BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Purchased Gas Adjustment Tariff Revisions to be Reviewed in its 2000-2001 Actual Cost Adjustment	)))	**Case No. GR-2001-382**
In the Matter of Missouri Gas Energy's Purchased Gas Cost Adjustment Factors to be Reviewed in its 1999-2000 Actual Cost Adjustment	)))	**Case No. GR-2000-425**
In the Matter of Missouri Gas Energy's Purchased Gas Cost Adjustment Factors to be Reviewed in its 1998-1999 Actual Cost Adjustment	)))	**Case No. GR-99-304**
In the Matter of Missouri Gas Energy's Purchased Gas Cost Adjustment Tariff Revisions to be Reviewed in its 1997-1998 Actual Cost Adjustment	)))	**Case No. GR-98-167**

STAFF'S INITIAL BRIEF

I. INTRODUCTION

A. Procedural History

These are consolidated cases to consider Missouri Gas Energy, a Division of Southern Union Company's, (MGE or Company) Actual Cost Adjustments (ACA) for the periods 1997-1998, 1998-1999,1999-2000, and 2000-2001. In each of the consolidated cases the Staff of the Missouri Public Service Commission (Staff) has questioned the cost of MGE's transportation contract with Riverside Pipeline/Mid-Kansas Pipeline (KPC). In the 1999-2000 ACA period Staff raised questions about the adequacy of MGE's reliability report. In the 2000-2001 ACA period Staff has also raised questions about MGE's failure to post unused KPC capacity for release; the adequacy of MGE's hedging levels; MGE's use of its storage gas volumes; and Staff again raised questions about the adequacy of MGE's reliability report. The Commission has stayed consideration of the KPC contract issues. As a result, the only issues for consideration at

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this time are the four issues raised in the 2000-2001 ACA period and the reliability issue in the 1999-2000 ACA period. .

Staff filed its recommendation for the 2000-2001 ACA period on May 31, 2002. The Commission ordered the four captioned cases consolidated by its order dated September 10, 2002, and set a procedural schedule by order dated November 4, 2002. To address questions raised for the first time at the May 13-15, 2003 hearing, the Commission issued a further procedural schedule on July 1, 2003. After the filing of supplemental direct and rebuttal testimony, a further hearing was held on November 24 and 25, 2003.

B. Burden of Proof

This case is one to determine the rates to be charged by MGE for natural gas. In a rate case, the burden of proof that the proposed increased rate is just and reasonable is on the gas company. §393.150.2. In the instance of an Actual Cost Adjustment hearing the Commission has noted:

> It is well settled that the utility (WRI in this instance) has the burden of showing that the gas costs passed on to ratepayers through operation of the PGA tariff are just and reasonable.
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> * * * *
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> The standard is that when some participant in a proceeding creates a serious doubt as to the prudence of an expenditure, then the company has the burden of dispelling those doubts and proving that the questioned expenditure was prudent.

In the Matter of Western Resources, Inc., 3 Mo.P.S.C. 480, 488-89 (1995). *See*, *State ex rel. Associated Natural Gas Company v. Public Service Commission*, 954 S.W.2d 520, 528-29 (Mo. App. 1997) (Citing *Union Electric*, 27 Mo.PSC (NS) 183, 193 (1985) for the same proposition, with apparent approval.).

Thus, the burden of proving that the proposed charges for natural gas are reasonable remains on MGE. Once MGE makes a prima facie showing of reasonableness, the burden of going forward with evidence that the proposed charges are imprudent shifts to opposing parties. If, in the case of an ACA proceeding, a party raises a serious doubt as to the prudence of

particular expenses, the burden of going forward with the evidence reverts to the rate applicant. The burden of proof, established by statute, never shifts from the rate proponent. *See, McCloskey v. Koplar*, 46 S.W.2d 557, 563 (Mo. banc 1932). (But during all this time the burden of proof, the risk of nonpersuasion, remains with the plaintiff, except as to affirmative defenses, etc. The burden of evidence is simply the burden of making or meeting a prima facie case.)

C. Reliability Report/Data Problems

Staff used the estimates of normal usage and low-case usage to calculate the proposed adjustment for purchasing practices – storage. Staff uses the estimate of normal usage to calculate the proposed adjustment for purchasing practices – minimum level of hedging. The Staff relied upon and used information contained in the Company's 2000/2001 Reliability Report in preparing its initial analyses and adjustments.

