BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of Missouri Gas Energy's Purchased Gas Cost Adjustment (PGA) Factors to be Audited in its 2003-2004 Actual Cost Adjustment.	))))	Case No. GR-2005-0104

MISSOURI GAS ENERGY'S RESPONSE TO STAFF RECOMMENDATION

Comes now Southern Union Company, through its Missouri Gas Energy ("MGE") division, and for its response to the Recommendation of the Staff of the Missouri Public Service Commission ("Staff"), respectfully states the following:

1. On December 29, 2005, the Staff filed its Recommendation and Memorandum herein in which it states that it has reviewed MGE's 2003-2004 Actual Cost Adjustment (ACA) filing covering the period of July 1, 2003 through June 30, 2004. By order dated December 30, 2005, the Commission directed MGE to respond to the Staff's recommendation no later than January 30, 2006. This is MGE's filing in compliance with that order.

2. The recommendation alleges that monetary disallowances should be imposed on MGE for two topics which the Staff identified as: A) Mid-Kansas Partnership/Riverside Pipeline Company ("MKP/RPC"); and B) Excess Reserve Margin. The Staff also included six recommendations it alleges will improve MGE's gas supply planning in categories it listed as A) Short Term Gas Purchasing Practices, B) Peak Day Estimates, C) Upstream Pipeline Capacity, D) Storage Planning/Usage, E) Planning for Non-Normal Weather, and F) Hedging. MGE will address each of these in the order in which they were presented in the Memorandum.

I. Items Involving Proposed Disallowances

A. MKP/RPC Disallowance

3. MGE opposes this proposed disallowance. Without limiting any arguments it may make in the future if this case moves forward, MGE offers the following as its initial response. The proposed disallowance of $2,233,540 for this ACA period is based on the same rationale as the MKP/RPC disallowance proposed by Staff in Case No. GR-96-450. The Commission rejected that in Case No. GR-96-450 by Report and Order dated March 12, 2002, on the basis that the Staff had not sufficiently proved its allegations. There is no allegation in this memorandum of any evidence in the possession of the Staff that the Commission has not already considered on this subject. The Recommendation implies there were actions related to these contracts by MGE dating back to 1991, which is impossible since that was more than two years before MGE commenced operations. The Staff's continued pursuit of this matter when the Commission has already ruled on its merits is a waste of resources for everyone involved. While a portion of Case No. GR-96-450 is still on appeal relating to the scope of a settlement, the Commission's decision in that case to reject the Staff's proposal because of a failure of proof is not on appeal. Although MGE opposes the proposed MKP/RPC disallowance in this case on all of the same grounds that it previously expressed in Case No. GR-96-450, this more recent time period (July 2003-June 2004) presents a separate and compelling basis for the Commission to reject the proposed MKP/RPC disallowance in this case. The Staff uses the rates MGE paid to that interstate pipeline, compared to the rates of another interstate pipeline, as the basis for calculating the proposed disallowance. Thus, the essence of the Staff's argument is that the rates of one pipeline are too high compared to the rates of the other pipeline. The rates of *both* pipelines are under the exclusive jurisdiction of the Federal Energy

Regulatory Commission ("FERC"). The MKP/RPC rates that represent the starting point of the Staff's calculation first took effect under FERC auspices on May 11, 1998. *See, generally, Kansas Pipeline Company, et al.,* 83 FERC, para. 61,107 (1998), reh'g denied 87 FERC, para. 61,020 (1999). MGE had no choice to do anything different and therefore only paid MKP/RPC at the rate levels approved by FERC. The money MGE paid pursuant to these FERC-jurisdictional MKP/RPC rates is therefore not subject to disallowance by a state regulatory commission under the constitutional principles embodied in the filed rate doctrine. See, ***Nantahala Power & Light Co. v. Thornburg***, 476 U.S. 953, 90 L.Ed. 943, 106 S.Ct. 2349 (1986) and ***State ex rel. Associated Natural Gas Company v. Public Service Commission***, 954 S.W.2d 520, 530-531 (Mo.App.W.D. 1997). As noted in the memorandum, FERC has ordered significant reductions to those rate levels and ordered refunds by MKP/RPC totaling some $13.5 million dollars, all of which have been flowed back to MGE's customers through the operation of the PGA provisions. That there is an inextricable link between the level of the FERC approved rates and the Staff proposed disallowance is shown in the memorandum on page 3 where Staff says those FERC-ordered refunds "will reduce the disallowances" it has been proposing since GR-98-167. Staff does not quantify the extent of those reductions. The Commission has chosen to bifurcate this subject from other subjects in several recent MGE ACA cases on the basis that there is still an appeal pending by the successors in interest to MKP/RPC. At this time, from the information available to MGE, it appears that appeal is still pending.

