PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Gas Cost Adjustment Tariff Revisions to be Reviewed in its 1996-1997 Annual Reconciliation Adjustment Account.	Case No. GR-96-450 October 28, 1998 Jefferson City, Mo.

DEPOSITION OF THOMAS SHAW,

a witness, produced, sworn and examined on the 28th day of October, 1998, between the hours of 8:00 a.m. and 6:00 p.m. of that day at the law offices of Brydon, Swearengen & England, 312 East Capitol, in the City of Jefferson, County of Cole, State of Missouri, before

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and Notary Public within and for the State of Missouri, commissioned in Cole County, in the above-entitled cause, on the part of MGE, taken pursuant to agreement.

time, do a comparison of the Mid-Kansas 1 contract and the Mid-Kansas 2 contract?

A. No, I've not made such a comparison.

Q. Are you intending to do so in your testimony?

A. No, I don't believe.

Q. Have you read Mid-Kansas 1?

A. Yes, I have read it.

Q. You answered some questions, I believe, that Mr. Duffy had asked regarding the lower commodity costs and fixed transportation rates. Do you recall those questions?

A. Yes.

Q. Do you recall indicating that the commodity price and transportation terms were more favorable to MGE under Mid-Kansas 2 than under Mid-Kansas 1?

A. I did make that statement.

Q. I don't recall if Mr. Duffy asked this question. Are you familiar with the fact that under Mid-Kansas 1 there was a buying limitation of takes to 4 BCF a year, but under Mid-Kansas 2 that volume limitation was eliminated and MGE had the right to take 46,332 MMBtu every day?

A. I'm aware of that fact, yes.

Q. Will you agree that is a favorable provision for MGE as the LDC to have the buying limitation lifted?

A. Certainly since they had access to a cheaper gas supply, a historically cheaper gas supply, it made sense to transport as much of that cheaper gas supply as you possibly could to offset the cost of the reservation.

Q. And that historically cheaper gas you're referring to is the gas off the TRANSOK system, correct?

A. That's right.

Q. When you say historically low cost supply, is that -- would you agree that TRANSOK supplies has historically been cheaper than, say, the Williams supply or Panhandle supply or Mid-Continent supply in general?

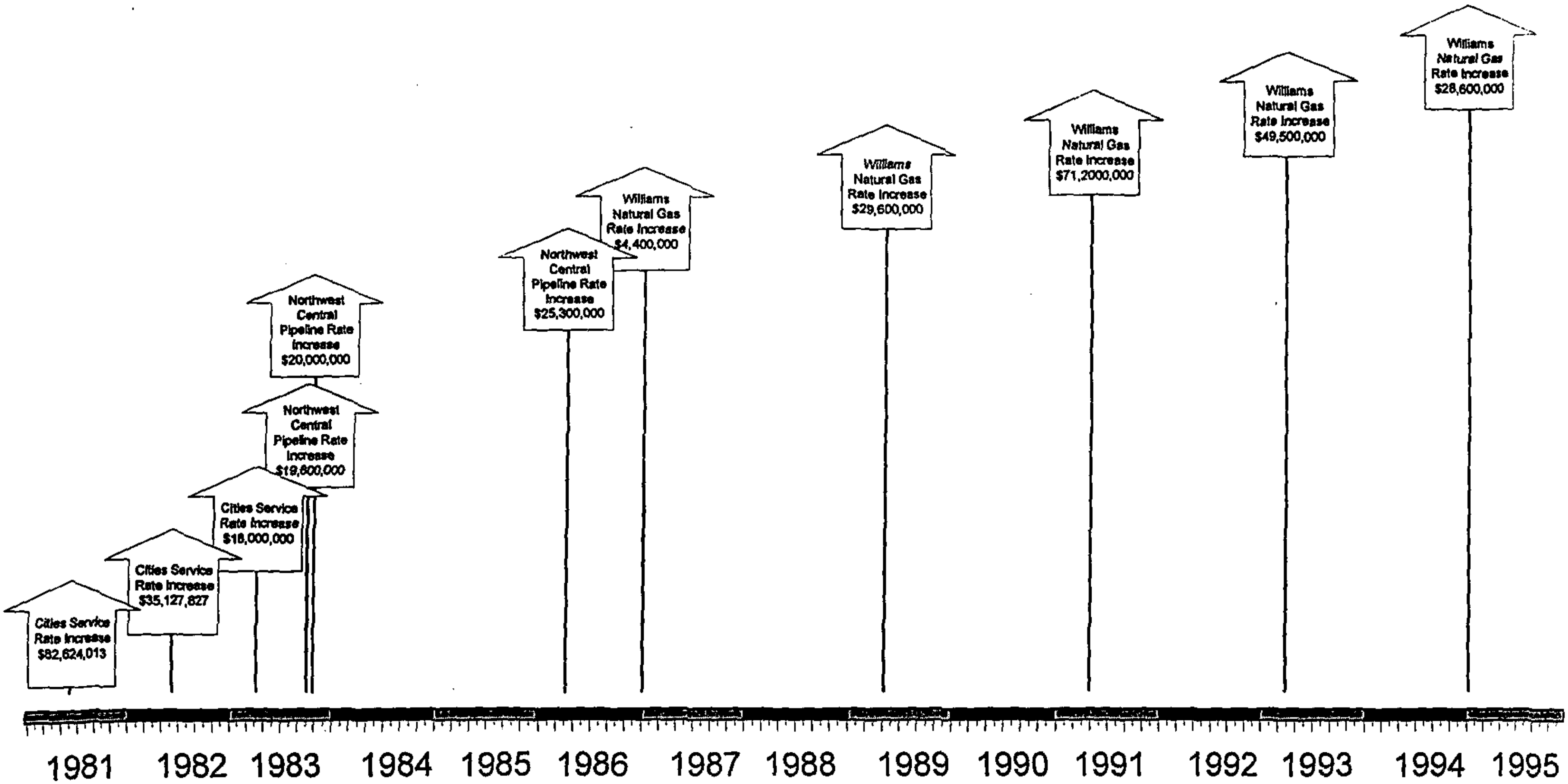
A. Certainly through the time where I testified on the gas supply incentive case, that was the case. I have not kept up with any differential in the indices after that point in time.

Q. It wouldn't surprise you, then, would it, if that historical trend continued forward?

A. No, that would not surprise me.

Q. Are you intending to do a comparative analysis of those commodity prices for your testimony?

Williams Natural Gas General Rate Case Filings



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BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri Gas)
Energy's Gas Cost Adjustment)
Tariff Revisions to be Reviewed) Case No. GR-96-450
in its 1996-1997 Annual)
Reconciliation Adjustment Account)

DEPOSITION OF MICHAEL T. LANGSTON,

a witness, sworn and examined on the 27th day of October, 1998, between the hours of 8:00 a.m. and 6:00 p.m. of that day at the law office of Brydon, Swearengen & England, 312 East Capitol Avenue, in the City of Jefferson, County of Cole, State of Missouri, before

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Notary Public, within and for the State of Missouri, in the above-entitled cause, on the part of the MGE, taken pursuant to agreement.

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responsibilities, do you manage the gas supply portfolios of all of those, I mean, in the head position? Is that a safe description of what your duties include?

A. Yes.

Q. Does MGE -- does Southern Union, generally, with respect to these 100 or so cities that you serve, have as one of its goals a desire to maintain a balanced or diversified transportation portfolio where possible?