During the hearing the validity, reliability, and application of the Company's November and December 2000 low case estimates was seriously eroded. For Staff, this also raised questions about the validity of the low case estimates for January through March 2001 and the normal estimates for all of these months, November 2000 through March 2001. Given the problems with November and December 2000 usage estimates, a review of the data and a consideration of the estimates being used in all of the heating season months was warranted.

After the May 12-15, 2003 hearing, Staff requested and received additional monthly usage data from the Company. This usage data was more current than whatever data was used in the 1994 Company analyses, and was available to the Company prior to the 2000/2001 winter. In light of the concerns with the information in the 2000/2001 Reliability Report, Staff undertook a regression analysis of the Company data for actual heating degree days and actual usage for July 1998 through June 2000. This regression analysis results in a coefficient of determination, R^2, of 0.9855, which implies a strong relationship between HDD and expected usage. Staff used the outputs from the regression analysis together with estimates of normal and historically

warmest month HDD to obtain reasonable estimates of normal month and warmest month usage for the heating season of November 2000 through March 2001. Staff's analysis results in different estimates of normal or base case usage and warmest month or low case usage than previously provided by the Company. It is not surprising that these estimates are different since the Company numbers in the 2000/2001 Reliability Report are based on 1994 analyses that cannot be found or verified by the Company.

In the supplemental proceedings, Staff no longer relied on data from the Company's 2000/2001 Reliability Report to calculate the purchasing practices – minimum level of hedging and purchasing practices - storage adjustments. Rather, Staff has considered and analyzed information that was available to the Company at the time that decisions were made for each of the heating season months of November 2000 through March 2001. Staff believes that its revised adjustment more accurately reflects information that should have been used by the Company when it was making purchasing decisions for its customers for November 2000 through March 2001.

II. ARGUMENT

1. Was MGE's decision not to post the KPC capacity for release, or alternatively, release equivalent Williams capacity, within the range of prudent behavior; and, if not, is $858,158 an appropriate measure of economic harm?

During the months of April through October, 2001, MGE did not utilize any of its firm capacity on Riverside/MidKansas Pipeline (KPC). MGE did not post any of the capacity on KPC's bulletin board for release to other shippers, nor did it seek to utilize the KPC capacity itself, and release capacity on the other pipelines serving it – specifically, Williams Pipeline Central (now Southern Star Central, hereafter Williams). Staff calculates that by releasing its

excess capacity that MGE could have realized additional revenues of $858,158, and MGE's ACA balance should be adjusted to reflect that released capacity. (Sommerer)

MGE did not even attempt to post the idle KPC capacity on the electronic bulletin board during the ACA period in question. Although virtually all aspects of KPC rates are higher than Williams, MGE should have evaluated the possibility of releasing an equivalent amount of Williams capacity if the KPC release was too burdensome.

It is the very fact that MGE did not even make the attempt to market this idle capacity that is so disturbing. This lack of even minimal effort to test the market, is itself evidence of imprudence. MGE criticized the Staff's evaluation of actual capacity releases on the Williams system for the ACA period. Beyond establishing that no identical releases could be found to the Staff's hypothetical, MGE could not show what a release would have yielded if it had tried. There was clearly a market for capacity on the Williams system in the summer, and many different ways of offering the capacity (term, recall provisions, rate flexibility). The Staff calculation is a reasonable estimate of damages associated with the failure to evaluate the release option and attempt to market the capacity.

2. Staff maintains that MGE should have hedged at a minimum 30% of each winter month's normal volumes; MGE maintains there was no hedging standard in place prior to the winter of 2000/2001 but, regardless, it hedged 38% of normal winter volumes. Was MGE's hedging conduct prudent behavior for the winter of 2000/2001; if not, is $130,137 an appropriate measure of economic harm?

Hedging is an activity intended to limit the exposure of volumes required by utility customers to protect against price risk or uncertainty in price movements. (Herbert Direct, Ex. 6, p. 3) The 1996/1997 heating season forcibly brought home to the Commission, Missouri LDCs, and the Staff, the need to protect captive ratepayers from spot market price spikes. The Commission opened a docket for each Missouri LDC to investigate the problems and to begin to find some solutions. MGE's case was GO-97-409, and resulted in an experimental hedging program. Additionally in case GO-97-409, Staff responded in June 1997 (Sommerer Surrebuttal,

page 2) that "…the market should not "beat up" the customer. Price spikes of short duration but large impact can be avoided through proper hedging. Furthermore, a market price could be considered to be a combination of fixed prices, capped variable prices, and monthly index prices." Mr. Sommerer went on to say that, "the Company should not have guarantees that no matter how high the spot market goes, the consequences will be borne by the customer." In June of 1997, the Staff filed testimony in MGE Case No. GO-97-409 warning that indexed based contracts contained no real cap against spot market prices and that fixed priced contracts should be considered.

