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MISSOURI PUBLIC SERVICE COMMISSION

MISSOURI GAS ENERGY

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

DIRECT TESTIMONY

OF

DAVID N. KIRKLAND

ON BEHALF OF MISSOURI GAS ENERGY

Jefferson City, Missouri

November 2005

Denotes Highly Confidential Material

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DIRECT TESTIMONY OF

DAVID N. KIRKLAND

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DIRECT TESTIMONY OF DAVID N. KIRKLAND
ON BEHALF OF
MISSOURI GAS ENERGY

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. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am the Director of Gas Supply for Missouri Gas Energy ("MGE"), a division of Southern Union Company ("Southern Union").

Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND EMPLOYMENT BACKGROUND.

A. My formal education includes a Bachelor of Science degree in Civil Engineering from New Mexico State University and professional development programs at the University of Colorado and the University of Michigan. My industry experience and employment history includes:

- 1973 – 1982: Southern Union Gas Company; The City of Las Cruces, New Mexico; Northwest Pipeline Corporation; Gas Company of New Mexico - Engineer and Senior Engineer positions.

- 1982 – 1986: Gas Company of New Mexico - Operations Manager, San Juan District; Responsible for all technical operations of a natural gas gathering and transmission system comprised of 2700 wells, 900 miles of gathering line, 750 miles of transmission pipeline and compression operations.

- 1986 – 1988: Public Service Company of New Mexico - District Manager, San Juan District; Responsible for all operations of the San Juan District natural gas gathering and transmission systems.

- 1988 – 1991: Public Service Company of New Mexico - Director Volume Control; Responsible for gathering systems production control, gas purchase contract obligations, gas transportation functions and negotiating contract settlements.

- 1991 – 1997: Public Service Company of New Mexico - Director Transmission Engineering; Responsible for transmission facility planning, storage operations, reservoir engineering, transmission systems engineering, and business case development for new market opportunities.

- 1997 – 2002: Public Service Company of New Mexico - Director Gas Systems Operations and Engineering; Responsible for supply planning, interstate transportation agreements, FERC regulatory activities, transmission facility planning, storage development, facility engineering and compressor operations.

- 2002 - Present - Missouri Gas Energy - Director of Gas Supply

Q. WHAT ARE YOUR DUTIES AND RESPONSIBILITIES AS MGE'S DIRECTOR OF GAS SUPPLY?

A. The primary responsibilities of this position are threefold: the planning and acquisition of a supply and capacity portfolio to provide continuous reliable gas service to MGE's customer; the management of that supply and capacity portfolio to minimize cost to customers; and regulatory responsibilities associated with these supply/capacity acquisition and management responsibilities.

I. INTRODUCTION

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

A. The purpose of my direct testimony is to provide the Missouri Public Service Commission ("Commission") with the following:

- A general description of the capacity planning and acquisition process undertaken by natural gas local distribution companies ("LDCs") such as MGE, including the identification of some of the objectives, tools and constraints involved in the process;

- The history surrounding MGE's capacity planning and acquisition from February 1994 through June 2003, or the time MGE commenced service through the end of the Annual Cost Adjustment ("ACA") period covered by the cases in this proceeding; and

- The history surrounding the regulatory treatment of MGE's capacity-related sharing mechanisms that have generated substantial monetary benefits for customers.

Q. WHAT IS YOUR UNDERSTANDING OF THE ISSUES IN THIS CASE AT THIS TIME?

A. It is my understanding that the Commission Staff ("Staff") filed a memorandum in December 2003 and another memorandum in December 2004 alleging that MGE had surplus capacity in the 2001/2002 and 2002/2003 ACA periods, respectively, and as such, recommended a combined disallowance for both ACA periods of slightly greater than $4 million. It is also my understanding that Staff's recommended disallowances are based on a new and unique approach as to how MGE should conduct its capacity planning and acquisition process, a process that was neither communicated to MGE prior to the 2001/2002 ACA period nor approved by the Commission.[1]

[1] Although Staff raised other issues in its memoranda, my understanding is that those other issues are not being addressed at this time. Specifically, the Kansas Pipeline issue addressed by the Commission in its order in Case No. GR-96-450 has been bifurcated, and is not being addressed at this time, pending resolution of the appeal of that order. (*See*, Order Consolidating Cases And Establishing Procedural Schedule, Case Nos. GR-2002-348 and GR-2003-0330, Dated April 12, 2005). Staff also addressed "gas supply plans - planned storage" in its memorandum and, in response to an MGE pleading, suggested that this issue "go no further" in this proceeding. (*See*, Staff Response to MGE's Response to Staff Recommendation and Motion to Strike, p. 8, filed on or about March 7, 2005, in Case No. GR-2003-0330). Staff also addressed in its memorandum the matter of increasing flowing supplies for regulated customers to make up for volumes needed by transportation customers and, in response to an MGE pleading, agreed ". . . to set aside this issue for now." (*See*, Staff Response to MGE's Response to Staff Recommendation and Motion to Strike, p. 9, filed on or about March 7, 2005, in Case No. GR-2003-0330). Staff also made comments in its memorandum (cont. next page)

