BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

STAFF RESPONSE TO MGE'S RESPONSE TO

STAFF RECOMMENDATION AND MOTION TO STRIKE

COMES NOW the Staff ("Staff") of the Missouri Public Service Commission in the above-captioned matter and for response to MGE's Response to Staff Recommendation and Motion to Strike states:

1. On December 29, 2004, Staff filed its recommendation to the Commission in this case, suggesting among other things, that MGE has failed to make prudent decisions regarding gas purchases. As a result of its analysis Staff has proposed disallowances for two issues - MKP/RPC disallowance and excess capacity disallowance.

Staff also recommended additional analysis and documentation related to reliability and hedging. Staff recommended that additional information be submitted by March 23, 2005, to address Staff's comments and concerns in the Reliability Analysis and Purchasing Practices – General section of its recommendation including: (a) MGE Gas Supply Plans – Planned Storage; (b) MGE Documentation for Decisions Related to Natural Gas Purchasing and Storage; (c) Increasing Flowing Supplies for Regulated Customers to Make Up for Volumes Need by Transportation Customers; and (d) Warm Winter Requirements Estimates and Supply Plans for Normal, Warm, and Cold Weather.

Staff recommended that the Company analyze its hedging risk and document its hedging plans and decisions.

2. On February 25, 2005, MGE filed its response and disagreed with the Staff's analysis and proposed that the Commission reject Staff's proposed MKP/RPC disallowance, strike Staff's proposed excess capacity disallowance and strike Staff's documentation comments and recommendations related to reliability and hedging.

3. Staff's Recommendation to the Commission is Staff's response to the Company's ACA filing made on October 17, 2003, in this case and a Motion to Strike is both premature and unfounded. As part of this PGA/ACA case, all contested issues will be fully developed and all supporting documentation will be submitted to the Commission when testimony is filed in this matter. Until that time, it would be premature, and an injustice to the MGE customers for the Commission to strike any of Staff's recommendations.

4. Additionally, in the 2001/2002 ACA, case number GR-2002-348, MGE made similar motions to strike a proposed MKP/RPC disallowance, excess capacity disallowance and the documentation concerns raised by Staff. The Commission order that denied MGE's Motion to Strike also bifurcated the issues of the MKP/RPC disallowance and excess capacity disallowance, and directed the parties to file a proposed procedural schedule.[1]

5. In response to MGE's statement that in this case the Commission reject Staff's proposed MKP/RPC disallowance, in Case No. GR-96-450, MGE overlooks the fact that the Commission stated in its Order that its disallowance in that case did not mean that Staff could not pursue the issue in subsequent cases. MGE's own response (page 3) admits that the nature of the transportation service changed on May 11, 1998. In reviewing the Commission's decision in

[1] See Commission Order in GR-2002-348.

Case No. GR-96-450, it is clear that MGE and KPC made extensive arguments about how KPC's service was not comparable (apples and oranges) to other interstate pipeline services in the area. In fact, MGE and KPC forwarded the premise that in some ways KPC's bundled sales service was superior to firm transportation service on Southern Star Central, the main pipeline used for a comparison. The comparison between the two pipelines rates becomes clearer after May 11, 1998 because the supply feature that was traditionally bundled with the transportation costs was eliminated. This is a critical change since Case No. GR-96-450. But what didn't change is that KPC's transportation charges were well in excess of the alternative, Southern Star Central.

6. MGE criticizes the Staff for its continued display of the disallowance from Case No. GR-96-450 (page 2). The table in Staff's recommendation is a historical listing of the Case No., ACA Period and proposed disallowances on the KPC issue. The recommended disallowance for GR-96-450 is included in this table for illustrative purposes. Staff has no intention to disregard the Commission's decision in Case No. GR-96-450.

7. Also, MGE argues that it had no choice in this contractual issue (page 3), and states that it is wrongly being criticized for actions taking place in 1991, two years before MGE commenced operations (page 2). These were also issues that were discussed in Case No. GR-96-450. However, no ruling was made on whether or not MGE, after acquiring the Missouri properties of Western Resources, Inc. (WRI), effectively "stepped into the shoes" of its predecessor, WRI. The "no detriment standard" was used in the 1993 sales case when MGE purchased these properties from WRI. MGE was assigned this contract by WRI as part of the sale. MGE willingly accepted the contract as part of the property and agreements that came along with the purchase. Much like a contingent liability, there was a detriment contained within the terms of the contract, even though the terms had been negotiated by WRI, not MGE. Using

the "no detriment standard", the Staff identified detriments that could take place *because of the sale,* not detriments that were already part of WRI's business. To ask MGE to cure a pre-existing detriment as a condition of approval would amount to imposing a higher standard than is required. MGE, as part of its negotiations, willingly took on the responsibility for defending the contractual decisions of WRI. Any other interpretation would require an intolerable situation where the buyer is expected to cure all faults of the seller. The adoption of an existing contract that contains additional buyer risk may be negotiated in the sales price and is subject to the due diligence of the buyer to assess the costs and benefits of the overall transaction.

