

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the matter of Missouri Gas Energy's)	
Purchased Gas Cost Adjustment tariff)	
Revisions to be reviewed in its 2002-)	Case No. GR-2003-0330
2003 Actual Cost Adjustment.)	

**MISSOURI GAS ENERGY'S RESPONSE TO STAFF RECOMMENDATION;
MOTION TO STRIKE**

Comes now Missouri Gas Energy ("MGE" or "Company"), a division of Southern Union Company, and for its response to the Recommendation of the Staff of the Missouri Public Service Commission ("Staff"), and Motion to Strike portions of the same, respectfully states the following:

1. On or about December 28, 2004, the Staff filed its Recommendation and Memorandum herein. By order dated January 18, 2005, the Commission directed that MGE respond to the Staff's recommendation no later than February 27, 2005.

2. In its recommendation, the Staff proposes two monetary disallowances: A) the Mid-Kansas Partnership/Riverside Pipeline Company ("MKP/RPC") disallowance; and B) Excess Gas Costs for Peak Day Reserve ("Excess Capacity") disallowance. The Staff also recommends that the Commission order MGE to take certain actions, and/or address certain comments made by the Staff, in regard to: C) reliability analysis (peak day selection and appropriate reserve margin); D) purchasing practices – general (storage plans; documentation related to purchasing and storage use decisions; transportation customer impact on supply for system sales customers; and planning documentation under various temperature scenarios); and E) hedging documentation.

A. MKP/RPC Disallowance

3. MGE opposes this proposed Staff disallowance. Without limiting any arguments it may make in the future if this case moves forward, MGE offers the following as its initial response. This proposed disallowance of \$3,570,935.52 is based on the same rationale as the MKP/RPC disallowance proposed by the Staff in Case No. GR-96-450. The Commission rejected the Staff's MKP/RPC disallowance in Case No. GR-96-450 by Report and Order dated March 12, 2002, on the basis that the Staff had not sufficiently proved its allegations. There is no allegation of any evidence that the Commission has not already considered. The Recommendation even attempts to ascribe actions to MGE dating to 1991 which was more than two years before MGE commenced operations. The Staff's continued pursuit of this matter when the Commission has already ruled on its merits is a waste of resources for everyone involved. Amazingly, the Staff even goes so far as to continue showing in the table on page 2 the Case No. GR-96-450 recommended disallowance amount that has already been rejected by the Commission. The display of this previously rejected disallowance amount effectively disregards the Commission's decision in Case No. GR-96-450. While a portion of Case No. GR-96-450 is still on appeal, the Commission's decision to reject the Staff's proposed disallowance because of a failure of proof is not on appeal. Although MGE opposes the proposed MKP/RPC disallowance in this case on all of the same grounds that it previously expressed in Case No. GR-96-450, this more recent time period (July 2002-June 2003) presents a compelling basis for the Commission to reject the proposed MKP/RPC disallowance in this case. The Staff uses the rates MGE paid to that interstate pipeline, compared to the rates of another interstate pipeline, as the basis for calculating the proposed disallowance. The MKP/RPC rates that

represent the starting point of the Staff's calculation first took effect under the auspices of the Federal Energy Regulatory Commission ("FERC") on May 11, 1998. *See, generally, Kansas Pipeline Company, et al.*, 83 FERC, para. 61,107 (1998), reh'g denied 87 FERC, para. 61,020 (1999). MGE had no choice to do anything different and therefore only paid MKP/RPC at the rate levels approved by FERC. The money MGE paid pursuant to these FERC-jurisdictional MKP/RPC rates is therefore not subject to disallowance by a state regulatory commission under the constitutional principles embodied in the filed rate doctrine. *See, Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 90 L.Ed. 943, 106 S.Ct. 2349 (1986) and *State ex rel. Associated Natural Gas Company v. Public Service Commission*, 954 S.W.2d 520, 530-531 (Mo.App.W.D. 1997).

B. Excess Capacity Disallowance

4. MGE opposes this proposed Staff disallowance. Without limiting any arguments it may make in the future if this case moves forward, MGE offers the following as its initial response.

