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

CHERLYN D. VOSS, Presiding,
REGULATORY LAW JUDGE.

JEFF DAVIS, Chairman,
LINWARD "LIN" APPLING,
TERRY JARRETT,
COMMISSIONERS.

REPORTED BY:

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P R O C E E D I N G S

JUDGE VOSS: On the record. We're here today for the presentation of the stipulation filed by the Office of -- excuse me, by the Staff of the Commission and Southern Missouri Natural Gas Company in Commission Case No. GR-2007-0352, in the matter of Southern Missouri Gas Company, LP's purchased gas adjustment factors to be reviewed in its 2005-2006 actual cost adjustment.

We're going to begin with entries of appearance, beginning with the company.

MR. FISCHER: Yes, Judge Voss. Let the record reflect the appearance of James M. Fischer with the law firm of Fischer & Dority, PC. My mailing address is 101 Madison Street, Suite 400, Jefferson City, Missouri 65101, and we're appearing today on behalf of the company, Southern Missouri Natural -- Southern Missouri Gas Company, LP, doing business as Southern Missouri Natural Gas. Thank you.

JUDGE VOSS: Staff of the Commission?

MR. REED: Steve Reed and Jennifer Heintz for the Staff, P.O. Box 360, Jefferson City, Missouri 65102.

JUDGE VOSS: Office of the Public Counsel?

MR. POSTON: Thank you. Marc Poston appearing for the Office of the Public Counsel and the public, P.O. Box 2230, Jefferson City, Missouri 65102.

JUDGE VOSS: Thank you. We're going to now move to statements in support of the stipulation. Would anyone like to begin? The company, I assume.

MR. FISCHER: Yes, Judge. We support the stipulation as it has been filed. There was only one real issue that was subject to litigation, and we have resolved that issue by compromise on the dollars. The compromise is that the company will have an adjustment of $75,000 on its ACA balance, and we are supportive of it.

We will be happy to answer questions about it from the Commission regarding the underlying issues.

JUDGE VOSS: Commission Staff?

MR. REED: Thank you, Judge. The Staff of the Commission has reached what it believes to be a fair and reasonable settlement of this ACA case. One of the things that often arises that is dealt with when these -- when the ACA is -- the PGA and the ACA are reviewed and adjusted is what does the future hold and what will the company do with regard to any change in behavior that's necessary or that Staff believes is necessary. And in this case we have witnesses here who can address that as well this morning, if the Staff has -- if the Commissioners have questions.

Primarily arising out of a complaint filed by the Office of the Public Counsel, there was a Stipulation & Agreement reached in GC-2006-0180. In that case there's quite a detailed list of things that Southern Missouri Gas determined and promised that it would do and has, in fact, been performing since the time of that Stipulation & Agreement. So the future that Staff is always concerned about has been addressed, is being dealt with, and with regard to the dollar amount that was agreed to in this case, the Staff believes it to be a fair and reasonable amount.

JUDGE VOSS: Thank you. Let's see. Commissioner Appling, do you have any questions?

COMMISSIONER APPLING: I'm sorry. I just got here. I shouldn't embarrass myself.

JUDGE VOSS: Okay. No problem. Commissioner Jarrett?

COMMISSIONER JARRETT: Thank you, Judge. Good morning. I had a question regarding the settlement. Maybe Staff could address this, and if the company has any comments as well, but I wanted to know if there's any adverse effect to the ratepayers here, you know, given that -- given that there is a compromise on the money, will this adversely affect the ratepayers?

MR. REED: Judge, there's some questions that I can answer and there are probably some that the

Staff can better answer.

The manager of the procurement analysis department, David Sommerer, is here this morning, although Kwang Choe was the witness in this case. Some of the overall issues and policy issues are better addressed by Mr. Sommerer. If we could swear in the witnesses now possibly, at least Mr. Sommerer and Mr. Choe, they could take some of these questions.

JUDGE VOSS: That would be fine. And is there anyone that I should swear in also from the company so that Commission questions can be addressed without having to break them up?

MR. FISCHER: I do have Randy Maffett, the managing partner of the company here, and he's available to answer questions, although I think I can probably answer most of your questions regarding the settlement, too.

JUDGE VOSS: I'm going to go ahead and swear in Mr. Sommerer first. Could you please state your name for the record.

MR. SOMMERER: David Sommerer.

(Witness sworn.)

JUDGE VOSS: Thank you. Mr. Choe, do you also wish to state your name for the record?

MR. CHOE: Kwang Choe.

JUDGE VOSS: Is it Choe?

MR. CHOE: That's fine.

(Witness sworn.)

JUDGE VOSS: Thank you. And Mr. Maffett.

(Witness sworn.)

JUDGE VOSS: And because I neglected to do so, could you please state and spell your full name for the record?