Q. BASED ON YOUR REVIEW OF STAFF'S ANALYSIS, WHAT CONCLUSIONS HAVE YOU DRAWN?

A. The disallowances as calculated by the Staff are unfounded and inappropriate for a number of reasons. First, the capacity planning process is not simply a formulaic process as Staff seems to suggest. Rather, there are numerous variables and constraints that have to be addressed by a LDC to secure sufficient natural gas supplies and pipeline capacity to make sure that customers have natural gas when they need it the most, particularly considering the potentially severe human and economic consequences if curtailments and/or outages occur. Second, there are numerous benefits beyond simply meeting design day demand[2] that MGE's capacity portfolio presents, including supply diversity, operating and economic flexibility, and reliability benefits. Lastly, MGE's customers derived substantial benefits from the capacity portfolio that MGE held during the 2001/2002 and 2002/2003 ACA periods, and those benefits have already been realized by customers, yet Staff is now seeking to penalize MGE for holding the very same capacity portfolio that made those benefits possible.

regarding "MGE warm winter requirements estimates and supply plans for normal, warm, and cold weather" but, in response to an MGE pleading, agreed ". . . to set this documentation issue aside for this ACA case." (*See*, Staff Response to MGE's Response to Staff Recommendation and Motion to Strike, p. 9, filed on or about March 7, 2005, in Case No. GR-2003-0330). The Staff also proposed, in response to an MGE pleading, ". . .not to further advance the hedging issue" in this case. (*See*, Staff Response to MGE's Response to Staff Recommendation and Motion to Strike, p. 10, filed on or about March 7, 2005, in Case No. GR-2003-0330)

[2] As noted in the testimony of MGE Witness Reed, design day demand is defined as the maximum demand that the utility is expected to experience under extreme conditions, which may or may not occur during a particular year.

II. THE LDC CAPACITY PLANNING AND ACQUISITION PROCESS

Q. DO LDCs OWN OR CONTROL THE SUPPLY AND TRANSPORTATION ASSETS THAT ARE REQUIRED TO DELIVER GAS FROM PRODUCTION AREAS TO MARKET AREAS?

A. No. As a general matter, LDCs such as MGE do not own or control assets that produce the natural gas commodity it distributes to its customers. Likewise, as a general matter, LDCs do not own or control assets that transmit the natural gas commodity from the producing areas to the market areas where it is distributed to end use customers. Consequently, LDCs must contract with third parties to acquire the natural gas commodity and then to transport it to their distribution system.

Q. PLEASE DESCRIBE THE PROCESS A LDC UNDERTAKES TO ACQUIRE PIPELINE CAPACITY TO MEET THE NEEDS OF ITS CUSTOMERS.

A. The planning process begins with a comparison of the amount of capacity currently under contract to the projected design day demand over a future planning horizon. Typically, the forecast extends for a minimum of ten years, and seeks to analyze and project future system demand based on historical weather, customer usage patterns and customer growth. It is important to understand that demand forecasts are exactly that – forecasts – and are thus estimates that are subject to on-going revision as subsequent periodic analyses are undertaken on the basis of more current information (e.g., customer demand, customer growth, current weather data). The projected demand is then compared to the existing and available capacity, and any difference indicates the amount and timing of capacity that may need to be added to the portfolio. It is also important to recognize that

this quantification represents a starting point in the capacity acquisition process that is also affected significantly by a host of other factors.

Q. AFTER THE AMOUNT AND TIMING OF CAPACITY NEEDS HAVE BEEN PROJECTED THROUGH THE DEMAND FORECASTING PROCESS, WHAT IS THE NEXT STEP IN THE CAPACITY PLANNING AND ACQUISITION PROCESS?

A. Once the demand forecast has been conducted, capacity availability and alternatives must be identified and assessed in light of a number of factors, including competitive market factors, economics, reliability, supply basin diversity, pipeline diversity, regulatory considerations and pipeline tariff requirements. Since natural gas pipelines construct incremental capacity in large blocks on a periodic basis as opposed to having capacity available on a continual basis, and since actual demand rarely mirrors forecasted demand, it is generally not possible to match capacity to forecasted demand with precision. As such, capacity must be acquired when it becomes available through a capacity posting process or when an expansion-related opportunity becomes available through an open season.