Also in June of 1997 the Staff filed a recommendation in Case No. GR-96-78 recommending that MGE not rely too heavily on index pricing. Staff told the Commission and MGE in its memorandum filed September 24, 1999 in Case No. GR-2000-231 that hedging is a reasonable component of an LDC's gas procurement portfolio and the language contained in the PGA provides adequate permission for a LDC to hedge without the need for special authority each year. Thus, by the time that the 2000/2001 heating season approached there was a history of hedging to protect Missouri consumers. In fact, in the December 18, 2000 letter to then-Chair Lumpe, MGE's president, Steven Cattron, reassured the Commission that MGE recognized its management responsibility with regard to hedging gas costs. (Sommerer Direct, Schedule 11)

There are two aspects to this issue. First, what is the appropriate planning period for natural gas hedging; second, what volumes of natural gas should reasonably be hedged for each period. There is overwhelming, substantial evidence that the proper planning period is each of the winter heating season months, as suggested by Staff; there is no substantial evidence that the proper planning period is the entire heating season. Staff has provided an analysis that demonstrates that hedging 30% of expected normal volumes provides a reasonable minimum level in this case. MGE has complained that this analysis was not provided, gift-wrapped, to it before the heating season, yet has not provided a persuasive analysis that its aggregate storage, approximately 38% of its total normal winter load, serves as an effective hedge position.

The undisputed evidence shows that MGE nominates a substantial portion of its flowing gas (gas coming from sources other than storage) on a monthly basis at first of the month prices. Further, heating season weather differs from month to month; ranking normal weather from coldest to warmest reveals January is coldest followed by December, February, March and November. Financial hedging instruments are traded on a monthly basis. MGE's gas supply plans are executed on a monthly basis. (e.g., Langston Direct, Ex. 3 , Sch. MTL-16, pp. 15, 23, 26; Ex. 19 HC; Ex. 20 HC) MGE's assertions that the hedge provided by storage and fixed price contracts should be considered on an entire heating season basis is a weak, post-hoc attempt to justify its failure to protect customers. It is also at odds with its actual operation of its storage assets, as will be addressed separately.

The General Report on Analysis of Gas Supply and Hedging Practice by Regulated Natural Gas Utilities in Missouri March 2002 (Herbert Direct, Ex. 6, Sch. 2) discussed minimum purchase requirements or monthly requirements during historically warmest heating season months. These monthly requirements for many distribution companies are approximately 70% of requirements for normal heating degree-days. It could be argued that to mitigate price risk to customers, 100% of warm weather requirements for each month should be hedged because these demands represent the lowest expected demand for that month; even if the warmest temperature were encountered, customer demand would be at the warmest month usage. Companies that have flexibility in their operations and in their contracts might want to reduce this exposure further by hedging more than 100% of warmest month requirements.

However, Staff does not propose that 100% of the warmest month volumes or 70% of normal month volumes should have been hedged for the 2000-2001 ACA period. Staff proposes that for the heating season of 2000-2001, a minimum reasonable hedge for the Company to have in place heading into the heating season would have been 30% of normal for each month of the heating season. Staff chose this very low level of hedging as a standard for several reasons. Some Missouri local distribution companies are experienced with some aspects of hedging such

as use of natural gas from storage, but are new to other aspects of hedging. Staff believes that a minimum hedging level of 30% for each heating season month is reasonable for all Missouri local distribution companies for 2000-2001, even if the companies wanted to be extremely conservative in their use of hedging instruments because of their inexperience.

If 30% of normal requirements had been hedged for MGE, this would mean that when a warm month (low case) was encountered, 38% of the estimated volumes required would have been hedged. This also means that when a cold month (high case) was encountered, only 24% of the estimated volumes required would have been hedged. Hedging less than 30% of normal requirements implies that for a cold winter, more than 76% of customer natural gas requirements would have been exposed to price risk, and this level of exposure is not reasonable.

