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MISSOURI PUBLIC SERVICE COMMISSION

MISSOURI GAS ENERGY

CASE NOS. GR-2002-348/GR-2003-0330

REBUTTAL TESTIMONY

OF

DAVID N. KIRKLAND

ON BEHALF OF MISSOURI GAS ENERGY

Jefferson City, Missouri

February 1, 2006

** Denotes Highly Confidential Material **

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REBUTTAL TESTIMONY OF

DAVID N. KIRKLAND

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REBUTTAL TESTIMONY OF

DAVID N. KIRKLAND

CASE NOS. GR-2002-348 and GR-2003-0330 (Consolidated)

February 1, 2006

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is David N. Kirkland and my business address is 3420 Broadway, Kansas City, Missouri.

Q. ARE YOU THE SAME DAVID N. KIRKLAND THAT PRESENTED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes.

Q. COULD YOU SUMMARIZE THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of this testimony is to rebut the allegations of imprudence contained in the direct testimony of Staff witness Lesa Jenkins. To summarize what I intend to do, I first need to provide some perspective.

Prior to the filing of her direct testimony, basically all MGE had in black and white regarding the basis of the Staff allegations was contained in the recommendations Staff filed in each of the two ACA periods under review in this proceeding. That consisted of the recommendation filed December 19, 2003 in Case No. GR-2002-0348 (reproduced as Schedule JJR-1 attached to the direct testimony of Mr. Reed) that covers the ACA period of July 1, 2001 to June 30, 2002, and the recommendation filed December 29, 2004 in Case No. GR-2003-0330 (reproduced as Schedule JJR-2) that covers the ACA period of July 1, 2002 to June 30, 2003. My understanding of the ACA process followed by the Commission is that it examines discrete twelve month periods. Because two of those periods for MGE have been combined in this proceeding, the total time period under review here is the two-year period of July 1, 2001 through June 30, 2003.

As Ms. Jenkins states on pages 5 and 6 of her direct testimony, the Staff views the purposes of an ACA review as including (1) a reconciliation of the actual gas costs MGE incurred with the billed revenues for the same purpose, (2) an examination of the reliability of MGE's gas supply, transportation, and storage capabilities, and (3) a review of purchasing practices and operating decisions for prudence purposes. In this proceeding, there is no controversy about anything in category (1). The Staff's allegation that MGE holds excess capacity appears to be a combination of categories (2) and (3). The Staff has combined an allegedly imprudent decision by MGE (i.e., the level of contracted capacity existing as of June 2001) with a flawed design day forecast method[1] the Staff developed on its own. The conclusion reached by Ms. Jenkins as a result of that combination is an allegedly excessive level of contracted capacity on interstate pipelines. If that sounds a little bit confusing, it is.

[1] As explained in Mr. Reed's rebuttal testimony.

MGE has already addressed flaws in the Staff's design day forecasting method in the direct testimony (pages 22 through 46) of Mr. Reed and flaws in the Staff's forecasting methodology are further explained in his rebuttal testimony. Mr. Reed also provided a discussion (See Mr. Reed's direct testimony, pages 11 through 22) of the aspects of a prudence review. In particular, he noted that the prudence standard establishes the basis for evaluation in terms of decisions, not results. He also pointed out that the review of the utility's decision cannot be made on the basis of hindsight, but must be made based on what was known at the time. This brief background is important because it is the benchmark I will use to demonstrate the flaws in the Staff's reasoning, as set out in Ms. Jenkins' direct testimony.

While a prudence review is supposed to consider allegations that a utility's decision was unreasonable compared to the other options known and available at the time, I will provide a time-line of decisions and events that shows Ms. Jenkins has not identified any purchasing or operational decision made by MGE in the time period between July 1, 2001 and June 30, 2003, that allegedly created excess capacity. In other words, there was no decision by MGE in this time period to which the Staff can attach a claim of imprudence. The Pony Express decision the Staff identified took place in 1996,[2] which is outside the scope of this case. In addition, the Southern Star decision that Staff has identified took place in June 2001, which is also outside the scope of this case.[3]

2 Direct testimony of David N. Kirkland, p. 10.
3 Ibid, p. 17-18.

Further, in conjunction with Mr. Reed, I will explain how the application of Staff's design day analysis in this case is really a prohibited "hindsight" review. This can be seen clearly from statements made by the Staff back in the time periods when the capacity planning decisions were being made. Those statements show that the Staff reviewed MGE's capacity planning process back then and concluded that the approach MGE was taking was "adequate." So if MGE's capacity planning was considered "adequate" by the Staff back when the decisions were being made, how can it now – years later – suddenly be imprudent when Staff's new design day method is applied, unless the Staff is resorting to "hindsight" review?

I will also, in conjunction with Mr. Reed, provide more background on the complexity associated with capacity decisions. This will demonstrate that there is much more involved in the making of capacity decisions than a one-time snapshot comparison of contracted capacity with an estimate of future customer demand.

II. TIME LINE AND KEY EVENTS

Q. WHAT IS THE "IMPRUDENT" DECISION THAT MS. JENKINS ALLEGES IN HER DIRECT TESTIMONY?

A. The alleged imprudent decision is set forth on pages 29 and 30 of Ms. Jenkins' direct testimony under the heading of "Imprudent Decision for 2001/2002 ACA and 2002/2003 ACA" on line 16 of page 29. At this point, a question and her answer appear as follows:

> **Q. DID THE TRANSPORTATION CAPACITY REMAIN THE SAME IN 2001/2002 AS IN THE PRIOR WINTER?**
>
> A. No. The transportation capacity increased from ** ** dekatherms per day **because of a prior commitment** on **

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> **. Additionally, transportation contracts on ** **. The total contract volumes on ** ** **remained the same**, but there is no evaluation or documentation indicating that the transportation contract volumes could not have been reduced when the term was revised. The MGE decision to maintain the same transportation capacity on ** ** affects the costs to customers beginning in the 2001/2002 ACA and continuing through the 2005/2006 ACA. It is Staff's position that MGE has not adequately calculated its peak day requirements and has not provided justification for its excess reserve margin. MGE modified **
>
> **
>
> **MGE did not evaluate customer demand to assure that its decision was prudent.** Specifically MGE failed to adequately evaluate and document its decision to maintain the ** ** total transportation contract volumes at the same level. (Emphasis added)

Q. COULD YOU REPHRASE THE SIGNIFICANT PARTS OF HER ANSWER IN LESS TECHNICAL TERMS THAT ARE MORE UNDERSTANDABLE?

A. What she is saying in the first sentence is that MGE's total transportation capacity increased by ** ** MMBtus per day during the two year period under review in this case -- July 1, 2001 to June 30, 2003 -- but the increase was because of a "prior" contract provision; meaning that it had been agreed to sometime before then. What she did not include in her answer is that the "before then" was back in 1996. In other words, MGE contracted in 1996, based on prior negotiations, for a ** ** MMBtu per day increase in the Pony Express pipeline contract capacity to take place in October 2001.[4]

[4] Direct testimony of David N. Kirkland, p. 16.

In the second and third sentences, she is saying that there were revisions made to several contracts MGE had with Williams Gas Pipeline (now known as Southern Star Central) that became effective in June 2001. It is important to note that once again, she is describing something that took place **before** the start of the two ACA periods under review in this case. Nevertheless, she notes that the contract revisions did not change the total amount of Southern Star capacity that previously was under contract. She then interprets the fact that the revisions, effective June 15, 2001, were a "decision" by MGE to not reduce the previous level of contracted capacity. This was a "decision" that was, according to her, premised on MGE's alleged failure to "reasonably evaluate customer demand."[5]

Q. HOW DO YOU KNOW THAT WHAT YOU HAVE DESCRIBED CONSTITUTES THE STAFF'S ALLEGATION OF IMPRUDENCE IN THIS CASE?

A. First, as noted above, her answer appears under the heading of "Imprudent Decision for 2001/2002 ACA and 2002/2003 ACA" on line 16 of page 29 of her direct testimony.