B. Excess Reserve Margin

4. MGE opposes this proposed Staff disallowance. Without limiting any arguments it may make in the future if this case moves forward, MGE offers the following as its initial

response. MGE's first impression is that this proposed disallowance of $2,044,795 is grounded in the same approach pursued by the Staff in the currently pending consolidated cases of GR-2002-348 and GR-2003-0330 where it was referred to as an "Excess Capacity Disallowance." MGE has documented significant flaws in the assumptions and methods underlying Staff's conclusions in its filed testimony in that proceeding – mistakes that if properly corrected wipe out the theoretical basis for the disallowance completely. The current schedule in the consolidated GR-2002-348 and GR-2003-0330 cases calls for rebuttal testimony addressing this issue to be filed on February 1, 2006, surrebuttal on March 16, 2006, and the hearing to commence on April 10, 2006.

5. MGE has contracted for pipeline capacity in a manner designed to meet customer demand given the numerous uncertainties inherent in the process, including actual weather conditions, peak load forecasts, the timing of capacity availability, benefits of supply diversity, and the possibility of capacity or supply failure, among other factors. Many of those factors require judgment to be exercised. The Memorandum is completely devoid of any discussion of any specific capacity contracting decision the Staff contends that MGE made unreasonably in this ACA period, exactly when that supposedly unreasonable decision was made, or what viable alternatives were then available to that supposedly unreasonable decision. The success of MGE's performance in regard to capacity contracting is supported by the fact that MGE's system sales customers have never experienced a capacity-related curtailment, a matter to which the Staff's proposed disallowance gives little apparent consideration.

6. In proposing to disallow pipeline capacity costs incurred by MGE on the basis MGE has contracted for allegedly "excess" capacity, the Staff has completely ignored the fact that significant financial benefits of capacity release transactions flowed to the benefit of

customers during this ACA period. The Second Revised Stipulation and Agreement approved by the Commission in Case No. GR-2001-292 included the following provision related to capacity release revenues:

> 9. The Staff, Public Counsel, and MGE agree, and MGUA and JACOMO/Riverside agree not to oppose, to recognize in revenue requirement a total of $1,200,000 in revenues from off-system sales and capacity release . . .. (Second Revised Stipulation and Agreement, page 5, Case No. GR-2001-292).

Consequently, beginning on August 6, 2001 (the effective date of the rates from Case No. GR-2001-292) and continuing through this 2003-2004 ACA period, MGE's customers have benefited from a base rate revenue requirement $1.2 million lower per year than it otherwise would have been absent recognition of capacity release and off-system sales revenues. As a matter of fact, for the period ending June 30, 2004, MGE has only rarely made off-system sales—and has made none for any purpose other than system protection—so MGE has only been able to achieve a positive boost to earnings from capacity release revenues generated above $1.2 million annually, the amount of revenue recognized in base rates to the benefit of customers.

II. Items Involving Staff's Planning Recommendations

A. Short Term Gas Purchasing Practices

7. Staff states on pages 4 and 5 that MGE should document in writing all the details of its gas supply transactions. Without limiting any arguments it may make in the future if this case moves forward, MGE offers the following as its initial response. MGE is uncertain what the Staff is specifically recommending on this topic. It appears the Staff is requesting that MGE maintain or produce significantly more documentation than MGE currently does. MGE believes it already produces significant amounts of documentation for Staff review during the ACA process, including monthly supply plans, deal memos, correspondence with an external

consultant, rolling storage reports and estimates, etc. What specific additional information and documentation the Staff believes is necessary is not readily apparent to MGE from the Memorandum, nor is MGE therefore able to assess the relative costs and benefits associated with such unspecified additional documentation. Although MGE is willing to use reasonable efforts to address the Staff's expressed needs and has done so in the recent past, including extensive meetings to discuss planning topics, MGE must first fully understand what the Staff thinks it needs. Moreover, MGE questions the wisdom of being required to generate still more documentation when, at least in MGE's opinion, it seems that the Staff does not have a solid understanding of the information MGE already provides.

