Missouri Public Service Commission

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June 30, 2000

Mr. Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102

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Missouri Public Service Commission

RE: Case No. GO-2000-705

Dear Mr. Roberts:

Enclosed for filing in the above-captioned case are an original and eight (8) conformed copies of **STAFF'S RECOMMENDATION.**

This filing has been mailed or hand-delivered this date to all counsel of record.

Thank you for your attention to this matter.

Sincerely yours,

Thomas R. Schwarz Jr.

Thomas R. Schwarz, Jr.
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TRS:sw
Enclosure
cc: Counsel of Record

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of Missouri Gas Energy's fixed commodity price PGA and transportation discount incentive mechanism.	))))	Case No. GO-2000-705

STAFF'S RECOMMENDATION

COMES NOW the Staff of the Missouri Public Service Commission ("Staff") and makes the following recommendation to the Missouri Public Service Commission ("Commission") concerning the Amended Stipulation and Agreement filed by the Staff, Missouri Gas Energy, a division of Southern Union Company ("MGE") and the Office of the Public Counsel ("OPC") on May 15, 2000.

I. Background

A. History of MGE's incentive plans and price stabilization fund.

MGE's original incentive plan was approved in Case No. GO-94-318, and ended June 30, 1999. Additionally, in Case No. GO-2000-231, MGE received approval for the capacity release sharing mechanism for the period of November 1, 1999 until October 31, 2000.

The Commission also authorized MGE to maintain an Experimental Price Stabilization fund in order to reduce the impact of natural gas price volatility in Case Nos. GO-97-409, GO-98-364, GO-2000-231, relating to the winter periods of 1997/1998, 1998/1999, and 1999/2000, respectively.

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B. This stipulation and agreement.

The original Stipulation and Agreement was filed on April 28, 2000 by MGE and Staff. An Amended Stipulation and Agreement was filed May 15, 2000, to which OPC was also a signatory. Specimen tariffs were submitted May 19, 2000. This Stipulation and Agreement represents the outcome of more than a year of discussions and negotiations between MGE and the Staff, and frequently OPC. The Fixed Commodity Price PGA and Transportation Discount Incentive Mechanism (FCP) attempts to build off of the experience gained from prior incentive plans. Overall, the Staff had the goals of seeking more stable and lower prices than would be achieved under traditional regulation, and providing proper incentives for prudent gas supply management. The Staff considered the opportunity to "re-base" benchmarks before extending the program to be a critical feature of this plan. Re-basing allows a timely and critical review of the starting points and benchmarks used to calculate savings. If the benchmarks need to be revised to consider changing circumstances, the opportunity to re-base allows for this.

Another principle that Staff applied to this proposed plan was that existing savings, and practices that resulted from historical regulation and market conditions, should not qualify as savings to be shared under the plan. Nor should sharing be allowed when one component of gas cost is increased at the expense of another.

Some of the key features of the plan include: a provision that allows MGE to freeze the commodity price of gas for two years if certain criteria are met; a provision that allows for sharing of savings from the transportation component; and a provision that continues authorization of the price stabilization fund.

II. Explanation of Specific Provisions

A. Commodity price.

One of the key features of the plan is to allow MGE to freeze gas commodity prices for two years. If natural gas prices on the New York Mercantile Exchange (NYMEX) settle at or below $2.25/Mcf for five (5) consecutive days (the trigger price), the fixed commodity price component of the PGA clause is fixed. The fixed commodity price component of the PGA is $.25816/Ccf to reflect items such as pipeline fuel, losses, and gas supply premiums.

The fixed commodity price component of the PGA would be in effect for two years after being triggered and becoming effective. The $2.25/MMBtu trigger calculation was based upon a three-year average of gas prices for the period ending August 1999. This three-year average is much lower than current gas prices (trading recently above $4.00/MMBtu) and gives the customer the assurance that the fixed level of prices will not be locked in at an historically high level without further agreement of the parties, and approval of the Commission. However, absent a significant decrease in the market price of natural gas or a significant increase in the trigger price, or some negotiated middle ground, the fixed commodity price component of the PGA will not take effect, and will not provide customers protection from further increases in the market price of gas. The Amended Stipulation and Agreement allows the parties to re-examine the trigger price to consider subsequent market activity every two months following approval.

The Amended Stipulation and Agreement also provides for the continuation of the experimental price stabilization program approved by the Commission in Case No. GO-2000-231. This provision recognizes that the fixed commodity price component of the PGA may not take effect prior to the upcoming heating season, and is intended to provide MGE the opportunity to obtain financial instruments as price protection in that event. The Amended Stipulation and Agreement provides that such financial instruments and price protection for the upcoming heating season would be obtained, in accordance with the conditions of the Commission's order in Case No. GO-2000-231, no later than September 30, 2000. The Commission should be aware, however, that such financial instruments and price protection are not available within the strike price cap and overall cost conditions set forth in the Commission's order in Case No. GO-2000-231 under current market conditions. Absent some adjustment to those conditions or a significant reduction in the current market price of natural gas, the program will not cover nearly as many volumes. The Staff will continue its discussions with MGE on the above two items.

B. Transportation and Storage Costs

MGE can claim a portion of the savings associated with transportation and storage only if MGE is in compliance with a number of basic principles. These basic principles ensure that (1) reliability shall not be reduced to achieve savings; (2) savings cannot be claimed from new services unless those services are a direct substitute for historical services; (3) savings cannot be claimed when cost components of the delivered cost of gas are increased to achieve decreases in transportation costs; (4) savings cannot be claimed when achieved rates are not below the lesser of final FERC rates or currently effective discounted rates; and, (5) savings cannot be claimed for discounts that are available by tariff or rule as part of FERC proceedings.