A. I'm not sure if I understand what you mean by a balanced transport portfolio.

Q. Let me try to rephrase that and be more specific. You had earlier said that you agreed it was a goal when you acquired the Western Resources distribution property -- that one of your goals was to move away from reliance upon Williams that is, basically, the predominant supplier.

What I'm trying to get at is, is that a philosophy of -- the philosophy of not relying on one pipeline for transportation, is that a philosophy that you have applied to the other cities in which Southern Union has local distribution companies?

A. Yes. In general, our intention is to provide the maximum amount of interconnected capacity from as many alternative pipelines as are available in our service territories. Now, that may be with or without any contractual commitment to them, but we do want to have them as interconnected pipelines.

Q. We have described Riverside I, generally speaking, as the transportation-only version of Mid-Kansas II where MGE makes the purchasing decisions and the pipe -- and I'll refer to the Riverside pipe as all of the pipe from Oklahoma to Missouri -- only transports it.

Is the role of being the purchaser of the commodity, the gas, something that MGE and Southern Union generally prefer to have, rather than have the merchant function held by a third party?

A. Generally, that's true.

Q. Okay. I believe you -- in answering questions posed by the MPSC Staff counsel, you were present and directly involved in negotiations surrounding the execution of the Mid-Kansas II agreement; is that correct?

A. Yes.

Q. And, generally speaking, were you involved in the negotiations regarding the acquisition of the Western Local Distribution Company?

A. I was not involved in the negotiation of the

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BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the matter of the investigation of certain PGA-related issues involving Missouri Gas Energy, a division of Southern Union Company.	))))	<u>Case No. GO-94-318</u> <u>Phase II</u>

REPORT AND ORDER

Issue Date: January 31, 1996

Effective Date: February 14, 1996

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the matter of the investigation of certain PGA-related issues involving Missouri Gas Energy, a division of Southern Union Company.	))))	Case No. GO-94-318 Phase II

APPEARANCES

Gary W. Duffy, Brydon, Swearengen & England, P.C., 312 East Capitol Avenue, Post Office Box 456, Jefferson City, Missouri 65102, for Missouri Gas Energy, a division of Southern Union Company.

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William G. Riggins, Staff Attorney, Kansas City Power & Light Company, 1201 Walnut Street, Kansas City, Missouri 64106, for Kansas City Power & Light Company.

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Penny G. Baker, Deputy General Counsel, Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102, for the staff of the Missouri Public Service Commission.

ADMINISTRATIVE LAW JUDGE: Thomas H. Luckenbill, Deputy Chief.

REPORT AND ORDER

On April 8, 1994, Missouri Gas Energy, a division of Southern Union Company (MGE), filed a motion to establish a docket to address certain Purchased Gas Adjustment (PGA) related issues. This motion was made by MGE under the terms of the unanimous stipulation and agreement filed by the parties in Case No. GR-93-240. Case No. GR-93-240 was the most recent rate case of Western Resources, Inc. d/b/a Gas Service, a Western Resources Company (WRI). MGE is the successor of WRI with respect to all Missouri properties formerly owned and operated by WRI with the exception of the Palmyra service area, which was purchased by United Cities Gas Company. Southern Union Company (parent of MGE) acquired all the Missouri properties of WRI, except for the Palmyra service area, on or about January 31, 1994. The unanimous stipulation and agreement filed in GR-93-240 deferred all issues raised by the parties in that proceeding relative to the PGA to a subsequent proceeding. Some of these issues (e.g., transition costs) have been addressed by interested parties and the Missouri Public Service Commission (Commission) in Cases GT-95-32 and GR-95-33.

On April 15, 1994, the Commission issued an Order And Notice which established a prehearing conference and made parties to GR-93-240 parties to this docket.

Trigen-Kansas City District Energy Corporation; Williams Natural Gas Company; the City of Kansas City, Missouri; Union Electric Company; Tartan Energy Company, L.C., d/b/a Southern Missouri Gas Company, L.C.; Fidelity Natural Gas, Inc.; Greeley Gas Company, a division of Atmos Energy Corporation; Missouri Public Service, a division of UtiliCorp United Inc.; Associated Natural Gas Company, a division of Arkansas Western Gas Company; United Cities Gas Company; St. Joseph Light and Power Company; Laclede Gas Company; and Cohen-Esrey Real Estate all applied for and were granted intervention in this proceeding.

On July 29, 1994, the parties jointly filed a list of issues and positions. On or about August 19, 1994, further statements of position and recommended procedural treatment of issues were filed by various parties. On or about September 2, 1994, responses to the recommendations of various parties were filed.

On October 19, 1994, the Commission issued an Order Defining Scope Of Docket, Providing Notice And Establishing Prehearing Conference. This order defined seven issues for consideration in this docket.

On January 27, 1995, the Commission issued an Order Establishing Procedural Schedule. This order separated the docket into two phases. On October 19, 1995, the Commission convened a prehearing conference with respect to Phase II of this case.

On September 7, 1995, the Commission issued a Report And Order in this docket with an effective date of September 19, 1995, which order dealt with the certain issues delineated as Phase I issues.

On October 27, 1995, a hearing memorandum was filed which provided the positions of the parties on the issue to be decided by the Commission in Phase II of this docket. The issue framed by the Commission for consideration in Phase II of this docket is:

> Whether MGE's Purchased Gas Adjustment/Actual Cost Adjustment (PGA/ACA) tariff provisions should be

modified or eliminated to effectuate a gas cost recovery mechanism where MGE bears financial risk in connection with gas procurement practices in addition to or distinct from the current prudence review mechanism.

On November 6, 1995, the evidentiary hearing commenced. The evidentiary hearing adjourned on November 8, 1995. Briefs have been filed and the Phase II issue (and related subissues as identified by the parties) are now before the Commission for decision.

Findings of Fact

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact.

MGE currently operates under tariff provisions approved by the Commission which allow MGE to alter the rates for the cost of gas outside the context of a general rate case. The Purchased Gas Adjustment tariff provisions establish a process whereby MGE may periodically file estimated changes in the cost of gas it obtains from suppliers of natural gas. MGE then makes an Actual Cost Adjustment (ACA) filing after each twelve-month ACA period. The ACA filing is made to ensure that gas costs passed on to customers reflect the MGE's actual cost of gas. In addition, the ACA filing and related contested case provide the Commission an opportunity to review the prudence of decisions underlying gas costs passed on to ratepayers by MGE through the PGA provisions.

The parties divided the issue as identified by the Commission into several subissues. The Commission will address the issues as framed by the parties to the case. The first two subissues are so closely related that the Commission will consolidate them for purposes of this Report And Order.

1. **Should the PGA/ACA process be eliminated?**

2. **<u>Should traditional rate case treatment be used in lieu of the PGA and incentive PGA mechanisms?</u>**

MGE's position is that the PGA/ACA process should not be eliminated. MGE states that the PGA/ACA has served to keep costs to ratepayers low by allowing gas companies to deal with price fluctuations outside of their control. MGE states that changes in federal regulation of the natural gas industry present an opportunity to modify the PGA/ACA process to provide a process which is designed to allow a local distribution company an incentive to minimize overall gas costs without jeopardizing reliability. MGE states that the PGA/ACA mechanism should not be eliminated if the replacement would be to thrust consideration of gas costs into a traditional rate case. MGE further states that an incentive aspect can be added to the existing PGA/ACA process to reduce potential litigation over prudence issues and reduce the administrative requirements of the Staff of the Commission (Staff).