Second, we specifically asked Ms. Jenkins, in MGE Data Request No. 167(g), to specify which decisions to add capacity were made by MGE during the 2001/2002 or 2002/2003 ACA periods. Ms. Jenkins responded by repeating the passage from her testimony quoted above, which indicates that the change to the Pony Express contract was because of a prior commitment and that the Southern Star transportation contracts were revised in

[5] Ms. Jenkins response to MGE Data Request No. 195(a).

June 2001. In other words, there were no decisions made by MGE in the time period of July 1, 2001 to June 30, 2003 that added to or changed transportation capacity contracts.

Q. DO YOU BELIEVE THAT IS SIGNIFICANT?

A. Yes. I think it is very significant. As I said, my understanding is that one purpose of an ACA proceeding is to assess the prudence of decisions made by the utility during the period under review. The decisions the Staff has identified all took place before the start of either of the two ACA periods under review in this proceeding. It is my understanding that MGE provides copies of all its pipeline contracts to the Staff in response to the Staff's routine data requests in ACA cases. Therefore, the 1996 decision regarding the Pony Express capacity, as reflected in the contract, was reviewed by Staff in the July 1, 1997-June 30, 1998 ACA period. I understand that would have been in Case No. GR-98-167 which covered that time period. Similarly, the decision to consolidate the Southern Star contracts in June 2001 was reviewed by Staff in the July 1, 2000 through June 30, 2001 time period, which I understand was Case No. GR-2001-382. We have no indication the Staff found either decision to be imprudent in those reviews since I understand neither one was raised by the Staff as an issue in those cases. My understanding is also that the issues in Case No. GR-98-167 were consolidated with issues in three other ACA periods, including Case No. GR-2001-382. While I was not involved in those cases, my understanding is that the issues presented to the Commission in those consolidated cases were tried in November of 2003, and submitted for decision in February 2004.

Q. WERE THE DECISIONS THAT MS. JENKINS ALLEGES TO BE IMPRUDENT ACTUALLY BASED ON THE 2001/2002 AND 2002/2003 RELIABILITY REPORTS AS INDICATED IN HER DIRECT TESTIMONY?

A. No, they were not. Ms. Jenkins alleges that the so-called imprudent action was based on forecasts that were presented in the 2001/2002 and 2002/2003 Reliability Reports. (See Ms. Jenkins' direct testimony, page 11, at lines 11-16, and her subsequent discussion of forecasts.) That, of course, would be impossible since the decision to add the ** ** MMBtu/day in 2001 on the Pony Express system was made in 1996. The consolidation of the Southern Star contracts was not based on the 2001/2002 Reliability Report, but, to the extent that forecasts were a factor in that decision, the forecast would have had to have been developed before July of 2001 since the contract was effective in June of 2001.

The decisions that Ms. Jenkins identifies were based in part on earlier evaluations made by MGE. In particular, the decision to acquire the additional Pony Express capacity was based on evaluations and analyses that were made in the 1996 timeframe that Staff had previously found to be adequate.

Q. WHY WOULD PIPELINE CAPACITY DECISIONS INCLUDE INFORMATION FROM RELIABILITY REPORTS FILED BEFORE THE CAPACITY DECISION?

A. As discussed in detail in my direct testimony, pipeline capacity decisions are based on numerous factors and considerations[6] all of which are evaluated and considered before the capacity is contracted. In other words, the support and analysis was by necessity conducted prior to the decision to execute the contract.

Q. MS. JENKINS ASSERTS ON PAGE 30 OF HER DIRECT TESTIMONY THAT MGE HAS NOT ADEQUATELY CALCULATED ITS PEAK DAY REQUIREMENTS AND FAILED TO ADEQUATELY EVALUATE AND DOCUMENT ITS DECISION TO MAINTAIN THE SOUTHERN STAR TOTAL TRANSPORTATION CONTRACT VOLUMES AT THE SAME LEVEL. DO YOU AGREE WITH THIS ASSERTION?

A. No. First and foremost, the capacity planning process is measured in multiple years, if not decades. MGE not only "adequately calculated" its peak day requirements and provided several reliability reports during the period prior to making the decisions but in addition, the Staff on several occasions found MGE's process and planning to be "adequate".[7] Therefore, to place Staff's recommendations submitted in December of 2003 in proper context, I will review certain relevant events and dates, followed by an explanation that shows conclusively that Ms. Jenkins' assertions are wrong and

6 Direct testimony of David N. Kirkland, p. 6-9.

7 Staff recommendations in Case No. GO-96-243, Missouri Gas Energy's Reliability Report, June 28, 1996, May 30, 1997 and May 28, 1998.

completely at odds with what was known and relied on at the time the decisions being discussed were made.

Q. PLEASE IDENTIFY THE RELEVANT KEY EVENTS AND DATES THAT YOU BELIEVE PROVIDE CONTEXT TO THE SOUTHERN STAR AND PONY EXPRESS CAPACITY DECISIONS.

A. Below, in chronological order, is a list of certain key events and dates that I have identified by reviewing certain documents, specifically:

- May 1, 1996: MGE submits the first Reliability Report for the period 1996 through 2006
- June 28, 1996: Staff submits its recommendations with respect to MGE's 1996 Reliability Report finding MGE's analysis "adequate"
- December 1996: MGE contracted with Pony Express for the addition of two separate increments of capacity on the newly developed Pony Express Pipeline (i.e., ** ** MMBtus effective November 1997, and an incremental ** ** MMBtus effective October 2001)
- May 1, 1997: MGE submits Reliability Report for the period 1997/1998 through 2007/2008
- May 30, 1997: Staff submits its recommendations regarding MGE's 1997 Reliability Report finding MGE's analysis "adequate"
- May 1, 1998: MGE submits Reliability Report for the period 1998/1999 through 2008/2009
- May 28, 1998: Staff submits its recommendations regarding MGE's 1998 Reliability Report finding MGE's analysis "adequate"
- May 2000: MGE reduced its capacity on Southern Star by ** ** MMBtu/day
- July 1, 2000: MGE submits Reliability Report for the period 2000/2001 through 2010/2011
- August 1, 2000: Staff submits its recommendation with respect to MGE's 1998-1999 ACA period stating that Staff had no concerns with MGE's reliability analysis and recommending that MGE continue providing reliability reports as agreed in Case No. GO-2000-705
- August 1, 2000: PSC issues Order Approving Stipulation and Agreement in Case No. GO-2000-705

- October 2000: MGE increased it transportation on PEPL by ** ** MMBtu/day. MGE also increased its PEPL storage capacity by ** ** MMBtu
- Fall of 2000: Initial contract discussions between MGE and Southern Star
- Spring of 2001: MGE and Southern Star finalize contract discussions
- June 1, 2001: Execution of new Southern Star contract to be effective June 15, 2001
- July 1, 2001: MGE submits the Reliability Report for the period 2001/2002 through 2011/2012
- August 6, 2001: Effective date of PSC Order Approving Stipulation and Agreement in Case No. GR-2001-292 imputing in the calculation of base rates $1.2 million of revenues associated with capacity release/off-system sales
- October 2001: As a result of the November 1996 contract negotiation, the additional ** ** MMBtu/day of Pony Express capacity becomes effective
- November 27, 2001: Staff submits its recommendation with respect to MGE's 1999-2000 ACA period concluding, among other things, that additional capacity was not needed until 2005-2006
- May 31, 2002: Staff Recommendation in MGE's 2000-2001 ACA period concluding, among other things, that additional capacity was not needed until 2005-2006
- July 1, 2002: MGE submits the Reliability Report for the period 2002/2003 through 2012/2013
- December 18, 2003: Staff Recommendation in MGE's 2001-2002 ACA period concluding, among other things, that MGE had contracted for excess capacity
- December 28, 2004: Staff Recommendation in MGE's 2002-2003 ACA period concluding, among other things, that MGE had contracted for excess capacity

