

Exhibit No.:
Issue: Hedging Decisions
Witness: Randal T. Maffett
Sponsoring Party: Southern
Missouri Gas Company, L.P. d/b/a
Southern Missouri Natural Gas
Type of Exhibit: Surrebuttal Testimony
Case No.: GR-2006-0352

SOUTHERN MISSOURI GAS COMPANY, L.P.
D/B/A SOUTHERN MISSOURI NATURAL GAS

SURREBUTTAL TESTIMONY

OF

RANDAL T. MAFFETT

Jefferson City, Missouri

November 16, 2007

BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of Southern Missouri)
Gas Company, L.P.'s Purchased Gas)
Adjustment Factors to be Reviewed) Case No. GR-2006-0352
In Its 2005-2006 Actual Cost Adjustment.)

AFFIDAVIT

STATE OF TEXAS)

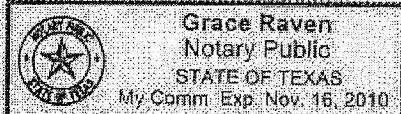
) ss.

COUNTY OF HARRIS)

Comes now Randal T. Maffett, having been duly sworn, upon his oath and states that he has caused to be prepared the attached written testimony in question-answer form and attached exhibits to be presented in the above-captioned proceeding, that the answers and information contained therein are true and correct to the best of his knowledge, information and belief.


Randal T. Maffett

Subscribed and sworn to before me this 16th day of
November, 2007.




Notary Public

My Commission Expires: Nov 16th 2010

1 BEFORE THE PUBLIC SERVICE COMMISSION
2 OF THE STATE OF MISSOURI

3
4 SURREBUTTAL TESTIMONY
5 OF
6 RANDAL T. MAFFETT

7
8 CASE NO. GR-2006-0352
9

10
11 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

12 A. My name is Randal T. Maffett. My business address is 1001
13 Fannin, Suite 550, Houston, Texas 77002.
14

15 Q. ARE YOU THE SAME RANDAL T. MAFFETT THAT PRESENTED DIRECT AND
16 REBUTTAL TESTIMONY IN THIS PROCEEDING?

17 A. Yes.
18

19 Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

20 A. The purpose of my testimony is to respond to the rebuttal
21 testimony of Commission Staff ("Staff") Witness Kwang Y. Choe
22 in this proceeding. Essentially, Mr. Choe has re-iterated his
23 conclusions contained in his direct testimony and alleged that
24 Southern Missouri Natural Gas ("SMNG" or "Company") engaged in
25 imprudent natural gas hedging practices for the winter months,
26 November 2005 through March 2006. Mr. Choe continues to
27 recommend that the Commission disallow between \$220,000 and
28 \$378,000 from the Company's gas costs for the winter months,
29 November 2005 through March 2006.

1 Q. DO YOU DISAGREE WITH MR. CHOE'S CONCLUSIONS?

2 A. Absolutely. For all the reasons that I have already discussed
3 in my Direct and Rebuttal Testimony, I believe that Staff is
4 incorrect that SMNG engaged in any imprudent natural gas
5 hedging practices or other natural gas purchasing decisions in
6 the ACA period. SMNG does not believe there is any basis for
7 a disallowance of its actual cost of gas in this proceeding.

8
9 Q. BEFORE YOU ADDRESS THE AREAS OF DISAGREEMENT WITH STAFF, DO
10 YOU BELIEVE THAT THERE ARE SOME AREAS OF AGREEMENT BETWEEN
11 SMNG AND STAFF IN THIS CASE?

12 A. Yes. Mr. Choe agreed "with the fact SMNG locked in all-time
13 high basis differentials" during this ACA period. (Choe
14 Rebuttal, p. 7, lines 13-14) In fact, Staff's proposed
15 adjustments assume that the locking in of these record high
16 basis differentials was a prudent hedging strategy.

17
18 In addition, Mr. Choe agreed that "It is a fact that [natural
19 gas] prices were high during this period. . . ." (Choe
20 Rebuttal, p. 4, lines 11-12). Mr. Choe's Schedule 4
21 graphically illustrates the extremely high natural gas prices
22 that existed during the summer and fall of 2005, especially
23 after the hurricanes, Rita and Katrina, hit the U.S. Gulf
24 region.

