Exhibit No.:	______________
Issue(s):	Off-System Sales and Capacity Release Revenues
Witness/Type of Exhibit:	Busch/Direct
Sponsoring Party:	Public Counsel
Case No.:	GR-2001-292

DIRECT TESTIMONY

OF

JAMES A. BUSCH

Submitted on Behalf of the Office of the Public Counsel

Missouri Gas Energy

Case No.: GR-2001-292

April 19, 2001

NP

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of tariff revisions of Missouri Gas Energy, a division of Southern Union Company, designed to increase rates for natural gas service to customers in the Missouri service area of the company.	)))))	Case No. GR-2001-292

AFFIDAVIT OF JAMES A. BUSCH

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

James A. Busch, of lawful age and being first duly sworn, deposes and states:

1. My name is James A. Busch. I am the Public Utility Economist for the Office of the Public Counsel.

2. Attached hereto and made a part hereof for all purposes is my direct testimony consisting of pages 1 through 11 and Schedules JAB-1 and JAB-2 .

3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.

James A. Busch

Subscribed and sworn to me this 19th day of April, 2001.

Bonnie S. Howard, Notary Public

My Commission expires May 3, 2001.

DIRECT TESTIMONY

OF

JAMES A. BUSCH

CASE NO. GR-2001-292

MISSOURI GAS ENERGY

Q. Please state your name and business address.

A. My name is James A. Busch and my business address is P. O. Box 7800, Jefferson City, MO 65102.

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

A. I am a Public Utility Economist with the Missouri Office of Public Counsel (Public Counsel).

Q. Please describe your educational and professional background.

A. In June 1993, I received a Bachelor of Science degree in Economics from Southern Illinois University at Edwardsville (SIUE), Edwardsville, Illinois. In May 1995, I received a Master of Science degree in Economics, also from SIUE. I am currently a member of the American Economic Association and Omicron Delta Epsilon, an honorary economics society. Prior to joining Public Counsel, I worked just over two years with the Missouri Public Service Commission as a Regulatory Economist in the Procurement Analysis Department and worked one year with the Missouri Department of Economic Development as a Research Analyst. I accepted my current position with Public Counsel in September 1999.

Furthermore, I am currently a member of the Adjunct Faculty of Columbia College, Jefferson City Campus, teaching Managerial Economics in the MBA program.

Q. Have you previously testified before this Commission?

A. Yes. Attached is Schedule JAB-1 which is a list of the cases in which I have filed testimony before this Commission.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to provide Public Counsel's recommendation for off-system sales and capacity release revenues for Missouri Gas Energy (MGE or Company).

Q. How is your testimony organized?

A. First I will give a brief history of relevant incentive plans in Missouri. Then I will provide Public Counsel's recommendation in this case.

INTRODUCTION

Q. When did the Commission approve the initial gas supply incentive plan for MGE?

A. The original gas supply incentive plan (GSIP) in Missouri was approved for MGE in Case No. GO-94-318 Phase II. This plan was referred to as an Experimental Gas Cost Incentive Mechanism (EGCIM). The Commission's Report and Order in that case became effective February 14, 1996 and authorized MGE to implement a three-year experimental GSIP for natural gas procurement costs and capacity release revenues.

Q. Please briefly explain the natural gas procurement component of MGE's original GSIP?

A. Historically, local distribution companies (LDCs) were not allowed to profit from procuring natural gas for their customers. The LDC purchased natural gas from suppliers and passed the cost on to customers on a dollar-for-dollar basis. Under MGE's GSIP, the Company had an opportunity to profit from procuring natural gas. The profit was based on MGE's actual natural gas costs compared to a weighted benchmark based on floating, first-of-month indices.

Q. Please briefly explain capacity release.

A. Capacity release provides owners of pipeline capacity (in this case LDCs) the ability to release unutilized capacity and receive revenues to mitigate pipeline reservation charges. Capacity release was implemented by the Federal Energy Regulatory Commission (FERC) as a result of FERC Order No. 636. When a LDC purchases pipeline capacity it is reserving sufficient capacity to meet the maximum demand for natural gas service. However, due to variations in service requirements, the LDC's contractual capacity is not fully utilized at all times. Whenever the LDC's system needs are less than the amount of capacity the LDC has reserved on the pipeline, the LDC has excess capacity available to release to the market.

Q. Please describe the capacity release component of MGE's original GSIP.

A. Under MGE's original GSIP, MGE was able to keep a percentage of the capacity release revenues it generated from releasing excess capacity to third parties. This revenue percentage was based on the following sharing grid:

Capacity Release Amount	MGE's Percentage
First $200,000	50%
Next $200,000	40%
Next $200,000	30%
Next $200,000	20%
Amounts over $800,000	10%

Q. Did other Missouri LDCs request a GSIP following Commission approval of MGE's plan?

A. Yes. Laclede Gas Company (Laclede) requested and pursuant to a settlement was granted a GSIP in its rate case, Case No. GR-96-193. Union Electric (UE) also requested and pursuant to a settlement was granted a GSIP in its rate case, Case No. GR-97-393.