B. Peak Day Estimates

8. Staff states on page 5 that its comments on this topic are the same as what was presented in its recommendation in Case No. GR-2003-0330. MGE is unable to locate a topic heading in the Staff memorandum of December 28, 2004 entitled "Peak Day Estimates," so it is somewhat unsure as to the reference Staff is making. There was a discussion under the heading of "MGE Peak Cold Day Selection" beginning on page 3. If that is the topic the Staff is incorporating by reference, then MGE's initial response is that it opposes the recommendations and disputes the Staff's conclusions. As MGE stated in its response to the Staff memorandum in Case No. GR-2003-0330, the Staff comments in these sections of its memo in Case No. GR-2003-0330 (pages 3-6) appear to be part and parcel of the rationale for Staff's excess capacity disallowance. MGE is not presently able to discern any other specific action proposed by the Staff regarding the topics of peak day selection or appropriate reserve margin. Subsequent events lead MGE to conclude that these topics are the theoretical foundation for Staff testimony that has been filed in Case Nos. GR-2002-348 and GR-2003-0330 (consolidated), that is

currently scheduled for hearing in April 2006. Given that this will be a litigated issue in that proceeding and prepared testimony has already been filed on the topic, MGE considers that a detailed response here would be inappropriate. However, in general, it is MGE's position that the method Staff has used to make its own peak day calculations suffers from numerous flaws with the result that it should not be accepted as either a *de facto* or *de jure* standard. The Staff's discussion of confidence intervals in relation to the Heating Degree Day level used in its peak day analysis and the appropriate reserve margin also clearly demonstrates, in MGE's opinion, a significant shortcoming in the Actual Cost Adjustment process as currently implemented by the Staff. MGE is unaware of any universally accepted industry standard regarding either confidence interval levels or reserve margin levels. What the Staff appears to seek through its recommendations on these issues is the establishment of Commission-sanctioned standards for these items. Commission adoption of the Staff's proposals and consequential monetary disallowances would essentially be an *ex post facto* action and extract millions of dollars from MGE's shareholders based on a failure of MGE to observe standards that did not exist when the unidentified decision or decisions apparently being challenged were made. In MGE's view, this is patently unlawful and unfair in addition to being inefficient and wasteful policymaking. To the extent that the Staff seeks to implement any such standards in Missouri, then the appropriate way to do so is through the rulemaking process. That process at least is designed to allow a certain level of scrutiny and debate to take place prior to the establishment of standards that a company such as MGE would be required to observe. In turn, the publication of these standards before they take legal effect would enable companies to make decisions in compliance with the published standards.

C. Upstream Pipeline Capacity

9. Staff alleges on page 5 that MGE does not record how it evaluates upstream capacity to assure that it has sufficient capacity at an acceptable cost, recommending that MGE provide "more details of its evaluations." Staff wants MGE to submit such information for 2004-2005 and 2005-2006 not later than May 1, 2006. Staff further states that if MGE does not have such an analysis for the 2004-2005 or 2005-2006 ACA periods, Staff recommends that the Commission order MGE to provide, no later than May 1, 2006, a more detailed analysis for the 2006-2007 ACA period.