1 Finally, Mr. Choe also agreed that "NYMEX fell substantially
2 in January 2006 after sustained spikes from two major U.S.
3 Gulf hurricanes in the early fall of 2005. . . . (Choe Rebuttal,
4 p. 5, lines 21-22). This fact is also illustrated graphically
5 in Mr. Choe's Schedule 4. The precipitous drop in the natural
6 gas prices continued in later months of the winter and spring
7 of 2005/2006 as illustrated in my Schedule RTM-1 attached to
8 my Direct Testimony.

9
10 Q. DID STAFF DISAGREE WITH YOUR DIRECT TESTIMONY THAT EXPLAINED
11 YOUR UNDERSTANDING THE FOUR PRINCIPLES SHOULD BE FOLLOWED IN
12 EVALUATING THE PRUDENCE OF GAS PURCHASING DECISIONS?

13 A. No. Mr. Choe has not disagreed that the following four
14 principles should be followed by the Commission when
15 evaluating SMNG's gas purchasing decisions:

16 1) There is a presumption of that SMNG's gas purchasing
17 decisions were prudent;

18 2) SMNG's gas purchasing decisions must be evaluated in
19 light of what was known, or reasonably knowable at the time
20 the gas purchasing decisions were being made;

21 3) SMNG's gas purchasing decisions must be evaluated
22 based upon the reasonableness of the circumstances that
23 existed at the time the decisions were being made, and
24 therefore, the use of hindsight to evaluate SMNG's gas

1 purchasing decisions is not appropriate; and

2 4) The Commission must have a record of the facts, not
3 subjective opinions based upon hindsight, as they existed at
4 the time SMNG made its hedging decisions to support any
5 disallowance of gas costs.

6
7 Q. WHAT IS YOUR UNDERSTANDING OF THE BASIS OF STAFF'S
8 CONCLUSIONS?

9 A. Mr. Choe identifies three primary points in his Rebuttal
10 Testimony in support of his conclusions. First, he asserts
11 that SMNG solely relied on its perceived market view that the
12 natural gas prices were too high to fix the prices during the
13 summer and fall of 2005. Second, he alleges that SMNG failed
14 to provide Staff with crucial information on which it based
15 its alleged hedging decision. Third, he alleges that SMNG
16 failed to follow its own Gas Supply Plan.

17
18 Q. DO YOU AGREE WITH MR. CHOE'S SUGGESTION THAT SMNG SOLELY
19 RELIED UPON ITS PERCEIVED MARKET VIEW THAT NATURAL GAS PRICES
20 WERE TOO HIGH TO FIX THE PRICES DURING THE SUMMER AND FALL OF
21 2005?

22 A. No. As I have already explained in my Direct and Rebuttal
23 Testimony, SMNG personnel carefully reviewed the unique
24 markets circumstances that existed during the summer and fall

1 of 2005, and decided that using basis swaps (also known as
2 "basis differential hedging") was a more reasonable and
3 appropriate strategy than securing 60-75% of the winter
4 heating season load at record high prices. SMNG did not
5 solely rely upon our opinion that natural gas prices were
6 higher than justified by the existing market conditions.
7 While SMNG did believe that natural gas prices were likely to
8 have a substantial correction (which it eventually did), SMNG
9 pro-actively decided to enter into basis hedges in order to
10 secure the record discounts that were then available in the
11 market. By locking in basis differentials in favorable
12 markets, SMNG had the opportunity to secure larger discounts
13 from the NYMEX futures index and secure a lower overall price
14 for its customers.

15
16 SMNG never intended, however, to execute the basis swaps and
17 nothing else. SMNG fully intended on locking in its winter
18 gas prices as called for in its Gas Supply Plan of 2005.
19 However, the destruction that resulted from two hurricanes,
20 Rita and Katrina, caused natural gas prices to spiral even
21 higher, as Mr. Choe's Schedule 4 illustrates, to all time
22 highs during the summer and fall of 2005, and effectively
23 delayed SMNG's ability to lock-in prices using fixed price
24 contracts.

1 Q. DO YOU AGREE WITH MR. CHOE THAT SMNG DID NOT PROVIDE STAFF
2 WITH CRUCIAL INFORMATION ON WHICH IT BASED ITS GAS PURCHASING
3 DECISIONS?