MGE has mischaracterized the 30% hedging level as some sort of new and unannounced prudence standard conjured up by the Staff after-the-fact. The 30% level for each heating season month is no more than a factor for a measurement (or estimate) of the damages resulting from MGE's failure to hedge sufficient volumes for each heating season month. A measurement of damages is required in any disallowance, and by its very nature may involve a reasonable range of values. However, MGE's proposal to use a single measure for the entire heating season is not within the range of reasonableness because it does not reflect or fit the actual monthly operations of an LDC.

To understand why MGE's 38% proposal is not appropriate, one needs to look no further than an example of the havoc that can result from the possibility that two winter months could be 100% covered (hedged) while the rest were exposed to unlimited price increases. Such a scenario could result in a net of 38% for the "entire winter period" but have devastating consequences on customers. Until price exposure of an LDC only happens seasonally, coverage needs to address monthly and daily price exposure from gas supply contracts. MGE's argument regarding 38% entire winter coverage belies one of the greatest problems with the experience from the winter of 2000-2001, that heavier hedging or storage use in early months does little to

protect subsequent months that have almost no hedging at all. A prime example of this is January 2001, where prices peaked, little storage was left to withdraw, and minimal other hedging was in place.

This review must consider whether MGE's hedging levels had a negative impact on customers. Thus, the Commission must quantify the impact of the MGE purchasing plan. During the course of the hearing it became clear that the information contained in the Company's 2000/2001 Reliability Report was not current or complete. Thus, Staff revised the estimates of normal usage. Using these revised estimates, Staff determined that the cost to customers for MGE's failure to hedge a minimum of 30% of normal requirements for each heating season month of November 2000 through March 2001 was $130,137. Staff believes that the adjustment of $130,137 accurately reflects the harm from MGE's failure to use information that it had, and should have considered when it was making purchasing decisions for its customers for November 2000 through March 2001.

This adjustment is relatively small because MGE gets credit for the fact that it goes into winter with a nearly 30% PER MONTH hedge just with storage alone. Another way to look at the adjustment is that it can be quantified using MGE's planned storage withdrawals, without reference to how MGE ultimately used storage withdrawals. The effect of MGE's actual storage use is addressed in issue 3, below. Staff recommends that the Commission order an adjustment of $130,137 for MGE's failure to adequately hedge its gas supply.

3. MGE utilizes natural gas from first-of-month contract purchases, intra-month contract purchases and storage to meet its customers' heating season requirements. Was MGE prudent in its management of first-of-month and intra-month contract purchases and use of storage withdrawals; and, if not, is $2,924,398 an appropriate measure of economic harm?

Staff has provided evidence showing that MGE's planned use of storage results in unreasonably large amounts of natural gas being withdrawn in November 2000 and December 2000. It is also shown that this unreasonable plan was most extreme for heating season

2000/2001 when compared to other heating seasons. Using higher levels of flowing supplies in November would have preserved storage for the normally colder months of December, January, and February.

Because of extended cold weather, little other fixed pricing besides storage, and MGE's plan to use storage early, consumers became exposed to the higher flowing gas costs in the later winter months. The economic damage to customers was substantial. Accordingly, Staff has computed a disallowance to reflect this damage.

The Company's gas supply plan and the storage plan provided to Staff consider usage for normal weather. When plans are being made for the winter months, no one knows if the weather will be warm, cold or normal for each of the heating season months of November through March. The Company plans must consider natural gas requirements and the supply plans (flowing supply and withdrawal of natural gas from storage) for any of these weather conditions – warm, cold or normal weather.

A. Planned November Storage Use.

Heating Degree Days (HDD) are a measure of heating season temperatures relative to a base temperature of 65 degrees Farenheit. HDD are calculated by subtracting the mean daily temperature from 65 degrees. Thus, a day with a high of 40 degrees and a low of 20 degrees has 35 HDD.

The distribution of HDD for the heating season months of November through March reveals that the coldest month is January followed by December, February, March, and then November. MGE planned to withdraw the greatest volumes from storage in November (the heating season month with the fewest number of HDD) and the smallest volumes in January (the heating season month with the greatest number of HDD). A review of recent Reliability Reports, illustrates that the planned withdrawal for November 2000 was higher than that shown for November in the previous three Reliability Reports. For the immediately preceding Reliability Report (1998/1999), MGE planned to withdraw 15.9% of the storage - 7.5 percentage points less

than the 23.4% planned by MGE for November 2000. It is not reasonable to have the largest planned withdrawal in the winter of 2000/2001 for the month of November 2000, the heating season month with the fewest number of HDD. Nor is it reasonable for MGE to have increased its planned withdrawals in November 2000 compared to the planned withdrawals for the month of November in the previous years. MGE presented no evidence that it considered the use of increased flowing supply as an alternative to its planned gross over-reliance on storage to meet its November requirements.