Q. WOULD YOU CHARACTERIZE THE CAPACITY PLANNING AND ACQUISITION PROCESS AS STRAIGHTFORWARD OR FORMULAIC?

A. Absolutely not. The capacity planning and acquisition process is a complex process that requires the consideration of numerous factors, many of which are beyond the control of

the LDC. As such, I would characterize the capacity and acquisition process as part art and part science.

Q. CAN THERE BE SERIOUS CONSEQUENCES ASSOCIATED WITH NOT HAVING SUFFICIENT PIPELINE CAPACITY TO MEET CUSTOMERS' DESIGN DAY DEMAND REQUIREMENTS?

A. Yes, there can be very dire consequences if a LDC does not have sufficient capacity to meet its customers' requirements during extreme cold weather events. Specifically, the lack of sufficient capacity can result in the curtailment of service to lower priority customers (from a human needs perspective) or the loss of service to all customers in a given geographic region, depending on the circumstances. Such situations can result in significant direct and indirect human and financial costs. For example, direct consequences include human harm/loss of life, the time and expense associated with shutting all affected customers down safely and then safely re-establishing service to those customers, and personal property damage associated with a lack of heat during extreme cold weather. Indirect costs include damages claims beyond the direct human or personal property harm resulting from the lack of gas service, including lawsuits, lost business, and displacement costs for those required to seek alternative housing. Therefore, while the capacity planning and acquisition process is full of uncertainty, and LDCs such as MGE strive to address those uncertainties in a cost-effective manner, the consequences of insufficient capacity are so significant that it is imperative to develop a reasonable, yet conservative, capacity plan designed to meet firm customer requirements under extreme cold weather conditions.

III. CAPACITY PLANNING AND ACQUISITION BY MGE

Q. HAVE THE DISTRIBUTION SERVICE TERRITORIES CURRENTLY SERVED BY MGE ALWAYS BEEN A PART OF MGE?

A. No. Prior to February 1994, Western Resources operated natural gas distribution systems in both Kansas and Missouri and operated those systems as an undivided whole. However, in February 1994, Southern Union purchased the Missouri distribution properties of Western Resources, and these properties became MGE. Since Western Resources retained the Kansas distribution properties, the sale of the Missouri properties to Southern Union required that the existing pipeline supply and capacity contracts be apportioned between the two states/companies. The apportionments were provided for in the sale contract between Western Resources and Southern Union, which was approved by the Commission in late 1993.

Q. WHAT PIPELINES SERVE MGE'S SERVICE TERRITORY?

A. MGE's distribution system was originally supplied by three pipeline companies: Williams Gas Pipeline – Central (now known as Southern Star Central ("Southern Star")), Panhandle Eastern Pipe Line Company ("PEPL"), and Kansas Pipeline Operating Company ("KPOC") (also referred to as Riverside or Mid-Kansas Partnership and now known as Enbridge Pipelines (KPC)). In 1997, a new pipeline was constructed that provided additional access to MGE's service territory, i.e., the Pony Express Pipeline. A representational map of the pipelines currently serving MGE's service territories is attached as Schedule DNK-1. This map is not intended to be an accurate portrayal of the

entire length of all the different pipelines, but rather only those portions that serve MGE and to provide a sense of the various supply basins that are accessed by each pipeline.

Q. TO WHICH SUPPLY BASINS ARE THE PIPELINES THAT SERVE MGE'S SERVICE TERRITORY DIRECTLY CONNECTED?

A. Southern Star is directly connected to the Anadarko, Hugoton and Rocky Mountain supply basins. PEPL is directly connected to the Anadarko and Hugoton supply basins. KPOC, through the Energex pipeline system, is connected to the Anadarko and Arkoma supply basins. Pony Express is directly connected to the Rocky Mountain supply basins. As such, as shown on Schedule DNK-1, MGE has access to diverse supply sources, including the Texas/Oklahoma and Rocky Mountain regions.

Q. PLEASE DESCRIBE MGE'S CAPACITY PLANNING PROCESS.

A. Since commencing operations in Missouri in February 1994, MGE's capacity planning effort has been an ongoing and evolving process that considers all of the factors that I described previously. Generally, MGE's capacity planning efforts have been reflected in documents known as Reliability Reports that were submitted to the Commission.

Q. WHEN DID MGE FIRST BEGIN SUBMITTING RELIABILITY REPORTS TO THE COMMISSION?

A. MGE submitted its first reliability report on July 1, 1996, as a result of the Commission's orders in Case No. GO-94-318 (*Re: Missouri Gas Energy*, 4 MPSC 3d 299, 312 (January 31, 1996)) and GO-96-243 (*Re: Missouri Gas Energy*, 4 MPSC 3d 419 (April 2, 1996)).

