

Exhibit No.: _____
Issue: Actual Cost Adjustment
Witness: Timothy R. Johnston
Exhibit Type: Direct
Sponsoring Party: Missouri Gas Utility, Inc.
Case No.: GR-2008-0136
Date: October 24, 2008

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. GR-2008-0136

DIRECT TESTIMONY

OF

TIMOTHY R. JOHNSTON

ON BEHALF OF

MISSOURI GAS UTILITY, INC.

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**DIRECT TESTIMONY
TIMOTHY R. JOHNSTON
MISSOURI GAS UTILITY, INC.**

INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Timothy R. Johnston, 7810 Shaffer Parkway, STE 120, Littleton, CO 80127.

Q. ON WHOSE BEHALF IS YOUR TESTIMONY PRESENTED?

A. Missouri Gas Utility, Inc (“MGU” or the “Company”).

Q. BY WHOM AND IN WHAT CAPACITY ARE YOU EMPLOYED?

A. I am the Executive Vice President of MGU, and also hold that position in Summit Utilities, Inc., of which MGU is a wholly-owned subsidiary.

Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND RELEVANT BUSINESS EXPERIENCE.

A. Information responsive to this question is shown in the attached **Schedule TRJ-1**.

Q. HAVE YOU TESTIFIED BEFORE OTHER REGULATORY BODIES?

A. Yes. I have testified before the Colorado Public Utilities Commission.

Q. IN WHAT CAPACITY?

A. I have testified as a policy witness and as the representative for Colorado Natural Gas, Inc., an affiliate of MGU.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. I will describe MGU and give a brief history of the system, including the derivation of the initial rates set in Case No. GO 2005-0120. I will lay out the rationale for recovery of the interest expense incurred by the Company for funds used to

1 purchase natural gas during the spring and summer of 2007 and for the funds used
2 to transport that gas to storage and inject it into storage. I will also describe the
3 recovery mechanism currently used by the Company for that interest expense and
4 the reason the Company chose that recovery method.

5 Q. **ARE YOU SPONSORING ANY SCHEDULES?**

6 A. Yes, I am sponsoring Schedule TRJ-2.

7 Q. **WERE THESE EXHIBITS PREPARED BY YOU OR UNDER YOUR DIRECTION?**

8 A. Yes.

9 **DESCRIPTION OF MGU SYSTEM**

10 Q. **PLEASE PROVIDE A BRIEF DESCRIPTION OF MISSOURI GAS UTILITY, INC.**

11 A. MGU was formed in October, 2004. Along with Colorado Natural Gas, Inc.,
12 Colorado Water Utility, Inc., Deer Creek Water, LLC and Wolf Creek Energy, LLC,
13 MGU is a wholly owned subsidiary of Summit Utilities, Inc. Of the affiliates,
14 Colorado Natural Gas, Inc. and Colorado Water Utility, Inc. are utilities regulated by
15 the Colorado Public Utilities Commission. Deer Creek Water, LLC is an entity that
16 holds water rights for use in present and future water utility projects, and Wolf Creek
17 Energy is a natural gas broker that normally only sells gas to three transportation
18 customers located in Teller County, CO.

19 In the summer of 2004, we became aware that the towns of Gallatin and Hamilton,
20 Missouri had elected not to appropriate funds for the payment of two separate
21 lease/purchase contracts. The termination of the contracts by the non-appropriation
22 of funds by the towns was permitted under the terms of the contracts that the towns

1 had entered into to acquire the municipal natural gas systems located in their
2 respective communities. The owner of the systems, a bank trust department, was
3 attempting to sell the systems to retire the debt secured by the systems and had
4 engaged an investment bank to find prospective buyers. A rapid assessment of the
5 systems and an analysis of the financial records led to the formation of MGU and the
6 submittal of a bid to purchase the systems from the owner. Once advised that our
7 bid was accepted, MGU personnel contacted the MPSC Staff and set up a meeting
8 to discuss a transfer application. The MPSC Staff and the Company worked closely
9 to expedite the transfer; as neither the cities nor the systems' owner would commit to
10 purchase any additional gas to cover the winter heating season, and a projection of
11 the daily usage compared to the quantity of gas in storage revealed that the systems
12 would be out of supply in early December, 2004. Subsequent analysis showed that
13 this did indeed occur. The gas in storage that was owned by the cities was depleted
14 on December 4, 2004, but by that time Wolf Creek Energy, LLC, an affiliate of MGU,
15 had purchased additional gas into storage to cover system needs through the
16 transfer period.