MR. MAFFETT: Randal T. Maffett. Randal with one L, M-a-f-f-e-t-t

JUDGE VOSS: Could you please spell your name, Mr. Choe?

MR. CHOE: C-h-o-e.

JUDGE VOSS: Thank you. Now, Staff or the company, if you'll direct whoever can most appropriately address Commissioner Jarrett's question.

MR. FISCHER: Judge, could I take a shot at that perhaps?

JUDGE VOSS: Sure.

MR. FISCHER: The litigation positions were that there would be -- the Staff had suggested a -- between a $220,000 and a $378,000 adjustment to the ACA. Our position was that that was not appropriate, that there should be no adjustment. The compromise is in between. Had the Staff prevailed on all its litigation position, there would have been a larger adjustment on the ACA which would have reduced gas costs more for consumers than what we're agreeing to.

However, in the event that the Commission adopted the company's position, there would have been a zero adjustment, and then in that case, the settlement actually would have been -- well, the settlement is more favorable to consumers because there is a $75,000 adjustment. However, if the company's position had prevailed, there would have been no adjustments at all to reflect any change in gas costs.

COMMISSIONER JARRETT: Thank you, Mr. Fischer. Does the company have any -- or the Staff have any thoughts on that?

MR. REED: We can address that, and I think Mr. Sommerer is prepared to address that. Can he take the witness stand for this?

JUDGE VOSS: Yes. It would be better for the video. You might check and see that the microphone is on over there. I'm not certain if they turned it on this morning.

MR. SOMMERER: Test.

JUDGE VOSS: Thank you.

DAVID SOMMERER testified as follows:

MR. SOMMERER: I would echo the comments of

Mr. Fischer. It is a settlement at a percentage of what the Staff requested that will be a reduction in gas costs, which is a favorable outcome for the customer to the extent that the company would have prevailed. This is an issue which is often difficult to litigate, and the success over the years with prudence disallowances has been somewhat limited, frankly, and so I think this outcome for the customer being a reduction in gas costs is a favorable outcome.

COMMISSIONER JARRETT: Thank you.

JUDGE VOSS: Chairman Davis?

QUESTIONS BY CHAIRMAN DAVIS:

Q. Mr. Sommerer, I don't want to hear about the settlement. I want you to tell me what your basis is for seeking the disallowance. I want you to state it here in your own words right now, and I want you to tell me your theory of how customers were actually harmed. Actually. Not theoretically, but actually.

A. Yes. First of all, we believe that the company should have hedged, that it's not prudent to hedge.

Q. Okay. Let me cut you off right there. If they would have hedged, would customers have been better off or worse off?

A. Depending upon when they would have hedged, they would have been better off or worse off. The timing is everything.

Q. Okay. All right. So when should they have hedged?

A. We believe they should have hedged ratably over the course of that summer preceding the winter of '05-'06, that that would have been a reasonable course of action, sort of a dollar cost averaging approach.

Q. And when you say summer, should they have bought gas in July when it was say $5 or $6 per million BTU? Is that what you're saying?

A. That was certainly one of the scenarios that we had, that they should have gone in, say, in June, July and August and placed hedges ratably, yes.

Q. Okay. And then how much should they have hedged at that time? Do you have this articulated on a piece of paper?

A. This is in testimony. We developed three scenarios, distinct scenarios. One took a look at if they would have placed their hedges in July and September, I believe, the same time that they placed their basis discounts or their discounts to the NYMEX.

Q. Okay.

A. The other was sort of a ratable hedging approach where we assumed that a 50 percent coverage of normal winter was an appropriate approach to take. And the third was looking at the previous owners and the techniques that they used, and we picked the winter of '04-'05 as an example of a way that they could have hedged for the winter of '05-'06, and these hedges were generally, all my recollection, between 50 and 66 percent of normal winter.

Q. Okay. And had they have done that -- I'm sorry, I don't have the exhibit here in front of me -- what would have been the outcome?

A. That was our range of disallowances from $220,000 to approximately $370,000.

Q. Okay. Now, do any other gas LDCs have a hedging strategy similar to that which was employed by SMNG?

A. No.

Q. No. Okay.

A. Let me make sure I understand your question.

Q. Okay. Let me ask it this way. My impression was, you know, Laclede didn't book anything that year either until November or whenever, and if that's incorrect, please tell me, but I'm just trying to compare, you know, I'm trying to compare how SMG came out compared to Laclede Gas, Missouri Gas Energy and some of the other

LDCs in terms of the total winter heating costs for their customers and to compare their strategies.