The Commission's rationale for requiring the submission of these reliability reports was as follows:

> [T]he Commission is concerned that the use of the gas cost incentive mechanism has the potential of causing MGE to modify its purchasing strategy too much in favor of short term supply and, thus, potentially jeopardizing gas supply reliability. Thus, the Commission shall order MGE to file gas supply reliability data no later than May 1, 1996. The filing shall relate to MGE's gas procurement strategy for its next ACA period (July 1, 1996, through June 30, 1997). The purpose of the filing is to ensure that MGE procures natural gas in a manner consistent with the goal of maintaining gas supply reliability. The Commission shall further order MGE to file gas supply reliability data by May 1, 1997, and May 1, 1998, for the then immediately subsequent ACA period. The Staff shall file, and other parties to GO-96-243 may file, a response to MGE's gas supply reliability in GO-96-243 no later than June 1, 1996, June 1, 1997, and June 1, 1998, for the then immediately subsequent ACA period. The response(s) shall indicate whether the filing party is in agreement with MGE. If there are areas of disagreement, those areas shall be identified and party positions provided for Commission determination. The Commission shall create docket no. GO-96-243 in this Report And Order for the receipt of the gas supply reliability filings and other filings pertaining to the financial incentive mechanism. (*Re: Missouri Gas Energy*, 4 MPSC 3d 299, 311 (January 31, 1996).

The reliability reports filed by MGE on or about July 1, 1996, July 1, 1997 and July 1, 1998, along with the Commission Staff's responsive filings, are attached to this testimony as Schedules DNK-2, DNK-3 and DNK-4, respectively.

Q. DID THE COMMISSION STAFF CONDUCT A RELIABILITY ANALYSIS SUBSEQUENT TO ITS SUBMISSION OF ITS RESPONSE TO MGE'S JULY 1998 RELIABILITY REPORT (APPENDED HERETO AS A PART OF SCHEDULE DNK-4)?

A. Yes. In a memorandum filed in Case No. GR-99-304 (MGE's 1998 – 1999 ACA) on or about August 1, 2000 the Staff stated:

> [I]n 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**.
>
> (*See* Schedule DNK-5, Appendix A, page 1 of 3, emphasis supplied)

Also, in a memorandum filed in Case No. GR-2000-425 (MGE's 1999 – 2000 ACA) on or about November 27, 2001, the Staff stated:

> [I]n addition, Staff conducted a reliability analysis for MGE including a review of estimated peak day requirements and the capacity levels to meet those requirements, peak day estimated demand, and annual estimated demand.
>
> (*See* Schedule DNK-6, Attachment A, page 1 of 3)

Later in that same memorandum, the Staff stated:

> [I]n 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.
>
> (*See* Schedule DNK-6, Attachment A, page 2 of 3)

Q. DID MGE CONTINUE TO SUBMIT RELIABILITY REPORTS SUBSEQUENT TO JULY 1, 1998?

A. Yes. While MGE did not submit a reliability report on July 1, 1999, as a result of the Commission's approval of an Amended Stipulation and Agreement ("Amended Stipulation") in Case No. GO-2000-705, MGE submitted reliability reports on or about July 1, 2000, July 1, 2001, and July 1, 2002. A copy of the Commission's order approving the Amended Stipulation is attached as Schedule DNK-7, and copies of the July 2000, July 2001 and July 2002 reliability reports are attached as Schedules DNK-8,

DNK-9 and DNK-10, respectively. In preparing the reliability reports, MGE analyzed the changing growth and usage characteristics and updated subsequent design day demand forecasts based on these changing characteristics.

Starting with the July 2000 Reliability Report, Staff reviewed MGE reliability report submissions through the ACA process, and thus the Staff's responses to those MGE reliability reports were not filed with the Commission until much later, i.e., Staff submitted its response to MGE in December 2002 concerning the July 2000 Reliability Report, in December 2003 concerning the July 2001 Reliability Report, and in December 2004 concerning the July 2002 Reliability Report, or eighteen months after the reports were first submitted by MGE. Those Staff responses are attached to my testimony as Schedules DNK-11, DNK-12 and DNK-13, respectively.

Most recently, MGE submitted a Demand/Capacity Analysis in October 2004, which is attached hereto as Schedule DNK-14. MGE intends to submit updated demand/capacity analyses, similar to Schedule DNK-14 on a periodic basis going forward.

