Exhibit No.:	
Issues:	*Purchasing Practices; Refunds*
Witness:	*Anne M. Allee*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Direct Testimony*
Case No.:	*GR-2001-382, GR-2000-425, GR-99-304 and GR-98-167 (Consolidated)*
Date Testimony Prepared:	*January 15, 2003*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY
OF

ANNE M. ALLEE

MISSOURI GAS ENERGY

CASE NOS. GR-2001-382, GR-2000-425,
GR-99-304 AND GR-98-167
(CONSOLIDATED)

Jefferson City, Missouri
January 2003

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 Adjustment	)))	**Case No. GR-2001-382**
In the Matter of Missouri Gas Energy's Purchased Gas Cost Adjustment Factors to be Reviewed in its 1999-2000 Actual Cost Adjustment	)))	**Case No. GR-2000-425**
In the Matter of Missouri Gas Energy's Purchased Gas Cost Adjustment Factors to be Reviewed in its 1998-1999 Actual Cost Adjustment	)))	**Case No. GR-99-304**
In the Matter of Missouri Gas Energy's Purchased Gas Cost Adjustment Tariff Revisions to be Reviewed in its 1997-1998 Actual Cost Adjustment	))	**Case No. GR-98-167**

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 Direct Testimony in question and answer form, consisting of 10 pages to be presented in the above case; that the answers in the following Direct 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 14th day of January 2003.

D SUZIE MANKIN
Notary Public - Notary Seal
STATE OF MISSOURI
COLE COUNTY
MY COMMISSION EXP. JUNE 21,2004

D Suzie Mankin

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(CONSOLIDATED)

Q. Please state your name and business address.

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

Q. By whom are you employed and in what capacity?

A. I am a Regulatory Auditor with the Missouri Public Service Commission (Commission).

Q. Please describe your educational background.

A. I graduated from the University of Missouri at Columbia with a Bachelor of Science degree in Accounting in 1989. I am currently a licensed Certified Public Accountant in the state of Missouri.

Q. Please describe your work background.

A. During college and after graduation, I worked for Capital Bank as a Teller, New Accounts Representative and temporary Branch Manager.

Q. What has been the nature of your duties while in the employ of the Commission?

A. My employment with the Commission began in October 1990 as a Regulatory Auditor in the Accounting Department. My duties included assisting with audits and examinations of the books and records of utility companies operating within the state of Missouri.

In October 1993, I obtained my current position as a Regulatory Auditor in the Procurement Analysis Department. Since that time, my responsibilities include reviewing and analyzing amounts charged by natural gas local distribution companies (LDCs) through the Purchased Gas Adjustment (PGA)/Actual Cost Adjustment (ACA) mechanism.

Q. Have you previously filed testimony before this Commission?

A. Yes, I have previously filed testimony before this Commission. Schedule 1, attached to my direct testimony, is a list of cases and issues in which I have filed testimony.

Q. Did you make an examination and analysis of the books and records of Missouri Gas Energy (MGE or Company) in regard to matters raised in this case?

A. Yes. A review was made to ensure that the gas costs passed on to the consumers through the PGA provision reflects the Company's actual cost of gas. I also reviewed the prudence of the Company's purchasing decisions underlying the gas costs passed on to the ratepayers through the PGA provision.

Q. What matters will you address in your testimony?

A. I will address issues identified in Staff's May 31, 2002 ACA recommendation for MGE Case GR-2001-382; specifically the sections of the Staff recommendation entitled "Refunds" and "Purchasing Practices." After Staff filed its recommendation in this 2000-2001 ACA Case No. GR-2001-382, this case was consolidated with Case Nos. GR-2000-425, GR-99-304 and GR-98-167, which are MGE's 1999-2000, 1998-1999 and 1997-1998 ACA cases. Case No. GR-2001-382 has been designated the lead case number.

