Exhibit No.:	
Issues:	*Gas Inventory and Capacity Release*
Witness:	*Anne M. Allee*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Surrebuttal Testimony*
Case No.:	*GR-2004-0209*
Date Testimony Prepared:	*June 14, 2004*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

ANNE M. ALLEE

MISSOURI GAS ENERGY

CASE NO. GR-2004-0209

Jefferson City, Missouri
June 2004

****Denotes Highly Confidential Information****

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BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's	)	
Tariffs to Implement a General Rate	)	Case No. GR-2004-0209
Increase for Natural Gas Service	)	

AFFIDAVIT OF ANNE M. ALLEE

STATE OF MISSOURI	)	
	)	ss.
COUNTY OF COLE	)	

Anne M. Allee, being of lawful age, on her oath states: that she has participated in the preparation of the following surrebuttal testimony in question and answer form, consisting of 8 pages to be presented in the above case; that the answers in the following surrebuttal testimony were given by her; that she has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of her knowledge and belief.

Anne M. Allee

Anne M. Allee

Subscribed and sworn to before me this 9th day of June 2004.

TONI M. CHARLTON
STATE OF MISSOURI
NOTARY SEAL
NOTARY PUBLIC

Toni M Charlton

TONI M. CHARLTON
NOTARY PUBLIC STATE OF MISSOURI
COUNTY OF COLE
My Commission Expires December 28, 2004

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OF

ANNE M. ALLEE

MISSOURI GAS ENERGY

CASE NO. GR-2004-0209

Q. Please state your name and business address.

A. Anne M. Allee, P.O. Box 360, Jefferson City, Missouri 65102.

Q. Are you the same Anne M. Allee who has previously filed direct and rebuttal testimony in this case?

A. Yes. I filed direct testimony on April 15, 2004, and rebuttal testimony on May 24, 2004.

Q. What is the purpose of your surrebuttal testimony?

A. The purpose of my surrebuttal testimony is to respond to Missouri Gas Energy (MGE) witness Michael R. Noack's rebuttal testimony regarding gas inventory and capacity release/off-system sales (capacity release). I will also respond to MGE witness John Hayes rebuttal testimony regarding capacity release.

<u>Gas in Inventory</u>

Q. Does the Staff have any changes to its calculation of natural gas storage inventory levels proposed in its direct testimony?

A Yes. Based on current market conditions and information provided in the Company's rebuttal testimony, the Staff proposes to change its calculation of the gas inventory level included in rate base. The Staff recommends using an average of the natural gas inventory account balances for the twelve months ending April 30, 2004. This method reflects MGE's actual weighted average cost of gas of $5.68/MMBtu for the twelve months ending April 30, 2004. Schedule 1 attached to my surrebuttal testimony shows the calculation of the inventory value Staff proposes to use in this case.

Q. What methodology has the Company proposed to price natural gas in inventory?

A. MGE proposes to use the average NYMEX strip adjusted for any basis difference to price inventory (Noack rebuttal, page 9, lines 17-18). This methodology results in a $5.35 gas price as of December 31, 2003. However since gas prices are a true-up item, Mr. Noack updates his gas price to $6.14/MMBtu through April 2004 (Noack rebuttal, p. 7, ll. 19-20).

Q. Does Staff agree with the Company's proposed inventory pricing methodology?

A. No. As I stated in my rebuttal testimony, NYMEX futures prices have not been a particularly reliable predictor of future natural gas prices. The Company even admits this in Mr. Hayes' rebuttal testimony at page 5, lines 14-19:

> Q. How reliable are the strip prices when it comes to predicting what actual prices will be?
>
> A. Strip prices reflect the cost of gas in the future based upon today's marketplace. No one can predict the future. Economic growth, natural gas storage levels, and weather patterns are always changing. The strip price will change with these events going higher or lower in price.

Q. Does the Company agree that Staff's methodology may be a reasonable alternative to using NYMEX strip prices?

A. Yes. As an alternative to its proposed use of the NYMEX strip price, the Company does suggest the Commission use an average of the twelve-month ending inventory balance as of April 30, 2004, (Noack rebuttal, p. 9, ll. 18-20). Thus, one of MGE's alternative proposals is identical to Staff's recommendation.

