BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Purchased Gas Adjustment (PGA) Factors to be Audited in its 2002-2003 Actual Cost Adjustment.	))))	Case No. GR-2003-0330

BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

This case is to determine Missouri Gas Energy's (MGE) Actual Cost Adjustments (ACA) for 2001-2002 and 2002-2003 and will require the Commission to resolve a difficult issue involving the complex and inexact practice of forecasting capacity needs. The Commission's Staff and MGE disagree on the methodology that should have been used to calculate MGE's pipeline capacity requirements. The Staff maintains that MGE's imprudent decisions caused MGE to purchase more capacity than it needed, and recommends two adjustments for excess transportation capacity: an adjustment for 2001-2002 of $2,041,931; and an adjustment for 2002-2003 of $2,015,661, for a total adjustment of $4,057,592. The parties identified the issue as follows:

> Given that MGE is entitled to recover in rates only its prudently-incurred gas costs, should the amount MGE is entitled to recover be reduced by $4,057,592 because of Staff's claim that MGE imprudently contracted for an excessive amount of pipeline capacity based upon its reliance on an allegedly unreasonable and inadequate capacity forecasting methodology, or should there be no disallowance because of MGE's claim that Staff's approach and calculations are allegedly unreasonable and flawed?

The Office of the Public Counsel supports the Staff's position to require an adjustment for excess transportation capacity as outlined below.

1. Standard of Commission Review

In State ex rel. Midwest Gas Users' Association v. Office of Public Counsel, 976 S.W.2d 470, 483 (Mo. App. 1998), the Missouri Court of Appeals for the Western District explained that the Commission has the authority to determine how gas distribution companies will be permitted to allocate gas costs among customers and to review the prudence of a company's "decision to enter into a particular contract when a less costly alternative is available." The Court explained that because the Commission does not conduct a prudence review of the purchased gas adjustment (PGA) before it goes into affect, the Commission may disallow some or all of the adjustment sought when fuel costs are "unreasonable or the result of imprudent purchases."[1] This review is necessary to ensure all charges are just and reasonable as required by Section 393.130.1 RSMo 2000.

The Commission applies certain standards during an ACA review. In State of Missouri ex rel. Associated Natural Gas Company v. Public Service Commission, 954 S.W.2d 520 (Mo. App. W.D. 1997), the Western District explained:

> The PSC has employed a "prudence" standard to determine whether a utility's costs meet this statutory requirement. If a utility's costs satisfy the prudence standard, the utility is entitled to recover those costs from its customers. … Where some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent.

In *ANG v. PSC,* the Court stated that the prudence standard adopted by the Commission is to judge the reasonableness of the company's conduct "at the time, under all circumstances, considering that the company had to solve its problem prospectively rather than in reliance on hindsight." The Western District concluded that the Commission must not base its decision on recoverability of gas costs without reference to any detrimental impact of those practices on

[1] *Midwest Gas Users Assoc., 976 S.W.2d at 483.*

the company's charges to its customers. Such a detrimental impact could include evidence that the costs which the company seeks to pass on to its customers are "unjustifiably higher than if different purchasing practices had been employed."

2. MGE was Imprudent by Purchasing More Capacity than Necessary

The Staff alleges MGE imprudently purchased excessive gas when it unnecessarily entered into a gas purchase contract with Southern Star Pipeline Company. The standard identified above requires a challenging party to cast a serious doubt on the prudence of the gas purchases. If the challenging party satisfies this standard, the burden of proof shifts to the gas company to prove that the questioned expenditures were prudent.

Staff's evidence creates a serious doubt as to the prudence of MGE's capacity purchases for several reasons. First, MGE neglected to use the best data available that would allow it to more accurately determine its capacity needs for 2001/2002 and 2002/2003. MGE used far fewer forecasting data points than what was readily available to MGE at the time. Using this limited data set created a larger standard deviation and an unreasonable expectation of peak heating degree days.[2] Staff witness Ms. Lisa Jenkins explained:

> Reasonable analysis is critical because determination of peak day requirements is crucial to adequate risk analysis and management so that customers' needs are met without overestimation of the risk. MGE conducted a review of daily data for each service area, but only after it made contract decisions impacting the 2001/2002 and 2002/2003 ACA periods.[3]

Second, MGE's expert witness acknowledged that the theory employed by MGE was inferior to the theory that Staff's expert witness believes MGE should have used when forecasting capacity

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[2] Jenkins Rebuttal Testimony, Ex. 8, p. 8.

[3] Jenkins Direct Testimony, Ex. 7, p. 20.

needs for 2001/2002 and 2002/2003.[4] The Commission looks to the decisions made by MGE "at the time" and choosing an inferior theory is strong evidence of imprudence. Third, MGE carelessly failed to separately determine the capacity needs for Joplin from the Kansas City and St. Joseph capacity needs. Joplin is served separate from Kansas City and St. Joseph and experiences significantly warmer weather than northwest Missouri.[5] Although this does not appear to be relevant to the Southern Star contract specifically, it indicates a pattern of imprudent decisions that failed to rely upon the best available data and capacity forecasting practices.