Q. WHAT CAPACITY ADDITIONS HAS MGE MADE TO ITS MARKET AREA PORTFOLIO SINCE FEBRUARY 1994?

A. Since 1994, there have been only three primary instances in which MGE has made capacity additions/realignments to its market area pipeline capacity position, i.e., in 1996, 2000 and 2001. Specifically, in 1994, MGE had approximately **_____** MMBtu/day of market-area pipeline capacity. Through capacity additions and

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realignments over the following nine years, MGE's capacity portfolio increased to ** ** MMBtu/day by the end of the 2002/2003 ACA period. The additional capacity was not only added to provide for customer growth, but also to increase reliability by diversifying access to pipelines and supply basins.

For ease of reference, I will describe MGE's capacity position according to the following time periods in which the capacity was held, i.e., February 1994 through September 1997; October 1997 through May 2000; and June 2000 through June 2003. Tables summarizing MGE's pipeline capacity position during each of these three periods are attached as Schedule DNK-15.

Q. PLEASE DESCRIBE MGE'S PROJECTED DEMAND AND CAPACITY UNDER CONTRACT DURING THE FEBRUARY 1994 THROUGH SEPTEMBER 1997 TIMEFRAME.

A. As noted earlier, MGE's distribution system was supplied by three pipelines, i.e., Southern Star, PEPL and KPOC, upon commencing operation on February 1, 1994. As shown on Schedule DNK-15, MGE had **___** MMBtu/day of pipeline capacity and **___** MMBtu of storage capacity during this period that had been allocated to it as part of the Western Resources sale. However, as shown on Schedule DNK-16, which is a summary of MGE's projected design day demand from its various reliability reports, the projected design day demand as of July 1, 1996 exceeded MGE's existing capacity, indicating an immediate need for additional capacity.

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Q. PLEASE DESCRIBE MGE'S PROJECTED DEMAND AND CAPACITY UNDER CONTRACT DURING THE OCTOBER 1997 THROUGH MAY 2000 TIMEFRAME.

A. Due to the projected need for additional capacity, MGE contracted with Kinder Morgan (formerly KN Interstate Gas Transmission) in November 1996 for the addition of two separate increments of future capacity on the newly developed Pony Express Pipeline ("Pony Express") from the Cheyenne Hub in the Rocky Mountain supply basin:

- **___** Dth/day of transportation capacity to be effective November 1997; and
- **___** Dth/day of additional transportation capacity effective October 2001.

At the same time, MGE also reduced its capacity on Southern Star by a net of **___** MMBtu/day, which included a **___** MMBtu/day reduction to serve Kansas City/St. Joseph and a **___** MMBtu/day addition to serve Joplin.

Therefore, with these Pony Express and Southern Star contracts, MGE's capacity increased by a net of approximately **___** MMBtu/day. Based on the forecast in the July 1996 Reliability Report, this additional capacity was necessary to meet the projected design day demand through the winter of 2000/2001. In addition to meeting design day demand, the incremental Pony Express capacity provided MGE with access to the Cheyenne Hub and lower cost gas supplies from the Rocky Mountains supply basin. The Rocky Mountains supply basin continues to be the fastest growing region of supply additions in the continental United States, and the access to this supply basin provided by the Pony Express contract has benefited MGE customers by diversifying MGE's capacity portfolio away from the more mature and declining Hugoton and Anadarko supply

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basins. Furthermore, the Pony Express/Panhandle interconnection provided access to a major interstate pipeline, thereby increasing access to Mid-Continent gas supplies, storage services and trading opportunities. Moreover, the addition of the Pony Express capacity, as a new pipeline entrant to MGE's market area, provided beneficial pipeline diversity, reduced MGE's previous heavy reliance on Southern Star, and added significant new competitive dynamics to MGE's market.

Q. PLEASE DESCRIBE MGE'S PROJECTED DEMAND AND CAPACITY UNDER CONTRACT DURING THE JUNE 2000 THROUGH JUNE 2003 TIMEFRAME.

A. In mid-2000, MGE increased the amount of transportation capacity it held with PEPL, while at the same time reducing capacity on Southern Star. Specifically, MGE reduced its transportation capacity on Southern Star in May 2000 by **___** MMBtu/day, and then increased its transportation capacity on PEPL in October 2000 by **_____** MMBtu/day. MGE also increased its PEPL storage capacity by **___** MMBtu at this time as well. These changes allowed MGE to meet the growing needs of Warrensburg, Missouri (which is also served by Southern Star) and provided an additional source of physical supply for MGE delivery points and firm delivery to the Pony Express system. This capacity added supply and delivery flexibility, allowed MGE to meet Southern Star tariff operating requirements, and reduced MGE's reliance on Southern Star while maintaining a high degree of reliability.