Q. WHEN DID MGE FIRST BEGIN SUBMITTING RELIABILITY REPORTS AND WHY?

A. As indicated in the timeline above and in my direct testimony (on pages 11-12), MGE submitted its first reliability report in 1996. It is my understanding that the first report was submitted in response to a concern raised by the Commission itself in a proceeding where it approved an incentive procedure for MGE relating to gas costs. The Commission expressed concern that MGE might attempt to "game" the incentive process by intentionally sacrificing reliability for cheaper prices in order to benefit financially. Therefore, it ordered MGE to submit reliability information so that the Commission could assure itself that MGE was not sacrificing reliability in its contracting decisions.[8]

Q. WHAT MATERIAL OR INFORMATION WAS PROVIDED BY MGE IN THE 1996 RELIABILITY REPORT?

A. In that report, MGE covered a variety of topics including its approach to calculating and projecting peak day demand, and MGE also outlined the design weather planning standard of 85 HDDs. That reliability report had a ten-year forecast horizon ending in 2006 and identified the 1996 MGE capacity as ** ** MMBtu per day and was expected to increase to ** ** MMBtu per day.[9]

Q. DID THE 1996 RELIABILITY REPORT DISCUSS THE OBJECTIVE AND TIMING OF PIPELINE CAPACITY ACQUISITION?

A. Yes, MGE discussed how the capacity portfolio needs to serve firm customers' peak day requirements over the defined time period, specifically:

> "...The planning process must result in a transportation portfolio that meets firm customers' peak day requirements during the period of the study.
>
> The planning cycle of a pipeline company is substantially longer than for a local distribution company (LDC). This is due to the longer lead times and economics associated with pipeline construction and capacity expansion projects. For this reason, the LDC must contract capacity in longer blocks, usually five to ten years. The timing of pipeline expansion

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[8] Direct testimony of David N. Kirkland, p. 11-12.

[9] Direct testimony of David N. Kirkland, Schedule DNK-2, p. 000073-000074.

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> projects do not necessarily match the needs of the LDC and may result in a temporary surplus of firm capacity."[10]

Q. DID STAFF REVIEW THE 1996 RELIABILITY REPORT?

A. Yes. On June 28, 1996, Staff submitted a memorandum ("the 1996 Staff Memo") to the Commission in which it summarized Staff's recommendations with respect to the MGE 1996 Reliability Report.[11]

Q. WHAT WERE STAFF'S GENERAL OBSERVATIONS AS OUTLINED IN THAT MEMO?

A. Staff provided two general observations in the 1996 Staff Memo. First, Staff outlined its perspective on supply reliability. Second, Staff discussed certain other planning issues that are not in the LDC's control.

With respect to supply reliability, Staff said:

> "...the Staff believes that it is important to provide some background data associated with the concept of supply reliability. The discussion that follows relates to supply reliability to the firm customers that are dependent upon their Local Distribution Company (LDC) to provide natural gas every day of the year, **especially those days in mid-winter when the temperature never rises above 0 degrees Fahrenheit**. (Emphasis added)
>
> It is important to remember that natural gas supply reliability to LDC firm customers is quite different from reliability in the telecommunications or electric industry...maintaining reliability is a much more dynamic process in the gas industry, involving the coordinated efforts of a diverse group of participants...One of the most important things to remember is that natural gas demand has to be anticipated and ordered...Many of Missouri's LDCs receive their natural gas from only

[10] Ibid, p. 000064.
[11] Ibid, p. 000137-000141.

one interstate pipeline…This puts the LDC at the mercy of the reliability of that interstate pipeline…"[12]

Q. PLEASE DISCUSS STAFF'S OBSERVATIONS IN THAT MEMO WITH RESPECT TO LDC RELIABILITY.

A. Staff correctly identified the objective of LDC reliability which is to provide natural gas every day of the year, and particularly on very cold days, i.e., days in which the temperature never rises above 0 degrees, to firm customers that depend on the LDC. In fact, the introductory sentences in the Peak Day Projections section of the MGE 1996 Reliability Report states: "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 to meet all of its firm sales obligations under such conditions."[13] It would appear, therefore, that in 1996, MGE and Staff were in agreement regarding the objective of LDC reliability.

Staff also drew a distinction in the 1996 memo between natural gas reliability and reliability in other regulated services.[14] Specifically, Staff identified the number of participants involved in the delivery of natural gas and the associated administrative coordination required. This is simply an acknowledgement of the fact that the process of delivering natural gas requires the LDC to administer and coordinate across gas producers, storage providers and interstate pipelines.

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12 Ibid, p. 000137.
13 Ibid, p. 000006.
14 Ibid, p. 000137-000138.

Staff also identified a timing issue with respect to the delivery of natural gas.[15] Specifically, Staff addressed the requirement for natural gas to be ordered ahead of time based on anticipated demand, which of course during the winter is driven to a large degree by weather. Thus, the LDC must manage the delivery of natural gas under anticipated and changing weather/demand circumstances, utilizing assets and processes which are not under the control of the LDC.

Finally, Staff identified the risk of an LDC being tied to only one interstate pipeline, and concluded that the reliability of the LDC is directly tied to the reliability of that particular interstate pipeline.[16]

Q. PLEASE DISCUSS THE SECOND GENERAL OBSERVATION IN THE STAFF MEMO, I.E., OTHER PLANNING ISSUES.

A. Staff identified three significant factors that were beyond the control of MGE, specifically:

> "The following three significant factors that impact supply reliability are, to a large degree, beyond MGE's ability to control:
>
> 1. Extreme Weather Conditions
> 2. Extensive Supply Well Freeze-offs and/or Storm Damage
> 3. Transmission Pipeline and/or Compressor Failures"[17]

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15 Ibid, p. 000137-000138.
16 Ibid, p. 000138.
17 Ibid, p. 000138-000139.

Q. PLEASE DISCUSS STAFF'S FIRST SIGNIFICANT FACTOR, I.E., EXTREME WEATHER CONDITIONS.

A. LDC supply reliability for firm customers considers a wide range of factors; some of which are in the LDC's control, while others (e.g., the three discussed by Staff) are not in the LDC's control. As outlined in the 1996 Staff Memo, weather that is colder than the planning standard may occur and result in the LDC being unable to supply firm demand. Specifically as stated by Staff:

> "...Other LDCs are quite conservative in that they design for the worst weather observed in the last 100 years...Weather extremes beyond the most conservative LDCs designed-for-weather can occur and it must be understood by all who review reliability data that no absolute guarantee of supply can be granted by any LDC."[18]

Staff therefore recognized in 1996 that extreme weather even beyond the most conservative standard can occur and impact the ability of the LDC to serve demand. The impact of this issue, i.e., insufficient capacity, will be discussed in detail in the rebuttal testimony of Mr. Reed.

Q. PLEASE DISCUSS THE OTHER TWO SIGNIFICANT FACTORS THAT STAFF RECOGNIZED IN 1996 AS BEING BEYOND THE LDC'S CONTROL.

A. The other two issues mentioned by Staff are examples of operational issues that could influence the natural gas supply delivery process, albeit different components of the delivery chain. Specifically, the extensive supply well freeze-offs and/or storm damage

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[18] Ibid, p. 000138.

(i.e., the second significant factor) are potential weather-related events that impact the production of natural gas and therefore, the reliability of the LDC to meet demand.[19]

The recent hurricanes (i.e., Katrina and Rita) are unfortunate examples of these types of weather-related events.

The last issue raised by Staff concerns equipment failures of the pipeline (i.e., the third significant factor) that impact the delivery of natural gas[20] and therefore the reliability of the LDC.

While the weather is obviously not in the control of MGE, the operational issues on the pipelines and in the supply basins may be minimized by a portfolio approach to supply/capacity planning. In other words, LDCs with the ability to contract on several pipelines or in geographically-diverse supply basins are better positioned with respect to managing reliability than LDCs that are not able to diversify across pipelines or supply basins. In fact, Staff in the 1996 Memo recognizes the reliability value of not depending on one pipeline or supply basin, but rather diversifying across several pipelines.