Staff's evidence casts serious doubts on MGE's planning and the prudence of MGE's decision to purchase unnecessary capacity from Southern Star, thus shifting the burden to MGE to prove that its decision to contract with Southern Star was prudent. MGE responded by offering testimony from individuals not involved with MGE's decision to enter into the Southern Star contract. MGE's response does not provide analyses conducted at the time to justify MGE's planning decisions, and does not support a finding that MGE used the best data available and exercised prudent decision-making when it entered into the Southern Star contract. MGE offers only an after-the-fact analysis and has not satisfied the burden of proving that it exercised prudent planning to overcome the serious doubts raised by the Staff. MGE's excess contract purchase is unjust and unreasonable and MGE's ACA must be adjusted accordingly pursuant to Section 393.130.1 RSMo 2000.

3. A Strict Standard will Provide the Missing Incentive to Keep Costs Low

The incentive for MGE to ensure it incurs no more gas costs than necessary is different from the incentive for MGE to ensure it incurs no more non-gas costs than necessary.

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[4] Reed Testimony, Tr. 47.

[5] Jenkins Direct Testimony, Ex. 7, p. 19.

Once rates are established for non-gas costs in a general rate proceeding, any reduction in non-gas costs becomes additional profits for MGE and creates a strong incentive for the company to employ practices that reduce non-gas costs. Gas costs, however, are different in two ways. First, gas costs are simply passed through to MGE's captive customers through the PGA dollar for dollar and therefore minimizing these costs does not profit MGE. Second, the Gas Cost Incentive Mechanism approved in Case No. GR-2004-0209 actually creates a profit incentive for MGE to increase capacity releases and off-system sales by *increasing purchased volumes*.[6] MGE retains through the Gas Cost Incentive Mechanism between fifteen percent (15%) and thirty percent (30%) of the revenues generated by capacity releases and off-system sales. This creates the need for a strong outside incentive for MGE to keep purchased volumes to no more than what is necessary. One purpose of the ACA is to provide this missing incentive, which can only act as a true incentive if the Commission applies the same strict review the Commission employs in a general rate proceeding.

4. Conclusion

The importance of the Commission's decision in this case extends beyond the specific facts of MGE's 2001/2002 and 2002/2003 ACA. This case may set the standard that companies follow when forecasting demand in the future. Public Counsel urges the Commission to set this standard high and protect Missouri's consumers from careless business practices that cost the public millions of dollars in unnecessary costs. Captive Missouri ratepayers deserve nothing less than for the Commission to hold monopoly gas companies to a high standard, which will encourage companies to use the best available data in their planning and to properly document their planning decisions. MGE failed in both respects. By employing a strict standard in this

[6] See Attachment A: P.S.C. MO No. 1, Fourth Revised, Sheet No. 24.2, effective October 24, 2004.

case, the Commission will create an incentive for all gas companies to use nothing less than the best data and the best methodologies available. Public Counsel requests that the Commission send a strong message to MGE and to all gas companies in Missouri and order the adjustment recommended by the Staff.

Respectfully submitted,

OFFICE OF THE PUBLIC COUNSEL

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, emailed or hand-delivered to the following this 23rd day of October 2006:

/s/ Marc Poston

FORM NO. 13
P.S.C. MO. No. 1 | Fourth Revised | SHEET No. 24.2
Canceling P.S.C. MO. No. 1 | Third Revised | SHEET No. 24.2

Missouri Gas Energy,
a Division of Southern Union Company
Name of Issuing Corporation

For: All Missouri Service Areas
Community, Town or City

PURCHASED GAS COST ADJUSTMENT
PGA

IX. GAS COST INCENTIVE MECHANISM

This Section IX implements, consistent with the Report and Order in Case No. GR-2004-0209, a revenue sharing grid pursuant to which revenues generated by capacity release and off-system sales (net of revenues from off-system sales made for "system protection" purposes) shall be shared between Company and its customers. The Company will set up an Incentive Revenue ("IR") Account into which the Company will record that portion of revenue retained by the Company according to the following percentages:

Capacity Release Credit	Company Retention Percentage
First $300,000	15%
Next $300,000	20%
Next $300,000	25%
Amounts Over $900,000	30%

DATE OF ISSUE: September 24, 2004 (month day year)
DATE EFFECTIVE: October 24, 2004 (month day year)

ISSUED BY: Michael R. Noack, Director, Pricing and Regulatory Affairs
Missouri Gas Energy, Kansas City, Missouri 64111

FILED
MO PSC

Attachment A