8. During a renegotiation of the contract in early 1995 MGE made some improvements to the contract, but successfully argued in Case No. GR-96-450 that it could not win significant concessions from KPC regarding the high transportation fees. The point of MGE and KPC's argument was that because the contract from 1991 was still in place, MGE had little choice or leverage to insist upon a major reduction of the rate. This argument failed to address the undeniable fact that MGE became responsible for WRI's decisions when it took assignment of the existing contract. MGE chose to buy WRI's Missouri properties. MGE chose the price it paid for the WRI properties and related obligations. These decisions were under MGE's control. If MGE asserts that the Commission "pre-approved" all contracts – including gas supply and others - then MGE should be able to cite an Order with specific language pre-approving the contracts. To date, all that MGE has been able to reference is a "list" of agreements that it was acquiring as part of the sale. Just as certain aspects of the rate base that MGE acquired could be questioned and disallowed in a subsequent rate case, the gas supply and transportation contracts could similarly be questioned. Again there was *no change* regarding these agreements due to the sale. Agreements were reassigned or split between WRI and MGE.

9. Finally, new evidence has come to light from Case No. GR-2001-382, the 2000-2001 ACA case, where MGE witness Mr. Langston argued that in virtually every instance KPC was a more expensive option than Southern Star Central. Mr. Langston stated that the capacity release market (a market that allows some ability to mitigate fixed pipeline transportation fees) was not liquid on KPC because KPC-sourced gas was often more expensive than alternatives. Variable transportation on KPC was more expensive; and, operationally, KPC's contracts were more difficult to administer.

10. MGE raises the filed rate doctrine as a defense. The Staff is not challenging the FERC rate, but is instead challenging MGE's judgment in entering into this contract. A failure of judgment is not protected by the filed rate doctrine

11. It is premature for the Commission to consider striking Staff's proposed excess capacity disallowance. In addition to the reasons noted above, all of which are sufficient alone to deny MGE's Motion, Staff has raised serious doubts about, among other things, the adequacy of the information on which MGE is basing its natural gas capacity decisions and MGE's acumen and judgment in making its decisions. This challenge to MGE's prudence should not be determined until the Commission has had a full and fair hearing. The courts have held that a utility is only entitled to recover costs that are prudently incurred.

> All charges for gas service must be just and reasonable. Section 393.130.1, RSMo 1994. The PSC has employed a "prudence" standard to determine whether a utility's costs meet this statutory requirement. If a utility's costs satisfy the prudence standard, the utility is entitled to recover those costs from its customers. The PSC has defined its prudence standard as follows: [A] utility's costs are presumed to be prudently incurred. However, the presumption does not survive "a showing of inefficiency or improvidence."
> ... [W]here some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent.

State ex rel. Associated Natural Gas Co. v. Public Service Comm'n, 954 S.W.2d 520, 528 (Mo.App. 1997). Staff has shown and will further demonstrate in testimony filed in this case, the inefficiency and improvidence of MGE's decisions.

12. MGE's request that Staff's recommendations regarding MGE's hedging and MGE's Reliability Analysis and Purchasing Practices- General be stricken also lacks any sound basis. It is specious to argue that the Commission may not order corrective action in a PGA/ACA review. The Commission has the statutory mandate to assure that consumers are paying only just and reasonable rates. Section 393.130.1, RSMo 2000. MGE is a regulated utility, subject to the oversight of the Commission for its natural gas supply and transportation decisions. Staff must review the LDC's actions in light of conditions and information known at the time the decisions and actions were taken and make a recommendation to the Commission in response to the Company's ACA filing.

13. The alternative to identifying deficiencies in a procurement planning process is to remain silent about concerns that arose during the ACA review. In past ACA proceedings, MGE has commented that it is at a disadvantage when no upfront notice is given regarding Staff's concerns. Additionally, MGE's argument that Staff seeks to implement standards in Missouri and that the way to do so is through a rulemaking rather than through comments in the ACA process, are inappropriate. Staff is not seeking to establish the same requirements or standards for each and every LDC in Missouri. Staff's comments in this case do not address the actions of the other LDCs, but are directly tied to the planning and documentation process of MGE. Each LDC has its own planning process based on its specific conditions and restrictions such as growth that is unique to its service areas, customer consumption patterns in each LDC service area, tariff constraints that are specific to the pipelines in each service area, natural gas supply

and pricing considerations that are specific to each service area, and natural gas storage constraints that are unique to that service area. An LDC must have the flexibility to plan for its needs, not the needs of all the LDC's in Missouri. Thus, Staff's review is specific to each LDC and Staff is only addressing the planning and documentation process of MGE in this case. To defer the issues specific to MGE to a rulemaking proceeding delays action on issues to some uncertain time in the future, and corrective action may need to be taken promptly to protect consumers.