In 2001, MGE reached an agreement with Southern Star to consolidate certain of MGE's existing firm transportation and storage contracts into a no-notice service (known as TSS

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Service on Southern Star) contract. The total capacity under contract with Southern Star did not change as a result of this consolidation; however, the consolidation reduced MGE's reservation charges by $321,108 over the five-year term of the agreement. More importantly, the new TSS Service contract provided MGE with substantially increased flexibility at less cost. Specifically, the enhanced flexibility allowed MGE to utilize the Southern Star storage service to balance daily over- and under-pulls from gas supplies scheduled and flowing on Southern Star without making any scheduling orders or nominations in advance. This renegotiated contract provided MGE with greater latitude to receive volumes exceeding contracted deliveries at any individual citygate without incurring contract over-run penalties. By consolidating these contracts, MGE also reduced the administrative burden associated with periodic renewal or bidding of smaller capacity contracts, thereby reducing the risk of being the losing bidder on such smaller capacity contracts. Securing this capacity was important since Southern Star has historically operated with subscription levels approaching 100% for both storage service and transportation service.

In addition to the other capacity changes just described, MGE's transportation capacity also increased by the additional **___** MMBtu/day on Pony Express effective October 2001 as a result of the contract negotiated in November 1996. Thus, with each of these changes, MGE's transportation capacity increased to its current level of **_____** MMBtu/day, or a level approximating the projected design day demand for 2004/2005 forecast in the July 2001 Reliability Report.

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Q. FROM A HISTORICAL PERSPECTIVE, HAS THE AMOUNT OF CAPACITY HELD BY MGE BEEN REASONABLE COMPARED TO ITS DEMAND FORECASTS?

A. Yes. Based on when the capacity was added and/or contracts realigned, MGE's level of capacity has been reasonable compared to its demand forecasts. As discussed, considering that capacity generally becomes available in large blocks, and capacity accessing new supply sources is not usually readily available, MGE's capacity has consistently been sufficient to meet design day demand within a projected period of five years or less.

Q. WHAT BENEFITS DOES THE CAPACITY PORTFOLIO THAT MGE HAS ASSEMBLED TO MEET ITS CUSTOMERS' DESIGN DAY REQUIREMENTS PROVIDE?

A. There are numerous benefits that MGE's capacity portfolio provides:

- First and foremost, MGE has developed a capacity portfolio that will provide reliable service throughout the year, including during extreme cold weather events;
- Second, the portfolio has a mix of assets, i.e., both pipeline and storage, that enhance reliability and minimize cost;
- Third, the portfolio is diversified both in terms of pipelines relied upon and supply basins accessed, which reduces concentration risk;
- Fourth, MGE's capacity portfolio provides access not only to new supplies, but also to a diversity of suppliers and marketing companies operating on these pipeline systems; and
- Lastly, the portfolio is sufficiently flexible allowing MGE to successfully respond not only to short-term market conditions, but future changes as well.

Q. DOES THE PORTFOLIO MGE HAS ASSEMBLED TO MEET ITS CUSTOMERS DESIGN DAY REQUIREMENTS PROVIDE ANY ADDITIONAL BENEFITS?

A. Yes. In addition to the benefits just discussed, MGE has actively managed its supply portfolio to provide substantial mitigation of the costs of holding that capacity. Through the management of its capacity portfolio, MGE has been able to provide mitigation savings to customers in two ways: capacity release revenues and transportation contract discounts. Since a capacity portfolio is assembled in order to meet customers' design day requirements, the capacity is not fully utilized for most of the year. As such, on many days, there is capacity that is not required to meet customer demand and thus can be attempted to be sold to third-parties. In addition to capacity release opportunities, there are also opportunities to obtain discounts. Depending on the specific circumstances at the time, pipeline customers with competitive alternatives have the opportunity to obtain discounts from the pipeline for transportation service. As described earlier, MGE has diversified its capacity portfolio over time. In addition, because it is a relatively large customer on certain pipelines, MGE has and continues to actively seek leverage opportunities in order to obtain pipeline transportation discounts.

Q. PLEASE DESCRIBE THE HISTORY OF THE COMMISSION'S REGULATORY TREATMENT OF CAPACITY RELEASE REVENUES GENERATED BY MGE.

A. Since July 1, 1996, the Commission has approved various capacity release sharing mechanisms.[3] These mechanisms have provided for capacity release revenues to be

[3] Since August 6, 2001, both capacity release revenues and off-system sales revenues have been subject to the sharing mechanisms.

shared between customers and MGE shareholders in one form or another. The capacity release revenues generated by MGE have been audited on numerous occasions by Staff and, to my knowledge, neither Staff nor any other party has challenged, nor otherwise taken issue with the accuracy of, these figures as reported by MGE. A summary of these capacity release sharing mechanisms and the capacity release revenues generated pursuant to each mechanism is shown on Schedule DNK-17.