17 The result of the transfer application, Case No. GO 2005-0120, was that MGU
18 became the owner of the two former municipal systems. MGU has operated these
19 systems since January 1, 2005.

1 **INTEREST ON STORAGE BALANCE**

2 **Q. WHAT PERIOD OF TIME IS ADDRESSED BY THIS CASE?**

3 A. This case addresses the results of the Commission Staff's audit of the billed
4 revenues and actual gas costs for the period September 1, 2006 through August
5 31, 2007, included in MGU's 2006-2007 Actual Cost Adjustment (ACA) filing.

6 **Q. ON JULY 14, 2008, THE STAFF FILED ITS RECOMMENDATION AND**
7 **MEMORANDUM IN THIS MATTER. DOES MGU DISAGREE WITH ONE OF**
8 **STAFF'S ADJUSTMENTS?**

9 A. Yes. MGU does not agree with Staff's proposed reduction in the cost of gas in the
10 amount of \$17,185, representing the interest charges incurred by MGU for funds
11 borrowed to pay for gas placed into storage as part of the Company's hedging
12 strategy.

13 **Q. WHAT BASE RATES WERE IN EFFECT FOR MGU DURING THE PERIOD OF**
14 **TIME ADDRESSED IN THIS CASE?**

15 A. The original rates established as a result of Commission Case No. GO-2005-0120.

16 **DERIVATION OF ORIGINAL RATES FOR MGU**

17 **Q. PLEASE DESCRIBE THE RATES ESTABLISHED IN CASE NO. GO-2005-0120**
18 **AND THE PROCESS THAT LED TO THE ADOPTION OF THOSE RATES.**

19 A. The Gallatin and Hamilton municipal systems had different rate structures, which
20 had been established by the two City Councils. MGU examined these rates and
21 proposed initial rates that met two criteria: the Monthly Customer Charge was to
22 remain the same as the lower of the two municipal rate structures for each class of

customer, and no customer would experience an initial increase in rates as a result of the acquisition. MGU would characterize the current rates as historically derived rather than set in accordance with the usual regulatory procedure.

Q. DID THE GENERAL RATES ADOPTED IN CASE NO. GO-2005-0120 INCLUDE RECOVERY OF THE INTEREST EXPENSE INCURRED ON FUNDS USED TO PURCHASE GAS FOR INJECTION INTO STORAGE?

A. No. Appendix F from the MGU Application in Case No. GO-2005-0120 was the pro forma balance sheet and income statement submitted to show the projected financial results from using the historically derived rates. The first four pages of Appendix F are attached as **Schedule TRJ-2**. On page 3, the Rate Base used in that case is described, and includes a \$179,652 Working Capital component. On page 4, the Current Assets section in the Balance Sheet shows the components of this Working Capital: \$80,177 of Receivables, \$10,000 for a deposit with the gas supplier, and materials and supplies inventory of \$89,475. The average balance of gas in storage was not included in this Working Capital in the Rate base.

Q. WERE THE RATES ESTABLISHED IN CASE NO. GO-2005-0120 REVIEWED TO DETERMINE IF ANY RECOVERY OF GAS COSTS WAS OCCURRING THROUGH THE GENERAL RATES ADOPTED IN THAT CASE?

A. Yes. The Staff of the MPSC conducted an audit of the rates adopted in Case GO 2005-0120 during 2005. This audit was conducted in accordance with the provision in Section 6 of the Non-Unanimous Stipulation and Agreement in that case, which states on page 4 that "The scope of the audit is to determine

whether MGU's margin rates (non-gas rates) include any gas costs. A conclusion that margin rates include gas costs will be based on whether or not margin rates produce revenues in excess of MGU's non-gas costs." This audit determined that MGU's margin rates did not include any gas costs.

Q. WHY DID MGU NOT INCLUDE THE VALUE OF THE AVERAGE STORAGE BALANCE AS A COMPONENT OF WORKING CAPITAL IN THE PRO FORMA ANALYSIS IN CASE NO. GO-2005-0120?

A. Colorado Natural Gas, Inc., the only regulated gas distribution affiliate of MGU, does not have access to gas storage, and Company personnel were not familiar with this method of recovery of this expense.

MGU TARIFF AND COMMISSION RULE

Q. WHAT DOES THE MGU TARRIFF INDICATE IN REGARD TO RECOVERY OF THE INTEREST EXPENSE ON THE STORAGE BALANCE VALUE THROUGH THE PGA?

