BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's	)	
Purchased Gas Adjustment Tariff Revisions	)	
to be Reviewed in its 2000-2001 Actual Cost	)	Case No. GR-2001-382 et al.
Adjustment.	)	

REPLY BRIEF OF
MISSOURI GAS ENERGY

Gary W. Duffy MBE # 24905
Brydon, Swearengen & England P.C.
312 E. Capitol Ave.
P.O. Box 456
Jefferson City, MO 65102-0456
(573) 635-7166
Duffy@Brydonlaw.com

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INTRODUCTION

The Staff of the Commission was the only party other than MGE to file an initial brief in this case. In order to respond to it in a logical fashion, MGE will either state or paraphrase a Staff argument and then provide a response. MGE anticipated many of the Staff's arguments with a full discussion in MGE's initial brief and will endeavor not to duplicate the discussion here. References will be made to MGE's initial brief where more facts and discussion can be found.

Overall, the Staff's brief is singularly unconvincing that any "imprudent" conduct – as the Commission has defined the concept of prudence -- occurred in the period under review. At most, the Staff has shown that through the *perfect* vision enabled by hindsight and the creation of new standards after-the-fact, it would have made *different* decisions that would have produced different results. That does not qualify as imprudence.

The Staff's brief continually harps on the alleged negative "impacts" or results of decisions MGE made, but the Staff has utterly failed to produce *evidence* showing that MGE's decisions were outside the range of reasonable business conduct based on the information known or knowable at the time. In other words, under the test of "prudence" utilized by the Commission (See MGE's Initial Brief, pp. 6–13), the Staff has neither created nor maintained "serious doubt" about the questioned decisions.

Burden of Proof

The Staff's one-page discussion of this topic (Staff brief, pp. 2-3) is exceedingly terse and uninformative. In contrast, MGE's discussion of the prudence standard (MGE

Initial Brief, pp. 6 –11) provides a much more thorough analysis. It is too simplistic for the Staff to merely argue that the "burden of proof" rests with MGE. Instead of making one-sentence declarations incorporating abstract concepts, MGE's initial brief provides quotations from relevant cases and the context in which the Commission has acted in applying the prudence standard in ACA reviews. MGE's discussion in its initial brief points out that the Staff must create "serious doubt" about an issue, and if that occurs, that shifts the responsibility to the utility to "dispel" those doubts.

The Commission's self-described task in these cases is "to determine how reasonable people would have performed the tasks that confronted the company." ***In Re Union Electric Company***, 27 Mo.PSC. (N.S.) 183, 192 -194 (1988). That means, as Mr. Reed testified in his review of the prudence standard, that the focus has to be on whether the company's conduct was reasonable at the time the decision was made. If management uses available information to make reasonable decisions within the then-current framework, the decision is prudent regardless of the outcome. (Ex. 1, p. 6)

As the following discussion shows, the Staff has failed to create "serious doubt" in any of the issues and any doubt Staff may have created has been dispelled by MGE's presentation of contemporaneous facts. It is the contemporaneous facts -- as opposed to Staff's subjective judgments based on hindsight analysis – that govern in a prudence review.

Reliability Report/Data Problems

In this portion of its brief (pp. 3-4) Staff alleges that the "validity, reliability, and application of the Company's November and December 2000 low case estimates was seriously eroded." It is true that the validity of ***Staff's application*** of those numbers in its proposals in this case was "seriously eroded." But the validity, reliability and application of those numbers for their *original and intended purpose,* which was to demonstrate that MGE was not putting reliability at risk in the gas purchases it makes, were never even attacked by the Staff. The numbers in the Reliability Report were developed for a *totally different application* than they were put to by the Staff and they did not represent what the Staff has mistakenly portrayed them to represent. MGE demonstrated the numbers were not suitable for the use to which they were put by the Staff. As a result of Staff's mistake, and its stubborn refusal to acknowledge its error and use appropriate data or methods for its calculations, the only thing "seriously eroded" has been the credibility of the Staff.

MGE did not come into this case advocating particular monthly estimates of demand. Rather, demand estimates were components of the method the Staff invented solely for purposes of this case to measure alleged ratepayer harm. The 2000 Reliability Report, from which the Staff obtained the numbers used in its original calculations, was not prepared for or filed in this ACA case and has little, if any, connection to this case.

The Staff witness told the Commission on the witness stand in the May 2003 hearings that she was using "warmest month" numbers as her demand estimates. (Ex. 28, pp. 3-4) Instead of being upfront and forthright in the development of her approach and simply sending data requests for actual customer usage data for "warmest month" experiences, the Staff decided that it would rely on "Low Case" numbers it found in the 2000 Reliability Report. MGE demonstrated that the numbers Staff used from the

Reliability Report did not represent "warmest month" demand experience. (Ex. 5HC, p. 4; Ex. 28, pp. 1-2, 8-9)