14. The Commission opposed additional burdensome regulation on planning when it stated in its June 2, 1995, GO-95-329 Order Regarding Joint Motion to Determine the Need for Integrated Resource Planning Rules for Gas Utilities:

> It is clear that, in a post-636 era of governmental restraint and greater freedom in the operation of the competitive market, additional burdensome regulation imposed by this Commission would be undesirable and regarded as anathema. It is equally clear that capable long-range planning is no longer an option, but a business necessity for those utilities that hope to survive in an increasingly competitive environment. …..
>
> The Commission would restate, therefore, that the purpose of IRP rules is to promote well-supported, thorough, long-range planning by regulated utilities. …
>
> …the Commission has determined that the wisest course of action at the present time is to postpone consideration as to whether the Commission should go forward with some type of planning rule for gas.

The Commission order states that workshops and all other efforts by the Staff of the Commission to advance the preparation of integrated resource planning rules for gas utilities are cancelled pending further order of the Commission. It further ordered that the Commission will reconsider the necessity for planning rules for gas utilities after the final first-round electric utility IRP filing is completed and approved.

The regulated electric utilities are currently operating under a waiver from the requirement to file an Integrated Resource Plan in compliance with the Electric Utility Resource Planning Rules 4CSR240-22.010 through 22.080.

15. MGE attempts to limit the Commission's jurisdiction to review its gas purchasing procedures is directly counter to the court's decision in which it found the PGA/ACA process to be lawful.

16. Although MGE asked the Commission to strike numerous Staff recommendations, MGE also responded to some of the comments made in the Staff recommendation related to reliability. Staff's response to the Company comments follow:

(a) MGE disagrees with Staff's comments regarding MGE Gas Supply Plans – Planned Storage. Storage plans were also an issue in the 2000/2001 ACA, case number GR-2001-382. Staff proposes no dollar adjustment for this issue. Staff suggests this issue go no further other than to emphasize its continuing concern about MGE's planned use of natural gas from storage and its dollar impact in subsequent Staff ACA reviews.

(b) MGE disagrees with Staff's comments regarding MGE Documentation for Decisions Related To Natural Gas Purchasing and Storage Utilization. MGE asserts that Staff is requesting MGE to produce much more documentation than MGE currently maintains. Staff disagrees. Based on MGE responses to Staff data requests, it appears that weekday storage analysis reports were available at one time, and were in fact run more than once per day on numerous occasions. Staff is not asking MGE to create more information, as MGE stated in its Response. Staff is merely asking MGE to keep the copies of the daily storage reports that MGE claims to run, and to provide those report copies to Staff during the ACA review, instead of discarding them. Staff recommends that the Commission Order MGE to retain copies of reports

that it already generates, rather than discarding them, and to provide these copies to Staff during the ACA reviews.

(c) MGE states that it believes the issue of Increasing Flowing Supplies for Regulated Customers To Make Up for Volumes Needed by Transportation Customers should have been addressed by virtue of the more rigorous balancing requirements applicable to MGE's Large Volume Transportation customers contained in tariff sheet number 59-67 effective November 1, 2003. Staff also believes that its documentation concerns regarding this issue will be addressed going forward because MGE began keeping more detailed information in March 2003. Accordingly, Staff agrees to set aside this issue for now.

(d) MGE disagrees with Staff's comments regarding MGE Warm Winter Requirements Estimates and Supply Plans for Normal, Warm, and Cold Weather. MGE asserts that the Staff's recommendation is vague and not a proper topic for consideration in this ACA proceeding. However, on April 1, 2004 MGE provided a draft March 2004 Demand/Capacity Analysis and this draft report contains information for normal months forecasts and design winter forecasts. MGE has stated on numerous occasions that a key consideration in the forecasting process is firm demand during extreme weather conditions. Staff believes that this issue is not vague. MGE has made an attempt to provide a more detailed natural gas demand/capacity analyses. The MGE draft March 2004 Demand/Capacity Analysis and the October 2004 Demand/Capacity Analysis will affect the Company's planning for the 2004/2005 ACA. Staff points out these supply concerns so that MGE is aware of Staff's belief that inadequate supply plans could have large dollar impact in subsequent Staff ACA reviews. Thus, Staff agrees to set this documentation issue aside for this ACA case.

17. Since there are no dollar adjustments in this ACA related to hedging, Staff proposes not to further advance the hedging issue. But Staff raises hedging concerns so that MGE is aware of Staff's belief that inadequate plans for hedging including supporting documentation - could have large dollar impact in subsequent ACA reviews. MGE asserts that Staff's Hedging recommendation is vague. Staff has noted that there is no current hedging plan or risk management plan. To be more specific, MGE has not provided an updated hedging policy to Staff since fiscal year 1998. Staff recommends that this four-year-old plan be updated. Staff also raises concerns regarding hedging coverage, with specifics given in the Staff recommendation. If MGE finds any other hedging comments vague, Staff suggests that a meeting be scheduled to discuss these areas.

WHEREFORE, for the above stated reasons, the Staff recommends that the Commission deny MGE's Motion to Strike.

Respectfully submitted,

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I hereby certify that copies of the foregoing have been mailed, hand-delivered, or transmitted by facsimile or electronic mail to all counsel of record this 7th day of March 2005.

/s/ Robert S. Berlin