4 A. No. SMNG provided Staff with voluminous responses to the
5 Staff's 107 data requests in this case. To my knowledge,
6 there was never a discovery dispute between Staff and SMNG in
7 this proceeding.

8
9 Q. DO YOU AGREE WITH MR. CHOE'S SUGGESTION THAT SMNG FAILED TO
10 FOLLOW ITS GAS SUPPLY PLAN FOR HEDGING?

11 A. No. As I explained in my Rebuttal Testimony, SMNG was
12 following its Gas Supply Plan of 2005 during this ACA period.

13 As was specifically mentioned in SMNG's Gas Supply Plan
14 (dated August 26, 2005, p. 2), it was always SMNG's Plan to
15 "continue to evaluate and monitor opportunities to use
16 financial derivative contracts such as call options, basis
17 swaps, costless collars and knock-out options as a means to
18 provide better price stability to its customers." (Schedule
19 RTM-R-1, page 2) (emphasis added).

20
21 Ultimately, SMNG executed basis differential hedges on two
22 separate occasions; one at NYMEX minus 59 cents on July 26,
23 2005 and another at NYMEX minus 98.5 cents on September 2,
24 2005. Subsequently, on October 27, 2005, December 27, 2005,

1 and January 3, 2006, SMNG entered into several fixed priced
2 contracts for a substantial portion of its expected natural
3 gas requirements for the winter load, and effectively utilized
4 the basis differential hedges secured in July and September,
5 2005, to obtain a lower price for its customers for the
6 winter. SMNG's actual gas purchasing practices were consistent
7 with our Gas Supply Plan, although the purchase of the fixed
8 price contracts were somewhat later than originally
9 anticipated, due to the effect that the hurricanes had on
10 natural gas prices.
11

12 Q. BEGINNING ON PAGE 2, LINE 22, MR. CHOE CRITICIZES SMNG FOR
13 WAITING FOR THE NYMEX TO CHANGE MORE FAVORABLY, SUGGESTING
14 THAT THIS STRATEGY "WORSENEDED THE BUYER'S POSITION BY \$2.45
15 (\$9.25-\$6.80)". DO YOU AGREE WITH HIS COMMENTS?

16 A. No. At the time the decisions were being made to utilize
17 basis hedging, SMNG did not know that the hurricanes were
18 going to hit the U.S. Gulf, and prices would spike to \$9.25 or
19 higher. Mr. Choe's example illustrates the type of analysis
20 which SMNG believes should be avoided when conducting a
21 prudence review of a public utility's decisionmaking. As I
22 mentioned in my Rebuttal Testimony, Staff did not know whether
23 natural gas prices were going to spiral upward in September of
24 2005, and neither did SMNG personnel who had to make the gas

1 purchasing decisions. The Commission should not use such
2 20/20 hindsight in reviewing the Company's decisions in this
3 case.
4

5 Q. BEGINNING ON PAGE 3, LINE 16, MR. CHOE STATES: "WHILE SMNG
6 SPECULATED THAT THE NATURAL GAS PRICES WOULD HAVE A MAJOR
7 DOWNWARD CORRECTION, NYMEX NATURAL GAS FUTURES PRICES
8 CONTINUED TO SURGE DURING THE FALL OF 2005. CONSEQUENTLY,
9 SMNG AND ITS CUSTOMERS WERE FACED WITH A WORSE SITUATION WHEN
10 SMNG EVENTUALLY FIXED THE NATURAL GAS PRICES ON OCTOBER 27,
11 2005, DECEMBER 27, 2005, AND JANUARY 3, 2006 THAN IN THE
12 SUMMER OF 2005." DO YOU AGREE WITH HIS COMMENTS?

13 A. No. It is easy to suggest that purchasing decisions did not
14 turn out as favorably as they might have with the benefit of
15 complete and total hindsight information. SMNG believes that
16 Staff's proposed disallowance in this case is based upon the
17 same type of hindsight analysis, and should be rejected by the
18 Commission.
19

20 Q. HAS STAFF PROVIDED THE COMMISSION WITH ANY INFORMATION THAT
21 WAS AVAILABLE AT THE TIME THE GAS PURCHASING AND HEDGING
22 DECISIONS WERE BEING MADE THAT DEMONSTRATED THAT SMNG'S
23 STRATEGY WAS IMPRUDENT OR OTHERWISE UNREASONABLE?