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19 Staff described this issue as: "A prudent LDC reviews the historical performance of its potential suppliers. Extensive and severe cold weather and/or hurricane damage in Texas, Oklahoma, and/or Louisiana could result in many supply contract force-majeure occurrences and the associated supply deficiencies To the degree that these occurrences cannot be anticipated and designed for, an LDC is 'without blame' if it has been prudent in its review of the historical performance of its suppliers." – Ibid, p. 000139.

20 Staff described this issue as: "Where possible and cost effective, an LDC is prudent to contract for supply from several interstate pipelines, not only to avoid dependency on one interstate pipeline, but to encourage competition among interstate pipelines and enhance their diversity of supplies. Where access to several interstate pipelines is not an option, transmission pipeline and/or compression station failures could result in immediate supply deficiencies that would be beyond the LDC's control." – Ibid, p. 000139.

Q. WHAT AREAS OR TOPICS DID THE 1996 STAFF MEMO DISCUSS WITH RESPECT TO LDC RELIABILITY?

A. There are two primary topics regarding LDC supply reliability[21] that are discussed in the 1996 Staff Memo: (i) system demand projections; and (ii) supply/delivery resources. Within each of these two primary topics, Staff identified several subtopics, specifically:

> "Natural gas supply reliability to LDC firm customers can be broken down into the following two primary topics:
>
> I. System Demand Projections
>
> A. Peak Day Projections
>
> B. Annual Load Projections
>
> C. Projected Supply/Transportation Requirements
>
> II. Supply/Delivery Resources
>
> A. Pipeline Transportation/Storage Capacity
>
> B. Gas Supply Resources"[22]

Q. ON EACH OF THE PRIMARY TOPICS AND ASSOCIATED SUBTOPICS, IN THE 1996 STAFF MEMO, DID STAFF PROVIDE FEEDBACK TO MGE REGARDING ITS CAPACITY PLANNING PROCESS?

A. Yes, on every subtopic listed above, Staff deemed MGE's actions to be **adequate**. (The emphasis is mine.) Although Staff deemed the MGE Reliability Report to be adequate across all topics and subtopics, I would like to specifically point out two areas important

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[21] As the Staff stated in this memo: "Pursuant to the Case No. GO-94-318, Phase II, Report and Order issued on January 31, 1996, Docket No. GO-96-243 was created for the receipt of gas supply reliability and financial incentive mechanism filings. Pursuant to the same Report and Order, a "technical workshop" was held on February 26, 1996. Representatives of Missouri Gas Energy (MGE), the Staff of Commission (Staff), Union Electric Company (UE), the Office of Public Counsel (OPC), and the City of Kansas City met on this date and discussed the components of both reliability and gas cost incentive monitoring reports. As a result of these discussions, an outline for MGE's reliability report was agreed to by all parties. Pursuant to the order issued on May 21, 1996, MGE provided a Reliability Report that follows the same outline as was agreed to by all parties on February 26, 1996." – Ibid, p. 000139.

[22] Ibid, p. 000138.

to the issues in this proceeding. Specifically, Staff reviewed the Peak Day Projections which was defined as: "This information reviews the historic weather induced peak day gas demand and the criteria utilized for estimating peak demand during the forecast period."[23] It is important to note that the forecast period as outlined by MGE in the 1996 Reliability Report was a ten-year period covering 1996 to 2006. The Staff deemed the MGE process for Peak Day Projections to be <u>**adequate**</u>. (Emphasis added)

In addition, Staff reviewed the pipeline transportation/storage capacity area which was defined as: "This information reviews existing transportation capacity and storage deliverability and any areas with identified additional capacity needs."[24] Similar to the Peak Day Projections, Staff deemed the MGE process for pipeline transportation/storage capacity to be <u>**adequate**</u>. (Emphasis added)

Q. WAS THERE A RECOMMENDATION PROVIDED BY STAFF IN THE 1996 STAFF MEMO?

A. Yes. Staff provided the following recommendation:

> "The Reliability Report that MGE provided to the Staff appears to fulfill the purpose of ensuring that MGE procures natural gas in a manner consistent with the goal of maintaining gas supply reliability."[25]

Q. IN THE 1996 STAFF MEMO, DID STAFF PROVIDE ANY INDICATION THAT MGE WAS NOT BEING REASONABLE IN THE DEVELOPMENT OF THE DEMAND FORECAST OR LEVEL OF ITS CAPACITY PORTFOLIO OR THAT

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23 Ibid, p. 000140.
24 Ibid, p. 000140.
25 Ibid, p. 000141.

MGE WAS INTENTIONALLY CONTRACTING FOR MORE CAPACITY THAN IT NEEDED BASED ON ITS PROJECTIONS?

A. No, there was no indication in the 1996 Staff Memo that MGE was not reasonable in the development of the demand forecast or the capacity portfolio. In fact as discussed above, MGE's process was deemed adequate in all topics and subtopics of the reliability report.

Q. WHEN DID MGE FILE ITS NEXT RELIABILITY REPORT?

A. On May 1, 1997, MGE filed its next reliability report and it is attached to my direct testimony as Schedule DNK-3.

Q. DID THE 1997 RELIABILITY REPORT COVER SIMILAR TOPICS AS THE 1996 RELIABILITY REPORT?

A. Yes, the 1997 Reliability Report covered the same topics as the 1996 Reliability Report (i.e., system demand projections and supply/delivery resources). The forecast period was from 1997/1998 through 2007/2008 and identified the current capacity as ** ** MMBtus increasing by ** ** MMBtus/day (i.e., the Pony Express contracted volumes) in 2001/2002 for a total capacity of ** ** MMBtus/day.

Q. DID STAFF REVIEW THE 1997 RELIABILITY REPORT?

A. Yes. The Staff recommendations memorandum in that case ("1997 Staff Memo") is reproduced as part of Schedule DNK-3 attached to my direct testimony. (Please see direct testimony of David N. Kirkland, Schedule DNK-3, p. 000128-000132)

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Q. PLEASE SUMMARIZE THE 1997 STAFF MEMO.

A. Similar to the 1996 Staff Memo, the 1997 Staff Memo reviewed MGE's Reliability Report using the same two primary topics (i.e., system demand projections and supply/delivery resources) and the same associated subtopics. MGE was found to have performed all the subtopics in an adequate manner.

Q. ARE THERE PARTICULAR STATEMENTS IN THE 1997 STAFF MEMO THAT YOU BELIEVE ARE RELEVANT TO THIS PROCEEDING?

A. Yes, there are several statements I would like to discuss. First, Staff states when discussing extreme weather conditions: "Some LDCs are quite lean (i.e. very low reserve margin) in that they only design for the worst weather they have observed in the last 5 to 10 years. Other LDCs are quite conservative in that they design for the worst historical weather observed in the last 100 years."[26] As shown, Staff observes that LDCs have various approaches to planning for extreme weather conditions and, "how they do this depends on the individual LDC's philosophy."[27] In addition, Staff offered this recommendation: "The Reliability Report that MGE provided to the Staff appears to fulfill the purpose of ensuring that MGE procures natural gas in a manner consistent with the goal of maintaining gas supply reliability."[28] In other words, after reviewing the MGE Reliability Report Staff concluded that MGE was planning and acting to reliably serve its customers.

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[26] Direct testimony of David N. Kirkland , Schedule DNK-3, p. 000129.
[27] Ibid, p. 000129.
[28] Ibid, p. 000132.

Q. WHEN DID MGE FILE ITS NEXT RELIABILITY REPORT?

A. On May 1, 1998, MGE filed a reliability report. This reliability report is attached to my direct testimony as Schedule DNK-4.

Q. DID THE 1998 RELIABILITY REPORT COVER SIMILAR TOPICS AS THE 1996 AND 1997 RELIABILITY REPORTS?

A. Yes, the 1998 Reliability Report covered similar topics as the 1996 and 1997 Reliability Reports, including peak day projections and pipeline transportation/storage capacity. The forecast period in the 1998 Reliability Report was from 1998/1999 to 2008/2009, and identified the then-current MGE capacity as ** ** MMBtu/day increasing to ** ** MMBtu/day.[29] As stated earlier, this increase was attributable to the ** ** MMBtu/day of Pony Express capacity previously contracted.