Q. DID MGE'S CUSTOMERS DERIVE SUBSTANTIAL FINANCIAL BENEFITS FROM MGE'S ACTIVE MANAGEMENT OF ITS CAPACITY PORTFOLIO DURING THE ACA PERIODS IN QUESTION IN THIS PROCEEDING?

A. Yes. MGE's customers derived substantial benefits from capacity release revenue during the 2001/2002 and 2002/2003 ACA periods. In fact, for the period July 1, 2001 through June 30, 2003, the overall capacity costs for MGE's customers were reduced by nearly $2.4 million due to the crediting of capacity release and off-system sales revenues. Specifically, as shown on Schedule DNK-17, capacity release revenues of $84,399 for the period July 1, 2001 through August 6, 2001 were credited to customers in compliance with the provisions of the Commission's order in Case No. GO-2000-705. Then, from August 7, 2001 through June 30, 2003, MGE's distribution rates were calculated inclusive of a credit to customers associated with an annual capacity release and off-system sales revenue amount of $1,200,000. This was done pursuant to the terms of the Commission's order in Case No. GR-2001-292. Since this is nearly a 23-month period, customers were credited with approximately $2,300,000 over this timeframe.

Q. PLEASE DESCRIBE THE HISTORY OF THE COMMISSION'S REGULATORY TREATMENT OF TRANSPORTATION DISCOUNTS OBTAINED BY MGE.

A. In the Amended Stipulation in Case No. GO-2000-705, the Commission approved, among other things, a sharing mechanism between customers and shareholders applicable to transportation discounts obtained after April 28, 2000. (*See*, pp. 5-8 of Schedule DNK-7). Pursuant to this sharing mechanism, 70% of the achieved discounts were credited to customers and 30% to MGE's shareholders.

Q. DID MGE'S CUSTOMERS DERIVE SUBSTANTIAL FINANCIAL BENEFITS FROM TRANSPORTATION DISCOUNTS OBTAINED BY MGE?

A. Yes. As shown on Schedule DNK-18, MGE's customers derived substantial benefits from transportation discounts obtained by MGE during the 2001/2002 and 2002/2003 ACA periods. Specifically, MGE obtained transportation discounts totaling over $7.5 million from July 2000 through June 2003, and the overall costs for MGE's customers were reduced by over $5.2 million during this same period. In particular, MGE's customers' overall costs were reduced by over $3.0 million associated with transportation discounts obtained by MGE covering the 2001/2002 and 2002/2003 ACA periods in question in this proceeding. Again, these figures have been subject to audit during Case Nos. GR-2001-382, GR-2002-348 and GR-2003-0330, and to my knowledge, neither Staff nor any other party has challenged, nor otherwise taken issue with the accuracy of, these figures as reported by MGE.

Therefore, for the 2001/2002 and 2002/2003 ACA periods combined, MGE's overall costs have been reduced by over $5.4 million associated with the share of capacity release revenues, off-system sales revenues, and transportation discounts that have been credited to customers.

Q. ARE THERE ANY OTHER FACTORS REGARDING THIS ISSUE THAT ARE IMPORTANT FOR THE COMMISSION TO CONSIDER?

A. Yes. It is important to remember that the capacity release, off-system sales and transportation discount sharing mechanisms negotiated and ultimately approved by the Commission for the 2001/2002 and 2002/2003 ACA periods were based on MGE's capacity portfolio in existence at the time. Therefore, customers have already received substantial benefits from that portfolio, yet now Staff is seeking to penalize MGE for having that portfolio from which customers have already benefited. This is not reasonable nor equitable, and appears very much to be Staff wanting to have its cake and eat it too.

IV. CONCLUSION

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. MGE has consistently undertaken a capacity planning process that focuses on the reliability that the Commission has stressed should be present so that MGE's customers' requirements are met on a design day when extreme cold weather occurs. Pursuant to this process, MGE has regularly analyzed design day demand, developed design day demand forecasts and made periodic capacity acquisitions, reductions and realignments

to meet customer needs. MGE has typically utilized a ten-year planning horizon and has been able to contract for a reasonable level of capacity that provides many benefits to its customers beyond meeting design day requirements. It is rarely possible to achieve a precise match between the amount of pipeline capacity under contract and the projected design day demand since capacity typically becomes available only in large blocks (either with the construction of new capacity and/or the termination of contracts for capacity already constructed). Due to the fact that there is only periodic availability of pipeline capacity, and because there are numerous other factors that impact the capacity planning and decision-making process that are beyond the control of the LDC, the LDC capacity planning and acquisition process must consider a number of factors and objectives beyond simply matching contracted capacity with the design day demand forecast, including factors such as competitive market issues, economics, reliability, supply basin diversity, pipeline diversity, regulatory considerations and pipeline tariff requirements. It is critically important to remember that sufficient capacity be available to meet design day requirements considering that not having sufficient capacity on a design day can result in severe consequences.