As stressed repeatedly by MGE, the Reliability Report was not designed to show "warmest month" numbers. Mr. Langston testified that "the information contained in the Reliability Report was not prepared for, nor is it appropriate to be utilized for, determining how storage should be dispatched throughout the winter." (Ex. 5NP, p. 4) It was instead designed to show the structure of contracted supply arrangements to demonstrate the steps the company was taking in order to meet a reliable delivery requirement each month. (Tr. 181-182) It is also totally irrelevant that the estimates in the 2000 Reliability Report were based on 1994 calculations and whether the back-up data for the 1994 calculations is still available. The Reliability Report was not designed to be an operating plan for storage withdrawals or monthly flowing supplies. (Tr. 182; 286-287; 302) Specifically, what appears as a "Low Case" in the Reliability Report is simply not the same thing as a calculation of "warmest month" demand as the Staff witness tried to portray it. (Tr. 658-659)

MGE pointed out to the Staff that numbers representing actual warmest month demand could be found in MGE's direct testimony and had been available to the Staff throughout the case. (Ex. 28, p. 9) For example, it is undisputed that November 1999 was the warmest November in the past 40 years. The daily average actual usage in that month on MGE's system was 147,151 Dth/day. (Ex. 28, p. 9) Using the Staff's original method and the actually experienced demand would have produced a demand level of 142,151 Dth/day for purposes of Staff's original analysis. (Ex. 28, p. 10) That is in stark contrast to Staff's unwarranted reliance on the "Low Case" number from the

Reliability Report that produces a daily demand number of 181,265 Dth/day. This simple comparison shows that the *actually experienced* demand in a very recent "warmest month" was 39,114 Dth/day less (or over 1.1 million Dth for the month less) than Staff was advocating. That makes a huge difference in the Staff's damage calculation, even if you assume the Staff's underlying method is appropriate – which it is not. The Staff has never presented convincing evidence that proves its demand *estimates* are inherently superior to recent actual experience.

What this discussion demonstrates is that the numbers from the 2000 Reliability Report were not "invalid" or "unreliable" in the sense of being "incorrect" as the Staff's brief implies. There was never any evidence that the 2000 Reliability Report numbers failed to represent what they were intended to represent in the context of system reliability throughout the winter season. What happened is that the Staff mistakenly used those numbers to represent something that those numbers inherently did not represent. When told that accurate and verified actual usage numbers had been available all along, instead of using actual data, the Staff chose to create a totally new and faulty (for a different set of reasons) group of *estimates* for monthly demands.

Staff's new demand estimates, i.e., those unveiled with its October 3, 2003, testimony filing, are significantly different than *actual* demand experienced on MGE's system. This is a huge "red flag" in terms of their accuracy and suitability for the purpose intended by Staff. Their demonstrated inability to accurately predict demand – even with a high R-squared number -- is due to several errors MGE has already discussed. (See MGE's Initial Brief, pp. 61-63) The bottom line is that if the Staff's group of new demand estimates constitutes the yardstick by which ratepayer harm is to be measured in this case, much greater scrutiny needs to be made of the Staff's yardstick. Right now (because Staff keeps changing its method), the evidence MGE has provided shows that the Staff's yardstick is about 45 inches long.

KPC Capacity Release

Staff claims on page 5 that it is "very disturbing" that "MGE did not even make an attempt to market this idle capacity." Building upon that factual assertion, the Staff concludes "this lack of even minimal effort to test the market, is itself evidence of imprudence."

The Staff should have checked its facts before making that assertion because it is incorrect. The fact is that MGE negotiated releases of its Williams capacity and also attempted to release a portion of its Williams capacity during the ACA period by open postings on the Williams electronic bulletin board, and has made other attempts since then. (Ex. 3, p. 22-23) There were no bidders for that open posted capacity during the ACA period in question in this case, nor have there been any bidders since that time. (Id.) So the facts are that MGE has made attempts to market its idle capacity on both Williams and KPC.

MGE did not attempt to post its idle KPC capacity on the KPC electronic bulletin board during the ACA period because MGE knew from experience that anyone seeking that capacity had much more attractive alternatives <u>and</u> there had never been a capacity release in KPC's history. (Ex. 3, p. 5) MGE knew that the likelihood of any such capacity release was therefore "effectively zero." (Id.) The Staff did not produce any evidence that proves MGE's perception of the market for its idle capacity was anything other than what MGE said it was. Therefore, the Staff has not cast "serious doubt" on MGE's decision-making because the contemporaneous facts unequivocally document the reasonable basis for MGE's decision.

In fact, the evidence presented by MGE dispels the possibility of any doubt. Staff has not demonstrated <u>any</u> potential for success in its hypothetical capacity releases at <u>any</u> price, much less at the arbitrary 75% figure it proposed. The Staff cannot point to even a single capacity release on KPC because the unchallenged evidence shows there never has been one. (Ex. 3, Schedule MTL-3) The Staff did not show a comparable release transaction on Williams in the ACA period because the unchallenged evidence shows there never was one. (Ex. 4, p. 43-44)

In short, the evidence proves that Staff's proposed adjustment required MGE to go on a fool's errand. It assumed an impossible result. MGE cannot be penalized under the prudence standard for failure to attempt or achieve the impossible or for failing to waste time and effort on pointless tasks.

