

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

In the Matter of Southern Missouri Gas	)	
Company, L.P.'s Purchased Gas	)	
Adjustment Factors to be Reviewed in its	)	Case No. GR-2006-0352
2005-2006 Actual Cost Adjustment.	)	

**PUBLIC COUNSEL'S RESPONSE  
TO THE STIPULATION AND AGREEMENT**

**COMES NOW** the Office of the Public Counsel and in response to the Stipulation and Agreement states:

1. On November 27, 2007, Southern Missouri Gas Company, L.P. d/b/a Southern Missouri Natural Gas (SMG) and the Staff submitted a Stipulation and Agreement to resolve all remaining issues in this actual cost adjustment (ACA) proceeding. On November 29, 2007 the Commission conducted an on-the-record proceeding to hear from the parties regarding the Stipulation. During that proceeding counsel for the Office of the Public Counsel indicated that Public Counsel would not oppose the Commission's approval of the Stipulation. This pleading provides the basis for Public Counsel's decision not to enter into the Stipulation and the basis for Public Counsel's decision not to oppose Commission approval of the Stipulation.

2. The history of this case can be traced back to Case No. GC-2006-0180, a complaint filed by Public Counsel against SMG. Public Counsel's October 21, 2005 complaint alleged that SMG was in violation of Commission Rule 4 CSR 240-40.018 and stated:

...SMG has failed and/or refused to implement any of the pricing structures, mechanisms or instruments set forth by the Commission in [4 CSR 240-40.018]. The only thing SMG has done is to lock in a discount off of the

market price which does absolutely nothing to protect its customers from the volatility of the market price. In fact, rather than establish a purchasing strategy that would ‘mitigate upward natural gas price spikes, and provide a level of stability of delivered natural gas prices.’” SMG established a strategy that was entirely a gamble on a hope that market prices would decline this fall and winter.

The parties to the Complaint entered into a Stipulation and Agreement on March 13, 2006, which was later approved by the Commission on April 21, 2006 by a 3-2 vote. The terms of the agreement provided that SMG would provide hedging activity updates to Staff and Public Counsel every spring, with updates provided every summer and fall. The agreement also provided that SMG would secure normal winter-heating gas supplies for winter 2006-2007 at fixed prices or otherwise hedged against market exposure as follows: 1) A minimum of 20% no later than April 30, 2006; 2) A minimum of 40% no later than July 15, 2006; and 3) A minimum of 55% no later than October 1, 2006.

3. On May 3, 2006, Commissioners Robert M. Clayton and Steve Gaw filed a joint Dissent. The Dissent is critical of the approved Stipulation and Agreement in GC-2006-0180 and states that it “produces insignificant consequences for [SMG’s] failure to protect its customers by utilizing hedging practices” and “leaves Missouri’s natural gas consumers with inadequate protections.”

4. Following the resolution of Case No. GC-2006-0180, the Commission has had two opportunities to impose disallowances against utilities for violating 4 CSR 240-40.018. In Case No. GR-2004-0273, *In the Matter of the PGA Filing for Laclede Gas Company*, the Commission’s Staff recommended disallowances of Laclede’s 2003-2004 ACA due to Laclede’s purchase of swing gas supply at first-of-month prices. The Commission’s Report and Order in GR-2004-0273 denied the disallowances despite concluding that: 1) Laclede should have recognized that demand charges for swing

supply were increasing more drastically than other demand charges; and 2) Laclede had not considered the impact of the demand charges on the ratepayers, but only considered the overall impact on shareholders.

5. On October 2, 2007, the Commission issued its Report and Order in Case No. GR-2003-0330, *In the Matter of Missouri Gas Energy's Purchased Gas Adjustment Factors to be Audited in its 2002-2003 Actual Cost Adjustment*, denying disallowances recommended by the Commission's Staff. In that case the Staff showed that Missouri Gas Energy (MGE) failed to use the best data available in forecasting its capacity needs, and failed to acquire capacity requirements for MGE's northern territories separate from its capacity requirements for MGE's southern territories. Despite these findings and the resulting higher rates paid by consumers, the Commission denied any disallowance for MGE.

6. The Staff's evidence in the present case indicates that SMG failed to hedge its gas supply and gambled that gas rates would fall in time to acquire SMG's winter-heating requirements for the winter of 2005-2006. Staff's evidence was not surprising to Public Counsel, which complained of SMG's failure to hedge in Case No. GC-2006-0180 as discussed above. The price spikes of late 2005 are precisely the reason the Commission promulgated 4 CSR 240-40.018 – to protect consumers by diversifying supply purchases to minimize the impact of price spikes. The Direct Testimony of Staff witness Mr. Kwang Y. Choe provides the most compelling evidence of how SMG's imprudent decision to gamble on the market resulted in obvious harm to consumers. Schedule 1 to Mr. Choe's Direct Testimony shows the increased volatility in gas prices beginning around 2001 and continuing to today. SMG ignored this volatility and failed

to purchase any winter-heating gas for 2005-2006 until October 2005 when it contracted for 10% of SMG's winter volumes. Schedule 4 to Mr. Choe's Direct Testimony indicates that in the past three previous winters SMG has contracted for over half of its necessary volumes by September. Mr. Choe's testimony also indicates that SMG's own gas supply plan for 2005-2006 called for the purchase of 60%-75% of its winter-heating volumes at fixed prices by September 2005. Despite SMG's knowledge that the market was volatile and could spike at anytime, despite SMG's commitment to purchase over 60%-75% by September, and despite SMG's history of protecting consumers through hedging prior to the winter-heating season, SMG had hedged nothing by September 2005 and had not even purchased half of its winter-heating supply by December 2005. The result is apparent from Mr. Choe's Schedule 3 to his Direct Testimony which shows the NYMEX natural gas futures daily settlement ranged from \$7.00/mmbtu to \$9.00/mmbtu through July 2005. At that point prices trended upward into the \$14.00/mmbtu range by October 2005 when SMG began making its purchases. Consumers were negatively impacted by this gamble and paid excessive prices for gas. If gas utilities were expected to gamble on the future price of the entire winter gas supply, the Commission would not have promulgated 4 CSR 240-40.018.

7. The results of Case Nos. GR-2004-0273 and GR-2003-0330 suggest that this Commission does not hold local distribution companies to a high standard on their gas purchasing decisions under 4 CSR 240-40.018. Public Counsel believes those cases should have resulted in over \$6,000,000 flowing back to ratepayers. Unfortunately, those cases resulted in zero dollars flowing back to ratepayers and Public Counsel is doubtful that the Commission in Case No. GR-2006-0352 would order more disallowances than

the \$75,000 stipulated to by SMG and Staff if Public Counsel were to oppose the Stipulation and bring this matter to an evidentiary hearing. For this reason, Public Counsel chooses not to oppose the Stipulation and Agreement between SMG and Staff. However, because Public Counsel believes SMG's actions resulted in consumers paying \$220,000 to \$378,000 more than they would have incurred had SMG hedged, Public Counsel chooses not to support the Stipulation and Agreement.

WHEREFORE, the Office of the Public Counsel respectfully offers this response to the Stipulation and Agreement.

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 4th day of December, 2007:

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