5. First, MGE has contracted for pipeline capacity in a manner designed to meet customer demand given the numerous uncertainties inherent in the process, including actual weather conditions, peak load forecasts, the timing of capacity availability, benefits of supply diversity, and the possibility of capacity or supply failure, among other factors. Many of those factors require judgment to be exercised. The Staff's Recommendation is completely devoid of any discussion of any specific capacity contracting decision the Staff contends that MGE made unreasonably, when that supposedly unreasonable decision was made, or what viable alternatives were then available to that supposedly unreasonable decision. The success of MGE's performance in regard to capacity contracting is

supported by the fact that MGE's system sales customers have never experienced a capacity-related curtailment, a matter to which the Staff's proposed Excess Capacity disallowance gives little apparent consideration.

6. Second, in discussing this proposed disallowance, the Staff inexplicably omits mention of the existence of a transportation and storage cost incentive mechanism, approved by the Commission in Case No. GO-2000-705, that was in effect for a portion of this ACA period and pursuant to which MGE achieved \$3,832,560 in transportation savings (70% of which—\$2,682,791.98—were credited to the benefit of customers, and 30% of which—\$1,149,768.02—were credited to the benefit of MGE and shareholders). By virtue of MGE data request responses, the Staff is well aware that MGE performed successfully under this plan and booked the appropriate portion of these savings to the benefit of shareholders pursuant to the Commission's order in Case No. GO-2000-705. Nevertheless, the Staff has made no attempt to either challenge the propriety of MGE's reliance on that Commission order or to explain how monies earned by MGE for successfully generating transportation cost savings pursuant to the Commission-approved procedure under Case No. GO-2000-705 can reasonably or lawfully be nullified by the Staff's theory underlying this proposed disallowance for part of the same period of time.

7. Third, in proposing to disallow pipeline capacity costs incurred by MGE on the basis the MGE has contracted for allegedly "excess" capacity, the Staff has completely ignored the fact that significant financial benefits of capacity release transactions flowed to the benefit of customers during this ACA period. The Second Revised Stipulation and Agreement approved by the Commission in MGE's most recently concluded general rate

proceeding prior to (and thus applicable to) the 2002-2003 ACA period included the following provision related to capacity release revenues:

9. The Staff, Public Counsel, and MGE agree, and MGUA and JACOMO/Riverside agree not to oppose, to recognize in revenue requirement a total of \$1,200,000 in revenues from off-system sales and capacity release . . .
(Second Revised Stipulation and Agreement, page 5, Case No. GR-2001-292).

Consequently, beginning on August 6, 2001 (the effective date of the rates from Case No. GR-2001-292) and continuing beyond the June 30, 2003 conclusion of the 2002-2003 ACA period, MGE's customers have benefited from a base rate revenue requirement \$1.2 million lower per year than it otherwise would have been absent recognition of capacity release and off-system sales revenues. As a matter of fact, MGE has only rarely made off-system sales. It has made none since August 6, 2001 for any purpose other than system protection. So MGE was only able to achieve a positive boost to earnings from capacity release revenues it generated above \$1.2 million annually - the amount of revenue recognized in base rates to the benefit of customers.

8. Motion to Strike: In light of these pre-existing Commission-approved mechanisms under which MGE generated approximately \$3.9 million in total cost savings and revenues (\$2,682,791.98 in transportation cost savings and \$1.2 million annually in capacity release revenues) for the benefit of customers, MGE asserts that the Staff recommendation related to the Staff's Excess Capacity Disallowance—which makes no mention whatsoever of any specific capacity contracting decision the Staff believes MGE made imprudently—is insufficient to raise the serious doubt necessary to rebut the

presumption of prudence.¹ Therefore, MGE asks that the Commission dismiss or strike the Staff's proposed Excess Capacity disallowance from consideration in this proceeding.

C. Reliability Analysis

i. Peak Day Selection

ii. Appropriate Reserve Margin

9. MGE opposes these Staff recommendations. Without limiting any arguments it may make in the future if this case moves forward, MGE offers the following as its initial response. The Staff comments in these sections of its memo (pages 3-6) appear to be part and parcel of the rationale for Staff's excess capacity disallowance to which MGE stated its general opposition in section B of this pleading, above. MGE is not presently able to discern any other specific action proposed by the Staff regarding the topics of peak day selection or appropriate reserve margin. Not desiring to engage in an apparently purely academic exercise exploring arcane topics, MGE declines to offer any further substantive response at this time. If, as MGE suspects, these topics become a theoretical foundation for Staff testimony in a contested proceeding, MGE will address them at the appropriate time in the detail necessary and appropriate to their use.