Hedging

Staff's brief claims on page 5 that "the 1996/1997 heating season forcibly brought home to the Commission, Missouri LDCs, and the Staff, the need to protect captive ratepayers from spot market price spikes." The Staff is therefore implying that everyone has known since the winter of 1996 that customers should be fully protected against price spikes.

The evidence shows, however, that whether customers should be protected from "price spikes," and if so, to what extent, is still subject to debate and there is no national or state-level consensus. (See MGE Initial Brief, pp. 34-35) Hedging does not generally result in the lowest cost of natural gas to the customer. (Ex. 2, p. 10) MGE believes that hedging a portion of its portfolio is appropriate, and it has done so.

The discussion on pages 5 and 6 of Staff's brief reflects just the opinions of the Staff, not policy adopted by the Commission on the subject of hedging. This is proven by the fact that the Commission has not acted in the years since 1996 to set a standard for a minimal level of hedging that would be used to determine a utility's prudence. Certainly, no such standard was in place prior to this ACA period. (Ex. 1, p. 35; Ex. 4, p. 31; Tr. 340-343) The Commission did not make its first general pronouncement on the subject until it enacted 4 CSR 240-40.018, effective December 30, 2003. In that new rule, the Commission set no specific hedging standard either.

The evidence shows the Commission in the past has chosen to deal with each Missouri gas company separately by approval of a specific plan with clear tariff language authorizing recovery for hedging expenditures. When MGE took that approach but the hedging plan approved by the Commission could not be accomplished due to market conditions outside of MGE's control, the Commission just told MGE to "apply reasonable purchasing practices based upon its own evaluation of risks in its gas supply portfolio." (Order Denying Application to Renew Price Stabilization Fund and Rejecting Tariff, Missouri Public Service Commission, Case No. GO-2001-215, October 26, 2000) As the National Regulatory Research Institute observed, if a commission does not prohibit hedging but also gives no guidance, this is "likely to discourage hedging since a utility would need to know whether the costs associated with hedging would be recovered from consumers and how the commission would retroactively view its hedging activities." (Ex. 1, p. 47)

On page 6 the Staff argues that a calendar month is the "appropriate planning period for natural gas hedging." What the Staff did, though, is use a strict calendar month in evaluating the results of its 30% standard. Physical and financial hedging is not done on a month to month basis during the winter, but rather done prior to the winter on a seasonal basis. (Ex. 3, p. 44) Due to factors outside the control of the gas company, such as weather and customer demand, pipeline operational issues, and market prices, the actual amount of hedges will vary significantly from month to month. (Id.) This alone makes the month-by-month cut-off unreasonable.

Also on page 6 of its brief, Staff notes that MGE has complained that Staff's proposed 30% standard was not "gift-wrapped" and sent to MGE before the heating season. Not only was it not "gift-wrapped" prior to the heating season, it did not even exist prior to the heating season. MGE's complaint about the timing of this standard is the same complaint that you would have if, after driving at 35 mph down a country road where no speed limit sign had ever been posted, the police stopped you and announced that they had just decided to make that area a 20 mph zone, and you are going to pay a hefty fine.

On page 7, Staff suggests that 100% of warm weather requirements for each month should be hedged. At a threshold level, there was no evidence in the case that customers actually want 100% of their gas prices hedged, or what level MGE's customers consider economical or desirable. Nevertheless, the evidence does show that with the Fixed Commodity Price (FCP) Settlement, MGE and the other signatories (which included Staff) attempted to fix the price for 100% of the supplies for MGE's customers. (Ex. 3, pp. 28-30) That settlement was filed with the Commission on April 28, 2000. (Ex. 3, p. 30) The Commission did not approve the settlement until August 1, 2000. (Id.) Unfortunately, market prices for gas rose during that period to a point outside of the parameters contemplated by the settlement. (Ex. 3, pp. 30-31) MGE sought Staff's approval to modify the settlement parameters so the 100% coverage could still be achieved. (Ex. 3, p. 31) The Staff – apparently worried that the high gas prices would later go down -- refused to modify the agreement. (Ex. 3, pp. 31-33) So it is highly disingenuous for the Staff's brief to criticize MGE for not achieving 100% hedging in this ACA period when the Staff's refusal to modify the FCP settlement was a significant barrier to achieving 100% hedging for this ACA period.

On page 8 of the brief, Staff claims that its proposed 30% test is not a prudence standard, but "no more than a factor for a measurement for damages." Shakespeare provided an appropriate response to that in *Romeo and Juliet* by saying: "A rose by any other name would smell as sweet." In less prosaic but more definite terms, Mr. Reed documented how the 30% test has indeed been used by the Staff as a prudence standard in this case. (Ex. 2, pp. 6-7) In fact, Staff's claim is completely undercut by the admission of its own witness, who stated that its development was based, in part, on the amount of damages it would calculate rather than its assessment of MGE's decision-making. (Ex. 4NP, p. 31-32)

Also on page 8 and again on page 9, the Staff mischaracterizes the percentage of MGE's actual hedged volumes in the ACA period as a "proposal" by MGE. (The derivation of the percentage is shown in Exhibit 3 at p. 45.) MGE did not advocate that its actual experience in the ACA period should be used as a "proposal" or standard. MGE was simply pointing out in its defense to the Staff's proposed standard that the actual experience, looked at more properly on a seasonal basis, exceeded the Staff's proposed 30% test by at least eight percentage points.