10. MGE's response is that it is opposed to this recommendation. Without limiting any arguments it may make in the future if this case moves forward, MGE offers the following as its initial response. There is no existing requirement in any statute or rule that MGE record how it evaluates upstream capacity, no statute or rule of the Commission that specifies how such an evaluation should be conducted, nor which specifies what "details" should be included in such an evaluation. No "details" as to what "details" MGE is supposed to record are included in the Staff recommendation, so even if MGE were to attempt to comply with this recommendation, it would necessarily have to guess at what was expected of MGE given the vagueness of the Staff recommendation. If the Staff believes this an important matter needing attention, then it should pursue a more reasonable and appropriate approach. It can either send MGE informally a detailed example of specifically what it wants so that MGE can at least have some understanding of what is sought and be able to evaluate the practicality of complying, or the Staff should initiate a rulemaking process to require all natural gas companies under the jurisdiction of the PSC to supply particular information in a particular fashion. Further, this is not even a proper topic for consideration in this ACA proceeding. As the style of this case indicates,

the purpose of this proceeding is to review PGA adjustments for the 2003-2004 ACA period, not mandate requirements for future data submissions in other docketed cases. Because the topic raised here by the Staff is necessarily aimed at setting standards and requirements regarding future activity and relates to future periods, it is absolutely irrelevant to the issues properly before the Commission in this case.

D. Storage Planning/Usage

11. Staff raises a "concern" on pages 5 and 6 about MGE's use of storage and mentions that it would expect the plan for storage withdrawals to follow a similar distribution to that of normal heating degree days. Additionally, it makes comments about the fact that MGE's actual storage withdrawals in 2003-2004 differed from the plan. Finally, it recommends that "MGE explain" certain things within 30 days and file other things by May 1, 2006.

12. MGE's response is that it is opposed to this recommendation. Without limiting any arguments it may make in the future if this case moves forward, MGE offers the following as its initial response. This recommendation appears to be a re-hash of the Staff's storage-related theories and arguments presented in Case No. GR-2001-382, especially as to Staff's expected distribution of storage withdrawals. Unlike Staff's approach in Case No. GR-2001-382, the Staff here does not appear to be recommending a specific dollar disallowance regarding this topic. Case No. GR-2001-382 has been fully briefed and submitted and is awaiting decision by the Commission. MGE opposed the Staff's theories and arguments in that case with numerous facts and explanations by expert witnesses and sees no need to repeat here the detailed basis of its opposition, especially since no recommended disallowance has been identified. If these topics become a theoretical foundation for Staff testimony in a contested proceeding, MGE will address them at the appropriate time in the detail necessary and appropriate to their use. As to

the Staff's comments that actual withdrawals differed from the storage plan in the past, MGE's response is similar to that which was presented in testimony in Case No. GR-2001-382. It was and is a "plan." Plans are developed on various assumptions of weather and customer usage. It would be highly unusual indeed for *actual* storage withdrawals to *ever* match what was *planned* because actual weather conditions that drive natural gas usage never occur exactly as predicted. Finally, if Staff desires particular information relating to MGE's storage plans, as it indicates it wants no later than May 1, 2006, MGE would observe that the Staff has always had the ability to make data requests from MGE seeking such information. There is no indication from the memorandum that this information has been sought and its production refused by MGE. Given that, MGE sees no compelling reason for the Commission to order MGE to make filings on this topic when the Staff has the ability on its own to obtain information.

E. Planning for Non-Normal Weather

13. On pages 6 and 7, Staff appears to be concerned that MGE does not plan for non-normal weather on its system, falsely implying that MGE is unprepared to deal with the situation if the weather is either extremely warm or extremely cold. Apparently as a result of this erroneous assumption, Staff recommends that MGE again be ordered to provide "more details" to address these alleged issues, and that this be submitted no later than May 1, 2006. Staff notes that it "expressed concerns" about this in Case No. GR-2002-348 and GR-2003-0330.