Q. What knowledge, skill, experience training or education do you have in these matters?

A. Since my time in the Procurement Analysis Department, I have performed and/or assisted in performing approximately 30 ACA reviews. I have evaluated the prudence of an electric company's gas purchasing practices. I have reviewed the impact of mergers on two LDC's gas procurement function. I have calculated the Staff's level of gas costs to be included in determining an applicant's viability and reviewed the reliability of natural gas supply and transportation. In addition, I have attended conferences on the mechanics of financial instruments and have assisted in reviewing the results of a futures market pilot program operated by an LDC in the state.

Q. What is the purpose of your direct testimony?

A. My direct testimony addresses issues identified in the "Refunds" and "Purchasing Practices" section of the May 31, 2002 ACA recommendation in Case No. GR-2001-382. The Purchasing Practices section contains two proposed reductions to gas costs. The first adjustment is for the Company's failure to hedge prior to the heating season at least 30% of its normal monthly requirements as a minimum level of hedge for the winter of 2000-2001. The second adjustment is related to the Company's plan for flowing supplies and storage operation. My direct testimony shows the calculation of the proposed adjustments related to hedging and storage operation. The direct testimony of Staff witness Lesa A. Jenkins provides support for the proposed adjustments related to the minimum level of hedging and the plan for flowing supplies and storage operation during the heating season as discussed in my direct testimony. The direct testimony of Staff witnesses John Herbert discusses the purpose and importance of hedging. He also describes how an LDC can hedge its price of gas. Staff witness David M. Sommerer discusses the experience MGE has had with hedging in the past and the support for hedging by the Commission within Missouri.

REFUNDS

Q. Please explain the Staff's adjustment related to refunds.

A. In the 1999-2000 review, the Staff discovered an error in the Residential and General Service Refund account balance. In the 2000-2001 ACA review, the Staff found that the Company had not corrected this error from the previous year. Therefore, the Staff adjusted MGE's Residential and General Service Refund ending account balance.

Q. Is this an issue in this case?

A. No. In Missouri Gas Energy's, Response To Staff Recommendation And Motion To Dismiss Or Strike, filed on July 11, 2002, the Company states that it agrees with, and has already made, this adjustment to its refund account balance.

PURCHASING PRACTICES-MINIMUM LEVEL OF HEDGING

Q. Please explain why the Staff proposed an adjustment to MGE's gas costs?

A. In this ACA period, MGE did not have a documented, formal hedging plan. It did not evaluate the different types and costs of hedging tools to use. *The General Report on Analysis of Gas Supply and Hedging Practice by Regulated Natural Gas Utilities in Missouri*, attached to John Herbert's direct testimony, discusses the design of a price risk management program or hedging plan in Chapter VI. A hedging strategy should be included in the Company's gas procurement process. Additionally, it is reasonable to expect MGE to hedge a minimum level of its natural gas purchases for the heating season months of the ACA period. The Company should have taken steps to hedge prior to the heating season at least 30% of its normal monthly requirements for each month during November 2000 through March 2001. The direct testimony of Staff witness Jenkins demonstrates why a minimum hedge of 30% of normal monthly requirements is a reasonable expectation.

Q. Please explain what you mean when you use the term “hedging.”

A. I use the term hedging to mean techniques used by an LDC to reduce its customers’ exposure to price risk or price volatility. Financial instruments and storage are some tools an LDC can use to fix its costs prior to the heating season. Hedging allows the Company to make the cost of gas to its customers more stable over time than it would be otherwise. In particular, hedging allows the Company to provide its customers protection from heating season price spikes, when they occur, for some portion of their requirements. An LDC can also hedge its gas supply in the form of contract provisions that fix or cap the price of gas.

Q. Please explain what you mean by the term “financial instruments.”

A. Futures and option contracts are financial instruments. Futures contracts allow the LDC to lock in or fix the price of future gas purchases. While a futures contract fixes the price of gas, an option contract establishes a ceiling for the price of gas. Both futures and option contracts are tools an LDC can use to hedge the price of gas.