A. Yes. LaClede and MGE and Ameren, which are the three largest LDCs in the state, all have storage, so they all have the advantage over SMNG to have an automatic hedge. In the case of LaClede and MGE, you're looking at anywhere from about 30 percent to 40 percent capability. With storage, there are pipeline requirements that need to be met in terms of ratable injections over the summer, and simply from reliability and safety concerns, most of our LDCs fill storage by around November the 1st or at least get close to filling storage. So that hedge is almost a given.

And so it's very difficult on an apples to apples basis to make a comparison between most of the other LDCs in Missouri and SMNG who has absolutely no storage. I would say --

Q. And they can't obtain storage, can they? Is it feasible for them to get storage?

A. Not under present conditions. They've made the attempt. Southern Star has no storage, firm storage available. That's the pipeline supplier that they have.

Q. Right. We are in agreement that fixing the -- a basis points difference in terms of a price is not hedging, correct?

A. I am in agreement with you on that, absolutely.

CHAIRMAN DAVIS: Judge, let me pass for a minute, see if anybody else has anything for Mr. Sommerer.

JUDGE VOSS: Commissioner Appling, did you have any questions at this point?

COMMISSIONER APPLING: I think I'm okay, Judge.

JUDGE VOSS: I have a couple from Commissioner Clayton, but Commissioner Jarrett, did that raise any questions for you?

COMMISSIONER JARRETT: No, no further questions.

QUESTIONS BY JUDGE VOSS:

Q. I had some questions about some things that were in the initial Staff rec. They talked about the going-forward hedging. It's my understanding that the company did not comply with their currently in place hedging plan and that was part of Staff's initial problem. Is it they have a hedging strategy that they have agreed to follow that they didn't follow?

A. Well, I would say that the previous owners had a hedging plan in place that we interpreted to be a type of dollar cost averaging. Basically, the hedges that would be placed would be perhaps two or three times, since this is a very small company, and I think the initial plans of the new owners mirrored the previous owners.

So the Staff expectation was, if you're going to place your hedges, you should do it over the course of the summer and the fall and you should diversify those placements, and we didn't believe that what the company had done, the so-called basis hedges really reflected that plan, that it was consistent with that plan.

Q. The one part was the future treatment of hedging and the future capacity. There was some concern by Staff that they didn't adequately explain, the company didn't adequately explain what it's going to do on a going forward basis, and I don't see anything that addresses that in the stipulation? Is that still a concern? If not, why is it not a concern?

A. I think that there were continuing concerns even by the subsequent filing of the company's gas supply plans. We saw improvement. Generally speaking, those supply plans indicated that the company would follow the Stipulation & Agreement that was entered into in Case GC-2006-180. Our main concern with regard to hedging would be just the lack of specificity.

We would like to see the company speak more about longer term hedging, the types of instruments that they intend to use. We simply don't want to limit their hedging to the baseline of what was agreed to in that complaint case with the Office of Public Counsel. That's to Staff, I think, a bare minimum. So we would just like to see some expansion of the company's discussion and planning with perhaps a longer term view when it comes to hedging.

CHAIRMAN DAVIS: Mr. Sommerer, when you say longer term, are you saying two years, three years, six years, seven, like Ameren does it, and what --

THE WITNESS: Yes, I think at least two to three years which would be consistent with MGE and LaClede.

CHAIRMAN DAVIS: Okay. So you're looking at layering in, what, say, 15, 16 percent a year for two, three years, maybe more, maybe less, depending on price?

THE WITNESS: Exactly.

CHAIRMAN DAVIS: Sorry, Judge.

JUDGE VOSS: No problem.

BY JUDGE VOSS:

Q. That's what Staff wants to see. Is that what Staff believes is going to happen? Maybe the company can address that. It may be something that the parties are still working on together. I just don't see it being handled in this docket at this point with the stipulation.

A. That's correct.

MR. FISCHER: Judge, maybe I should address that. There was a separate case where the company agreed to buy fixed price contracts on a specific percentage throughout the year at five specific dates, and that was a settlement with Staff and Public Counsel in the Public Counsel's hedging complaint case, which has been resolved quite some time ago. The company in the last two years has been following the terms of that Stipulation & Agreement, has filed gas plans and status reports showing that that's what they're doing.

I'm aware that Staff may continually have suggestions, and we're always interested in visiting with them about those, but as far as this case goes, this case was only involving the proposed disallowance based on the basis hedges, and it didn't -- we'd already addressed what was going to happen on a going forward basis in the other case. That's the reason you don't see anything in the stipulation related to that.

Regarding your comments or question regarding the company's gas plan and whether they followed it, that was one of the issues that was going to be litigated. The company's perspective was that it had filed a gas plan, it was following it. One of the major parts of that plan was that it would assess basis hedges as a reasonable starting point, and then it would do fixed price contracts after it got the basis hedges in place to get the largest discount it could, and then when it fixed the price of the contracts, it would use those discounts.