Building on its mischaracterization regarding the 38%, the Staff's brief then provides an example of what it claims as "havoc" and "devastating consequences" that could result if two months were 100% hedged "while the rest were exposed to unlimited price increases." This prophecy of doom becomes just hollow rhetoric when the Staff's own conduct is examined. Remember that the evidence shows Staff entered into an agreement just prior to the start of the 2000 heating season in which it recommended to the Commission that another Missouri gas company be given clear authority to do "the same or varying quantities [of hedging] for each month, including zero for certain months." (Ex. 3, pp. 44-45)

The Staff then says at the bottom of page 8 and the top of page 9 that "MGE's argument regarding 38% entire winter coverage belies one of the greatest problems with the experience from the winter of 2000-2001, that heavier hedging or storage use in early months does little to protect subsequent months that have almost no hedging at all." The Staff claims that "a prime example" of its concern "is January 2001, where prices peaked, little storage was left to withdraw, and minimal other hedging was in place." This quotation just highlights another place where the Staff's words are in direct conflict with its actions. Even though January 2001 is being held up in Staff's brief as the "poster child month" of MGE's alleged misconduct in 2001, there is no Staff disallowance currently proposed in this case that arises from January 2001. The schedules Staff included with Exhibit 36 show that the current Staff proposed disallowance for hedging is calculated on the basis of March 2001 and the proposed disallowance for storage use is calculated on the basis of February 2001.

Page 9 of Staff's brief contains a paragraph that demonstrates the Staff's flawed approach in this case. First, it says that the Commission "must consider whether MGE's hedging levels had a negative impact on customers. Thus, the Commission must quantify the impact of the MGE purchasing plan." Staff then brings up the 2000 Reliability Report again and claims the numbers were not "current or complete" which it in turn uses as justification for revising its own demand estimates. Then Staff claims that these new demand estimates "reflect the harm from MGE's failure to use information that it had, and should have considered when it was making purchasing decisions." That is a jumbled collection of half-truths that epitomizes the Staff's approach in this case. For example, this paragraph of Staff's brief implies that MGE was supposed to rely in the fall of 2000 on the Staff's method of making demand estimates when (1) Staff didn't create it until the fall of 2003 and (2) MGE has demonstrated the Staff's demand estimates are seriously flawed and less than adequate predictors of demand. The Staff also does not specifically identify the nature of this "information" that MGE allegedly "failed to use ... and consider... when making purchasing decisions." Contrast that vagueness with Mr. Reed's search of then-current publicly available information which documents that the level to which prices rose and the overall price volatility was "unforeseen and took virtually all market participants by surprise." (Ex. 1, pp. 24-25)

As noted earlier, a fundamental mistake the Staff made in this case was wrongfully assuming that the 2000 Reliability Report contained a current analysis of "warmest month" customer usage, or that it was even required to do so. Throughout the hearing and the briefing, the Staff has continued to criticize MGE for the alleged deficiencies in the Reliability Report when, in fact, that Report had little or nothing to do with the way MGE operationally planned to hedge or use storage. As MGE has pointed out, since it was Staff's expressed intent to determine "warmest month" demand, there were much more appropriate sources of demand information that the Staff should have used and much more appropriate methods by which to do its analysis.

That paragraph in Staff's brief also indicates that the Staff looks at prudence from exactly the opposite direction than is permitted by the law. The Staff first looks for "negative impacts" and quantifies them, and then looks for decisions that allegedly gave rise to these negative impacts. The "negative impact" it saw in the hedging realm was apparently the fact that MGE did not hedge 100% of the winter volumes. Of course, as has been demonstrated, there was no requirement that MGE hedge 100% in the first place and MGE's attempts to even do that were thwarted by Staff. So the Staff invented the 30% monthly test in order to have a "standard," and then used that to quantify its alleged ratepayer harm. Apparently realizing the weakness inherent in such a *post hoc* standard, the only direct allegation of imprudence the Staff made in this case on this issue was that MGE didn't have a "formal, documented" hedging plan. As the Commission is well aware, there is no such requirement for that, either. So while the Staff's brief strings together a collection of irrelevant accusations grounded in the alleged deficiencies in the 2000 Reliability Report, they prove absolutely nothing when it comes to the question of whether the Staff has substantiated a claim of imprudence.