In addition, the 1998 Reliability Report included the same language as the 1996 and 1997 Reliability Reports with respect to the planning process, lead time for pipeline construction, and the need for LDCs to plan over a five- to ten-year period.

Q. DID STAFF REVIEW THE 1998 MGE RELIABILITY REPORT?

A. Yes. The Staff recommendations memorandum in that case appears as part of Schedule DNK-4 attached to my direct testimony.

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[29] Direct testimony of David N. Kirkland , Schedule DNK-4, p. 000012.

NP

Q. PLEASE SUMMARIZE THE 1998 STAFF MEMO.

A. Similar to the 1996 and 1997 Staff Memos, the 1998 Staff Memo reviewed MGE's Reliability Report using the same two primary topics (i.e., system demand projections and supply/delivery resources) and the same associated subtopics.

Similar to the 1996 and 1997 Staff Memos, Staff concluded in 1998 that the MGE Reliability Report was adequate across the two primary topics and the associated subtopics. Specifically, with respect to Peak Day Projections and Pipeline Transportation/Storage Capacity, Staff found:

> "**I.A. Peak Day Projections** – This section details MGE's design and historic peak day demands and how MGE has accounted for these demands in the forecast period. MGE's most recent study covers a time horizon of 1998 through 2008 and indicates a need, based on projected annual growth, for additional capacity prior to the 2003-2004 winter season to be able to cover the historic peak day requirements.
>
> Staff Response: **Adequate**"[30]
>
> "**II.A. Pipeline Transportation/Storage Capacity** – This section details MGE's pipeline capacity and storage deliverability and identifies any needed changes to either during the forecasted period. MGE has increased the number of interstate pipelines with firm transportation contracts from three to four since last year's Reliability Report. The fourth pipeline serving MGE is the KN Interstate Gas Transmission Company (Pony Express Pipeline)...This additional capacity should cover MGE's projected design day through the 10 year period of 1998-2008. Staff agrees that the availability of a fourth source for transportation enhances reliability. However, Staff would caution that the cost of this enhanced reliability may not necessarily be viewed as prudent. The current ACA case, Case No. GR-96-450, will not address the Pony Express Pipeline since it was not put into use until October of 1997, which was after the 1996-1997 ACA period.
>
> Staff has further concerns that the design of MGE's incentive plan may encourage MGE to purchase less costly gas through the Pony Express Pipeline but at higher transportation costs. Staff has expressed these

[30] Ibid, p. 000136-000137.

> concerns in a currently pending complaint case, Case No. GC-98-335. For the purpose of this Reliability Report, however, Staff is not opposing MGE's contracts for the Pony Express Pipeline. Therefore, while Staff agrees that the Pony Express Pipeline enhances reliability, Staff is not necessarily agreeing that the contracts are prudent and retains the right to determine if these contracts are prudent during the ACA review of this period, during the review of the incentive plan monitoring report, or through other dockets which may be initiated or are currently open.
>
> Staff Response: **Adequate**"[31]

Q. PLEASE SUMMARIZE STAFF'S FINDING IN THE 1998 STAFF MEMO.

A. As discussed above, Staff concluded that MGE had performed an adequate analysis on all the subtopics below the two primary topics. Staff offered the following summary:

> "Staff's review of the Reliability Report indicates that MGE has not modified its purchasing strategy in favor of short term supply. This was the primary concern identified by the Commission which prompted the initiation of these Reliability Reports. Generally, it appears that MGE has taken extensive steps to continue to ensure reliable service to its customers. As previously stated, Staff expects to closely review the Pony Express Pipeline data for the 1997-1998 ACA period to be addressed in Case No. GR-98-167, but at this time does not dispute that it enhances system reliability...**The Reliability Report provided by MGE appears to fulfill the purpose of ensuring that MGE procures natural gas in a manner consistent with the goal of maintaining gas supply reliability**."[32] (Emphasis added)

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[31] Ibid, p. 000137-000138.
[32] Ibid, p. 000138-000139.

Q. IN THE 1998 STAFF MEMO, DID YOU FIND ANY PLACE WHERE THE STAFF INDICATES THAT MGE WAS NOT BEING REASONABLE IN THE DEVELOPMENT OF ITS DEMAND FORECAST OR LEVEL OF ITS CAPACITY PORTFOLIO?

A. No, in fact Staff states, "This additional capacity should cover MGE's projected design day through the **10 year period of 1998-2008**."[33] (Emphasis added)

Q. DID STAFF PROVIDE FURTHER RECOMMENDATIONS WITH RESPECT TO RELIABILITY IN THE MGE 1998 ACA FILING?

A. Yes. On August 1, 2000, the Staff provided certain recommendations to the Commission. This memo, which I will refer to as the "2000 Staff Memo," was attached to my direct testimony as part of Schedule DNK-5.

Q. PLEASE SUMMARIZE THE 2000 STAFF MEMO.

A. As discussed in my direct testimony, Staff stated the following: "In addition, Staff conducted a reliability analysis for the MGE distribution system including a review of MGE information regarding a) estimated peak day requirements and the capacity levels to meet those requirements, b) peak day reserve margin and the rationale for this reserve margin, and c) annual estimated demand. **No concerns were noted at this time.**"[34] (Emphasis added)

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[33] Ibid, p. 000137.
[34] Direct testimony of David N. Kirkland , Schedule DNK-5, p. 000003.

Q. IN ADDITION TO THE STAFF'S VARIOUS RECOMMENDATIONS REGARDING MGE'S RELIABILITY REPORT FILINGS, HAS THE REASONABLENESS OF MGE'S LEVEL OF CAPACITY BEEN INDICATED THROUGH ANY OTHER REGULATORY FILINGS?

A. Yes. On August 1, 2000, the Commission issued its Order Approving Stipulation and Agreement in Case No. GO-2000-075. Included in the agreement approved by the Commission was a mechanism for the sharing, between MGE and its customers, of transportation and/or storage discounts or savings generated by MGE. As provided in that Stipulation and Agreement, "[T]he benchmark calculation of the amount recovered from customers shall be based on existing contracted MDQ capacity, in agreements in effect as of April 28, 2000, on all pipelines for transportation capacity and storage capacity."[35]

Q. WHAT WAS THE EXISTING CONTRACTED MDQ CAPACITY, IN AGREEMENTS IN EFFECT AS OF APRIL 28, 2000, ON ALL PIPELINES FOR TRANSPORTATION CAPACITY?

A. ** ** MMBtu/day.

Q. IS THIS THE SAME LEVEL OF CAPACITY MGE HAS UNDER CONTRACT DURING ACA PERIODS THAT ARE THE SUBJECT OF THIS PROCEEDING?

A. Yes.

[35] Direct testimony of David N. Kirkland , Schedule DNK-7, p. 000007.

NP

Q. WHAT DOES THIS INFORMATION INDICATE TO YOU?

A. I see a significant inconsistency. The same level of capacity that was used in the Stipulation and Agreement in Case No. GO-2000-705 as the benchmark for the determination of transportation savings to be shared between MGE and its customers is now alleged by the Staff to be excessive.

Q. WHEN WAS THE SOUTHERN STAR CONTRACT RENEWED?

A. As discussed in my direct testimony, the Southern Star contract was renewed in June of 2001. This was the contract that Ms. Jenkins mentioned in her direct testimony. The Southern Star renewal process combined several previously existing contracts in order to improve efficiency and for other benefits described below. It did not increase MGE's overall capacity on Southern Star.

Q. WHAT SPECIFIC FEEDBACK FROM STAFF DID MGE RECEIVE REGARDING ITS CAPACITY PLANNING PRIOR TO EXECUTING THE CONTRACT WITH SOUTHERN STAR IN JUNE 2001?