10. However, the Staff's discussion of confidence intervals in relation to the Heating Degree Day level used in peak day analysis and the appropriate reserve margin clearly demonstrates, in MGE's opinion, a significant shortcoming in the Actual Cost Adjustment process as currently implemented by the Staff. MGE is unaware of any

¹ Management prudence is presumed in Missouri. *Re: Union Electric*, 27 Mo. P.S.C. (N.S.) 183, 192-193 (1985). "The standard is that when some participant in a proceeding creates a serious doubt as to the prudence of an expenditure, then the

universally accepted industry standard regarding either confidence interval levels or reserve margin levels. What the Staff appears to seek through its recommendations on these issues in this case (consciously or not), is the establishment of Commission-sanctioned standards for these items. Commission adoption of the Staff's proposals and consequential monetary disallowances would essentially be an *ex post facto* action and extract millions of dollars from MGE's shareholders based on a failure of MGE to observe standards that did not exist when the unidentified decision or decisions apparently being challenged were made. In MGE's view, this is patently unlawful and unfair in addition to being inefficient and wasteful policymaking. To the extent that the Staff seeks to implement any such standards in Missouri, then the appropriate way to do so is through the rulemaking process. That process at least is designed to allow a certain level of scrutiny and debate to take place prior to the establishment of standards that a company such as MGE would be required to observe. In turn, the publication of these standards before they take legal effect would enable companies to make decisions in compliance with the published standards.

D. Purchasing Practices – General

i. Storage Plans

11. This recommendation appears to be largely a re-hash of the Staff's storage-related theories and arguments presented in Case No. GR-2001-382. MGE has not been able to locate a specific dollar disallowance being recommended regarding this topic in the Memorandum. Case No. GR-2001-382 has been fully briefed and submitted and is

company has the burden of dispelling those doubts and proving that the questioned expenditure was prudent." *Re: Gas Service*, 3 Mo. P.S.C. 3d 480, 489 (1995).

awaiting decision by the Commission on that topic. MGE opposed those theories and arguments in that case with numerous facts and explanations by expert witnesses and sees no need to repeat here the detailed basis of its opposition, especially since no recommended disallowance has been identified. If these topics become a theoretical foundation for Staff testimony in a contested proceeding, MGE will address them at the appropriate time in the detail necessary and appropriate to their use.

**ii. Documentation Related to Purchasing and Storage
Use Decisions**

12. MGE is uncertain what the Staff is specifically recommending on this topic. Based on comments found on the bottom of page 9 and the top of page 10 of the Staff's Memorandum, however, it appears that the Staff is requesting that MGE produce significantly more documentation than MGE currently maintains. MGE believes it already produces significant amounts of documentation for Staff review during the ACA process, including monthly supply plans, deal memos, correspondence with an external consultant, rolling storage reports and estimates, etc. What additional information and documentation the Staff believes is necessary is not readily apparent to MGE from the Memorandum, nor is MGE therefore able to assess the relative costs and benefits associated with such unspecified additional documentation. Although MGE is willing to use reasonable efforts to address the Staff's expressed needs and has done so in the recent past (for example, MGE prepared the 2003-2004 draft demand capacity/analysis mentioned on page 3 of the Staff Memorandum in an effort to meet needs expressed by the Staff), MGE must first fully understand what the Staff thinks it needs. Moreover, MGE questions the wisdom of being required to generate still more documentation when, at least in MGE's opinion, it

seems that the Staff does not have a solid understanding of the information MGE already provides. Examples of the Staff's misunderstanding of the information available to or provided by MGE include the following:

A. On page 8 of its Memorandum, Staff contends that "MGE maintains insufficient documentation regarding storage inventory to support its purchasing decisions." MGE is unable to locate any place in the Memorandum where the Staff specifically seeks to disallow any dollars related to this claim. To support this assertion, however, the Staff erroneously assumes that MGE entered into the transaction documented on deal sheet no. 1-03 based solely on a storage analysis report dated Friday, Feb. 28, 2003. The Staff has it absolutely wrong. In fact, because i) the storage report for Feb. 28, 2003 compared to the storage plan for February 2003 shows that MGE had 405,802 MMBtu less gas in storage than planned as of the end of February, and ii) cold weather through March 1, 2 and 3, 2003 indicated that storage draws continued at levels exceeding the March storage plan by approximately 100,000 MMBtu/day for the next five to six days, it was clear that MGE would need to supplement existing arrangements by about 900,000 MMBtu to meet continued high demand by its customers. Therefore, MGE arranged to purchase an additional 863,380 MMBtu as documented in deal sheet no. 1-03 dated Monday, March 3, 2003. The Staff's perception and assumption that MGE entered into the transaction documented in deal sheet no. 1-03 solely on the basis of the Feb. 28, 2003 storage report is simply wrong.