MGE states that traditional rate case treatment should not be used in lieu of the PGA and incentive PGA mechanisms. MGE states that use of a traditional rate case to deal with gas costs would not be in the ratepayers' best interest. MGE states that elimination of the PGA/ACA process and replacement of that process with a traditional rate case will shift significant market risk to the utility company, thus requiring substantially higher rates of return and a correspondingly higher cost of service, including increased working capital requirements and increased gas costs. MGE states that rates of return have been set for the past 30 years for gas companies on the assumption that the market price of gas is flowed through to consumers with no profit to the gas company. MGE states that gas prices, which are now set by the market as a result of federal deregulation, have demonstrated significant volatility. MGE states that gas costs are a significant part of the overall cost of providing gas service. MGE states that this combination means that it will be difficult to arrive at gas costs in a traditional rate case that are representative of the future without risking significant gains or losses by the utility. MGE states that the magnitude of some potential losses could seriously jeopardize the financial viability of the company. MGE states that to require the gas company to take on these significant new risks will require a corresponding increase in the allowed return on equity to compensate it for these risks. MGE further states that no other states treat gas costs as a component of the cost of service in a traditional rate case so use of the traditional rate case for handling gas costs would make Missouri unique, which would further complicate the rate of return process.

Staff states that the current PGA/ACA process is administratively cumbersome and does not provide positive incentives for successful management. Staff states that other alternatives such as handling gas costs in a general rate case may not be feasible given the volatility of the spot market and the nature of the FERC process. Staff states that it is concerned with the likely potential for higher capital costs associated with changes to the current gas cost recovery mechanism that will cause increased volatility in earnings.

The Staff states that it does not believe a rate case approach should be used in lieu of the current PGA/ACA process. Staff states that even though a rate case approach could provide positive incentives for efficiency in the procurement of gas, it does not adequately address the issue of spot market volatility and the current nature of the FERC process.

The Office of the Public Counsel (OPC) states its belief that the PGA/ACA process should be eliminated. OPC provides five reasons for its position. First, OPC states that the historical basis on which the PGA/ACA has been based has changed with the enactment of Order 636 by the Federal Energy Regulatory Commission (FERC). Second, OPC states that the ACA and related prudence review fail to adequately monitor and enforce prudent gas procurement processes. Third, traditional regulation or an alternative regulatory format (total cost of service) would provide better incentives to minimize costs subject to risk and reliability and improve profitability. Fourth, the current PGA focuses on only one cost component of MGE's cost of service, gas supply costs. OPC believes the focus on one cost in determining a rate is not prudent regulatory policy and constitutes illegal single-issue ratemaking. Fifth, the current ACA process focuses on only one cost component of MGE's cost of service, gas supply costs. OPC believes the focus on one cost in determining a rate is not prudent regulatory policy and in the case of the ACA constitutes not only single-issue ratemaking but also retroactive ratemaking.

OPC states that it believes the traditional rate case treatment is the appropriate method to deal with MGE's gas costs. OPC states that traditional rate case treatment would give MGE better incentives to minimize costs subject to risk and reliability and to improve profits. OPC states that, moreover, it believes it is better regulatory policy to review all costs of service items at one time in the context of a rate proceeding where the company's authorized rate base is audited and reviewed as opposed to isolating one cost of service item, gas costs.

The United States Department of Energy (DOE) states the PGA/ACA process should be eliminated. DOE supports the position of OPC and the testimony and reasoning of OPC witness Mr. Trippensee. DOE agrees with OPC that because of the recent changes in the gas industry, the current PGA/ACA process does not meet the requirements for permissible single issue ratemaking under ***State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission,*** 585 S.W.2d 41 (Mo. banc 1979).

Midwest Gas Users Association (MGUA) states that it believes that at the present time the statutory rate case treatment is the only lawful and effective means of exploring all relevant factors which may be involved in a need for a rate increase.

Laclede Gas Company (Laclede) states that the PGA/ACA process should not be eliminated because it continues to perform functions that are vital to protecting the interests of both local distribution company (LDC) ratepayers and LDC shareholders. Laclede continues by stating more specifically that by permitting rates to be adjusted on a timely basis to reflect substantial changes in the LDC's purchased gas costs, the PGA/ACA process ensures that natural gas customers will not be arbitrarily deprived of the benefits of significant gas cost decreases and that the financial integrity of LDCs, and their ability to render reliable service, will not be continually threatened by gas cost increases that the LDCs are powerless to influence.

Laclede states that the traditional rate case approach is such a grossly inadequate and impractical alternative for recovering purchased gas costs that the Commission's use of such a mechanism would constitute an abdication of the Commission's statutory duty to set just and reasonable rates. Accordingly, Laclede states that the traditional rate case approach should not be used in lieu of the PGA or incentive PGA mechanisms.

The Small LDC Group (Tartan Energy Company, L.C., d/b/a Southern Missouri Gas Company, L.C., Fidelity Natural Gas, Inc., and Greeley Gas Company, a division of Atmos Energy Corporation) states that it does not believe that a traditional rate case approach is preferable to the existing PGA or an incentive PGA mechanism. The Small LDC Group believes that the PGA/ACA process should not be eliminated for the LDC industry, except on a case-by-case basis. The Small LDC Group takes no position on whether MGE's PGA/ACA should be eliminated.

Union Electric Company (UE) does not present a position on whether the PGA/ACA process as it applies to MGE should be eliminated. It is UE's position that the plan or form of gas cost recovery for gas utilities should be determined in the context of each gas utility's particular circumstances. UE offers no comments on the specific plan proposed by MGE.

The Commission finds that the PGA/ACA process should not be eliminated. The Commission finds that the PGA/ACA mechanism is an effective way to handle the risk associated with short term fluctuations in the price of natural gas. In addition, the Commission is of the opinion that the PGA/ACA does not constitute unlawful single-issue ratemaking. The Commission's opinion with regard to the legality of the PGA/ACA mechanism will be addressed in the Conclusions Of Law section of this Report And Order.

The Commission finds that the spot market price of natural gas fluctuates significantly. The Commission further finds that approximately 60 percent of the expenses of a typical Missouri LDC are expenses that the LDC incurs to purchase gas for resale to its customers. The Commission finds that elimination of the PGA/ACA process would have a detrimental impact on the financial viability of the LDC which would ultimately harm ratepayers.

The Commission is of the opinion that LDCs would likely respond to elimination of the PGA/ACA by increasing the requested authorized return on equity or engage in a substantial level of trading in natural gas derivatives to hedge against price change risks. The Commission finds that these are undesirable outcomes since either of these would cause the average price of natural gas charged to ratepayers to increase. Thus, the Commission finds that the PGA/ACA process should not be eliminated because it is the only process presented to date that results in LDCs maintaining a level of business risk that ensures the financial viability of LDCs while preserving just and reasonable rates for customers. The Commission, however, would note its concern regarding the length of time that it takes to process ACA cases. For instance, GR-92-80 is an open ACA case covering the 1991-1992 ACA period. In addition, ACA cases covering each subsequent ACA period for Western Resources, Inc., or MGE are still not resolved.

The Commission finds that traditional rate case treatment should not be used in lieu of the PGA or incentive PGA mechanisms because the PGA process is the only process presented to date that results in LDCs maintaining a level of business risk that ensures the financial viability of LDCs while preserving just and reasonable rates for customers.