A. MGE had received the Staff recommendations submitted in 1996, 1997, 1998, and 2000 which I summarized previously.

Q. DID MGE SUBMIT A RELIABILITY REPORT IN 2000?

A. Yes, on July 1, 2000, MGE submitted a reliability report which has a ten-year forecast period beginning in 2000/2001 and ending in 2010/2011. (See direct testimony of David N. Kirkland, Schedule DNK-8)

Q. DID STAFF REVIEW THE MGE RELIABILITY REPORT FILED ON JULY 1, 2000?

A. Yes, on November 27, 2001, Staff submitted a recommendation memo to the Commission. This memo, which I will refer to as the "2001 Staff Memo," was attached to my direct testimony as part of Schedule DNK-6. The 2001 Staff Memo was prepared **after the execution of the Southern Star contract**.

Q. DID THE RELIABILITY REPORT PROVIDED BY MGE ON JULY 1, 2000 INCLUDE INFORMATION SIMILAR TO THE PREVIOUS RELIABILITY REPORTS?

A. Yes, the information provided by MGE was consistent with the information provided by MGE in the previous reliability reports. This reliability report had a ten-year forecast horizon beginning in 2000/2001 and ending in 2010/2011.

Q. WHAT WAS THE CAPACITY LEVEL UTILIZED BY MGE IN THE RELIABILITY REPORT SUBMITTED ON JULY 1, 2000?

A. As illustrated on page 5 of the Reliability Report, MGE indicated a then-current capacity portfolio of ** ** MMBtu/day increasing to ** ** MMBtu/day due to the ** ** MMBtu/day Pony Express increase previously negotiated as part of a contract that first brought capacity in-service to MGE in 1997. This capacity portfolio was the same portfolio that was in the two previous reliability reports.

Q. PLEASE SUMMARIZE STAFF'S NOVEMBER 27, 2001 CONCLUSIONS REGARDING MGE'S RELIABILITY ANALYSIS.

A. Staff offered the following: "In the 2000/2001 Reliability Report, the Company states that additional capacity is needed prior to 2003/2004, however Staff's review of peak day estimates and capacity shows that additional capacity is not needed until 2005/2006."[36]

Q. DID THE STAFF RECOMMEND OR SUGGEST THAT MGE REDUCE ITS CAPACITY PORTFOLIO?

A. No. The only suggestion from Staff was to shift the need for incremental capacity to 2005/2006 from 2003/2004. It should be noted that Staff did not identify concerns with the existing MGE portfolio nor suggest that any of the capacity was not needed. In addition, Staff does not consider the timing of capacity availability relative to MGE's demand forecast. As I discussed, MGE's demand forecast is but one of numerous factors that must be considered when capacity is acquired. In fact the timing of available capacity (i.e., when the pipeline has available capacity) may require a decision by MGE prior to when the demand forecasts indicate a need.

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[36] Direct testimony of David N. Kirkland , Schedule DNK-6, p. 000003.

Q. CAN YOU SUMMARIZE YOUR ANALYSIS OF THE KEY EVENTS AND DATES RELATIVE TO MS. JENKINS' ASSERTION THAT MGE FAILED TO ADEQUATELY EVALUATE AND DOCUMENT ITS DECISION TO MAINTAIN THE SOUTHERN STAR TOTAL TRANSPORTATION CONTRACT VOLUMES AT THE SAME LEVEL?

A. Ms. Jenkins' current opinions regarding MGE's capacity planning process are completely at odds with the Staff's reports on its reviews and findings in the time period relevant to the Pony Express capacity addition and the Southern Star contract renewal. In 1996, 1997, 1998 and 2000, (i.e., less than one year prior to the Southern Star contract renewal decision and after the Pony Express contract decision), Staff provided specific feedback to MGE through public findings made with the Commission for the express purpose of reporting on MGE's reliability status that MGE's planning process was **adequate** and/or Staff had **no concerns**. (Emphasis added) An LDC's capacity decision process is long-term in nature for numerous reasons, including: the necessary coordination of multiple parties (i.e., pipelines, LDC's, other customers, regulatory bodies, and other intervenors); the engineering and design of the new facilities; and the actual construction and testing of the new facilities. Therefore, since these decisions are made with significant lead time before actual volumes flow, it is unreasonable for the Staff to now assert that the process utilized was not adequate, particularly since the Staff publicly deemed the process as adequate on numerous occasions before the decisions were made. Since the task of the Commission in a prudence situation, as described in the direct testimony of Mr. Reed, is to assess whether the conduct was reasonable at the time, it seems to me that the Staff evaluations of MGE's capacity planning process made contemporaneous with the decisions are far more relevant and convincing than Ms. Jenkins' assertions now.

Q. HAS MS. JENKINS DEMONSTRATED THAT CUSTOMERS HAVE BEEN HARMED BY THE MGE CAPACITY DECISIONS?

A. No. In my direct testimony, particularly pages 19 through 23, I list several benefits of the decisions that were made to add the Pony Express Capacity in 1997 and to consolidate the Southern Star contracts in June 2001. Ms. Jenkins in her direct testimony either ignores or dismisses the benefits associated with MGE's capacity portfolio and focuses exclusively on the costs associated with capacity that she alleges was not needed.

III. THE STAFF'S POSITION IGNORES THE FACT THAT A TRANSPORTATION CAPACITY PORTFOLIO HAS IMPORTANT OBJECTIVES NOT TIED TO PRECISE MATCHING OF DEMAND AT ANY ONE POINT IN TIME

Q. MS. JENKINS DISCUSSES CAPACITY PLANNING IN HER DIRECT TESTIMONY. DO YOU BELIEVE HER DISCUSSION FAIRLY AND ACCURATELY REFLECTS THE GOALS AND OBJECTIVES OF THE CAPACITY PLANNING PROCESS?

A. No.

Q. BASED ON YOUR EXPERIENCE, WHAT ARE THE GOALS OF CAPACITY PLANNERS FOR GAS DISTRIBUTION COMPANIES?

A. The primary goal is to ensure that there is the capacity to deliver the gas to customers with a high degree of certainty under all conditions, including the most adverse or unexpected. There are many other goals as well, including: access to supplies, diversity, flexibility, supply bargaining leverage, deliverability options, and considerations of future upstream capacity availability.[37]

Q. TO YOUR KNOWLEDGE, HAS THE STAFF EVER IDENTIFIED ISSUES THAT SHOULD BE CONSIDERED IN CAPACITY PLANNING AND SUPPLY RELIABILITY?

A. Yes. As I discussed in some detail earlier, the 1996 and 1997 Staff Memos identified certain issues with respect to supply reliability, specifically:

- "provide natural gas every day of the year, especially those days in mid-winter when the temperature never rises above 0 degrees Fahrenheit."[38]
- "maintaining reliability is a much more dynamic process in the gas industry, involving the coordinated efforts of a diverse group of participants"[39]
- "natural gas demand has to be anticipated and ordered"[40]
- Extreme Weather Conditions[41]
- Extensive Supply Well Freeze-offs and/or Storm Damage[42]
- Transmission Pipeline and/or Compressor Failures[43]

[37] Direct testimony of David N. Kirkland, p. 6-9.
[38] Direct testimony of David N. Kirkland , Schedule DNK-2, p. 000137.
[39] Ibid, p. 000137.
[40] Ibid, p. 000137.
[41] Ibid, p. 000138
[42] Ibid, p. 000139
[43] Ibid, p. 000139

Q. DID MS. JENKINS' DIRECT TESTIMONY ADDRESS THOSE ISSUES PREVIOUSLY LISTED BY THE STAFF?

A. No. Ms. Jenkins does not appear to consider the broader context of capacity planning issues/objectives but rather focuses exclusively on the demand forecasting process.