What MGE did with regard to hedging in this ACA period has to be considered in the context of several things. One is the conflicting direction in relation to hedging given MGE for this ACA period. First, consistent with the historical custom regarding hedging as conducted for the winters of 1997-1998, 1998-1999 and 1999-2000, the Commission — in August 2000 — approved an agreement offered by MGE, the Commission Staff and the Office of the Public Counsel that included detailed provisions regarding hedging activities to be conducted for the upcoming winter. Ultimately, because prevailing market conditions following this Commission action prevented implementation of the agreement, MGE sought Commission approval of amendments to that agreement. MGE viewed this filing as also consistent with past Commission custom regarding hedging activities. In response to that came the Commission's statement in an order issued at the end of October 2000, that MGE should "apply reasonable purchasing practices based upon its own evaluation of risks in its gas supply portfolio." Contrary to what occurred less than three months earlier, and in previous years, MGE was given no explicit authority to engage in financial hedging and no assurance of cost recovery if it did. Second, the Staff has not alleged that <u>any</u> purchase of natural gas by MGE in the ACA period was imprudent. The evidence shows all of the purchases were made in arms' length transactions and at market prices. By definition, that is prudent, because a reasonable price is generally interpreted as equivalent to the market price, namely the spot price or the contract price indexed to a designated market price. (Ex. 1, p. 47) Further, there is no recognized standard for an optimal level of hedging that is applicable in this case. Standards adopted by other state utility commissions run the gamut on how much to hedge.

Most importantly, at no time prior to the winter of 2000-2001 was MGE told that its hedging would be evaluated on the basis of 30% of normal demand volumes each month. To penalize MGE based on that approach now is a clear violation of the prudence standard because it does not consider the facts and circumstances at the time MGE was making its decisions.

Storage Utilization

Staff opens its discussion of this issue on page 9 with the allegation that MGE's storage plan was "unreasonable." The Staff has never proven that any specific aspect of MGE's storage plan is unreasonable in comparison to some recognized standard. All the Staff has done is produce two different *alternative* storage utilization "plans" of its own that it created after-the-fact, each of which was shown to have serious flaws when applied in the real world.

Both of Staff's plans rest upon seriously flawed estimates of monthly demands. The original one relied upon grossly excessive daily flows of First of Month flowing gas coming into MGE's system every day in November. Staff's second plan also suffers from that same problem, albeit to a lesser extent, but amazingly only plans on using 79% of MGE's contracted storage over an entire normal season. (Ex. 29, p. 23)

MGE has never claimed that its storage plan is perfect, but MGE's plan avoids the serious problems of Staff's alternatives. Further, as MGE has documented, its storage plan for 2000-2001 was essentially the same as it was for 1998 and the intervening years. No one -- Staff included – has ever previously raised any concerns about MGE's storage utilization plan. (Ex. 1, pp. 15-17; Ex. 4NP, pp. 9-11) The Staff even did its own analysis of MGE storage in the 1998 rate case and that contained substantially *higher* storage withdrawals than Staff is proposing here. (Ex. 4NP, p. 11) Staff never even asked to see the 1998-1999 storage plan. (Ex. 4NP, p. 11) All of this leads to the rhetorical question: If MGE's storage use plan is so "unreasonable" on its face, and it has been substantially the same since 1998, why is it that after extensive annual ACA reviews and other analyses, it took the Staff five years to come to that conclusion and articulate it?

On page 10, Staff claims that MGE's plan was deficient because "consumers became exposed to the higher flowing gas costs in the later winter months." First, this was not a unique experience for just MGE's customers and therefore, it is not something that can properly be characterized as resulting from an imprudent decision by MGE. The evidence shows that the same thing happened in areas all across the United States that depend on natural gas for heating. There were record cold temperatures in November and December 2000 and MGE's storage withdrawals in that period were consistent with but slightly lower than the national trend at that time. (Ex. 1, pp. 20-21)

Second, the only way the Staff can make the statement that customers were exposed to higher prices is with the benefit of 20/20 hindsight, because *only with hindsight* did it become apparent that prices in the later winter months were higher. As noted previously in this brief, there were no predictions of the price levels or the volatility actually attained that winter. The Staff acknowledges the obvious on page 10 of its brief when it says "no one knows if the weather will be warm, cold or normal for each of the heating season months." No one knows what the market prices for gas are going to be for those months either. The prices experienced then were unprecedented. (Ex. 1, p. 24) They could have just as easily been lower and it certainly was reasonable to expect them to be lower based upon the forecasts that were available. (Ex. 1, pp. 29-31) Indeed, the Staff's *own conduct* prior to the start of the winter is compelling evidence that that very perception existed. This is demonstrated by the fact that Staff refused to modify the parameters of the FCP Settlement in the fall of 2000 because of its perception at that time that prices could later go <u>down</u>. (Ex. 3, p. 32)

The Staff's conduct also proves that its approach in this case does not comport with the prudence standard. Staff does not focus on MGE's decision-making process and the facts known at the time, but rather the <u>results</u> of the decisions. The Staff then creates *post hoc* standards that it can easily manipulate so they were exceeded. (Ex. 1, pp. 17-18)

The Staff's brief contains a serious factual error on page 10. The brief says "MGE planned to withdraw the greatest volumes from storage in November (the heating season month with the fewest number of HDD) ***and the smallest volumes in January*** (the heating season month with the greatest number of HDD)." (Emphasis supplied) That is a complete misrepresentation of the facts. MGE's baseline storage plan going into the winter of 2000-2001 was shown in Table 2 in Exhibit 4NP at page 9. That clearly shows MGE planned on withdrawing the most storage volumes in November. The <u>second-highest level</u> of withdrawals, rather than "the smallest" as Staff alleges, was planned for January. The smallest level was planned for March.