The only wrinkle here was, of course, this was the year when Katrina and Rita hit, and whenever it got -- when we got into the summer it no longer made sense to fix record high prices using those basis hedges with the expectation there was going to be some reduction, and -- but they were following the plan. It's just they didn't necessarily anticipate Rita and Katrina were going to hit.

JUDGE VOSS: And might be a case of interpreting the plan different?

MR. FISCHER: Yes. Yes. No doubt about it. If we would have gone to litigation, we would have been talking a lot about what that plan really meant and whether it was being followed, I'm sure.

CHAIRMAN DAVIS: Mr. Fischer, doesn't that speak to the fact that maybe SMNG does need to consider at least hedging a modest amount two, three years out?

MR. FISCHER: I think the company is certainly looking at those possibilities. As a small company, though, they have more limited options than LaClede or Ameren regarding going far out. They can't use financial derivatives and those kinds of things for other reasons principally because they're small and they don't have that balance sheet strength that a large company would have. But yes, Judge, they are certainly looking at those options and -- and will continue to assess that as part of their prudence reviews.

CHAIRMAN DAVIS: I don't want to put words in your mouth, but let me just -- let me take a stab and see if I can interpret what you are saying, and that is, that because of SMNG's small size, to hedge 15 -- let's say 15, 16 percent out for either two or three years would put them at financial risk not only from -- it would put them at financial risk from both a credit standpoint and also from a -- from a competitive standpoint that, you know, if you're competing with say propane, then you get into a situation where if your price deviates substantially from the price of propane, you run the risk of people converting?

MR. FISCHER: Yes, Judge -- yes, your Honor, that's right. For example, let's just take a worst case scenario. Had this company hedged it whenever the price was at $15 for three more years, now that the prices are down in the 7 -- 6, 7, and $8 range, they would have been hedged out that far, yet propane prices -- they would have been having to compete with propane prices that might go up or down during that period. So that's exactly right.

CHAIRMAN DAVIS: But now, I realize, though, that hedging does not necessarily get you the lowest price, but what it does do is get you price stability, and I guess I'm having a hard time seeing why at least some minimal level of hedging out would not be that difficult or why we couldn't at least have a system where, you know, let's say gas is $15 per million BTU. You call up Mr. Sommerer and say, what do you think, Dave, buy, sell, hold?

MR. FISCHER: Yes.

CHAIRMAN DAVIS: Staff's hindsight is 20/20.

MR. FISCHER: Yes. That's another issue that had we gone to litigation we'd be talking about. Perhaps I should ask Mr. Maffett to address the question about whether -- what are the possibilities for two to three years out or further. He would be in a much better position to actually give you the technical details of that.

CHAIRMAN DAVIS: Swear him in, Judge.

JUDGE VOSS: He's been sworn in. Remind you you're under oath, Mr. Maffett.

MR. MAFFETT: Thank you. Good morning,

Commissioners. One of the things that you have to understand about the forward markets in any commodity is the fact that NYMEX posts a strip that runs out six years does not mean anybody's trading out there.

And if you look at the Wall Street Journal or Gas Daily on any given business day you'll see three columns. You'll see the month, you'll see the settle price, some publication will publish the range of trading that day, but then out to the side you'll see the number of contracts traded, and if you look out beyond 12 or 18 months, you'll see the liquidity in those contracts drops off rapidly, down to months like two years out there was one contract traded.

What that means -- being a former trader, what that means is the less liquidity there is in the market, as a trader you're establishing a bid offer, and that's -- the difference between that is what we call the spread. And the less liquidity there is out in the market, the larger that spread gets because the larger the uncertainty of transacting that far out in the market exists.

As Mr. Fischer pointed out, you didn't even have to -- you don't even have to go to the $15 price scenario. Had we locked in in August right prior to the hurricanes, if my memory's correct, we were in an 8, $9 gas price environment. If we had locked in for two or three years, we would now have a PGA that is roughly 20 percent higher than the winter PGA we just filed, which was a decrease from our summer PGA this same year. So we've actually lowered our upcoming winter gas prices by using the hedging program that we agreed to with OPC and Staff in the 2005-'06 settlement.

But there's -- you can't just say just because the market exists that you can transact. Sure, you can transact, but at what price? And the further out you go and the less liquid that market is, the higher the uncertainty for a trader. And the one thing a trader will never do is take risks they cannot manage.

The credit requirements get larger, too, because if the market moves against us, if we lock in a $9 price and the market moves to 7 bucks, we get hit with a $2 margin call. And because we are small, we don't have the financial wherewithal to be subject to -- if we had a situation where the market collapsed to 3 or $4 again, the margin calls could be disastrous for us.