Q. IN YOUR OPINION, HAS MS. JENKINS PORTRAYED THE CAPACITY PLANNING PROCESS APPROPRIATELY?

A. No. She has focused almost exclusively on a narrow five-year comparison of her alternative demand forecast (which we have documented to have severe flaws) to the level of MGE's contracted capacity. For example, Ms. Jenkins states on page 4 of her direct testimony that "Doing a thorough evaluation requires an adequate analysis with sufficient accuracy to avoid overbuying and charging customers more than is reasonable." On page 6 of her direct testimony, Ms. Jenkins states that, "Staff conducts its analysis to ensure that a company buys sufficient capacity, but not too much capacity, to meet firm customer peak day capacity and natural gas supply requirements." In making those statements, not only has Ms. Jenkins ignored several very important aspects of the capacity decisions that were made prior to the ACA periods that are the subject of these proceedings, but she implies a level of precision with respect to an LDC's capacity portfolio relative to expected demand that is not realistic.

As I explained in my direct testimony, there is much more involved in the planning process than a comparison of what Staff thinks the Company needs based solely on

Staff's flawed forecast and the total capacity MGE has under contract at any point in time.

IV. SOUTHERN STAR CONTRACT RENEWAL

Q. PLEASE DISCUSS YOUR UNDERSTANDING OF THE STRATEGY OF MGE WITH RESPECT TO THE CONSOLIDATION OF THE SOUTHERN STAR CONTRACT THAT MS. JENKINS HAS CRITICIZED.

A. As outlined in my direct testimony and in the 1996 Staff Memo, there are many planning issues involved in the capacity acquisition process. I can identify several of these issues and apply the particular issue to the Southern Star capacity decision in June 2001. Specifically, I can address:

- Long-term need/demand of the customers
- Asset/capacity flexibility
- Administrative and operational simplicity
- Future negotiations
- Reduction in reservation charges

Q. PLEASE ADDRESS THE LONG-TERM NEED/DEMAND OF MGE'S CUSTOMERS.

A. As explained in detail above, MGE submitted several reliability reports prior to the execution of the Southern Star contract in which MGE provided and documented its design day forecast approach. In addition, MGE identified the then-current capacity portfolio and additional capacity requirements projected over a ten-year period. Staff provided feedback at various points in time (1996, 1997, 1998, and 2000) that indicated no issues with MGE's planning process or projected capacity levels.

Q. PLEASE ADDRESS THE SECOND ISSUE -- ASSET/CAPACITY FLEXIBILITY.

A. The natural gas industry has undergone significant changes over the past ten to fifteen years and more change is possible in the future. Therefore, one of the considerations in capacity planning has to be the flexibility of the capacity. For example, part of the decision by MGE in June of 2001 to renew the same level of capacity on Southern Star but consolidated into one contract was the fact that the capacity consisted of a significant amount of storage. The value of storage has been well documented in other Commission proceedings involving the general topic of hedging (i.e., Case No. GR-2001-382), but I will briefly list the principal value drivers of the storage of natural gas:

- Storage provides a reliable source of supply should production regions experience events (i.e., well freezes) that cause a curtailment of supply;
- Storage provides the ability for an LDC to manage the demand swings (up and down) of the firm customers that is often not available through contracts for flowing supplies from production facilities, which tend to be fixed in their daily amounts;
- Storage typically provides price stability and acts as a physical hedge as compared to spot market winter gas purchases; and
- Storage may allow an LDC to avoid certain supply and pipeline demand charges.

In addition to the storage value drivers, the Southern Star capacity serves all the MGE regions; thus allowing MGE the ability to manage the load in each region with the storage asset.

Q. PLEASE DISCUSS THE ADMINISTRATIVE AND OPERATIONAL SIMPLICITY OFFERED BY THE SOUTHERN STAR RENEWAL.

A. Reducing the number of individual discrete contracts and services to one consolidated no-notice contract provided MGE operational and administrative benefits. As discussed in the 1996 and 1997 Staff Memos, LDC reliability is influenced by several factors, including the need to estimate demand since: "maintaining reliability is a much more dynamic process in the gas industry involving the coordinated efforts of a diverse group of participants…one of the most important things to remember is that natural gas demand has to be anticipated and ordered…"[44]

The Southern Star contract consolidation reduced the number of contracts that MGE had with Southern Star, reduced the number of nominations that MGE needed to make for gas scheduling, and reduced the administrative workload. In addition to this administrative advantage, MGE also improved its operational position. The new Southern Star contract was a no-notice service which provided MGE with an additional tool to meet weather variability and forecast error across all of MGE's service territory.[45] Specifically, MGE could streamline the gas nomination process, which in turn would improve its ability to meet changing demand situations imposed by its customers as well as the weather and also reduce the exposure to balancing penalties. The TSS contract provides service to all MGE delivery points, thus providing for automatic balancing against the TSS contract storage.

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[44] Ibid, p. 000137.

[45] Direct Testimony of David N. Kirkland, p. 18.

Q. MS. JENKINS STATES A "CONCERN" ON PAGE 19 OF HER DIRECT TESTIMONY REGARDING THE ALLEGED INABILITY OF MGE TO UTILIZE CAPACITY ASSIGNED TO ONE REGION IN ANOTHER REGION, AND SHE CITES SOME RESPONSES YOU GAVE TO DATA REQUESTS AS THE BASIS FOR HER CONCERN. HAS SHE INTERPRETED YOUR RESPONSES CORRECTLY?

A. No. She has misinterpreted the responses that were given. What I said in the responses is that Southern Star has advised that there is no additional firm capacity available at this time in Southwest Missouri and that capacity may be limited by line segment value during Operational Flow Order ("OFO") periods issued by the pipeline. This means that penalties can be assessed by Southern Star by line segment for excessive usage during OFO periods. That does not mean, as apparently she has interpreted, that capacity from one region can never be "used" in another region. Another value of the Southern Star consolidated contract under their TSS service is the ability of Southern Star to make deliveries system-wide, including deliveries to MGE service areas that exceed their assigned delivery point capacity. To the extent that Southern Star is physically able to make deliveries exceeding capacity rights at individual delivery points, Southern Star will do so. In my experience, Southern Star will curtail MGE only if the Southern Star pipeline system is under duress, which is typically the situation you have with OFOs. MGE has experienced this benefit due the flexibility of the TSS service. For example, MGE has exceeded the contract volumes in the Joplin area at the Ozark Nixa delivery point, yet Southern Star has continued to make deliveries and no penalties were incurred by MGE.

Q. DO YOU AGREE WITH MS. JENKINS' STATEMENT ON PAGE 24 AT LINES 16-18 OF HER DIRECT TESTIMONY THAT "EXCESS CAPACITY IN THE KANSAS CITY AND ST. JOSEPH AREAS CANNOT BE SHIFTED FOR DELIVERY TO THE JOPLIN SERVICE AREA WHERE CAPACITY IS INADEQUATE FOR A PEAK COLD DAY"?

A. No. It is true, as I stated in the responses to the data requests, that Southern Star has told MGE that there is no additional firm capacity available in the Joplin area. This coincides with my other statements that Southern Star is highly subscribed and it is very difficult to obtain new firm capacity on Southern Star at any time you might want some. It is also true that Southern Star will not allow a reassignment of firm capacity from St. Joseph and Kansas City to Joplin, since it has no excess capacity at Joplin. However, this does not mean that MGE is not able to utilize this capacity when Southern Star is physically capable of making deliveries over and above the capacity designated under the Southern Star contracts for the Joplin area. Ms. Jenkins' statement does not consider the operating flexibility of the TSS service which allows for the utilization of the entire contract capacity system-wide when the pipeline can provide this service. In other words, the capacity held by MGE in Kansas City and St. Joseph under the TSS contract has value over and above the capacity assignments shown by area in the October 2004 Demand Capacity Report. So, Ms. Jenkins is accurate to the extent she is saying that MGE cannot unilaterally take some of its contracted firm capacity from Kansas City or St. Joseph and reassign it for the remainder of the term of the Southern Star contract as firm capacity to Joplin. She is incorrect, though, to the extent her statements imply that MGE can never exceed its contract limits in Joplin without incurring penalties. As I said before, we can over-deliver to Joplin under our TSS contract, and we have done so, if Southern Star is not in a situation where that would jeopardize delivery to other customers.