Q. Were the GSIPs approved for Laclede and UE similar to MGE's?

A. Yes, the plans were similar, but not identical. Laclede's had the same type of procurement component. However, Laclede's capacity release sharing grid differed from that approved for MGE. In addition, Laclede's GSIP included two new components; off-system sales and transportation and storage discounts. UE's plan was similar to Laclede's except it did not have a gas procurement component.

Q. Please explain off-system sales.

A. Off-system sales are sales of a company's supply of natural gas to another party that is not a customer of the company making the sale. Off-system sales are usually bundled with the sale of excess pipeline capacity.

Q. How has MGE's experimental GSIP evolved over time?

A. The original GSIP approved in GO-94-318 Phase II expired on June 30, 1999. A subsequent filing by MGE to extend the program was denied by the Commission in Case No. GO-99-591. Then in September of 1999, MGE filed to only extend the capacity release component of the GSIP. The Commission in Case No. GO-2000-231 approved this request, effective October 14, 1999. This extension kept the capacity release sharing grid the same as the previous grid. However, it did not include a gas procurement component. In April of 2000, MGE, Staff, and Public Counsel filed an amended Unanimous Stipulation and Agreement that proposed a fixed rate incentive plan for procuring natural gas. The Unanimous Stipulation and Agreement also modified the capacity release sharing grid and created an off-system sales component. The Commission approved the Unanimous Stipulation and Agreement in Case No. GO-2000-705 with an effective date of August 31, 2000.

Q. How long is the new capacity release mechanism approved in Case No. GO-2000-705 in effect?

A. According to MGE's tariff sheets, the capacity release component shall remain in effect for two years after approval of the Stipulation and Agreement in Case No. GO-2000-705 by the Commission, or changes to the tariff sheets become effective pursuant to law. (P.S.C. MO No. 1, Sheet No. 24.28) The Stipulation and Agreement was approved by the Commission with an effective date of August 31, 2000.

Q. How was the capacity release sharing grid modified?

A. The grid was modified to allow the Company to receive a smaller profit percentage from the initial levels of capacity release and a larger profit percentage as the level of capacity release revenues increased. The new grid looks as follows:

Capacity Release Amount	MGE's Percentage
First $300,000	15%
Next $300,000	20%
Next $300,000	25%
Amounts over $900,000	30%

Q. Please explain the off-system sales component.

A. According to the tariffs approved in Case No. GO-2000-705, MGE is allowed to retain all revenues derived from the off-system sale of natural gas that exceed $100,000 per year net of sales incurred at a loss (P.S.C. Mo. No. 1, Sheet 24.28).

Q. What is the current treatment of off-system sales revenue in a base rate case?

A. In Case No. GT-99-303, Laclede submitted tariffs to modify its GSIP. At that time, the Staff and Public Counsel proposed modifications and elimination of various components of the Program. After an evidentiary hearing a new GSIP with certain modifications was approved for Laclede. One of the major modifications was that the off-system sales component was removed from the GSIP. Instead off-system sales revenue would be reflected as a revenue stream, and considered along with all the other relevant factors in a general rate case. This was a modification of the approach recommended by Public Counsel in that proceeding.

PUBLIC COUNSEL'S RECOMMENDATION

Q. What is Public Counsel's recommendation in this case?

A. In Case No. GT-99-303, Public Counsel recommended that capacity release and off-system sales should be treated as a normalized revenue stream in a general rate case proceeding. The Commission decided in GT-99-303, that off-system sales, but not capacity release revenues should be included in the development of general rates. In this case, Public Counsel is again recommending including both capacity release revenues and off-system sales revenues as normal revenue streams that should be utilized in the development of tariffed rates.

Q. Why is Public Counsel recommending that both components be included in the current rate case?

A. Public Counsel believes that the revenues associated with these two activities should be considered in a rate case because the actions involved by the Company to participate in capacity release transactions and off-system sales are a normal part of its everyday business activities. Including off-system sales and capacity release revenues in base rates provides a reasonable balance between Company and ratepayers interests. Also, Public Counsel believes that these two functions are interdependent and should not be treated differently.

Q. Please explain why Public Counsel believes these activities are a normal part of the Company's business decisions.

A. As I stated earlier, the Company has excess capacity at various times. Excess capacity occurs because the Company has to secure enough capacity to meet peak demand periods. When demand is not peaking, the Company has excess capacity that it can release to the market to generate additional revenue. The same is true with off-system sales. More natural gas may be nominated or reserved than is needed due to changes in the weather or other factors. MGE can create additional revenues by selling this excess natural gas to third parties that are not a part of its system. Therefore, Public Counsel believes that just like other revenues that the Company receives, appropriate regulatory treatment requires that a base amount of capacity release and off-system sales revenues should be placed in MGE's base rates to determine the appropriate rates to charge its ratepayers.