<u>Capacity Release/Off-System Sales</u>

Q. Please describe the Staff's and the Company's recommendations on this issue.

A. Staff has recommended continuing the current treatment of capacity release as a revenue item included in the cost of service for determination of MGE's base rates so that MGE has an incentive to maximize the use of its idle pipeline capacity. MGE disagrees with Staff's recommendation and proposes to change the current treatment by flowing capacity release/off-system sales revenues through the Purchased Gas Adjustment (PGA) mechanism, with an incentive mechanism placed in the PGA. MGE requests that the Commission authorize it to implement a capacity release/off-system sales revenue sharing grid so that revenues received will be shared between MGE and its customers. (Noack rebuttal, p. 27, ll. 3-5 and pp. 28-29).

Q. MGE states that it disagrees with the Staff's recommendation to reflect this item in base rates for two reasons. Addressing one argument at a time, Mr. Noack argues that since capacity release/off-system sales revenues relate to capacity and commodity costs that are recovered through the PGA, then it is appropriate that the associated revenues are handled through the same mechanism (Noack rebuttal, p. 27, ll. 1-12). He then proposes a revenue sharing grid (Noack rebuttal, pp. 28 and 29). Do you agree with the Company's proposal that a revenue sharing grid implemented through the PGA is the appropriate method to account for revenues associated with capacity release/off-system sales?

A. No. If MGE wishes to receive an incentive to maximize capacity release revenues, then capacity release/off-system sales revenues should continue to be reflected, as they presently are, in base rates. Including capacity release as a revenue item in the cost of service gives MGE an incentive to maximize the use of its idle pipeline capacity. By capturing capacity release/off-system sales revenues in base rates, MGE's ratepayers receive all of the benefits up to the amount of revenues included in base rates. Stated another way, MGE must at least accomplish a minimum level of capacity release to recover the capacity release/off-system sales imputed in the rates, thus the incentive to have a minimum level of performance. On the other hand, the shareholders will also receive all of the benefits of capacity release revenues achieved above the amount included in base rates.

Q. Do any other local distribution companies (LDCs) in Missouri currently have an incentive amount for capacity release/off-system sales reflected in base rates?

A. Yes. Laclede Gas Company (Laclede) is the only LDC in Missouri, other than MGE, that has capacity release/off-system sales revenues included in base rates.

Q. If the Commission wishes to recognize capacity release/off-system sales in the PGA mechanism, then what is Staff's recommendation?

A. If capacity release/off-system sales are to be included in the PGA mechanism, then the Staff recommends that 100% of capacity release/off-system sales be passed on to the ratepayers. This means that the Company's sharing grid proposal should be rejected. Otherwise, MGE's shareholders would benefit for every dollar of capacity release, but there is no downside to MGE for not achieving some minimum level of capacity release.

Q. Is this recommendation consistent with the regulatory treatment of other LDCs for capacity release/off-system sales?

A. Yes. With the exception of Laclede and MGE, capacity release/off-system sales flow through the PGA mechanism with 100% of the benefit passed on to the ratepayers for all other Missouri LDCs. These LDC PGAs do not contain capacity release/off-system sales revenue sharing grids, such as the one MGE has proposed.

Q. What is the second reason the Company gives for disagreeing with the Staff's recommended treatment of capacity release?

A. The second reason given by the Company is that, "…changes in market conditions have occurred and will occur in the future affecting the level of revenues that MGE **may** be able to generate by way of capacity release such that past performance is not a reasonable or reliable indicator of future performance" (emphasis added, Noack rebuttal, p. 27, ll. 12-15).

Q. What data does the Company include to support its statements about changing market conditions affecting capacity release levels?

A. Mr. Hayes includes an analysis of gas prices for the thirteen months prior to the Kern River pipeline expansion that occurred in May 2003, along with an analysis of prices for the thirteen months following the expansion. He claims that the value MGE attempts to capture in its capacity release transactions dropped from $1.33 to $.22 in the thirteen months following the Kern River pipeline expansion. Although Mr. Hayes lists this as an example of the effect pipeline expansions have had on the amount of money MGE can generate from capacity releases, it doesn't appear to have affected MGE's total capacity release revenues. Schedule 2 attached to this surrebuttal testimony shows the total capacity release dollars by month for MGE for the past three years. MGE argues that the May 2003 pipeline expansion has reduced the value MGE can obtain from capacity release; however, as can be seen from the graph in Schedule 2, with the exception of only five months, MGE has achieved greater capacity release dollars since the Kern River expansion than it has in the last three years.