3. Should the current PGA/ACA process be modified exclusive of an incentive PGA mechanism?

MGE's position is that the current PGA/ACA process should not be modified exclusive of an incentive PGA mechanism. MGE states that the modifications to the PGA suggested by the Staff which would reduce the frequency of PGA filings should not be implemented outside the context of a general rate proceeding. MGE states that the current thresholds for filing PGAs assume a certain level of cash working capital requirements, since MGE absorbs the effects of such changes up to the threshold level. Changes to the threshold PGA filing level should not be made outside the context of a general rate case where those cash working capital considerations can be addressed.

The Staff states that the trigger mechanism currently embodied in the PGA for MGE should be increased to reduce the number of PGA filings.

OPC takes no position on this issue because OPC is requesting that the PGA/ACA process be eliminated.

DOE asserts that the current PGA/ACA should be modified to exclude take-or-pay and transition cost components because they constitute impermissible single-issue ratemaking.

MGUA challenges the use of the PGA to charge costs to transportation customers who are not purchasing natural gas from the utility.

Laclede states that it is opposed to Staff's proposal to raise the threshold level of gas cost changes necessary to trigger a PGA filing. Laclede states that Staff's proposal could result in deferred costs or credits which are too large to expect LDCs or ratepayers to temporarily absorb.

The Commission is of the opinion that this is not the appropriate docket to implement an increase in the threshold amount required to trigger the PGA filing process. The purpose of Phase II in this docket is to consider fundamental changes to the PGA/ACA process in relationship to the current prudence review mechanism. The PGA threshold issue is one of mechanical detail and is not ripe for decision in this docket, which deals with the broad policy issue of whether a fundamental modification to the process is needed. The Commission would note that it is making no decision as to the merits of the PGA threshold issue. The Commission is of the opinion that if the parties have a dispute about the appropriate level of the PGA filing threshold, the issue should be presented to the Commission for decision in a separate proceeding.

4. **Should MGE's minimum filing requirements under the current PGA/ACA process be modified?**

Staff states that requiring LDCs to submit minimum filing requirements for review prior to the ACA period would be an improvement to the current PGA/ACA process. Staff states that this filing should include the provision of some information prior to the costs being incurred in order to avoid an attempt at "after-the-fact" justification regarding procurement decisions by either MGE or the Staff.

MGE's position is that the Staff has access now to all of the relevant data it needs to perform its audit functions and that additional minimum filing requirements are neither necessary nor desirable.

The Commission is of the opinion that MGE should be required to file information relating to MGE's gas supply reliability for the next ACA period.

In addition, if MGE implements the financial incentive mechanism as detailed in this Report And Order, MGE will be required to file monitoring reports after the conclusion of each ACA period. These requirements will be fully explained in the discussion of the implementation of a financial incentive mechanism (subissue 7 hereinafter).

5. **Are the incentive PGA mechanisms proposed by MGE and Staff legal?**

MGE has stated that the Commission can only order MGE to implement the proposal that it has offered. MGE states that the Commission has previously reached this conclusion in ER-95-411. In that case, the Commission stated that it can "not under current statutes order [a utility] to adopt a plan to share earnings with customers...."

The Commission is of the opinion that the true issue on this point would be whether the Commission, in conjunction with Missouri courts, can force a gas local distribution company to implement a financial incentive mechanism that the utility does not want to implement. The Commission is of the opinion that it has the lawful authority to order MGE to enter into a financial incentive mechanism other than the one proposed by MGE so long as the decision results in setting just and reasonable rates based on competent and substantial evidence. The financial incentive mechanism applicable in this case is different from the one discussed in ER-95-411 in that the mechanism in ER-95-411 was an earnings sharing plan while the mechanism proposed by MGE in this case involves sharing of gas costs or savings. Notwithstanding the foregoing, however, the Commission has no interest in forcing MGE to implement a financial incentive mechanism that MGE does not want to implement. The Commission does have an interest, and indeed an obligation, to establish the reasonable characteristics of a financial incentive mechanism, and has done so in this case.

6. **Should MGE be required to unbundle services as a prior condition to implementation of any incentive PGA mechanism?**

MGE states that the concepts of "unbundling" and "incentive PGAs" are mutually exclusive concepts if "unbundling" is used in the same sense that it has been applied to the interstate pipelines. MGE states that interstate pipelines have divested themselves of the merchant function and thus sell no gas. MGE states that the incentive PGA approach contemplates that MGE will continue to acquire and sell gas to its customers. MGE continues by stating that if "unbundling" is suggested as requiring changes to the transportation structure of MGE as a prior condition, the answer is still "no" because changes to the transportation structure of MGE were dealt with in issues 1 through 6 in this proceeding and also in GT-95-32.

The Staff states that the issue of unbundling was dealt with in Phase I of this proceeding and should not be reconsidered in Phase II.

Laclede states that there is no logical nexus between whether services are unbundled and whether an incentive PGA mechanism should be implemented. Laclede states that one should not be made contingent on the other.

MGUA states that MGE should be made to unbundle all its service offerings. MGUA states that customers should only be required to purchase those services that they desire and are willing to pay for. To the extent possible, competition should be permitted in the provision of these services.

MOUNTAIN IRON & Supply Company (MOUNTAIN IRON) states that MGE's proposal is premature and anticompetitive. MOUNTAIN IRON states that real competitive experience should be accumulated by MGE before it assumes the financial risk of open-market buying. MOUNTAIN IRON further states that MGE has clearly evidenced its opposition to fair and open competition in sales to small business. MOUNTAIN IRON further asserts that MGE's gas cost incentive proposal is driven by its dominant market share of gas buying for its certificated area. MOUNTAIN IRON states that MGE's offer to share profits with ratepayers is merely its cost of access to monopoly rents under conditions of monopolistic competition or imperfect competition in gas purchasing. MOUNTAIN IRON states that these rents will accrue to MGE's ratepayers and stockholders at the expense of its captive customers.

The Commission finds that there is no logical connection between requiring MGE to unbundle services and the implementation of a gas cost incentive mechanism. The Commission is of the opinion that unbundling of LDC services and gas cost incentive mechanisms are independent concepts. Thus, the Commission finds that MGE should not be required to unbundle service as a prior condition to implementation of a gas cost incentive PGA mechanism.

7. **<u>If the Commission adopts an incentive PGA mechanism for MGE, should it be the proposal of MGE or Staff?</u>**

MGE states that its proposal is a reasonable approach to provide an incentive to MGE to take on additional risks to provide benefits to ratepayers. MGE states that its proposal is based on superior aspects of programs developed in other states and tailored to some of the unique factors which apply to MGE. MGE states that its proposal is the only one presented in this docket with sufficient detail to allow implementation by the Commission. MGE states that the Staff's proposal is not complete and contains unnecessarily complex and subjective aspects which will not reduce the regulatory compliance aspects of the present system.

MGE's proposal uses a published monthly spot market price for natural gas (the index), plus a premium, in order to develop a benchmark. MGE proposes that the published prices of spot market natural gas from ***Inside F.E.R.C.'s Gas Market Report***. MGE would use a weighted average of the reported spot market prices for two pipelines that serve the MGE system, Williams Natural Gas Company (WNG) and Panhandle Eastern Pipe Line Company (PEPL). The weighting proposed by MGE is 70 percent WNG and 30 percent PEPL. MGE witness Langston testified that "over the long term", MGE anticipates that approximately 30 percent of the annual volumes consumed within the Missouri distribution system will flow through PEPL.