BY CHAIRMAN DAVIS:

Q. Okay. Mr. Sommerer, do you want to respond to that at all?

A. Well, I would agree with parts of it. I certainly think that their circumstances are not totally comparable to the larger LDCs in Missouri in terms of the size and the access to storage and perhaps the access to various instruments that are out there. I can't disagree with that.

I would still encourage the company to take a look at longer term hedges, whether they be physical gas supply contracts with their producers. It should be an option that they're looking at would be the point that I would make.

Q. Let me ask you this, Mr. Sommerer.

A. Yes.

Q. If Mr. Maffett sees gas for less than $5 per million BTU, is it your opinion that he should buy as much gas as he can?

A. In today's market environment, I certainly would.

CHAIRMAN DAVIS: Okay. Mr. Poston, do you want to answer that same question?

MR. POSTON: Well, I do not have the experience that Mr. Sommerer has. I would certainly defer to him as to what would be a good price to lock in at in today's market.

BY CHAIRMAN DAVIS:

Q. Okay. Mr. Sommerer, what about 5.50?

A. You're pressing me.

Q. Pressing you? It's my job.

A. That certainly is below the current forward prices. It's -- I don't know where the cash prices are for Southern Star. We look a lot at NYMEX prices, which tend to be very liquid and tend to be tracked in terms of monitoring where the market is. But Southern Star doesn't track the NYMEX in terms of being the same price. It follows it.

Q. Right.

A. But it's cheaper, and therefore, you know --

Q. Thank goodness.

A. Yes, absolutely. I'm not sure where the current cash price is. It may be around $6 or $6.25. So the company should absolutely be looking at these prices and making those judgments.

Q. Let me ask you this, Mr. Sommerer: Mr. Maffett here in the future decides, you know, he's got a good reason for deviating from his hedging strategy. Are you the person that he should call for Staff to find out, hey, Dave, should I do this or not? Should -- I want to -- I'm thinking that I should deviate. Here's my reason. Can you give me an opinion as to -- as to where Staff is going to come down on this based on these circumstances?

A. I certainly would be open for any phone call from any LDC at any time, and I would give my best advice.

Q. Okay. Well, I think Mr. Maffett would probably be seeking a little more certainty than that. The question is, if he calls you up and he's in a situation, we want to -- we want to encourage him to follow his hedging strategy, but if there is a reason for -- if he thinks there is a prudent business reason for deviating from that strategy, you agree with me that he should be calling you or Wes Henderson or somebody, correct?

A. I think he should let the Staff know, yes.

Q. Okay. And then the question is, you know, what information does he need to bring you and what's a reasonable time to give him a response as to whether or not he should engage in that course of action?

A. Well, I would always caution that communication to say that it still would be subject to a prudence review, that I could not -- I don't have the authority, even if I wanted to have that authority, to give him preapproval.

Q. Who does have the authority?

A. I would say perhaps the entire Commission if the question were brought to them where Mr. Maffett is looking for approval.

Q. He'd need a Staff rec, wouldn't he?

A. Yes, he probably would, or the Commission would want one.

Q. That's right. So once again, so who would he need to talk to first, you, Wes, Bob?

A. My phone is open. I would probably consult with my staff. I would consult with Bob Schallenberg, Wes Henderson.

Q. What information are you going to be looking for?

A. I would try and understand his position, what his options were, what he was looking at. I would use the experience that I have, the market knowledge that we have, and we would discuss the -- the situation, go from there.

Q. Probably need to call Mr. Poston, too wouldn't you?

A. That would be highly recommended.

Q. Mr. Mills?

A. Absolutely.

Q. We'd want a rec from them, too?

A. I agree.

Q. Then the question is, how do we achieve that when you've got a -- let's say the spot market price is 5 bucks. How do you -- how do you make that happen? You know, obviously if the price is $15, you've got a little bit more time, but if the price is low, how do you get -- how does Mr. Maffett get that certainty, I guess is what I'm asking, and get it in a timely manner? Because if you have a hurricane next week, that could shift the market and your opportunity could be lost. So I'm just trying to feel you out, Mr. Sommerer, on how, you know, how Mr. -- how can Mr. Maffett work best with this Commission to do the things that he needs to do going forward?

A. Open lines of communication, including the Office of Public Counsel, and that's the best advice that I can give.

Q. Still a little vague.

A. The market is very dynamic.

MR. FISCHER: Judge, could I --

CHAIRMAN DAVIS: So is the Staff.

MR. FISCHER: Could I address, that, too, a little bit?

CHAIRMAN DAVIS: Sure, Mr. Fischer, go ahead.

MR. FISCHER: Our company does want to keep open lines of communication with the Staff and the Commission on all these types of things, but I think our experience has been that Staff is reluctant to give you a definite decision about is it a good time to lock in or not. In this particular case, for example, the rebuttal testimony has transcripts from the September 29th hearing in 2005 whenever I asked Mr. Sommerer, should we lock in now, and he said, I wouldn't give you a recommendation either way.