B. On page 8 of its Memorandum, Staff contends that "MGE maintains insufficient documentation regarding storage inventory to support its purchasing decisions." MGE is unable to locate any place in the Memorandum where the Staff

specifically seeks to disallow any dollars related to this claim. To support this assertion, however, the Staff also erroneously claims on page 8 that MGE's decision to turn back 11,832 MMBtu of purchased gas was based on storage report data that was four or five days old, implying it was out of date and unreliable. The Staff has it absolutely wrong again. In fact, MGE's March 11, 2003, decision to turn back 11,832 MMBtu was made to avoid production area overrun charges on Southern Star Central Gas Pipe Line. That amount - 11,832 MMBtu - was not a significant volume of gas in light of the 863,380 MMBtu purchase on March 3, 2003, as documented in deal sheet no. 1-03. The decision made on March 11, 2003, to turn back 11,832 MMBtu of purchased gas was also based on the fact that weather forecasts showed a warming period with 8 heating degree days per day, on average, for March 11 through 16 in comparison to the 36.8 heating degree days per day, on average, historically experienced in the first six days of March. The Staff's claim that MGE made the March 11, 2003, decision to turn back 11,832 MMBtu of purchased gas on the basis of storage data that was four or five days old is simply wrong.

C. As further purported basis for its stated concern that "MGE maintains insufficient documentation regarding storage inventory to support its purchasing decisions," Staff contends on page 8 of its Memorandum that MGE's March 10, 2003, decision to purchase 65,500 MMBtu of additional gas for March 10 and 11, 2003, was based on storage report information two to four days old, implying that such information was out of date and therefore unreliable. MGE is unable to locate any place in the Memorandum where the Staff specifically seeks to disallow any dollars related to this claim. In fact, MGE produces storage reports only during the five workdays of each week

using daily storage and flow information provided by Southern Star (formerly Williams) only on workdays (typically by 11:30 a.m.). Consequently, the Friday, March 7, 2003, storage report was the most recent information available when MGE decided on the morning of Monday, March 10, 2003, to add 65,500 MMBtu of gas for March 10 and 11, 2003. In addition to being based on the March 7, 2003, storage report showing an estimate of 164,868 MMBtu TSS storage inventory as of March 10, 2003 (based on a projected 25 heating degree day average for March 7, 8 and 9), MGE made the decision to add 65,500 MMBtu because Southern Star had an operational flow order ("OFO") in effect at the time and because the actual heating degree days for March 7, 8 and 9 averaged 33.7 heating degree days per day. The implication left by the Staff -- that the Friday afternoon March 7 storage report was too old for use in making a decision on the morning of Monday, March 10 -- is simply wrong.

D. On page 8 of its Memorandum, Staff contends "The Company has the capability of updating its storage analysis spreadsheets several times a day, but has not done this when key decisions are made." MGE is unable to locate any place in the Memorandum where the Staff specifically seeks to disallow any dollars related to this claim. But again, the Staff has it absolutely wrong. In fact, as stated previously, Southern Star provides MGE with storage and flow information only once each day. MGE then takes that information and prepares a storage report that is typically available for use in the afternoon of each workday. In light of the fact that Southern Star provides MGE with storage and flow information only *once* each day, MGE fails to comprehend how it could meaningfully update its storage analysis *several times each day* as contended by Staff.

13. If any of these topics become a theoretical basis for Staff testimony in a contested proceeding, MGE will address them at the appropriate time in the detail necessary and appropriate to their use.

14. Motion to Strike: MGE also asserts that the Staff's topic "2. MGE Documentation Related to Purchasing and Storage Utilization" (Memorandum pp. 8-10) is not a proper topic for consideration in this ACA proceeding. As the style of this case indicates, the purpose of this proceeding is to review PGA adjustments for the 2002-2003 ACA year. Because the discussion (some of which at least is erroneous) by the Staff is necessarily aimed at setting standards regarding future activity, it is absolutely irrelevant to the issues properly before the Commission in this case. If the Staff believes such additional documentation is necessary on a going forward basis, then any such requirement should be imposed on all natural gas local distribution companies, not just MGE. The appropriate procedure to use for the adoption of such requirements is a rulemaking proceeding, not an ACA case. Therefore, MGE asks the Commission to strike the referenced portion of Staff's Memorandum from consideration in this case.