MGE proposes that a premium must be added to the weighted average of spot market prices because the spot market prices represent interruptible, base load supplies contracted on a short term basis. MGE states that it serves loads that are variable in use and requires more reliability than available with spot market gas which gas is provided on an interruptible basis. MGE states that in order to meet the requirements of customers who expect and demand service to keep them warm on the coldest day in winter, MGE must contract for gas supply in a manner that ensures: (1) that MGE has access to gas supplies on a continuing basis; (2) that supplies will be available for terms longer than 30 days; and (3) that volume "swing" capabilities are available to meet the changing market demand of MGE's customers. MGE states that in order to achieve these contracting goals it must pay more to the producer (and also the transporter) than the price reflected in the spot index.

MGE's proposal includes caps on potential gains and losses to MGE that put a limit on the additional business risk caused by the gas cost incentive mechanism. MGE stated at the hearing that it was willing to incorporate the Staff's recommendation for dealing with capacity release revenues.

The Staff states that the spot market price proposed by MGE (70 percent WNG and 30 percent PEPL) is a fair representation of an appropriate benchmark if certain adjustments are made. Staff states that the premium to be added to the weighted average of the spot market indices should be determined by using the gas sendout model and MGE's most recent contract mix subject to prudence review by the Commission.

Staff states that a tolerance zone around the benchmark is needed because weather can impact the actual premium paid by MGE. Staff states that the tolerance zone should be determined using the gas sendout model, MGE's most recent contract mix and simulating a wide range of weather conditions to determine the variability of the premium as a function of weather conditions.

Staff agrees with MGE's proposal for caps being placed on gains and losses. Staff proposes that a pipeline fixed cost incentive mechanism be added to MGE's proposal. MGE has not agreed to this component of Staff's proposal.

The DOE and MGUA state that either incentive mechanism fails because of the prohibition against single-issue ratemaking.

OPC states that MGE's and Staff's proposals still focus merely on one cost component of MGE's cost of service, gas supply costs. OPC states that this focus solely on one component of the cost of service is not prudent regulatory policy nor consistent with the regulatory framework established by the Missouri Legislature. OPC states that if the Commission adopts an incentive PGA mechanism, the as-filed Staff proposal should be adopted.

The Commission finds that MGE should implement a gas cost incentive mechanism on a three-year experimental basis. The Commission is of the opinion that certain modifications to MGE's proposal are necessary to ensure the provision of natural gas at just and reasonable rates. The Commission finds that the premium above the weighted average of WNG and PEPL *Inside F.E.R.C.* indices shall be set at four percent rather than 5.04 percent. Naturally, this premium above the weighted average of the published spot market indices requires removal of the Wyoming Tight Sands contracts from the calculations under the plan. Thus, the Commission finds that the benchmark is the weighted average of WNG and PEPL *Inside F.E.R.C.* indices plus four percent. The Commission finds that a tolerance zone of four percent (of the benchmark amount) above the benchmark is appropriate. The benchmark is the same as the floor of the tolerance zone. The ceiling of the tolerance zone is 1.04 multiplied by the benchmark. The tolerance zone is a band in which ratepayers will fund 100 percent of the incurred cost of gas, as they do under the current mechanism.

The Commission is of the opinion that the benchmark should be set at a level where the likelihood of MGE achieving results in the upper sharing grid is equal to the likelihood of MGE achieving results in the lower sharing grid. MGE's proposal of having the benchmark set at a level approximating the results achieved for the twelve months ended January 31, 1995, is built upon an implicit assumption that the mean of the probability distribution for results should be at the benchmark level. To achieve an even-handed and symmetrical financial incentive mechanism, however, the Commission believes that the benchmark should be set in a manner so that the most likely level of gas costs is equal to the benchmark plus one-half of the tolerance zone. Thus, if the tolerance zone is four percent, then the benchmark should be an estimate of the most likely level of gas costs less two percent. This approach makes it equally likely that MGE shareholders will gain or lose under the plan. After reviewing the historical data presented in this record about the difference between actual costs and *Inside F.E.R.C.* indices, the Commission finds that six percent is a reasonable estimate of the difference between actual gas costs and the weighted average of the *Inside F.E.R.C.* indices. Thus, the appropriate benchmark is four percent above the weighted average of the *Inside F.E.R.C.* indices because this is two percent below the Commission's estimate of the most likely level of gas costs to be incurred by MGE.

The Commission has found that setting the benchmark at four percent above the weighted average of the *Inside F.E.R.C.* indices promotes just and reasonable rates because this is designed to achieve balance and symmetry in the financial incentive mechanism. In addition, the Commission finds that a reduction in the benchmark from 5.04 percent to four percent promotes just and reasonable rates because the level of actual gas costs which will trigger a prudence review will be correspondingly reduced by 1.04 percent of the benchmark level. Thus, ratepayers are protected more from unusually high gas costs than they would be using MGE's proposed benchmark at 5.04 percent above the weighted average of the *Inside F.E.R.C.* indices.

The Commission shall adopt MGE's proposal that the incentive mechanism contain two distinct ranges within which ratepayers and MGE share on a 50/50 basis. The Commission will refer to these ranges as an upper sharing range and a lower sharing range. The Commission finds that the ceiling of the lower sharing range shall be the benchmark level. The floor of the lower sharing range shall be 94 percent of the benchmark level. The Commission finds that the floor of the upper sharing range shall be the ceiling of the tolerance zone. The ceiling of the upper sharing range shall be 1.10 multiplied by the benchmark.

If actual results during a twelve-month ACA period place MGE's costs below the floor of the lower sharing grid, 100 percent of the savings achieved below that floor shall be passed through to ratepayers. If actual results during a twelve-month ACA period place MGE's costs above the ceiling of the upper sharing grid, a rebuttable presumption of imprudence will be associated with any costs in excess of that ceiling. The ceiling of the upper sharing grid is approximately 14 percent above the weighted average spot market indices. If natural gas costs during a twelve-month ACA period exceed that level, the Commission would automatically have serious concerns about the gas purchasing practices that lead to those results and, using the rationale of the Callaway case (*RE: Union Electric Company*, 27 Mo. P.S.C. (N.S.) 183, 192 (1988)), which was repeated in GR-93-140, MGE would then have the burden to dispel these serious concerns in the mind of the Commission.

If natural gas costs during a twelve-month ACA period exceed the ceiling of the upper sharing grid, an ACA prudence review is necessary. However, so long as actual natural gas costs are equal to or below the ceiling of the upper sharing grid for a twelve-month ACA period, no ACA period prudence review is necessary.

The Commission will not require MGE to incorporate Staff's recommendation for inclusion of a pipeline fixed cost incentive mechanism because this Commission does not see sufficient justification for this component in the record. However, the Commission is of the opinion that MGE's gas cost incentive mechanism should include Staff's recommendation for the treatment of capacity release revenues.

The 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 periods. The Staff shall file, and other parties to GO-96-243 may file, a response to MGE's gas supply reliability filing 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. All parties to GO-94-318 shall be made parties to GO-96-243. Any party wishing to withdraw from GO-96-243 should file a notice of withdrawal from GO-96-243.