It's just the nature of the beast that the company is the one that has to make the decision, and then unfortunately the ACA reviews are usually done with 20/20 hindsight, and it's very difficult. The managers use the best judgment they can under the circumstances to make the best decision they can, and that is what I -- we do want to -- you know, things change. We have entered into a stipulation with Staff and Public Counsel on we were going to hedge, a certain percentage. If things look different, we would very much like to talk to Staff and Public Counsel about their thoughts on it. But I think as you're pointing out, Mr. Chairman, it's sometimes hard to get a definitive answer and, you know, what does it give you after you're there. You still have a 20/20 hindsight review.

BY CHAIRMAN DAVIS:

Q. Mr. Sommerer, do you remember the Empire rate case that we had, I guess back in '04 or '05? Do you remember that at all?

A. Very generally. This was the electric?

Q. Yeah, the electric case. They didn't own a gas company at that time.

A. Right. We have very little involvement with the electric side.

Q. You said you remembered it generally?

A. Yes.

Q. Do you -- do you have the same recollection that I have that it was extremely difficult to get Staff to opine as to what a good price or bad price for gas should be? Do you have that recollection? If you don't, that's fine. Just say so.

A. I don't believe I recollect those specifics, no.

Q. Okay. So you remember -- was Staff in here taking the position this is what gas ought to be? Do you remember that?

A. It wouldn't surprise me, given the fact that in an electric case you don't have or you didn't have at that time a fuel adjustment clause, so there is a tremendous amount at stake in terms of the value of the issue in developing what that number ought to be, and that is an extremely difficult problem to come up with a number.

CHAIRMAN DAVIS: Okay. Now, let's go back to Mr. Maffett.

RANDAL MAFFETT testified as follows:

QUESTIONS BY CHAIRMAN DAVIS:

Q. Mr. Maffett, where did you -- where did you acquire all of your energy trading experience?

A. Well, I know where you're headed with this, but I started well before Enron in the trading business. As a matter of fact, during my years at Enron, I was not a trader. They were the ones who taught me how to acquire companies and manage companies.

Q. Where did you acquire your trading experience?

A. I started with Lab Petroleum in 1986, and at that time, if you remember, FERC had just deregulated the natural gas markets with FERC Order 436. So I went through the implementation of 436, Order 500 and eventually what became known as the mega nova of Order 636.

Q. Now, I heard -- I heard your testimony about liquidity going out two, three, four, five, six years in the market. Is that why we need hedge funds and speculators to create that liquidity?

A. Judge, I can go a long time on the hedge funds.

Q. Well, I just --
A. They don't create the liquidity.
Q. No, they don't create the liquidity.
A. They create the volatility.
Q. They create the volatility. Okay.
A. And they run it, they push the prices in the direction they need to go by sheer mass and sheer momentum and velocity of capital.
Q. All right.
A. They have no best --
Q. So we don't need to hedge funds to create liquidity out four, five, six years?
A. I mean, liquidity -- any time any participant trades, you create liquidity. But there's also a point at which additional liquidity does not provide any additional value. The hedge funds are not out there speculating in the fourth, fifth and sixth years. They're out there speculating in this month, next month and the months forward, maybe the 12-month strip. There's lots of liquidity in the 12 -- 12 month range. I think you also need -- you should note that -- you have to remember as pure speculators, they have no vested interest in the natural gas markets.
Q. Right.
A. They're not consumers. They are not

producers. Their P and Ls do not depend on it. They're simply speculating.

Q. All right. Thank you for that dissertation.

How do we create more liquidity out further in the market? Because I mean, I just have a -- I have -- my impression is that that's something that the producers would like, too.

A. Yes and no. When you -- you can't just bundle producers any more than you can bundle LDCs. You have small privately owned producers. You have large Exon, Mobils and BPs. As a marketer of hedging instruments and a trader for many, many years, we have --

Q. But not at Enron?

A. But not at Enron. We had zero success marketing any long-term hedging products to the Exons and the BPs of the world for two simple reasons. No. 1, they're big enough that their balance sheets and their cash flows can withstand the volatility of the market.

But No. 2, they have an embedded belief at the executive management level that people who buy their stock do not want hedged stock. You've got to remember, that's 99 percent of their revenue base. So if they're hedging, then they're fixing the value of the stock. If crude goes to 100 and they're hedged at 40, what do you think the value of Exon's stock would be? Not what it is today.

Okay. On the other hand, smaller private producers who are -- who are more subject to maybe stringent credit requirements with their banks oftentimes project recourse finance. They may have requirements in their credit agreements that mandate that they stay 60, 70, 80 percent hedged, and while being hedged at $60 looked really good six months ago, anybody who's long in $60 swap right now is not real happy. Right? But as a smaller producer, they're still making money, and they're still servicing their debt requirements, and the banks like that.