MGE's planned level of withdrawals for November was due to the fact that November is the most volatile in terms of swings in weather, and thus, swings in customer demand. (Ex. 3, pp. 50-52; Tr. 55) There is also the operational consideration that MGE's contract storage is essentially full at the beginning of November and, depending upon the weather, there can be no opportunity to inject gas into storage in November. (Ex. 3, p. 54; Ex. 4, p. 19) In short, MGE fully justified the reasonableness of its plan that was developed through years of actual experience. MGE's plan stands in sharp contrast to the one created by Staff by plugging flawed averages or estimates of demand into an unsupported spreadsheet model based solely on theory and not on actual experience.

On page 11, the Staff's brief claims that "MGE presented no evidence that it considered the use of increased flowing supply as an alternative to its planned gross over-reliance on storage to meet its November requirements." Again, Staff is only using its 20/20 hindsight to justify its position. MGE does consider the level of flowing supplies compared to storage use. MGE presented graphic evidence that due to the temperature variability in November, it is operationally and economically vital not to schedule high levels of flowing supplies in that month because it is possible to end up with no place to put the gas if the demand is less than expected due to warm weather. (Ex. 3, Schedule MTL-15 and Ex. 29, Schedule MTL-43) Instead, intentional reliance upon storage gas to act as a "shock absorber" for those demand variations makes sense and is reasonable. (Ex. 4, p. 19; Tr. 57) The evidence is that at the end of November 2000 – before it received the major usage revision from Williams -- MGE believed that it was within a few percentage points of its planned storage withdrawals.

(Tr. 650, 633) Natural gas prices were at record highs at the time, which also argued for the use of the lower-priced storage gas as opposed to ordering new higher-priced flowing supplies. Therefore, based on the information available at the time, and in an attempt to protect the customers, there was no rational reason to order additional flowing supplies. It was not until mid-December that MGE received the information from Williams pipeline revising its numbers to show that customers had used significantly more gas than previously known. (Tr. 633) The evidence is that MGE, in response to that new information, did order more flowing supplies in mid-December once the need for that became known. (Tr. 651) Therefore, MGE unquestionably considered increasing flowing supplies, and in fact, did so when the need materialized.

Staff's simplistic argument completely fails to recognize that there are many more factors to consider than simply the amount of gas in storage. Gas supply decisions have to be made daily to account for numerous simultaneous conditions such as pipeline capacity, storage level, weather, and current and future natural gas pricing. No LDC can guarantee how much storage gas its customers will use in a given month. (Ex. 4 NP, p. 29)

On page 11, Staff's brief begins discussion of the December gas supply decision to which it has objected. It claims that MGE knew that January is usually the coldest month and that November had been "much colder than normal and that more natural gas had been withdrawn from storage than its normal plan."

While it is true that January is usually the coldest month in terms of the total *number* of heating degree days, it does not automatically follow as Staff implies that January will always experience the highest natural gas *prices*, and that therefore customers will always be exposed to higher flowing supply prices in January. As documented by MGE, in four of the previous five winters (1997 through 2002), the price of gas in January was not the highest price in the winter. Four out of the five times the price of gas in November was higher than the price in January. (Ex. 4, p. 23 and Schedule MTL-23) In that series of winters, only January 2000 had the highest price, which again demonstrates the arbitrary nature of Staff's proposed disallowance here for 2000 because only for that one winter could the Staff have facts to support its premise.

And what about the Staff's allegation that "more natural gas had been withdrawn" from storage in November than planned? Again, the focus needs to be on what MGE actually knew at the time about how much gas had been withdrawn. As recounted above, at the end of November, MGE believed based on the yet-to-be-revised figures from Williams that storage withdrawals were *not* significantly out of line with its plan. The information MGE had then was that it had withdrawn about 4.5 million MMBtus from storage compared to a plan volume of 4.15 million. (Tr. 633) "So we felt that we were roughly 350,000 Ms [MMBtus] above plan, which across an entire winter we did not consider to be a substantial number out of 17.8 Bcf [or million MMBtus] storage capacity. (Id.) Therefore, the implication from the Staff's brief that MGE should have been aware of the mid-December Williams measurement revisions two or three weeks *before they even existed* has no evidentiary basis.

On page 12, Staff states that "even knowing that November had been much colder than normal weather and that more natural gas had been withdrawn than planned, the Company planned to undersupply flowing gas for the month of December 2000." The Staff also contends MGE has never fully explained its decision.