The Commission would point out that this is an experimental program and, as such, new and useful information should come about in the course of utilizing the gas cost incentive mechanism. To facilitate appropriate analysis of the results of this experimental program, the Commission shall require that a monitoring report be filed no later than August 1, 1997, which report will contain actual gas costs of MGE during the July 1, 1996, through June 30, 1997, ACA period, and any other information necessary for the Staff, Commission, and other interested persons to verify that the financial incentive mechanism has been followed. The monitoring report will be filed in GO-96-243. The Commission will further order MGE to file monitoring reports no later than August 1, 1998, and August 1, 1999, for the then immediately preceding twelve-month ACA period. The purpose of the monitoring report is to ensure that MGE is following the gas cost incentive mechanism prescribed by this order. The Staff shall file, and other parties to GO-96-243 may file, a response to MGE's monitoring report no later than September 1, 1997, September 1, 1998, and September 1, 1999. 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 Staff, OPC, and MGE shall file recommendations, jointly or severally, regarding whether the gas cost incentive mechanism should be retained, modified or eliminated. These recommendations shall be filed no later than January 4, 1999, in Case No. GO-96-243.

The Commission makes no finding as to the necessary components of the gas supply reliability filings and monitoring reports. In order to facilitate the ability of the parties to reach a consensus regarding the necessary contents of the gas supply reliability data filings and the monitoring reports, the Commission shall schedule a technical workshop. The technical workshop shall commence at 10:00 a.m. on February 26 and continue through February 27, 1996.

The technical workshop shall be held in Room 520A of the Harry S Truman State Office Building.

The Commission shall order the parties to file a joint recommendation of the components of the gas supply reliability data and monitoring reports no later than March 5, 1996. The Commission requests that the parties endeavor to identify the components in a concise fashion while providing enough explanation that one can fairly discern what information is requested. The Commission further requests that the parties use their best efforts to try to agree on the components of the filing. If there are matters upon which the parties are unable to agree, then the parties may file a pleading showing the areas of disagreement and party positions no later than March 5, 1996. In addition, responses to party positions may be filed no later than March 19, 1996.

The Commission will issue an order in Case No. GO-96-243 which will specifically identify the components of the gas supply reliability filing and monitoring reports on or about April 1, 1996.

There may be issues relating to the mechanical details of the gas cost incentive mechanism as described in this order that the parties have identified but have not resolved. If such issues exist, the Commission would prefer being apprised of these matters early in this process. Thus, if the parties have identified matters upon which they do not agree in relation to the mechanical operation of the gas cost incentive mechanism, a statement of these issues and party positions on them should be filed in GO-96-243 no later than March 5, 1996. In addition, responses to party positions may be filed no later than March 19, 1996.

A timeline is attached to this Report And Order to show required actions and filings. (See Attachment A.)

Conclusions of Law

The Missouri Public Service Commission has arrived at the following conclusions of law.

Missouri Gas Energy, a division of Southern Union Company, is an investor-owned public utility engaged in the provision of natural gas service in the state of Missouri and, therefore, subject to the general jurisdiction of the Missouri Public Service Commission under Chapters 386 and 393, R.S.Mo.

Legality of PGA/ACA Mechanism

The DOE, MGUA, and OPC all maintain that the PGA/ACA mechanism is unlawful single-issue ratemaking because it conflicts with the Missouri Supreme Court's decision in ***State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission,*** 585 S.W.2d 41 (Mo. banc 1979). This case struck down a fuel adjustment clause which had been used by electric utilities.

The Commission determines that there are policy reasons of paramount importance for retaining the PGA/ACA mechanism for the recovery of gas costs paid by Missouri local distribution companies. The Commission finds that natural gas costs fluctuate widely on a month-to-month and year-to-year basis. The Commission further finds that approximately 60 percent of the total costs of Missouri Gas Energy's costs are the costs of gas purchased by it. The Commission finds that the elimination of the PGA/ACA mechanism could result in large windfall profits to Missouri Gas Energy at the expense of ratepayers or losses so large as to threaten the financial viability of Missouri Gas Energy.

The Commission makes the following observation in connection with the views expressed by the parties about the legality of the PGA/ACA mechanism. Missouri statutes provide that the Commission has a duty to ensure that charges made for natural gas are just and reasonable. Section 393.130.1, R.S.Mo. The Commission finds that rates resulting from use of the PGA/ACA mechanism are just and reasonable. The Commission finds that use of a gas cost incentive mechanism as described in this Report And Order takes advantage of the introduction of competitive forces into the wholesale natural gas market, and decreases the regulatory burden on the state and MGE while achieving an appropriate balance between the interests of MGE and MGE's ratepayers. The UCCM case is readily distinguishable from the situation presented here because forcing consideration of natural gas costs into a rate case would seriously jeopardize the viability of MGE, which would eventually be to the detriment of MGE's ratepayers as well as MGE.

The PGA/ACA mechanism was initially introduced into Missouri in 1962 by Laclede Gas Company. At that time, most gas costs handled through the PGA/ACA mechanism were subject to FERC approval. The fact that the rates paid by Missouri LDCs for gas were set by the FERC supports use of the PGA/ACA mechanism. The FERC has moved towards deregulation of the wholesale gas market primarily with FERC Order 636. Thus, the wellhead price of natural gas is no longer regulated. However, other components of the cost of gas are still regulated by the FERC. Transportation charges from interstate pipelines are set by the FERC. In addition, transition costs and take-or-pay costs which flow through the PGA result from FERC actions. The Commission concludes that a substantial portion of the cost of gas continues to be subject to FERC regulation and the PGA/ACA mechanism continues to fit well with the underlying nature of the gas costs incurred by LDCs.

The Commission finds that the natural gas industry is in the midst of a transition towards competition from regulation. The Commission finds that removal of the PGA/ACA mechanism at this time would be inappropriate. Moreover, the Commission is skeptical as to the feasibility of handling gas costs in a traditional rate case format. The evidence is clear that wide fluctuations in gas prices occur on weekly, and even daily, bases. Yet OPC, MGUA and DOE recommend that the Commission be put in a position of estimating these volatile costs months or even years into the future. In addition, since gas costs account for approximately 60 percent of LDC expenses, if the Commission's estimates are wrong, the LDC could reap enormous windfall profits, or the LDC could experience such drastic losses that the LDC will have to pursue emergency rate relief. At the same time, the Commission anticipates that the LDC would have to be compensated for the increased business risk that results from treating gas costs in a rate case. It appears to the Commission that this scenario, quite simply, is far from a practical solution and was clearly not intended in UCCM.

Faced with these circumstances and the statutory obligation to set just and reasonable rates, the Commission concludes that it has the lawful authority to authorize the continued use of the PGA/ACA mechanism. The Commission further concludes that the gas cost incentive mechanism authorized by this Report And Order allows MGE to take advantage of a more competitive wholesale natural gas market while placing appropriate limits on risk borne by MGE.

IT IS THEREFORE ORDERED:

1. That Missouri Gas Energy, a division of Southern Union Company, shall file no later than May 31, 1996, tariff sheets to implement a gas cost incentive mechanism identical to the mechanism proposed earlier in this proceeding by Missouri Gas Energy but with the modifications described by the Commission and contained in this Report And Order, with such tariff sheets to become effective for service rendered on and after July 1, 1996.

2. That Case No. GO-96-243 be, and is hereby, established for the receipt of gas supply reliability data and monitoring reports, the specifics of which will be prescribed by subsequent Commission order.

3. That a technical workshop will be held on February 26-27, 1996, in Room 520A of the Harry S Truman State Office Building, 301 West High Street,

Jefferson City, Missouri, which workshop shall commence at 10:00 a.m. on February 26, 1996.

4. That the parties shall jointly file the recommended components of Missouri Gas Energy's gas supply reliability data no later than March 5, 1996, in GO-96-243.

