Laclede margin rates. Of  
20 course, as was illustrated in the preceding section of this testimony, an assessment that  
21 this revised blocking proposal removes one-third of the weather variation from normal is  
22 just the Company's perspective since this adjustment only affects a very small portion of  
23 the customer's bill that is exposed to weather variations from both volumes risk and  
24 commodity price risk.

1       **Q.     PLEASE SUMMARIZE THE REASONS WHY PUBLIC COUNSEL OPPOSES THIS**  
2       **PROPOSAL.**

3       A.     This proposal would:

- 4               1)   Greatly reduce Laclede's weather risk but it would not provide significant weather  
5               risk mitigation benefits to Laclede's customers.
- 6               2)   Remove some of the risk of being in the gas utility business without giving explicit  
7               recognition to this reduced risk in the determination of the appropriate rate of  
8               return that should be used when rates are set.
- 9               3)   Decrease the price signal to consumers that increased future distribution system  
10              infrastructure costs are associated with increased levels of consumption.
- 11              4)   Decrease the price signal to consumers for marginal usage in the winter months,  
12              thereby encouraging the use of less efficient heating systems and gas appliances.
- 13              5)   Change the rate structure for collecting margin costs without any support from a  
14              cost of service study indicating the proposed changes are consistent with cost  
15              causation.
- 16              6)   Encourage consumers to use more of a non-renewable resource that contributes to  
17              serious environmental degradation.

18       **Q.     YOUR EARLIER TESTIMONY ALREADY EXPLAINED THE BASIS FOR THE FIRST AND**  
19       **SECOND REASONS LISTED ABOVE.   PLEASE PROCEED TO DISCUSS THE THIRD**  
20       **REASON LISTED ABOVE.**

21       A.     When Laclede seeks to support its proposals for changes to the rate structure it argues  
22       that its distribution cost which are collected through margin rates are essentially fixed.

1           example, if the price of gas doubled, some consumers would be expected to respond to  
2           this change by lowering the thermostat for their furnace and throwing on a sweater.

3           The fact that natural gas, like all other fossil fuels, is a non-renewable resource is  
4           common knowledge. The fact that the combustion of natural gas releases greenhouse  
5           gases into the atmosphere which most believe contributes to global warming is also  
6           common knowledge to most people, despite the fact that Laclede continues to promote  
7           natural gas as a product that is "virtually pollution free."

8           **IV.    OPC'S ALTERNATIVE PROPOSAL**

9           **Q.    BEFORE DISCUSSING OPC'S ALTERNATIVE PROPOSAL, PLEASE SUMMARIZE OPC'S**  
10          **PRIMARY RECOMMENDATION IN THIS CASE REGARDING THE WMC AND REVISED**  
11          **RESIDENTIAL BLOCK RATES THAT HAVE BEEN PROPOSED BY LACLEDE.**

12          A.    As stated previously, OPC is opposed to both of these proposals and our primary  
13                recommendation is that the Commission should resolve both of these issues by denying  
14                approval of Laclede's proposals. We believe that these proposals would provide  
15                enormous earnings and cash flow stabilization benefits to the Company and its  
16                shareholders while providing very little in the way of bill stabilization benefits to  
17                consumers. The modest bill stabilization benefits that consumers would receive are not  
18                sufficient to make the proposals beneficial to the public interest when all of the  
19                detrimental aspects of these proposals are taken into account. Approval of these proposals  
20                would still leave consumers exposed to weather-related volumes and commodity price  
21                risk on 82% of their winter bills.

22          **Q.    PLEASE OUTLINE THE ALTERNATIVE RECOMMENDATION THAT OPC IS PUTTING**  
23          **FORWARD IN THIS CASE IN RESPONSE TO LACLEDE'S TWO WEATHER STABILIZATION**  
24          **PROPOSALS.**

1 A. If the Commission believes that the public interest will be served by making changes that  
2 will mitigate the effects of abnormal weather, then Public Counsel's alternative  
3 recommendation is for the Commission to approve our comprehensive and balanced  
4 proposal for mitigating the impacts that abnormal weather (and often related high  
5 commodity gas costs) have on both customers and the Company. Public Counsel's  
6 recommended alternative proposal is to:

7 1) Implement OPC's Gas Supply Incentive Plan (GSIP) proposal in this case as  
8 described in Barbara Meisenheimer's rebuttal testimony and;

9 2) Increase the proportion of costs (as specified in Hong Hu's rebuttal testimony) that  
10 are recovered in the first residential rate block (with a corresponding decrease in  
11 the second rate block) **if the Company agrees** to implement OPC's GSIP proposal  
12 in this case.