Q. Please explain why capacity release and off-system sales are interdependent.

A. Capacity release involves the release of unutilized capacity, while off-system sales usually involves the sale of a bundled package of excess capacity and natural gas. If a Company is engaging in capacity release, off-system sales will be lower. Conversely, if a Company escalates its off-system sales, it will have less capacity available for release. Separating these two activities may provide the Company with an incentive to engage in one type of activity over the other. The decision to offer one over the other will be based on whichever activity will provide the Company and its shareholders with the most profit. Treating these two activities in the recommended manner mitigates such incentive.

Q. Please provide an example of this.

A. For example, assume the Commission approved $1,000,000 of additional revenues to be included in a rate case to represent off-system sales, and the Company has the following sharing grid for capacity release revenues in an approved incentive mechanism:

Capacity Release Amount	Company's Percentage
First $300,000	15%
Next $300,000	20%
Next $300,000	25%
Amounts over $900,000	30%

Under these conditions, the Company would have the incentive to do as many off-system sales transactions as possible, in lieu of capacity release transactions. This occurs because the Company has two incentives. First, the Company will want to reach the baseline level of off-system sales to avoid financial detriment. Second, the Company, once achieving the baseline level, will receive 100% of all profits. The Company may still release capacity; however, the profits the Company retains from those transactions will be substantially less. This is the incentive the Company has when these two components are separated. If off-system sales and capacity release revenues are treated in the same fashion (included in rates as a normal revenue stream), the Company will not have an incentive to choose one over the other.

Q. What is Public Counsel's recommendation regarding off-system sales and capacity release revenues?

A. The Commission should establish a combined amount of capacity release revenues and off-system sales as revenues. Consistent with the treatment of other test year revenues in a rate case, once the Company attained those levels, the Company would receive 100% of the revenues above the baseline amount. If the Company does not attain those levels, it would incur a financial detriment. In subsequent rate cases, capacity release revenues and off-system sales would be reviewed to determine the new baseline amount that should be included in revenues.

Q. What amount does Public Counsel recommend to include in this rate case as an appropriate baseline?

A. Public Counsel recommends that ** ________ ** represents an appropriate combined level of off-system sales and capacity release revenues. This reflects capacity release revenue of ** ________ .** and off-system sales revenues of ** ________ .**

Q. How did you arrive at those amounts?

A. I analyzed capacity release revenues generated by the Company since the inception of its GSIP in July of 1996. I then developed a five-year average to determine the annual amount of capacity release revenues the Company has generated. However, since the data is not complete for the current year, I estimated the capacity release revenues for March through June 2001, based on the prior year's information, to determine an annual amount for the 2000/2001 ACA period. However, recognizing that capacity release revenues have shown a downward trend over the past couple of years, I have recommended a slightly lower amount of capacity release revenues. I also analyzed off-system sales profits since February 1998. Based on a four-year average I determined the annual amount of off-system sales profits that the Company earned. Attached to my testimony is schedule JAB-2 that illustrates the amounts of capacity release revenues and off-system sales that I utilized to determine the appropriate amount to include in this rate case.

Q. What effect would these changes have on MGE's tariffs?

A. MGE's tariff, P.S.C. MO No. 1, Sheet No. 24.28 should be cancelled, and MGE tariff sheets, P.S.C. MO No 1, Sheet Nos. 24.27 and 24.29 should be modified to eliminate references to capacity release revenue sharing.

Q. Please summarize your testimony?

A. Public Counsel is recommending including a combined baseline amount of capacity release revenues and off-system sales revenues in developing MGE's base rates. Public Counsel believes that these two components belong in a rate case, and that capacity release and off-system sales are interdependent. The Commission has already ordered that off-system sales should be placed in a rate case proceeding. Public Counsel believes that the two components and their associated revenue streams need to be treated in the same manner.

Q. Does this conclude your testimony?

A. Yes it does.

Cases of Filed Testimony
James A. Busch

Company	Case No.
Union Electric Company	GR-97-393
Missouri Gas Energy	GR-98-140
Laclede Gas Company	GO-98-484
Laclede Gas Company	GR-98-374
St. Joseph Light & Power	GR-99-246
Laclede Gas Company	GT-99-303
Laclede Gas Company	GR-99-315
Fiber Four Corporation	TA-2000-23; et al.
Missouri American Water Company	WR-2000-281/SR-2000-282
Union Electric Company d/b/a AmerenUE	GR-2000-512
St. Louis County Water	WR-2000-844
Empire District Electric Company	ER-2001-299

SCHEDULE JAB-2

HAS BEEN DEEMED

HIGHLY CONFIDENTIAL

IN ITS ENTIRETY.