As the evidence shows, though, MGE has fully explained the basis for the November 27 decision to order less FOM flowing supply in December. (Ex. 3, pp. 58-59; MGE's Initial Brief pp. 66-68) When MGE made the decision at the end of November to "undersupply" flowing gas in December (and therefore rely on storage if that became necessary), the information MGE had was that its customers had used just a little more storage than reflected in the plan since November 2000 had been colder than normal. On November 27, MGE had a rational basis for the belief that it was within "350,000 M's" of its plan which was "pretty close, especially given the fact that we knew we'd had a cold November." (Tr. 650) MGE did not receive the Williams usage revision – which contained the "bust" in the Williams measurement numbers -- until about December 15. (Tr. 633, 674) So the picture that the Staff attempts to draw of MGE being reckless and intentionally over-pulling from storage in November cannot be justified by the facts.

MGE also had documentation at the end of November that supported a reasonable belief that natural gas prices – already at all-time record highs -- would decline after the first of December. (Ex. 1, pp. 30-31) There was a prediction of warmer than normal weather for the central United States and normal weather for the entirety of the United States for the first part of December. (Ex. 3, p. 59) A review of documentation by Mr. Reed showed that many LDCs in the United States acted in a similar fashion as MGE to attempt to protect their customers and avoid the seemingly "too high" price for gas available during bidweek at the end of November. (Ex. 1, pp. 31-33) On an objective basis then, considering what information was available at the time the decision had to be made, MGE acted within the range of reasonable behavior. Staff has not produced any evidence (and it certainly cites none in its brief) that MGE had, or should have had, different information that would have clearly mandated that MGE make a different decision. Rather than produce evidence of such hypothetical data, the Staff merely repeats the chant that MGE has not "fully explained" its decision.

All the Staff has done is show that, in hindsight, it might have done things differently. Furthermore, the Staff's brief conveniently does not discuss the fact that MGE made exactly the same supply decision in February 2001 on exactly the same type of information. (Tr. 651, 661-662) That time, prices turned out to be *lower* in the following month and MGE's customers benefited. The Staff has not objected to the February transaction. This clearly demonstrates that the Staff is not considering the contemporaneous information and the decision-making process itself, as required by the prudence standard. The Staff is only looking at the result, and only raising the issue when it did not like the result. Of course, the results are only known after-the-fact when viewed through 20/20 hindsight. Such an after-the-fact review violates the Commission's prudence standard.

On page 14 of the Staff's brief is a section discussing "Operational Considerations." This is apparently designed to make the point that MGE "must manage its storage inventory so that adequate volumes of storage gas are available for each of the heating season months in case cold weather occurs and these operating constraints are encountered." The "operating constraint" the Staff refers to here regarding a Williams tariff provision of a ratio of flowing gas to storage gas is only relevant on a "peak day." The mere existence of the provision does not prove, as the Staff implies, that there is an overriding need to apportion storage gas across the winter months according to some distribution of heating degree days. Mr. Langston testified that MGE litigated the provisions in the Williams tariff in 1995 and the result was a ruling by the FERC that the percentage splits referred to in Staff's brief as "operational constraints" only apply to a specific "peak day." (Tr. 652-653) As long as MGE has gas in storage, it can take the full maximum storage withdrawal capability on <u>any</u> particular day. (Tr. 653) Therefore, at times other than a "peak day" MGE is free to withdraw its storage gas as it desires, including up to 100% of its maximum daily deliverability quantity. (Id.) Obviously, MGE managed its storage to meet peak day events in the ACA period because there was no evidence that MGE failed to serve any customer. MGE's experience also shows that its baseline storage plan is not unreasonable because it weathered a record-cold two month period (November and December 2000) without incurring any pipeline imbalance penalties or encountering any service problems.

From pages 14 to 16, the Staff's brief summarizes its approach, the elements of which MGE has already discussed. Basically, it simply demonstrates that the Staff developed a different -- but certainly not superior -- approach to utilization of storage gas. Staff's brief does nothing to dispel the problems with (a) the documented and fundamental flaws in the Staff approach of only *planning* to use 79% of contracted storage in a normal winter (Ex. 29, pp. 23-2), (b) flowing too much gas into MGE's system on a daily basis than history shows is necessary (Ex. 29, p. 33), (c) relying on faulty calculated estimates when recent *actual* demand numbers are available (Ex. 29, pp. 31-32), and (d) having a poor predictability factor that amazingly gets <u>worse</u> as the weather gets more extreme (Ex. 29, p. 28).

MGE clearly demonstrated that when the Staff's storage utilization approach is back-cast on to recent *real world* experience, it only works in the record-cold winter of 2000-2001. In four of the previous five years, it would have produced a net cost to the ratepayers. (Ex. 4NP, pp. 21-25; Schedule MTL-23) The Staff never provided any convincing documentation that its approach would be economical for customers in anything other than the one particular winter that it was designed after-the-fact to address. A track record like that certainly should not convince the Commission to adopt the Staff's approach and thereby effectively endorse it as an operational plan for storage utilization. That would be the effect if the Commission accepted the Staff's proposed disallowance on this issue.