5. That Missouri Gas Energy shall file gas supply reliability data in GO-96-243 no later than May 1, 1996, May 1, 1997, and May 1, 1998, for the then immediately subsequent ACA period.

6. That the Staff shall file, and other parties to GO-96-243 may file, a response to Missouri Gas Energy's gas supply reliability filing in GO-96-243 no later than June 1, 1996, June 1, 1997, and June 1, 1998, for the then immediately subsequent ACA period.

7. That the parties shall jointly file the recommended components of Missouri Gas Energy's gas cost incentive mechanism monitoring report no later than March 5, 1996, in GO-96-243.

8. That Missouri Gas Energy shall file a gas cost incentive mechanism monitoring report in GO-96-243 no later than August 1, 1997, August 1, 1998, and August 1, 1999, for the then immediately preceding ACA period.

9. That the Staff shall file a response to Missouri Gas Energy's monitoring reports in GO-96-243 no later than September 1, 1997, September 1, 1998, and September 1, 1999, for the then immediately preceding ACA period.

10. That Missouri Gas Energy, the Staff, and the Office of the Public Counsel shall file in Case No. GO-96-243, no later than January 4, 1999, recommendation(s), jointly or severally, regarding whether Missouri Gas Energy's gas cost incentive mechanism should be retained, modified or eliminated.

11. That a copy of this Report And Order shall be placed in the official case papers of Case No. GO-96-243.

12. That those motions and objections not specifically ruled on in this Report And Order are hereby denied or overruled.

13. That this Report And Order shall become effective on the 14th day of February, 1996.

BY THE COMMISSION

David L. Rauch

David L. Rauch
Executive Secretary

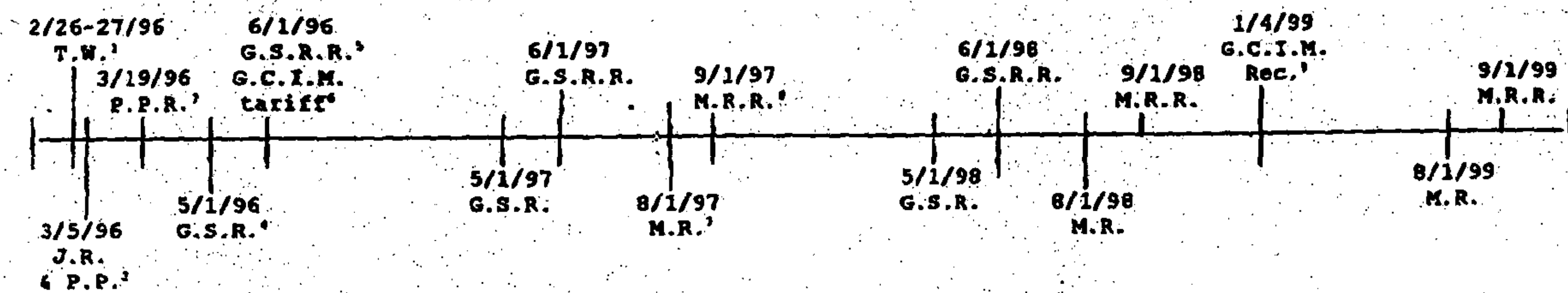
(S E A L)

Mueller, Chm., McClure, Kincheloe, Crumpton and Drainer, CC., concur and certify compliance with the provisions of Section 536.080, R.S.Mo. 1994.

Dated at Jefferson City, Missouri, on this 31st day of January, 1996.

Attachment A

TIMELINE



[1] T.W. means technical workshop.

[2] J.R. means joint recommendation on gas supply reliability data and monitoring reports. P.P. means pleading showing areas of disagreement and party positions.

[3] P.P.R. means responses to party positions.

[4] G.S.R. means gas supply reliability data.

[5] G.S.R.R. means responses to gas supply reliability data.

[6] G.C.I.M. tariff means MGE's tariff sheets necessary to implement MGE's gas cost incentive mechanism. (Note: tariff sheets must be filed no later than 5/31/96.)

[7] M.R. means monitoring report.

[8] M.R.R. means responses to monitoring report.

[9] G.C.I.M. Rec. means recommendations regarding whether MGE's G.C.I.M. should be retained, modified or eliminated.

PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Gas Cost Adjustment Tariff Revisions to be Reviewed in its 1996-1997 Annual Reconciliation Adjustment Account.	)	Case No. GR-96-450 October 28, 1998 Jefferson City, Mo.

DEPOSITION OF THOMAS SHAW,

a witness, produced, sworn and examined on the 28th day of October, 1998, between the hours of 8:00 a.m. and 6:00 p.m. of that day at the law offices of Brydon, Swearengen & England, 312 East Capitol, in the City of Jefferson, County of Cole, State of Missouri, before

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ASSOCIATED COURT REPORTERS, INC.
714 West High Street
P.O. Box 1308
JEFFERSON CITY, MO 65109
(573) 636-7551

and Notary Public within and for the State of Missouri, commissioned in Cole County, in the above-entitled cause, on the part of MGE, taken pursuant to agreement.

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to the Mid-Kansas 1 contract that was less favorable to MGE and -- rather than more favorable?

Let me clarify. Is there any provision in the Mid-Kansas 2 contract that was to the detriment of MGE that wasn't in the Mid-Kansas 1 contract?

A. I need to qualify my answer and the fact that when I read the Mid-Kansas 2 contract, that was subsequent to the ACA period that was under review and that we were discussing settlement of.

Although I was aware, generally aware of the changes that were made from prior to February '95 to subsequent to February of '95, we were aware that there was ratepayer benefits associated with that compared to the previous contract that was in effect.

Can I go back and say -- go through every provision and say it is detrimental to the ratepayer? I don't have that type of familiarity with the contract. I've not even, I don't believe, looked at the contract to any great extent subsequent to the settlement negotiations.

Q. So sitting here today, you cannot think of one single detriment to the ratepayers that's embodied in the Mid-Kansas 2 contract compared to the Mid-Kansas 1 contract?

A. I can't think of one, no.

PUBLIC SERVICE COMMISSION
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going to pay regardless of whether any gas is transported or not under the agreement.

Q. Are you aware that Williams Natural Gas has other charges that they sent to MGE that MGE has paid that are in addition to reservation charges?

A. Yes.

Q. What charges would they be?

A. Those would be, like, the Gas Research Institute surcharge. They've got an ACA surcharge. They've got transition costs. I'm not sure whether those are a surcharge or a direct bill. They've got variable transportation charges. They've got storage service if you've got that type of transportation.

I mean, there's many different variable transportation charges that could be paid depending on what contract.

Q. Would some of those -- would you agree sometimes they're generally referred to as sometimes transition costs?

A. That could be a category, yes.

Q. Okay. And isn't it true that in the past at times Williams Natural Gas has direct billed to MGE charges for, say, taker pay liabilities that it had incurred and that in turn MGE would then pass on to the ratepayer?

A. Yes.

Q. Are you aware of whether or not Mr. Wallis' calculations takes into consideration those additional charges above and beyond the reservation charge in doing his comparison?

A. I'm not aware whether they do or not.

Q. Assume for the time being that they do not. If they do not, don't you think it's unfair to do a comparison when you've got certain charges that MGE is paying for services passed along to the consumer, but yet it's not included in the calculation in comparing two different pipelines?

A. Certainly this was a topic of discussion when we settled the previous cases, and Staff's position was, and I think probably will be, that the direct bill taker pay charges are unavoidable costs as a result of FERC deregulation.