B. December Gas Supply Decisions.

The execution of natural gas supply plans must change as circumstances change. As November 2000 progressed, the Company was aware that the month had been much colder than normal and that more natural gas had been withdrawn from storage than its normal plan. Thus, less storage was available for the remaining winter months than it planned. When the Company decision for November and December flowing supplies were being made (on October 24, 2000 for November, and on November 27, 2000 for December), MGE did not know what the weather would be in each of the remaining heating season months. The Company routinely reviews Accuweather forecasts - forecasts for the current day and for the next six days, not for the entire winter. There was no crystal ball that could tell the Company in advance what the actual weather would for the balance of the 2000/2001 heating season.

However, the Company knew, or should have known, that a review of historical temperature data for the past 40 years reveals that January is usually the coldest month, followed by December, February, March and lastly by November. The Company knew that the month of November had been colder than normal. The Company knew from its Storage Analysis Report that it had withdrawn more natural gas from storage than planned in November 2000. The Company did not know if its storage gas for each of the remaining heating season months would have to cover warm, cold or normal weather. The Company plans must change as circumstances change, and the Company must consider usage requirements for the unknown weather in the

remaining heating season months. Thus, it must reserve sufficient storage to cover the remaining winter months.

Even knowing that November had been much colder than normal weather and that more natural gas had been withdrawn than planned, the Company planned to undersupply flowing gas for the month of December 2000. The Supply/Demand Summary provided in the responses to DR Nos. 21 and 68 for December 2000 listed the "TOTAL SUPPLY LESS TOTAL DEMAND OVERSUPPLIED (+)/ UNDERSUPPLIED (-)" as **H_____** MMBtu/day. Additionally, the Company response to DR No. 61 included copies of various documents maintained by the Managers of Supply. One of these documents is an email from David Twichell dated November 27, 2000, the date that MGE indicated that first-of-month nominations were made for December 2000, that includes the statement, "we are still leaving Williams supply **H____ ** short for FOM nominations." Another of these documents is an email from David Twichell dated November 28, 2000, that includes the statement, "This still leaves the overall supply ** HC ** Dth/day short of projected demand but allows us to take advantage of more attractive pricing on Williams."

The Company has not adequately explained why it planned to "undersupply" for December 2000. The Company had information that its expected natural gas storage inventory resources at the end of November 2000 were expected to be at 71.6% of the maximum storage quantity. Thus approximately 28% of the storage inventory had been used even though four heating season months remained, each of which is normally colder than the month of November. So even if December weather had been normal, the Company would have had to purchase additional swing or spot supplies or withdraw even more natural gas from storage because of this decision to undersupply December 2000.

One Company explanation for the **HC ** MMBtu/day undersupply for December 2000, states as follows:

> "The December planned undersupplies were an adjustment utilized as a result of significantly lower volumes that occurred during December 1999."

Review of December 1999 weather showed that there were 906 heating degree days compared to the normal for December of 1,073. December 1999 had 15.6% fewer heating degree days than normal. Thus, December 1999 would have lower natural gas volumes than for normal December weather. The Company's explanation provides no reasonable basis for the undersupply of December 2000 planned normal requirements. There was not then, and there has never been, any solid information indicating that all of December 2000 was expected to be warmer than normal.

Another Company explanation for the ** _____C** MMBtu/day undersupply for December 2000 is that MGE nominated less first-of-month supplies for December due to the expectation that prices could moderate in December from the record high levels.

Testimony has been filed in this case showing how difficult it is to predict price. Testimony has also been filed in this case showing that even though the Company incorrectly relies on the current prices and predictions about prices to guide its supply management decisions, the Company gets both the history and forecasts of price behavior wrong. The Company's claims about price behavior are not supported by market facts. Mr. Langston states that he expected the price level to drop because prices were at historically high levels. He relied on information in Schedule MTL – 24 which is a newsletter dated November 27, a Monday. He relied on dated short-term weather forecasts included in a secondary source in making his decision. This secondary source indicated that, when the weather forecast calling for above normal temperatures in the central US and "**normal**" weather for the entire country was combined with recent storage information, the net result on price was a wash. Thus, Mr. Langston cannot even make the claim that his speculation that prices would decline was supported by a strong signal from an uncertain weather forecast for a limited number of forward days. Mr. Langston also ignored the fact that the same newsletter on the same page indicated

that price volatility for December was 61% and for January was 82%, indicating a large amount of price risk in the market. The large price risk and the precarious storage situation were facts known at the time both prior to and during the heating season.