Q. Mr. Hayes also contends that the Cheyenne Plains Pipeline, expected to be in service in early 2005, along with other planned pipeline expansions, will likewise affect the value of MGE's capacity releases (Hayes rebuttal, pp. 8-12). How do you respond to these statements?

A. At this time, it is not known what the effects of the Cheyenne Plains or any other pipeline expansions will have on MGE's capacity release. Traditionally, the Commission has used known and measurable information to set rates. Therefore, the Staff based its analysis on known and measurable amounts of capacity release the Company has had for the past three years.

Q. Mr. Noack states that the Staff has made unfair adjustments to capture capacity release revenues in the context of a rate case and at the same time has proposed disallowing recovery of associated capacity costs in the context of the actual cost adjustment (ACA) process (Noack rebuttal, p. 28, ll. 5-9). Do you agree with Mr. Noack's characterization of Staff's actions?

A. No. Staff's proposed excess capacity adjustment in ACA Case No. GR-2002-348 relates to capacity needed for a peak cold day and Staff's adjustment does not hinder MGE's ability to generate capacity release revenues. MGE's pipeline capacity is reviewed in the ACA cases, to ensure that it has sufficient pipeline capacity but not excess capacity so that customers of MGE are not paying for capacity that does not have a related benefit. By allowing a capacity release incentive in the context of its rate case, it was never the Staff's intent to allow MGE to acquire an unlimited amount of capacity to the benefit of its shareholders and a detriment to its ratepayers.

Q. Mr. Noack proposes that the Commission authorize MGE to include the following tariff language in its PGA, "Any excess capacity disallowance resulting from an actual cost adjustment ("ACA") proceeding shall be offset by capacity release revenues before application of the above sharing grid and before any shareholder funding may be required" (Noack rebuttal, p. 29, ll. 9-11). Do you agree with this recommendation?

A No. Staff's rationale is the same as previously stated. Staff's proposed excess capacity adjustment in ACA Case No. GR-2002-348 relates to capacity needed for a peak cold day and Staff's adjustment does not hinder MGE's ability to generate capacity release revenues. If MGE's proposal to offset capacity disallowances with capacity release revenue is accepted, that would mean that MGE would share in capacity release revenues for capacity that goes beyond what is needed for a peak cold day. Stated another way, this is capacity that would not be used, even if a historic peak cold day were to occur. Customers should not have to pay for capacity that is not needed, not even on the coldest historical peak day.

Q. Please summarize your testimony.

A. **Gas Inventory** - The Staff recommends using an average of the natural gas inventory account balances for the twelve months ending April 2004. Schedule 1 attached to my surrebuttal testimony shows the calculation of the inventory value Staff proposes to use in this case.

Capacity Release - In the Staff's opinion, MGE's capacity release/off-system sales should be treated for rate purposes consistent with Laclede. The Staff recommends continuing MGE's current ratemaking treatment of capacity release with a revenue adjustment of $1,340,400 added to cost of service. However, if the Commission decides that capacity release/off-system sales should be handled through the PGA, then the Staff recommends that 100% of this item should be flowed through to the ratepayers.

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.

Missouri Gas Energy
Case No. GR-2004-0209
Gas Inventory - Underground Storage

	Gas Stored Underground		Total Underground Storage
Month/Year	Southern Star Central	Panhandle Eastern	
May-03	$ 46,382,792.39	$ 3,122,276.32	$ 49,505,068.71
June-03	65,962,933	3,671,435	69,634,368
July-03	75,084,859	4,040,803	79,125,662
August-03	83,093,401	4,040,803	87,134,204
September-03	88,587,212	5,975,325	94,562,537
October-03	93,325,374	6,955,682	100,281,056
November-03	77,092,801	6,410,770	83,503,572
December-03	64,557,143	4,490,325	69,047,468
January-04	37,562,053	3,016,349	40,578,402
February-04	17,697,646	1,141,037	18,838,683
March-04	17,138,157	116,212	17,254,368
April-04	34,109,912	116,212	34,226,124
Total	$ 700,594,284	$ 43,097,228	$ 743,691,512
12 Month Average	$ 58,382,857.02	$ 3,591,435.65	$ 61,974,292.67
Rate Base Inventory Levels	$ 58,382,857.02	$ 3,591,435.65	$ 61,974,292.67

SCHEDULE 2

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