The transition charges, if they're a surcharge on the transportation invoice, it may -- probably would be appropriate to consider doing the surcharge as a possible additional charge that should be considered when -- if you transferred your load to another pipeline system.

Q. I guess my question, I understand your position and the Staff's position you just testified

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Gas Cost Adjustment Tariff Revisions to be Reviewed in its 1996-1997 Annual Reconciliation Adjustment Account)	Case No. GR-96-450

DEPOSITION OF MICHAEL T. LANGSTON,

a witness, sworn and examined on the 27th day of October, 1998, between the hours of 8:00 a.m. and 6:00 p.m. of that day at the law office of Brydon, Swearengen & England, 312 East Capitol Avenue, in the City of Jefferson, County of Cole, State of Missouri, before

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Natural -- what I'll refer to as Williams Natural Gas. Is that correct?

A. Yes.

Q. And you testified that those contracts vary in terms from -- I believe anything from one year all of the way out to the year 2013?

A. I believe that's right.

Q. And under those contracts, generally, as MGE -- to your knowledge, has MGE and its predecessor Western paid any such additional charges for transportation such as transition costs, take-or-pay liabilities, pollution liabilities, GSR, ACI, et cetera?

A. Yes.

Q. Without recalling any specific numbers, would you generally recall those costs that Williams has assessed to MGE to be significant?

A. Yes, I -- the primary costs are what they refer to as gas supply realignment costs. Those run $2 1/2 to $3 million per quarter. We get approximately 40 percent of that allocation, so our costs are, you know, 1.1 to 1.2 million, normally. It does change every month -- I mean, every quarter.

Q. Does MGE absorb those charges or do you pass them on to the ratepayers in your charges, to the

PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Gas Cost Adjustment Tariff Revisions to be Reviewed in its 1996-1997 Annual Reconciliation Adjustment Account.	) Case No. GR-96-450) October 26, 1998) Jefferson City, Mo.

DEPOSITION OF MICHAEL WALLIS,

a witness, produced, sworn and examined on the 26th day of October, 1998, between the hours of 8:00 a.m. and 6:00 p.m. of that day at the law offices of Brydon, Swearengen & England, 312 East Capitol, in the City of Jefferson, County of Cole, State of Missouri, before

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the ACA period of July 1, '96 through June 30, '97, would you think it would be appropriate to take those into account?

A. If it relates -- if -- it might be. I mean, that's something that we might look at, certainly.

Q. In a response to one of MGE's Data Requests to the Staff, the Staff provided a work sheet to show how it had calculated the estimated supply cost that would be available through the Williams system. Are you with me so far?

A. Yes.

Q. On that sheet, it's our understanding that the gas supplies were valued at the Williams index price plus a 4 percent premium over the index price; is that correct?

A. That's correct. It's designed to kind of take into consideration MGE's incentive plan as approved by the Commission in GO-94-318 as a way of estimating what MGE could have or may have paid for gas supplies tied to the Williams index.

Q. Maybe you just answered that, but is that -- is what you just said the reason you used a 4 percent premium?

A. That's correct.

Q. You mentioned GO-94-318 as the Commission's

PUBLIC SERVICE COMMISSION
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basis, unquote?

A. Diversity is important, yes.

Q. Do you agree with the premise that reliability is improved with diversity of supply sources in order to minimize the impact of possible disruption from a single supply source?

A. Yes.

Q. In the reliability report which MGE filed in Case No. GO-96-243 in response to some Commission concerns about reliability associated with implementation of its gas supply incentive plan, on about page 55 of that report dated May 1, '96, MGE said, quote, given that approximately 90 percent of MGE's current capacity is provided by WNG, Williams, MGE has explored capacity replacement and incremental expansion opportunities on pipelines other than WNG in order to obtain greater diversity, flexibility, bargaining power and peak day reliability, unquote.

Have you ever seen or were you aware that that statement was made to the Commission by MGE back in 1996?

A. I was not aware of that.

Q. In your opinion, was it reasonable in May of 1996 for MGE to be concerned about the high level of capacity commitment on the Williams system alone from

PUBLIC SERVICE COMMISSION
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me exactly what the prudence -- what the imprudent act was.

A. Entering into a contract in 1995 with Mid-Kansas that has rates almost double what there are on Williams.

Q. And the rates that you speak of are the transportation rates, not the rates for the commodity, the gas itself?

A. That's correct. And our adjustment attempts to take into consideration the benefits from the Mid-Kansas contract as far as the gas supply's concerned. That's why you see a $3 million -- about 3.2 million offset to the difference in fixed and variable transportation, which is about 7.7 million.

Q. In general, would you agree with the statement that reliability is the primary concern of all LDCs because of the relatively high proportion of weather-sensitive residential and commercial heating loads on their systems?

A. Reliability is important, but I think you also have to look at the price you're paying for that reliability as compared to other alternatives.

Q. Would you agree with the statement that, quote, diversity of supply is cited as the key to managing security and reliability on a cost-effective basis, unquote?

A. Diversity is important, yes.

Q. Do you agree with the premise that reliability is improved with diversity of supply sources in order to minimize the impact of possible disruption from a single supply source?

A. Yes.

Q. In the reliability report which MGE filed in Case No. GO-96-243 in response to some Commission concerns about reliability associated with implementation of its gas supply incentive plan, on about page 55 of that report dated May 1, '96, MGE said, quote, given that approximately 90 percent of MGE's current capacity is provided by WNG, Williams, MGE has explored capacity replacement and incremental expansion opportunities on pipelines other than WNG in order to obtain greater diversity, flexibility, bargaining power and peak day reliability, unquote.

Have you ever seen or were you aware that that statement was made to the Commission by MGE back in 1996?

A. I was not aware of that.

Q. In your opinion, was it reasonable in May of 1996 for MGE to be concerned about the high level of capacity commitment on the Williams system alone from

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Gas Cost Adjustment Tariff Revisions to be Reviewed in its 1996-1997 Annual Reconciliation Adjustment Account) Case No. GR-96-450

DEPOSITION OF MICHAEL T. LANGSTON,

a witness, sworn and examined on the 27th day of October, 1998, between the hours of 8:00 a.m. and 6:00 p.m. of that day at the law office of Brydon, Swearengen & England, 312 East Capitol Avenue, in the City of Jefferson, County of Cole, State of Missouri, before

KRISTAL R. MURPHY, CSR, RPR, CCR
ASSOCIATED COURT REPORTERS, INC.
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Notary Public, within and for the State of Missouri, in the above-entitled cause, on the part of the MGE, taken pursuant to agreement.

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correct.

Okay. What I'd like to do, Mr. Langston, is talk a little bit about the differences between Mid-Kansas II and Mid-Kansas I, and you don't necessarily need to refer to the contract unless you -- unless you want to. I'm going to try to be broad enough where we can talk about concepts.

Is it fair to describe the commodity charge under the Mid-Kansas II agreement as a price equal to 105 percent of what is referred to as a TRANSOK spot index?

A. Yes, for any base load quantities that we nominated for the month.

Q. And with respect to the Mid-Kansas I contract, do you recall that the commodity cost there was 114 percent of an average spot of certain Mid-Kansas -- or Mid-Continent pipelines?

A. I don't recall the specifics, but that very well could have been the pricing provision.

Q. Okay. Do you recall the price provision under -- let me ask it this way: In your opinion, was the pricing provision of the Mid-Kansas II contract as to commodity better than the commodity pricing under the Mid-Kansas I agreement?

A. Yes.