1 A. No. Staff has not provided the Commission with any basis for
2 proving that experts in the field, other local distribution
3 companies, or anyone else for that matter, were suggesting,
4 before the advent of the hurricanes, that prices would
5 skyrocket to nearly \$15.00.

6
7 Q. HAS STAFF PROVIDED THE COMMISSION WITH EVIDENCE THAT
8 DEMONSTRATES THAT THE FUNDAMENTALS IN THE NATURAL GAS MARKET
9 PLACE DURING THE SUMMER OF 2005 BEFORE THE ADVENT OF THE
10 HURRICANES POINTED TO RAPIDLY INCREASING PRICES OF NATURAL GAS
11 LATER IN THE FALL?

12 A. Not in my opinion. Although Mr. Choe testified that many
13 factors will affect natural gas prices, including "weather,
14 oil prices, drilling rig counts, the level of electric
15 generation from natural gas-fired combustion, national storage
16 levels for natural gas, the level of economic activity, war,
17 and the psychology of the natural gas market participants",
18 Mr. Choe did not provide the Commission with information
19 related to such factors that was contemporaneously available
20 to SMNG at the time it had to make its gas purchasing
21 decisions. The only information that Staff provided was two
22 maps showing that the temperatures by state in June and July,
23 2005, and a chart showing sales of electricity from 2000-2005.
24 This information was not conclusive regarding the likely

1 effect of these factors on the natural gas markets.

2
3 Q. HAS STAFF PROVIDED THE COMMISSION WITH A RECORD OF THE FACTS,
4 AS THEY EXISTED AT THE TIME THE COMPANY MADE ITS GAS
5 PURCHASING DECISIONS?

6 A. No. Staff has not provided factual information from the
7 summer and fall of 2005 that was collected and evaluated
8 without consideration of the eventual outcome or result of
9 SMNG's gas purchasing decisions. In other words, Staff has
10 primarily relied upon information that was available after the
11 fact.

12
13 Q. HAS STAFF PROVIDED THE COMMISSION WITH INFORMATION THAT SHOWS
14 THAT SMNG'S ACTIONS WERE NOT WITHIN A ZONE OF REASONABLENESS
15 GIVEN THE INFORMATION THAT WAS AVAILABLE AT THE TIME THE GAS
16 PURCHASING DECISIONS WERE BEING MADE?

17 A. SMNG does not believe that Staff's case in any way rebuts the
18 presumption of prudence that exists. The Company's decisions
19 should be evaluated in light of what was known, or reasonably
20 knowable, at the time the decisions in question were being
21 made. Judged by that standard, SMNG does not believe its
22 actions can be considered imprudent, unreasonable, or in any
23 way improper. Clearly, basis hedging is a widely used
24 technique, which Staff does not challenge. Staff major

1 complaint in this proceeding appears to be that SMNG did not
2 anticipate the advent of the hurricanes, Rita and Katrina, and
3 did not lock-in fixed price contracts before these Acts of God
4 affected the natural gas prices. This is an unreasonable
5 expectation, given the unpredictable nature of hurricanes in
6 the U.S. Gulf region.
7

8 Q. IN YOUR OPINION, HAS STAFF PROVIDED EVIDENCE OF IMPRUDENCE IN
9 THIS PROCEEDING?

10 A. No. In my opinion, Staff has not met any of the criteria for
11 a finding of imprudence that I discussed in the Direct
12 Testimony. First, Staff has not relied upon the information
13 and circumstances that were available at the time of the
14 hedging decisions were being made by SMNG. Second, Staff has
15 not demonstrated that SMNG's actions and decisions were not
16 within a reasonable and generally-acceptable range of
17 behavior. Lastly, Staff was unwilling to communicate to SMNG
18 that it believed SMNG should lock-in record high natural gas
19 prices, when only contemporaneous information was available.
20
21
22

1 Q. DO YOU BELIEVE THAT SMNG'S HEDGING PRACTICES WERE PRUDENT
2 UNDER THE CIRCUMSTANCES THAT WERE KNOWN AT THE TIME SMNG MADE
3 ITS HEDGING DECISIONS?

4 A. Yes. Given the unique circumstances that existed at the time
5 the decisions were being made, I believe that SMNG acted
6 prudently in managing its gas supplies and hedging practices.

7
8 Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY AT THIS TIME?

9 A. Yes sir, it does.