**iii. Transportation Customer Impact on Supply for
System Sales Customers**

15. MGE is uncertain what the Staff is specifically recommending on this point (Item 3, "Increasing Flowing Supplies for Regulated Customers to Make Up for Volumes Needed by Transportation Customers") (Memorandum p. 10), and cannot locate any place where a dollar disallowance is recommended regarding it. However, MGE believes that the concerns expressed by the Staff should have been addressed by virtue of the more rigorous balancing requirements applicable to MGE's Large Volume Transportation

customers contained in tariff sheet numbers 59-67 that took effect on November 1, 2003, as a result of Case No. GT-2004-0049.

iv. Planning Documentation Under Various Temperature Scenarios

16. Motion to Strike: MGE opposes this Staff recommendation. MGE cannot locate any place where a specific dollar disallowance is recommended regarding this topic. Without limiting any arguments it may make in the future if this case moves forward, MGE offers the following as its initial response. MGE asserts that the Staff's "4. Warm Winter Requirements Estimates and Supply Plans or Normal, Warm and Cold Weather" recommendation (Memorandum p. 10) is vague and not a proper topic for consideration in this ACA proceeding. As the style of this case indicates, the purpose of this proceeding is to review PGA adjustments for the 2002-2003 ACA year. Because the topic raised here by the Staff is necessarily aimed at setting standards and requirements regarding future activity, it is absolutely irrelevant to the issues properly before the Commission in this case. If the Staff believes such additional documentation is necessary on a going forward basis, then any such requirement should be imposed on all natural gas local distribution companies, not just MGE. The appropriate procedure to use for the adoption of such requirements is a rulemaking proceeding, not an ACA case. Therefore, MGE asks the Commission to strike the "4. Warm Winter Requirements Estimates and Supply Plans or Normal, Warm and Cold Weather" recommendation (Memorandum p. 10) from consideration in this case. If these topics become a theoretical basis for Staff testimony in a contested proceeding, MGE will address them at the appropriate time in the detail necessary and appropriate to their use.

E. Hedging Documentation

17. Motion to Strike: MGE opposes this Staff recommendation (Memorandum pp. 11-12). MGE cannot locate any place where a specific dollar disallowance is recommended regarding this topic. Without limiting any arguments it may make in the future if this case moves forward, MGE offers the following as its initial response. MGE asserts that the Staff's Hedging recommendation is not a proper topic for consideration in this ACA proceeding. As the style of this case indicates, the purpose of this proceeding is to review PGA adjustments for the 2002-2003 ACA year. Because the Hedging recommendation by the Staff is vague and necessarily aimed at setting standards and requirements regarding future activity, it is absolutely irrelevant to the issues properly before the Commission in this case. If the Staff believes such documentation is necessary on a going forward basis, then any such requirements should be imposed on all natural gas local distribution companies, not just MGE. The appropriate procedure to use for the adoption of such requirements is a rulemaking proceeding, not an ACA case. Therefore, MGE asks the Commission to dismiss or strike the Staff's Hedging recommendation from consideration in this case. If these topics become a theoretical basis for Staff testimony in a contested proceeding, MGE will address them at the appropriate time in the detail necessary and appropriate to their use.

F. GENERAL

18. Due to the length and complexity of Staff's Memorandum, MGE has not attempted to address each allegation specifically. Therefore, any assertion in Staff's Recommendation and Memorandum to which MGE has not explicitly agreed should be considered as being disputed by MGE until it states otherwise.

WHEREFORE, MGE respectfully offers the foregoing response to the Staff's Recommendation and Memorandum and moves that the Commission dismiss or strike the Staff's proposed Excess Capacity disallowance, the topic of MGE Documentation Related to Purchasing and Storage Utilization, the topic of Warm Winter Requirements Estimates and Supply Plans or Normal, Warm and Cold Weather, and the topic of Hedging from consideration in this case as indicated herein.

Respectfully submitted,


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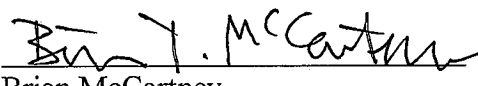
Certificate of Service

I hereby certify that a true and correct copy of the above and foregoing document was either mailed, hand delivered, or served electronically this 25th day of February, 2005, to:

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