Q. Please explain how storage can be used as a hedge.

A. LDCs generally inject gas into storage during the summer months for withdrawal in the winter months. Storage provides an effective hedge because it fixes the cost of gas prior to the heating season. Therefore, the Company knows the cost of this portion of its requirements prior to the heating season. Gas withdrawn from storage during the winter has a known, fixed price and thus helps to reduce the price risk exposure for some of the customer requirements during the heating season.

Q. Please explain the Company's monthly planned hedged volumes of gas.

A. The planned monthly hedged volumes are the Company's normal planned monthly storage withdrawals plus any other hedging mechanisms used by the Company. In this ACA period, MGE used a combination of storage and fixed prices to hedge its price of gas for the heating season of 2000-2001. Column C of Schedule 2, attached to this testimony, shows the Company's normal monthly planned storage withdrawals. Column D of Schedule 2 shows the volumes of gas purchased at a fixed price for November 2000-March 2001. The monthly planned hedged volumes are the sum of column C and column D and are shown in Schedule 2 column G.

Q. Please explain the calculation of the Staff's proposed hedging adjustment.

A. The Staff compared the Company's monthly planned hedged volumes to 30% of normal monthly requirements in order to determine if the Company met hedging expectations. The difference between the monthly planned hedged volumes and the 30% of normal requirements is shown in column H of Schedule 2 (attached to this testimony) and represents the volumes of gas that were unreasonably exposed to price risk. The Company hedged at least 30% of normal requirements for November, December and February, but failed to do so for January and March 2001. Column I of Schedule 2 shows the additional amount of gas the Company needed to have hedged in January and March in order to meet the minimum hedge of 30%.

Since the Company did not hedge the volumes shown in column I, the Staff then estimated a reasonable price at which the Company could have hedged these volumes prior to the heating season of 2000-2001. This estimated price appears in column K of Schedule 2. Next, the Staff subtracts the estimated hedged price from the monthly NYMEX closing price to determine the unit cost of gas that could have been avoided had the Company hedged 30% of normal requirements. The result of subtracting the estimated hedged price from the NYMEX closing price is shown in Schedule 2 column L. The cost of gas that could have been avoided in column L is multiplied by the amount of gas unreasonably exposed to price risk in column I to determine the increased cost to the customers of MGE because the Company failed to hedge at least 30% of normal monthly requirements.

Q. How did you estimate the price at which the volumes of gas could have been hedged as discussed above?

A. I computed a simple average of the NYMEX closing prices for June 1 through October 30, 2000 for each of the delivery months of November 2000 through March 2001. This is the estimate of the Company's price of gas had it hedged the volumes exposed to price risk with a fixed price contract or a futures contract prior to the winter of 2000-2001. The estimated hedged prices are shown in column K of Schedule 2.

Q. What was the result of the calculations discussed above?

A. The result is that the customers paid approximately $614,365 more for gas than they would have paid had the Company hedged at least 30% of normal monthly requirements. Therefore the Staff proposes to reduce MGE's gas costs by $614,365.

PURCHASING PRACTICES – STORAGE

Q. Please explain why the Staff is proposing a purchasing practices adjustment in regard to the Company's plan for flowing supplies and planned and actual storage operation during the heating season.

A. MGE relied too heavily on storage withdrawals rather than flowing supplies in November and December 2000, and this decision led to higher gas costs in January, February and March 2001. (Flowing supplies generally means gas that is purchased for current consumption and not withdrawn from storage). The direct testimony of Staff witness Jenkins addresses the decisions the Company made that led to higher gas costs in January through March 2001. I calculated the costs that could have been avoided had the Company followed a reasonable approach for planned and actual flowing gas and storage withdrawals for November 2000 through March 2001.

Q. What is the storage Weighted Average Cost of Gas (WACOG)?

A. The storage WACOG is the cost of gas withdrawn from storage weighted by its respective volumes for storage services with each pipeline. In this ACA period, MGE maintains storage services with Williams Gas Pipelines Central, Inc. (Williams) and Panhandle Eastern Pipe Line.