The Company's plans and actions left the storage inventory level at 30.2% at the end of December 2000. This does not mean that only 30.2% had been withdrawn from storage. It means that 30.2% is all that remained in storage. Even MGE's unreasonable original gas storage plan for normal weather in 2000/2001 called for 49.9% of storage to be available for January through March. A review of historical heating degree day (HDD) data shows that for normal weather, 62.3% of the HDD are in the months of January through March.

C. Operational Considerations.

MGE faces operating constraints in addition to weather-driven demands. ** ___ HC _____ HC _____ HC _____ HC _____ ** Thus, the Company must manage its storage inventory so that adequate volumes of storage gas are available for each of the heating season months in case cold weather occurs and these operating constraints are encountered.

D. Calculation of Harm.

In this review of MGE's decisions for the 2000/2001 heating season, the Commission must evaluate the Company's natural gas supply plan for flowing natural gas and withdrawals from storage, and the information known to the Company for the heating season months of November 2000 to March 2001. Staff originally used the Company's estimates of normal usage and low case usage (warmest month usage) from the MGE Reliability Report in the evaluation of the Company's purchasing practices. However, Staff has documented that the information

contained in the Company's 2000/2001 Reliability Report is not current or complete. Thus Staff's review considers revised estimates of usage.

It is reasonable to expect the Company to have sufficient "assigned term supplies"- planned first-of-month (FOM) flowing supplies- scheduled to cover warm weather requirements for November through March, and that these would be adjusted beginning in December if the Company had withdrawn more or less natural gas from storage than planned.

It is also reasonable to compare MGE's plan to a storage withdrawal plan that more closely followed the normal distribution of heating degree days for the winter months. Thus, more storage would be utilized in the coldest heating season month of January and the least storage would be utilized in the warmest heating season month, November. The purpose of the storage withdrawal approach laid out by Staff is that by purchasing more flowing FOM natural gas, the Company would preserve storage volumes so that natural gas from storage is available in later winter months when the potential for cold weather is still great; to ensure that adequate storage inventory is available to meet the pipeline constraints in each of the heating season months; and to maintain the price hedge that storage provides. Even so, a comparison of what MGE actually withdrew from storage in January 2001, versus what the Staff suggests should have been withdrawn does not yield the most significant impact of Staff's adjustment. This is true even though January 2001 was the month where current prices where highest, and is another reason why the Staff's adjustment is a conservative estimate of the damages.

Staff's review of the gas supply plans included the assumption that the Company's FOM nominations should cover warmest month requirements – adjusted for deviations from planned storage inventory levels. Because of Company concerns that it has less flexibility to inject natural gas into storage in November, Staff revised its methodology so that no more natural gas is calculated for FOM nominations than required for a warmest November. Staff's approach of factoring in deviations from planned storage inventory levels reflects that plans must change to meet changing conditions, and the revised plan must still ensure that sufficient storage will be

available for each of the remaining heating season months when the potential for cold weather was still great, and to ensure that adequate storage inventory is available to meet the pipeline constraints in each of the heating season months.

Due to the cold weather experienced in November and December 2000, it is reasonable to expect storage to be used more than in normal weather conditions. However, planning for adequate volumes of flowing natural gas supplies to meet warm month requirements for November and December would have left the Company in a more reasonable storage inventory position at the end of December for the remaining heating season months. A reasonable approach would have reduced both the price risk and operational exposure of the Company's customers for the remaining heating season months.

The Company's decisions about planned and actual flowing supplies and planned and actual withdrawals of natural gas from storage were not reasonable, and the cost to customers was $2,924,398. This adjustment accurately reflects information that the Company had, and that it should have considered, when it was making purchasing decisions for its customers for November 2000 through March 2001. Staff recommends that the Commission order the adjustment of MGE's ACA balance by $2,924,398.