A. The language on Sheet 47 of the MGU P.S.C. MO No. 1 tariff (emphasis added) supports recovery through the PGA. It states:

"For the gas commodity component of the RPGA factor, including variable transportation costs, gas supply commodity costs, and other FERC-authorized commodity charges, the Company will utilize any technique or method it deems reasonable for purposes of estimating the gas cost revenue requirement to be reflective for this component in each RPGA filing. The commodity-related charges **shall include, but not be limited to**, producer gas supply commodity

1 charges, pipeline transmission and gathering commodity charges, expected
2 costs or cost reductions to be realized for the entire winter period, related storage
3 withdrawals, gas purchases under fixed-price contracts, the Company's use of
4 financial instruments, except for call options for which only cost reductions
5 expected to be realized during the months covered by the Company's PGA filing
6 shall be reflected." (emphasis added).

7 **Q. IS THERE ALSO SUPPORT IN COMMISSION RULES FOR RECOVERY OF**
8 **THIS COST THROUGH THE PGA?**

9 A. Yes. The Commission Rules state that financial gains or losses associated with
10 gas mitigation efforts (to expressly include natural gas storage) are flowed
11 through the PGA mechanism, subject to the applicable provisions of the natural
12 gas utility's tariff. Commission Rule 4 CSR 240-40.018(1)(B). Based on this rule
13 and MGU's tariff provision described above, MGU believes it is entitled to
14 recovery of the interest expense incurred from providing funds to purchase gas
15 and place it into storage for later use.

16 **RECOVERY OF STORAGE BALANCE CARRYING COSTS**

17 **Q. WHAT IS THE IMPACT IN THIS CASE?**

18 A. For the period in this case (September 1, 2006 through August 31, 2007), this
19 interest expense was \$17,185, based on the average monthly balance of gas in
20 storage and the interest rate on the line of credit MGU used to cover this and
21 other short-term capital requirements.

22 **Q. WHERE SHOULD THIS EXPENSE BE RECOVERED FOR THE PERIOD AT**

1 **ISSUE IN THIS CASE?**

2 A. The Company believes that this expense is best recovered through the PGA
3 mechanism. Such an approach would match actual expenses to actual recovery
4 of those expenses. During the period covered by this Case, the only gas
5 mitigation effort in which the company was engaged was injection of gas into
6 storage for use during the next winter heating season.

7 **Q. IS MGU CONTINUING TO RECOVER INTEREST ON THE VALUE OF THE**
8 **STORAGE BALANCE THROUGH THE PGA MECHANISM?**

9 A. No. In MGU's first rate case, Case No. GR-2008-0060, MGU agreed to add the
10 value of the average storage balance during the test year to its Working Capital
11 component of Rate Base, and is now recovering this cost through margin rates.
12 MGU ceased to add the interest expense to its Actual Cost Adjustment worksheet as
13 of the effective date of the tariff sheets approved in Case No. GR-2008-0060 (April
14 15, 2008).

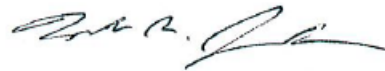
15 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

16 A. Yes

AFFIDAVIT

State of Colorado)
) ss.
City of Littleton)

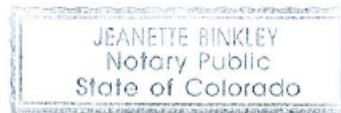
Timothy R. Johnston, being duly sworn, on oath says that he is the person identified in the foregoing prepared testimony and/or schedules; that such testimony and/or schedules were prepared by or under the direction of said person; that the answers and/or information appearing therein are true to the best of his knowledge and belief; and that if asked the questions appearing therein, his answers thereto would, under oath, be the same.



SUBSCRIBED AND SWORN to before me
on this 23rd Day of October, 2008.



Jeanette Binkley, Notary Public



Commission expires January 4, 2009

SCHEDULE TRJ-1

Educational Background and Experience of Tim Johnston, P.E.

Tim Johnston serves as executive vice president of Summit Utilities, Inc. Mr. Johnston was an original partner in Colorado Natural Gas, Inc., which began distribution operations in 1997 and is now a subsidiary of Summit. Prior to starting CNG, Mr. Johnston was with Atmos Energy as Manager of Engineering Design for a year, subsequent to Atmos Energy's acquisition of The Greeley Gas Company. Mr. Johnston served as engineering and measurement supervisor and as a supervisor in the engineering department of Greeley Gas for the nine years leading up to the sale of the company. Mr. Johnston began his career in the natural gas industry with MAPCO Inc., an oil and gas production company.

Mr. Johnston has a Bachelor of Science degree from the Colorado School of Mines and a Masters of Business Administration from Colorado State University. He is a professional engineer registered in the State of Colorado.