Q. What is the Williams first of the month (FOM) index?

A. This is the index reported in *Inside FERC's Gas Market Report* on the first day of each month. The Staff used the Williams FOM index because the majority of the pricing provisions of the Company's supply agreements are tied to the Williams FOM index. This represents the price the Company would pay for flowing supplies.

Q. Please explain the calculation of the purchasing practices storage operation adjustment.

A. The Staff calculated the difference between the expected storage withdrawals, based upon a reasonable plan for flowing volumes and storage for each month of the winter season, and the actual storage withdrawals for November 2000 through March 2001. Actual volumes of gas withdrawn from storage are shown in column E of Schedule 2. Expected or reasonable storage withdrawals are shown in column F of Schedule 2. The difference between expected storage withdrawals and actual storage withdrawals are shown in column N of Schedule 2. The negative numbers in November and December indicate that the Company withdrew more gas from storage than Staff considered reasonable. In January, February and March 2001, the positive numbers indicate that the Company withdrew less gas from storage than expected. The direct testimony of Staff witness Jenkins addresses the expected or reasonable versus actual storage volumes shown in Schedule 2 column N.

The Staff then compared the weighted average cost of storage withdrawals in Schedule 2 column O to the Williams FOM index price in column P. Schedule 2 column Q shows that the Williams FOM price of gas was greater than the weighted average cost of storage withdrawals each month. This means that it would have been cheaper to withdraw gas from storage than to buy flowing supplies based upon the Williams FOM index. The price difference between storage WACOG and Williams FOM, shown in column Q, was then multiplied by column N to determine the cost effect of withdrawing gas from storage versus buying flowing supplies to meet system requirements. The impact is determined for each winter month and the sum is the total amount of Staff's proposed adjustment.

The result of this calculation shows that the ratepayers paid $8,051,049 more than they would have had the Company followed a reasonable approach for planned and actual flowing gas and storage withdrawals.

Q. Please summarize your testimony.

A. The Staff proposes purchasing practices adjustments of $614,365 to MGE's gas costs to reflect the hedging activity shortfall during the 2000-2001 winter period. The

Staff also proposes an $8,051,049 purchasing practices adjustment to MGE's gas costs to reflect the damage to customers from the Company planned and actual flowing gas and storage withdrawals.

Q. Does this conclude your testimony?

A. Yes.

SUMMARY OF TESTIMONY
ANNE M. ALLEE

Company Name	Case Number	Issues
Choctaw Telephone Company	TR-91-336	Payroll; Payroll Taxes; Employee Pensions/Benefits; Voucher Analysis; Other Misc. Expenses
Laclede Gas Company	GR-92-165	Payroll; Payroll Taxes; Employee Pensions and Benefits
United Cities Gas Company	GR-93-47	Rate Base; CWC; Dues & Donations; Misc. Expenses
St. Louis County Water Company	WR-93-204	Rate Base; CWC; Dues & Donations; Misc. Expenses
Ozark Natural Gas Company	GA-96-264	Cost of Gas per Dth; Reliability of Transportation
Missouri Gas Energy Company	GR-96-285	Natural Gas Storage Inventory Prices
St. Joseph Light and Power Company	GR-96-47	Gas Purchasing Practices
Union Electric Company	GR-97-393	Natural Gas Storage Inventory Prices
Missouri Public Service	GR-96-192	Winter Storage Allocation; Overrun Penalties
Missouri Gas Energy	GR-98-140	Natural Gas Storage Inventory Prices
Ozark Natural Gas Company	GA-98-227	Cost of Gas per Dth; Reliability of Supply and Transportation
St. Joseph Light and Power Company	GR-99-246	Natural Gas Inventory Prices
UtiliCorp United Inc. and St. Joseph Light and Power Company	EM-2000-292	Conditions to be Made Part of Approved Merger
Atmos Energy Corporation and United Cities Gas Company	GR-2001-396 and GR-2001-397 (Consolidated)	Purchasing Practices- Neelyville; Purchasing Practices- Consolidated District; Deferred Carrying Cost Balance; Propane