Q. PLEASE DISCUSS HOW THE SOUTHERN STAR RENEWAL BETTER POSITIONED MGE WITH RESPECT TO FUTURE CONTRACT NEGOTIATIONS.

A. The consolidation of the numerous Southern Star contracts into one provides MGE with a strategic negotiation advantage. Specifically, by combining all the contracts into one contract, MGE has increased its bargaining position by reducing the potential of the capacity being bid away by another competitor in the interstate pipeline market. In other words, the consolidation of many contracts created one contract with a very large Maximum Daily Quantity (MDQ) that would reduce, if not eliminate, the number of parties who would be capable of bidding on this capacity.

Q. PLEASE DISCUSS THE RESERVATION CHARGE REDUCTION AS A RESULT OF THE CONTRACT CONSOLIDATION.

A. As discussed in my direct testimony, even though MGE was able to negotiate and achieve all the benefits described above, MGE also through this contract consolidation/renewal process was able to reduce the Southern Star reservation charges by $321,108 over the five-year term of the Agreement. That is a direct and quantifiable benefit to our customers.

Q. WOULD YOU PLEASE DISCUSS THE ALTERNATIVE SOUTHERN STAR CAPACITY SCENARIOS IDENTIFIED BY MS. JENKINS ON PAGES 32 AND 33 OF HER DIRECT TESTIMONY?

A. I think they are speculative and unreasonable. First, as stated above, the capacity acquisition process is based on numerous factors that Ms. Jenkins has not considered. Second, the actual alternatives suggested by Ms. Jenkins may not have been available as part of the Southern Star/MGE negotiation. She has not provided any evidence that Southern Star would have agreed to her assumed conditions and that everything else that came out of those negotiations (such as the $1.5 million in transportation discounts, for example) would have remained the same. Third, the Southern Star capacity is low-cost capacity that not only has access to different supply basins but also is the only pipeline that serves all three of MGE's regions. In addition, the Southern Star no-notice service provides MGE with administrative and operational benefits across the three service regions. Fourth, the Southern Star pipeline market area capacity has historically been fully subscribed such that any capacity turned back by MGE would have been re-marketed and likely sold to someone else and, hence, unavailable to MGE in the future. In addition, her proposed reduction of capacity on Southern Star (either as storage or transportation capacity) would have reduced the bargaining power of MGE in other pipeline negotiations and limited MGE's future options. In other words, Staff is suggesting that MGE reduce the most flexible capacity asset it has, which is also low-cost, to achieve a short term capacity reduction but at a potentially much higher long-term cost. I would like to note that regarding Ms. Jenkins' scenario analysis, MGE would not reduce storage as suggested as that would not be reasonable given the value of storage as I have discussed. As I understand her testimony, each of her scenarios 1 and 2 would require that MGE turn back storage capacity. Southern Star storage capacity is highly valued and it is very doubtful that MGE would ever regain the storage capacity it had turned back. As to Ms. Jenkins' scenario 3, it too is unreasonable, not only because it fails to consider the scheduling requirements of Southern Star Central FSS service versus the TSS "no-notice" service but, more importantly, because it would require that MGE turn back market area transportation capacity that, in all likelihood, MGE would not be able to regain in the future and more than likely would have to be acquired at a much higher cost in the future. This is because Southern Star's market area capacity has historically been fully subscribed which means that obtaining additional capacity would require paying higher costs associated with the construction of new capacity.

Q. **MS. JENKINS' POSITION IN THIS CASE APPEARS TO ASSUME THAT MGE COULD EASILY REDUCE CAPACITY ON SOUTHERN STAR IN ONE YEAR AND THEN EASILY AND CHEAPLY REACQUIRE CAPACITY ON THE SAME PIPELINE SEVERAL YEARS LATER IN ORDER TO MORE CLOSELY MATCH CAPACITY WITH ACTUAL DEMAND. FIRST, DO YOU AGREE WITH THAT CHARACTERIZATION OF HER TESTIMONY AND SECOND, DO YOU HAVE AN OPINION BASED ON YOUR EXPERIENCE AS TO WHETHER THAT ASSUMPTION IS VALID?**

A. Yes, I think that is a fair characterization of her testimony and no, I do not believe her assumption is valid. First, since Southern Star has one of the lowest pipeline and storage rates and offers flexible services, it is reasonable to expect that any available capacity would be very attractive to market participants. History shows that the Southern Star Central pipeline has been very highly subscribed. In addition, Southern Star has every incentive to market all of its available capacity; so, it is highly unlikely that MGE would be able to regain in subsequent years any Southern Star capacity that MGE would have turned back as a result of the 2001 negotiations if MGE had taken the course Ms. Jenkins suggested. Finally, the capacity was of some value since it consisted of not only storage but also accessed various supply basins, and provided service to all of MGE's regions.

Q. CAN YOU ELABORATE ON THE FERC RATE DESIGN AND THE DIFFERENT SUPPLY BASINS ACCESSED BY SOUTHERN STAR'S PIPELINE SYSTEM AND PROVIDE A LAYMAN'S EXPLANATION OF WHAT THAT MEANS?

A. The type of FERC-ordered rate design that Southern Star has, in essence, allows pipelines to recover costs via a demand charge (i.e., a fixed monthly rate). If the pipeline has excess capacity, it is not recovering its cost of service and not achieving the allowed profit. Therefore, the pipeline has every incentive to sell any and all excess capacity. Since the Southern Star pipeline has access to different supply basins, capacity on Southern Star offers significant value to MGE and its customers by providing MGE with supply reliability as well as potential commodity pricing advantages through supply basin diversity. In addition, Southern Star also serves Kansas City, St. Joseph, and Joplin, thus allowing MGE to provide no-notice service to these regions via the Southern Star and TSS service/storage assets.

V. CONCLUSIONS

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. Staff has alleged that two MGE capacity decisions (i.e., the 1996 contract bringing an additional Pony Express ** ** MMBtu/day in-service for MGE in October 2001, and the June 2001 Southern Star renewal) were imprudent because MGE did not reasonably evaluate customer demand. This conclusion was reached by Ms. Jenkins: (i) apparently without regard to the conditions existing at the time of the negotiations; (ii) based on a flawed demand forecast, as explained in Mr. Reed's direct and rebuttal testimony; (iii) without considering the numerous other capacity planning factors that an LDC must consider; and (iv) despite the fact that Staff, on four separate occasions closer in time to the decisions, found the MGE reliability reports, including design day forecasting and pipeline capacity described therein, to be adequate.

As I have stated, MGE has consistently provided reliability reports that, over a ten year planning horizon, provided the following information and in a format which was agreed to by several parties, including Staff:

- I. System Demand Projections
  - A. Peak Day Projections
  - B. Annual Load Projections
  - C. Projected Supply/Transportation Requirements
- II. Supply/Delivery Resources
  - A. Pipeline Transportation/Storage Capacity
  - B. Gas Supply Resources[46]

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[46] See, for example, direct testimony of David N. Kirkland, Schedule DNK-2, p. 000140.

Finally, the demand forecast is not the only information utilized by the LDC for capacity acquisition. The acquisition of capacity is a multi-year and multi-party process and will consider among other factors: demand, capacity availability, supply basin diversity, pipeline diversity, market issues (e.g., the influence of other market participants such as gas-fired electric generators), economics, service offerings, and state and federal regulatory issues.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, at this time.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Actual Cost Adjustment for the Period July 1, 2001 through June 30, 2002 and July 1, 2002 through June 30, 2003.	))))	Case No. GR-2002-348 Case No. GR-2003-0330

AFFIDAVIT OF DAVID N. KIRKLAND

STATE OF MISSOURI)
) ss.
COUNTY OF JACKSON)

David N. Kirkland, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

David N. Kirkland

David N. Kirkland

Subscribed and sworn to before me this 31st day of January, 2006.

Danielle McGaughy

Notary Public

My Commission Expires:

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

DANIELLE MCGAUGHY
My Commission Expires
November 7, 2008
Buchanan County
Commission #04409075