13 **Q. PLEASE EXPLAIN WHY PUBLIC COUNSEL IS PRESENTING AN ALTERNATIVE**  
14 **RECOMMENDATION IN THIS CASE WHICH INCLUDES SOMETHING SIMILAR TO THE**  
15 **LACLEDE REVISED BLOCKING PROPOSAL THAT YOU HAVE RECOMMENDED BE**  
16 **REJECTED BY THE COMMISSION IN YOUR PRIMARY RECOMMENDATION.**

17 A. One of the main reasons why Public Counsel is opposed to both of the Laclede weather  
18 stabilization proposals in this case is the fact that the vast majority of the weather  
19 stabilization benefits associated with these two proposals accrue solely to the Company  
20 and its shareholders. As this testimony has already demonstrated, Laclede's proposals  
21 completely fail to address the weather-related commodity price risk faced by customers  
22 and only address about 6% of the costs in a typical winter bill. Public Counsel  
23 recognizes that the Commission may want to do something to address the weather risk  
24 issues affecting both the Company and its customers that have been raised by Laclede in  
25 this case. We hope that the Commission agrees with our position that it is not appropriate

1 to fully address the weather risk faced by the Company while only “scratching the  
2 surface” of the weather risk faced by consumers.

3 In offering its alternative recommendation, Public Counsel believes that it is offering the  
4 Commission a viable option for addressing the weather risk faced by both the Company  
5 and its customers in a balanced and comprehensive manner. We perceive our  
6 recommendation as offering something that can benefit the Company’s interest in  
7 reducing its weather-related volumes risk, while offering both Public Counsel and the  
8 Commission an opportunity to try a new approach to Gas Supply Incentives that we  
9 believe meets the “well structured incentive plan” criteria that the Commission has  
10 articulated.

11 Public Counsel believes that a well structured GSIP can provide significant benefits to  
12 both the utility and its customers. The utility has an opportunity to increase its earnings  
13 during circumstances where customers are most at risk of facing high gas commodity  
14 prices and the customer can receive the benefits of the utility stretching to enhance its  
15 performance in controlling gas commodity costs at those times when customers are most  
16 exposed to possible run ups in their gas bills due to high gas commodity costs. While  
17 Laclede may argue that the GSIP proposed by OPC does not offer enough upside  
18 earnings potential during warm weather when its earnings are below average, Public  
19 Counsel would argue that this is how a well structured plan should work. A well  
20 structured plan is not designed with the primary goal of enhancing utility earnings,  
21 regardless of whether the incentive payments that lead to earnings enhancement will also  
22 lead to the desirable commodity price stabilization outcomes that the incentives are  
23 purportedly designed to encourage.

24 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

25 **A. Yes.**



# FINANCIAL ANALYSIS

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## UPDATE ON WEATHER NORMALIZATION CLAUSES

Weather normalization is a rate adjustment mechanism that neutralizes the impact of unusually cold or warm weather on a gas company's revenues and income. Similar to purchased gas adjustment clauses, weather normalization is an example of a regulatory mechanism known as an adjustment clause. Designed to allow rates to fluctuate in response to certain specific criteria, adjustment clauses are limited to major operating costs and conditions beyond the control of the utility and are actuated without the need for a formal rate hearing. Weather normalization clauses were first introduced in 1980 by Brooklyn Union Gas Company. In 1990, ten LDCs had instituted weather normalization and by 1992, after three successive winters of warmer than normal weather, the number of LDCs with weather normalization had grown to twenty-four.

## JURISDICTIONS WITH WEATHER NORMALIZATION

In the summer of 1990, the A.G.A. Rate Committee sponsored a survey on rate adjustment mechanisms that provide revenue stability in the event of abnormal weather conditions. The results of that survey, which was published in June of 1991<sup>1</sup>, showed that ten companies in four states and the province of Quebec had a weather adjustment clause. A follow-up report<sup>2</sup> in September of 1992 showed that twenty-four companies in ten states and Canada had established weather normalization clauses. In June of 1994, A.G.A. issued a Rate Issues S.O.S. on the subject of weather normalization. Specifically, all A.G.A. member companies were asked whether they had a weather normalization clause in effect, filed, or denied by their regulatory commission. Responses to that S.O.S. and subsequent follow-up phone conversations show that thirty-one companies in fourteen states and Canada have established weather normalization clauses. These states are Alabama, California, Connecticut, Georgia, Kentucky, Maryland, New Jersey, New York, North Carolina, Ohio, South Carolina, Tennessee, Texas and Virginia. A weather normalization clause has also been in effect in the province of Quebec since 1980.

<sup>1</sup>American Gas Association, "Weather Normalization Clauses," A.G.A. Financial Analysis, FA91-2, June 1991

<sup>2</sup>American Gas Association, "Weather Normalization: A Status Report," A.G.A. Financial Analysis, FA 92-2, September 1992