Instead, the Commission – in conformity with the prudence standard -- should carefully evaluate the evidence to determine if the decisions MGE made to which the Staff objects were outside the range of *reasonable* decisions when considered in the context of the information available to MGE at the time. The evidence shows that MGE has rational, reasonable, and experience-based reasons for planning to withdraw greater levels of storage gas in November. The test of time proves it is superior to any of the several proposals the Staff developed for this case. The evidence also shows that based on the information available to MGE on November 27, 2000, MGE made a rational supply decision to order less First of Month flowing supplies for December in a reasonable attempt to save its customers money.

In any proceeding where there is a prospect of the disallowance of gas costs, the Commission should not lose sight of the fact that the rate structure it has approved for MGE does not allow MGE to profit on the sale of natural gas *per se*. The costs MGE incurs for the gas it supplies to its customers are passed through on a dollar for dollar basis with no "mark-up" through the PGA/ACA process. As a result of that rate structure, MGE has no direct financial incentive to speculate on the price of natural gas for possible shareholder gain. (Ex. 1, p. 48) There is only a financial *disincentive* as a result of a disallowance for being found imprudent after-the-fact. MGE has already shared in the financial hardships incurred by its customers in the winter of 2000-2001 because MGE's uncollectibles for that period were nearly triple the level assumed in the cost of service. (Ex. 1, p. 50)

Reliability Report

Staff argues in this section of its brief (pp. 16-18) that the Commission must examine MGE's plans. In an attempt to show that the 2000 Reliability Report is suspect, the Staff says that it doesn't trust the data the Report contains and says that it only looks at a "peak day." The Staff concludes from this that the company's "plans" must be suspect, and therefore MGE must have been imprudent.

The Staff's simplistic logic has substantial gaps, mainly because it is comparing apples and oranges. There was no evidence that the regression analyses done by MGE in 1994 that cannot now be located would, if found, have made any difference in this case. Therefore, their absence is irrelevant to the issues in this case.

The Staff says on page 18 that it is "extremely concerned" that MGE relied on this 1994 analysis in making decisions for the winter of 2000-2001. The Staff never proved that MGE did that. There was no evidence presented that MGE uses the Reliability Report information or any approach implicit in the Report as a daily or monthly operational plan on how to dispatch storage. In fact, MGE has consistently denied that. (Ex. 5NP, pp. 4-5) Therefore, other than fulfilling its purpose of demonstrating that MGE goes into each winter with enough gas in storage or under contract to meet an estimated peak day demand situation (and thus ensure *reliability* of service), the Reliability Report is irrelevant to the specific issues in this case.

To help the Staff and the Commission understand the decision-making process, MGE provided the Staff with a comprehensive list of events and documents that governed its supply decisions in the ACA period. (See Exhibit 3, Schedule MTL-16) Other than noting at the beginning of the document that the Reliability Report was filed on July 1, at no point does that document show that MGE relied on the 2000 Reliability Report for any of its subsequent actions or decisions. Therefore, it is *irrelevant* to the specific issues in this case.

As Schedule MTL-16 shows, each of MGE's actions or decisions was based on the circumstances and information that existed at the time. The Staff has not proven otherwise. The schedule demonstrates that planning for supply to meet demand is a complex and dynamic process that requires a balancing of many externalities and is largely dependent upon the weather-induced demands the customers place on the system.

This discussion shows that the Reliability Report is what it is and does what it purports to do within the narrow parameters that it was designed to address. The Staff never proved anything to the contrary. Despite that, here in its brief the Staff is still trying to turn it into something that it is not and never was.

As MGE's Initial Brief shows on this topic, the Staff admitted that the additional categories of information it seeks as a result of this issue is not information that is unique to MGE. (Tr. 496) Moreover, an order to produce that information will not have *any bearing* on the issues in this case where the Staff has recommended a disallowance. The 2000 Reliability Report was not filed in any of these ACA cases but rather in a case that has not been consolidated with this case and pursuant to the terms of a stipulation that has ceased to be in effect. Thus, the proper forum for the Staff to have brought this issue is the case in which the Report was filed rather than an ACA case.

The position of MGE remains the same. The proper forum for the Commission to consider requiring all the gas companies to provide expanded levels of information is a rulemaking, not an ACA case.

Respectfully submitted,

Gary W. Duffy / tw

Gary W. Duffy MBE #24905
Brydon, Swearengen & England P.C.
312 E. Capitol Ave.
P.O. Box 456
Jefferson City, MO 65102-0456
(573) 635-7166
Duffy@Brydonlaw.com

CERTIFICATE OF SERVICE

The undersigned certifies that a true and correct copy of the foregoing document was served this 20th day of February, 2004, upon counsel for all parties of record in this proceeding by either hand delivery or by placing a copy of same with the United States Postal Service, postage prepaid.

Mr. Doug Micheel
Office of the Public Counsel
200 Madison St. Suite 650
P.O. Box 2230
Jefferson City, MO 65101

Thomas R. Schwarz, Jr.
Office of the General Counsel
Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102

James B. Deutsch
Counsel for City of Joplin
308 E. High St., Suite 301
Jefferson City, MO 65101

Jeffrey A. Keevil
Counsel for Kansas Pipeline Company
4603 John Garry Dr., Suite 11
Columbia, MO 65203