4. In July 2000, MGE filed an annual "Reliability Report" pursuant to a Commission order in a prior case. Staff reviewed the peak day and reliability information and the rationale for the reserve margin and has recommended in this case that the Commission order MGE to provide additional reliability information. Is this case an appropriate forum in which to consider the issue, and, if so, should the Commission order MGE to provide the requested reliability information?

In order for Staff to evaluate the prudency of MGE's purchasing practices, Staff must evaluate the Company's natural gas supply plans. In Staff's attempt to evaluate Company decisions for this actual cost adjustment (ACA) period, which must be based on information that was available at the time MGE made its purchasing decisions, Staff has found that the Company analyses were not supported.

The Company provided Staff with a copy of its *Missouri Gas Energy Reliability Report, July 1, 2000 through June 30, 2001*, dated July 1, 2000. This report provides Staff with information about the Company's plan for providing for customer needs during a peak cold day. It also provides information about normal monthly requirements (base case) and the monthly requirements for warm and cold weather (low case and high case). The Company states in this report that, "A key consideration in the forecasting process is the firm demand during extreme weather conditions. This information is necessary to allow the Company to ensure adequate supplies and pipeline capacity to meet all of its firm sales obligations under such conditions."

When Staff requested a copy of some of the data used in the preparation of this report, the Company stated that this analysis was undertaken in 1994 and cannot be found. This was surprising because it was Staff's impression from the review of the Company's reliability report that the Company reviewed usage information on an annual basis. Because the data cannot be found, MGE cannot establish, and Staff cannot confirm, that estimates provided in the Reliability Report are reasonable. Additionally, the Company cannot verify whether the data analyzed was 1994 data or data from three years prior to 1994. Even if the 1994 analysis could be found, there is the concern that analysis of data that was at least six-years old prior to the date of this Reliability Report would not be representative of customer usage for this ACA period.

The Company also states in this Reliability Report that a series of regression analyses are performed to determine certain factors used to develop the peak day estimate – customer usage that could be expected on a peak cold day. When Staff examined the information further, Staff discovered that these factors used by the Company are based on a review of usage for only one cold day each year, not a series of regression analyses. Staff does not believe that the review of one cold day in each year, a single data point, is sufficient to establish these factors.

By routinely evaluating usage data, the Company can determine whether usage patterns have changed and take appropriate action to update natural gas capacity and supply plans. Updated reliability reports and updated demand and capacity analyses are a means to document

usage patterns, projected growth, and changes in supply planning needed to meet customer needs during normal weather and the extremes of warmest month weather, coldest month weather and a peak cold day. Additionally, there may be other Company or system constraints that must be considered in a Company reliability report or demand and capacity analyses so that the Company adequately plans for the natural gas requirements of its customers.

The Company states that it has not argued that the Reliability Report information is inaccurate (Data Request No. 153). The response also states that once becoming aware of Staff's concerns, MGE sought to address this issue when it filed its 2002/2003 Reliability Report. Staff is extremely concerned that the Company made decisions for the 2000/2001 winter based on a 1994 analysis and that it seems that the Company is only making changes in 2002/2003 because of Staff concerns. It does not seem reasonable that Staff must point out to the Company that an analysis has not been done since 1994. Staff also has to question whether the Company is going to update its future reliability reports only when Staff has concerns, instead of making it a Company procedure to routinely evaluate data so that the Company has current information necessary to make prudent gas purchasing practices decisions.

MGE has referred to changes used in its 2002/2003 Reliability Report, and Staff has provided testimony regarding the adequacy of the Company's 2002/2003 Reliability Report. Because of concerns with inadequate documentation, use of outdated data, and unreasonable gas supply planning, the Commission should order the Company to provide more complete Reliability information.

II. CONCLUSION

In light of the evidence presented in this case, the Commission should order MGE to reduce its ACA balance by $858,158 for its failure to post KPC capacity for release; by an additional $130,137 for its failure to plan adequate hedges for the 2000/2001 heating season; and by an additional $2,924,398 for MGE's imprudent management of gas purchases from flowing

supplies and use of its storage gas during this ACA period. The Commission should also order MGE each year to prepare, utilize and provide to Staff a more accurate and reasonable reliability report for its gas supply decisions.

Respectfully submitted,

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I hereby certify that copies of the foregoing have been mailed, hand-delivered, or transmitted by facsimile or electronic mail to all counsel of record this 15th day of January 2004.

/s/ Thomas R. Schwarz, Jr.