Q. The smaller producers need the cash flow?

A. Well, they -- remember, I mean, the delta between $100 crude and 40 -- or $60 crude, that 40 bucks is still cash flow. The difference is the surety of their ability to meet their debt obligations.

Q. Right.

A. So there's a big span of, you know, the Exons of the world or the, you know, the Joe producers of the world and everybody in between, and then you have to introduce management philosophies.

CHAIRMAN DAVIS: All right. Thank you, Mr. Maffett.

Okay. Now I guess we'll get back to the stip here. Mr. Sommerer, could you go back to Schedule 5-1 of -- well, actually, this is Mr. Kwang Choe's testimony. This isn't yours. Are you familiar with Schedule 5-1 or do I need to ask Mr. Choe questions about 5-1?

MR. SOMMERER: I can try, and if I'm unable to answer, Mr. --

CHAIRMAN DAVIS: Mr. Choe will pitch in and help you out?

MR. SOMMERER: Yes.

CHAIRMAN DAVIS: Okay. So these are your three scenarios, correct? Or I see actual and two scenarios, and then Schedule -- I guess 5-2 is a continuation of this third scenario. Is that how I'm reading this, you've got the actual and then your three scenarios; is that correct?

MR. SOMMERER: That's correct.

CHAIRMAN DAVIS: Okay. So you've got the July 26, 2005 and September 2nd. Are those dates significant because those are the dates that they locked in the collars or --

MR. SOMMERER: Well, as we get into this schedule, I note that it's highly confidential, so I don't know if the company wants to waive all the data that's in here. It's somewhat old by this juncture.

MR. FISCHER: Judge, I'm not following which schedule you're actually talking about. What's that attached to?

CHAIRMAN DAVIS: It's Kwang Choe's direct testimony, Schedule 5-1 at the back, 5-1 and 5-2.

MR. FISCHER: Judge, the numbers themselves are okay to disclose. We wouldn't want to discuss who we actually bought the stock -- or bought the contracts from, but that's not listed here anyway. So we can talk about this in open session.

MR. SOMMERER: Okay. Well, then I can answer the question. The July 26, 2005 date and the September 2nd, 2005 date, my understanding is those were the dates that the company pulled the basis trigger or entered into their basis contracts.

CHAIRMAN DAVIS: Okay. So that's -- those are the dates that they actually bought gas at a fixed price?

MR. SOMMERER: They bought the gas and fixed to the basis.

CHAIRMAN DAVIS: Okay. They bought the gas and fixed the basis. Okay. So I think we're talking roughly the same thing. Okay. And can you just -- I've briefly skimmed Mr. Choe's testimony here, but can you just walk me through scenarios one, two and three briefly?

MR. SOMMERER: Yes. On page 9 of his direct testimony, he summarizes the three scenarios where he says the first scenario is a situation where the company locks in the final natural gas prices, not just fixing the basis discounts when it fixes the basis differential. So that first scenario is going to be looking to fix the entire gas cost, not just that basis piece on the dates that we just mentioned, July and September of 2005.

The second scenario is based on a situation where they fix their final natural gas price for the upcoming winter at 50 percent of the normal required volumes for the subsequent winter, so that would have been the ratable take or dollar cost averaging that you and I discussed earlier.

And then the third scenario resembles the company's hedging practice as it was in place in 2004 and 2005 where the company at that time fixed 54 percent of their normal winter volumes and they had that done by the end of August of 2004, so we would have mirrored that basic timing and hedge percentage and assumed that that was a reasonable practice going into '05-'06.

CHAIRMAN DAVIS: Mr. Fischer, do you have any criticisms of Mr. Choe, Mr. Sommerer's approach in

each of these three scenarios? If so, what are they?
MR. FISCHER: Well, Judge, had we gone to litigation, we certainly would have not agreed with that, that that was an appropriate position. We have a scenario that's attached to some of our testimony that shows if you used a different date, then the damages could have been much higher if you want to call it that, the effect on consumers would have been much higher than what the company actually chose to do with their particular scenarios.
Certainly if you look back and have 20/20 hindsight, pick the scenarios, the dollar -- the dates that the hedges were being assumed in the Staff's testimony, I don't think we really dispute that that's what could have been the result. It's just a question of whether that was, given what was known at the time, under the circumstances, when you had to make a decision not knowing what the prices were going to do, whether that was the prudent thing to do, or whether locking in the record high basis differentials and then locking in later on was also a prudent scenario, which is what the company did.
So that's, I think, a lot of what we would have done in the hearing. One of the -- one of the rebuttal testimonies, though, does show you that if you chose other dates, that certainly the results would have

been quite a bit different. And I believe it actually -- in our testimony it could have been $363,000 higher than the actual gas costs had you chosen a different date.