The transportation and storage portion of the proposed FCP allows MGE to retain a specified percentage of the savings associated with (1) Maximum Daily Quantity (MDQ) levels, (2) transportation rate discounts and, (3) mix of transportation services. This portion of the proposed FCP also specifies the treatment for (1) demand charge cost recovery, (2) Take-or-Pay (TOP) and Transition Cost recovery, and (3) pipeline refunds.

The proposed FCP allows MGE to retain 30% of any savings achieved from any reductions in the level of contract MDQs for agreements in effect as of April 28, 2000. Sales customers will pay, subject to a Staff prudence review, for any increases in contract MDQs.

The proposed FCP allows MGE to retain 30% of any transportation rate discounts achieved after April 28, 2000, which produce savings in excess of the amount of savings produced by the benchmark level of discounts. However, due to ongoing litigation, MGE is allowed to retain only 15% of any Kansas Pipeline Company discounts. The benchmark level of savings will be based on (1) existing contracted MDQ capacity in agreements in effect as of April 28, 2000 and (2) rates that are the lesser of currently effective discounts or final FERC rates. Increases in approved FERC pipeline rates will be recovered by MGE from its customers.

The proposed FCP allows MGE to retain 30% of any savings achieved by the use of alternative transportation services, e.g. seasonal transportation, back-hauls, etc. These savings will be calculated by comparing all costs actually avoided to all costs actually incurred.

The proposed FCP specifies that the recovery of transportation and storage demand charges will be based upon a specified expected level of volumes. At the end of each ACA period, the expenses and revenues associated with demand charges will be trued up to actual. The proposed FCP specifies that TOP and transition costs will be recovered from customers under the provisions of MGE's tariffs. The proposed FCP specifies that 100% of all pipeline refunds will be credited to MGE's customers under the provisions of MGE's tariff.

C. Off-System Sales and Capacity Release

The proposed FCP specifies that between April 28, 2000 and the date of the Commission's Report and Order in MGE's next general rate case, MGE will be allowed to retain 100% of all off-system sales revenues in excess of $100,000 per year, net of sales incurred at a loss for operating purposes. The Commission's Report and Order in MGE's next general rate case proceeding will govern the treatment of future off-system sales.

The proposed FCP specifies that MGE is allowed to retain a share of capacity release revenues. MGE's share of capacity release revenues is based on a grid which allows MGE to retain 15% of the first $300,000, 20% of the next $300,000, 25% of the next $300,000, and 30% of all capacity release revenues in excess of $900,000.

D. Miscellaneous Items

1. Duration. The transportation and storage portion of the proposed FCP will extend for two years from the effective date of the Commission's Order approving the Stipulation and Agreement for the proposed FCP. The fixed commodity price component portion of the proposed FCP will extend for two years after the fixed commodity price component becomes effective.

2. Documentation. The documentation which will be required from MGE in connection with the proposed FCP will include (1) a reliability report to be provided annually on July 1 of each year and (2) a monitoring report, to be provided on a semi-annual basis, which will detail (a) the savings achieved under the FCP and (b) the calculations supporting the claimed level of savings. Staff will audit MGE's FCP calculations and supporting documentation and make a recommendation to the Commission as to whether or not MGE should be entitled to retain its claimed share of the FCP savings.

3. PGA filings. MGE will retain the current PGA filings of November, April, and an unscheduled filing. The fixed commodity price component will be seasonalized (November to March and April to October) for the Large General Service and Large Volume Services customer classes, but will remain the same throughout the year for all other customer classes.

4. ACA factor. The ACA factor, during the term of the transportation and storage portion of the proposed FCP, will be used to balance gas commodity, transportation and storage cost recovery with gas commodity, transportation and storage cost incurrence. The ACA factor, during the term of the fixed commodity price component portion of the proposed FCP is in effect, will be used to balance transportation and storage cost recovery with transportation and storage cost incurrence, but not gas commodity costs.

5. Hedging. Until such time as the fixed commodity price component of the proposed FCP takes effect, MGE will be allowed to make use of financial instruments to obtain price protection on natural gas supplies. The specifics of MGE's price stabilization program are outlined in the Commission's Order in Case No. GO-2000-231.

6. Prudence reviews. Only during the two year period of time in which the fixed commodity price component portion of the proposed FCP is in effect, MGE will not be subject to prudence reviews for the fixed commodity cost component of the PGA or the associated gas supply contracts. MGE will be subject at all times to prudence reviews for the transportation and storage contracts and cost component of the PGA.

7. Other gas costs. The proposed FCP specifies that volumes and expenses associated with lost and unaccounted-for gas, compression fuel, and BTU conversion shall be included in the initial PGA rate. The expenses and volumes associated with these items will be trued-up in the ACA process and will be audited for prudence.

8. Rebasing. After the transportation and storage portion or the fixed commodity price component portion, or both, of the proposed FCP terminates, Staff, OPC, and MGE have the right to rebase the benchmark amounts and grids contained within the proposed FCP. Staff will likely propose to rebase the components of any proposed extension of the FCP at that time.

III. Recommendation and Conclusion

The Staff believes that the terms of the Amended Stipulation and Agreement put into practice lessons learned from earlier experimental gas cost programs. In light of that, and the foregoing discussion, the Staff recommends that the Commission approve the Amended Stipulation and Agreement, and order MGE to file its tariff sheets in compliance therewith.

Respectfully submitted,

DANA K. JOYCE
General Counsel

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record as shown on the attached service list this 30th day of June, 2000.

Thomas R. Schwarz, Jr.

Service List for
Case No. GO-2000-705
Revised: June 30, 2000

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