14. MGE's response is that it is opposed to this recommendation. Without limiting any arguments it may make in the future if this case moves forward, MGE offers the following as its initial response. This recommendation appears to be similar to the recommendation called "Planning Documentation Under Various Temperature Scenarios" that appeared in the GR-2003-0330 recommendation. It was not associated with a proposed monetary disallowance in

that case, either. As MGE noted in its response in GR-2003-0330, the Staff's proposal is vague and not a proper topic for consideration in an ACA proceeding since it relates to future ACA periods. It is simply another vague quest for more unspecified "details." The topic is necessarily aimed at setting standards and requirements regarding future activity, so it is irrelevant to the issues properly before the Commission in this case. If the Staff believes such additional documentation is necessary on a going forward basis, then any such requirement should be imposed on all natural gas local distribution companies, not just MGE. The appropriate procedure to use for the adoption of such requirements is a rulemaking proceeding where the merits can be addressed from the perspective of all those having to comply with proposed new requirements. If these topics become a theoretical basis for Staff testimony in a contested proceeding, MGE will address them at the appropriate time in the detail necessary and appropriate to their use. Finally, if Staff desires particular information in MGE's possession, as it indicates it wants no later than May 1, 2006, MGE would observe that the Staff has always had the ability to make data requests from MGE seeking such information. There is no indication from the memorandum that this information has been sought and its production refused by MGE. Given that and the other stated reasons, MGE sees no compelling reason for the Commission to order MGE to make filings on this topic when the Staff has the ability on its own to obtain information.

F. Hedging

15. Unlike its comments on the previous issues, the Staff concludes on page 7 that "MGE did a reasonable job of hedging for this ACA period." The Staff also makes some general recommendations regarding the hedging approach to which MGE will give due consideration. MGE's position that it will consider these particular recommendations should not be construed

as an indication that it necessarily agrees with them or any premise on which they may be based. It simply indicates that MGE will give them proper consideration. There is no indication in the discussion appearing on pages 7 and 8 that MGE is required to do anything by any particular deadline, and there is no indication of a monetary disallowance associated with any of the recommendations. However, on page 9 in item 7, the Staff states that MGE's hedging information for 2004-2005 and 2005-2006 ACA periods should be submitted no later than May 1, 2006, or if MGE does not have such an analysis for those periods, then it should provide one for the 2006-2007 ACA period no later than May 1, 2006.

16. MGE's response is that is an unexpected pleasure to see the Staff indicate in writing in an ACA proceeding that MGE did a "reasonable job" on something. However, in addition to stating its inability to understand precisely what the Staff means by "hedging information," MGE disputes the necessity for it to submit the requested information by the artificial deadline of May 1, 2006. MGE has worked with both the Staff and the Commission to make them fully aware of MGE's intentions regarding hedging and MGE intends to continue to do that. Most recently, MGE personnel briefed the Commissioners on October 12, 2005, as to its hedging plans and status for the winter of 2005-2006, as have other natural gas providers. Moreover, MGE continues to participate in Case No. GW-2006-0110, a working docket opened by the Commission to evaluate the Commission's current hedging rule (4 CSR 240-40.018), among other things. Given that MGE has already demonstrated a willingness to provide information regarding its hedging status and plans on a timely basis in such settings, and the fact that no recommendations have yet been proposed to the Commission in Case No. GW-2006-0110 regarding the current hedging rule, MGE sees no compelling reason why it should be ordered to make the suggested filing on May 1, 2006.

G. Recommendation Regarding Case Remaining "Open"

17. In the middle of page 8, the Staff says that it recommends that this ACA case "remain open" pending an order from the Commission in several other ACA cases. If that means that the Staff believes there should not be a pre-hearing conference set in this case to develop a procedural schedule at this time, then MGE concurs. As this response indicates, there are only two issues on which there is a recommendation for a monetary disallowance. Given the pending appeal, the MKP/RPC issue remains in essentially the same status as when it was first bifurcated in a previous ACA case. Until there is a final appellate resolution on the issues raised by Riverside's appeal, MGE sees no point in scheduling further hearings on that topic. The other issue associated with a disallowance in this case appears to be based on essentially the same Staff approach that will be examined in the hearing now set for April. Given all of these considerations, there is no compelling reason for the Commission to take any action in this proceeding at this time.

WHEREFORE, MGE respectfully offers the foregoing response to the Staff's Recommendation and Memorandum as ordered, and suggests that the Commission simply enter an order that this case will remain open pending further order from the Commission.

Respectfully submitted,

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Certificate of Service

I hereby certify that a true and correct copy of the above and foregoing document was either mailed or hand delivered this 30th day of January, 2006, to:

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