Q. DOES THIS CONCLUDE YOUR DIRECT 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 direct testimony in question and answer form, to be presented in the above case; that the answers in the foregoing direct 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 information, knowledge and belief.

David N. Kirkland

Subscribed and sworn to before me this 21st day of November, 2005.

Notary Public

DANIELLE MCGAUGHY
My Commission Expires
November 7, 2006
Buchanan County
Commission #04[illegible]75

My Commission Expires: _____.

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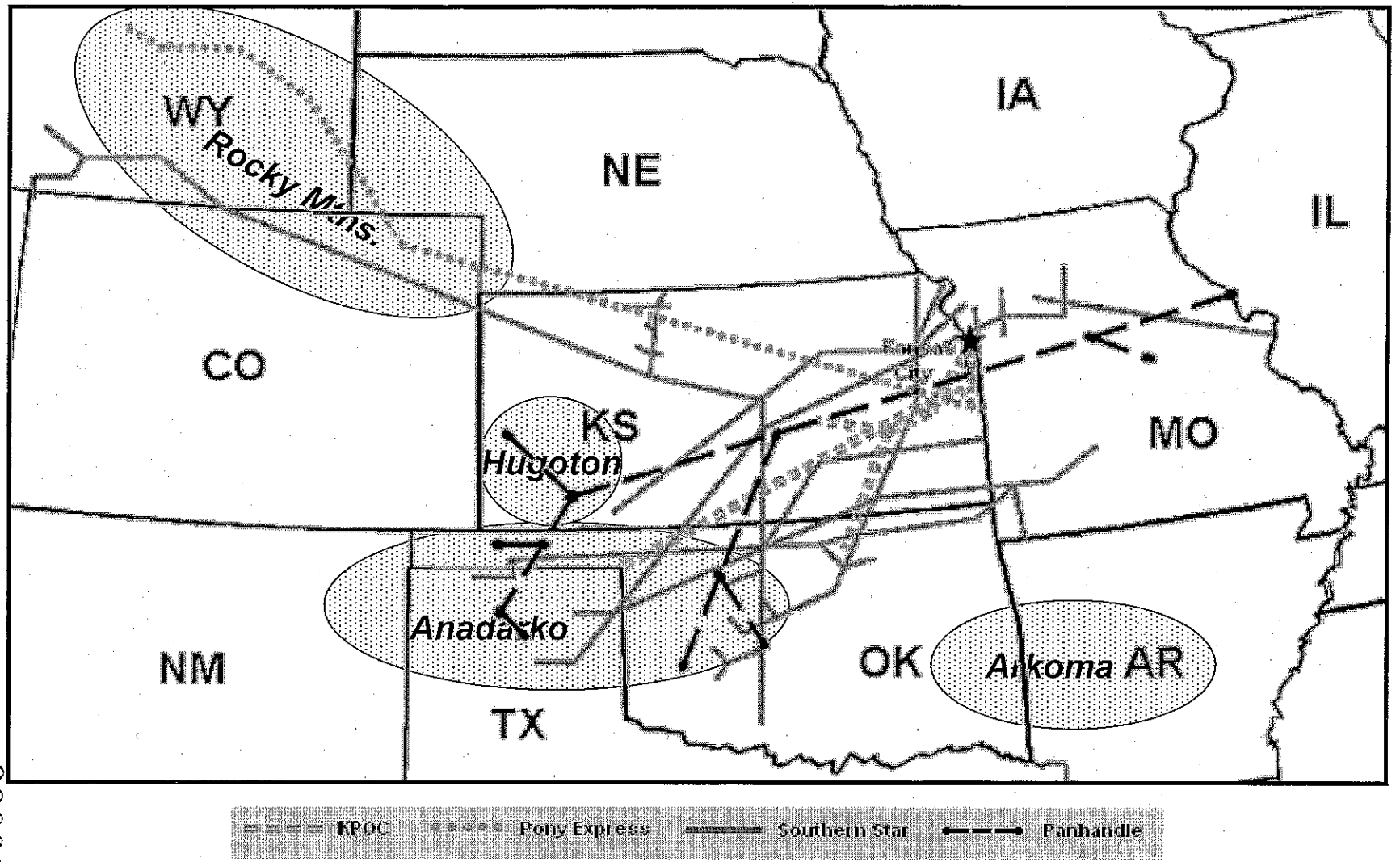
Pipelines Serving MGE's Service Territories



schedule DNK-1

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