CHAIRMAN DAVIS: And you're here to tell me that $75,000 plus your attorney's fees is a fair and just settlement?

MR. FISCHER: I have a feeling my client would think the attorney's fees is not just and reasonable, but other than that, we are certainly -- we believe the 75,000, given the litigation risk of spacing 350,000 or whatever that outside was, this makes sense to us as a compromise.

CHAIRMAN DAVIS: Mr. Maffett, you understand that -- that a -- at least to this Commissioner, a consistent hedging strategy on file with this Commission that is followed is preferable to speculation which, you know, could end up, you know, hurting consumers or -- or, you know, causing other problems?

MR. MAFFETT: Yes, sir.

CHAIRMAN DAVIS: No further questions, Judge.

JUDGE VOSS: Commissioner Appling, did you have any more?

COMMISSIONER APPLING: Good morning,

Mr. Sommerer.

MR. APPLING: Good morning, Commissioner.

COMMISSIONER APPLING: This is a very basic question. I think I have the answer already, but I just need to be able to repeat it to somebody else if they ask me. The agreement in front of us, is Staff okay with the agreement?

MR. SOMMERER: Yes, we are.

COMMISSIONER APPLING: And give me just one minute of why.

MR. SOMMERER: We believe that this is a significant reduction in gas cost for the company's customers. We believe that, based upon the litigation risk, there's not an absolute guarantee that we would win this case or that, even if it was upheld by the Commission itself, that it would be upheld through the appeals system. It would be extensively litigated as all prudence disallowances are.

And so based upon my experience, it's 15 years of looking at these types of adjustments, we believe that it's a reasonable settlement both for the customer and for the company.

COMMISSIONER APPLING: Okay. Thank you very much.

Mr. Poston, are you in similar agreement?

MR. POSTON: No, we did not enter into this stipulation. We didn't sign it. We think that the Staff's evidence does show that consumers were harmed more in the range of the 200 to $300,000 amount. For the same reasons that Mr. Sommerer stated, the uncertainty of taking this to the Commission and potentially getting a zero dollars flowed back to consumers we chose just not to oppose this stipulation and hope that the 75,000 will at least go back to consumers.

COMMISSIONER APPLING: Thank you very much, sir. Appreciate both of your comments.

MR. SOMMERER: Thank you.

CHAIRMAN DAVIS: Judge, just a quick question. Mr. Fischer, how many customers does Southern Missouri Natural Gas have? Is it 5,000 or 8,000?

MR. FISCHER: Closer to 8.

CHAIRMAN DAVIS: 8,000. So if you have divided it out equally, you're looking at roughly $9 and some change on a per customer basis, probably if you factor in usage more or less?

MR. FISCHER: About $10 for residential is probably --

CHAIRMAN DAVIS: Okay. All right. Thank you.

JUDGE VOSS: Commissioner Jarrett, do you have any questions?

COMMISSIONER JARRETT: No further questions.

JUDGE VOSS: The bulk of Commissioner Clayton's questions have been addressed. There's a couple little questions.

Mr. Sommerer, is Staff in any way monitoring the hedging practices and capacity procedures of the company on a going forward basis?

MR. SOMMERER: Yes, we are.

JUDGE VOSS: I assume so. So in -- if Staff had any issues, that could be addressed in a complaint type proceeding?

MR. SOMMERER: Our issues will be brought forward in the company's annual ACA filing. We will be starting review of the '06 and '07 period probably within the next two months, and so to the extent that we have continuing concerns, we will express those concerns in the ACA filing.

JUDGE VOSS: But as you said, the ACA filing is a hindsight, 20/20 look. If you're monitoring them on a going forward basis, if you think they're deviating from the stipulation that you entered previously, would Staff be able to come to the Commission in another proceeding to address it?

MR. SOMMERER: That would be our intent, yes.

JUDGE VOSS: Okay. I don't have any further questions. Anything else from the Bench? I guess this concludes the on the record presentation of the stipulation. Thank you everybody.

WHEREUPON, the hearing of this case was concluded.

C E R T I F I C A T E

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

I, Kellene K. Feddersen, Certified Shorthand Reporter with the firm of Midwest Litigation Services, and Notary Public within and for the State of Missouri, do hereby certify that I was personally present at the proceedings had in the above-entitled cause at the time and place set forth in the caption sheet thereof; that I then and there took down in Stenotype the proceedings had; and that the foregoing is a full, true and correct transcript of such Stenotype notes so made at such time and place.

Given at my office in the City of Jefferson, County of Cole, State of Missouri.

____
Kellene K. Feddersen, RPR, CSR, CCR
Notary Public (County of Cole)
My commission expires March 28, 2009.