Exhibit No.: ________________
Issues: Off-System Sales & Capacity Release
Witness: Michael T. Langston
Sponsoring Party: Missouri Gas Energy
Case No.: GR-2001-292

MISSOURI PUBLIC SERVICE COMMISSION

MISSOURI GAS ENERGY

CASE NO. GR-2001-292

REBUTTAL TESTIMONY OF

MICHAEL T. LANGSTON

Jefferson City, Missouri
June 1, 2001

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Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Michael T. Langston. My business address is Southern Union Company, 504 Lavaca, Suite 800, Austin, Texas 78701.

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

A. I am employed by Southern Union Company and hold the position of Vice President, Gas Supply.

Q. PLEASE DESCRIBE YOUR EDUCATION AND PROFESSIONAL EXPERIENCE.

A. I received a Bachelor of Science Degree in Electrical Engineering with honors from the University of Texas in Austin in 1975. I received a Master of Business Administration from Southern Methodist University in Dallas, Texas in 1978. I was employed by Mobil Pipe Line Company from 1975 to 1979 in various positions in their engineering department. From 1979 through most of 1986, I was employed by Texas Oil and Gas Corp. and its affiliate, Delhi Gas Pipe Line Corporation, holding various positions in corporate planning, special projects, and project development. I joined Southern Union in September 1986 and have been employed by Southern Union since that time. I am also a Registered Professional Engineer in the states of Texas, Louisiana, and Oklahoma.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to respond to the recommendation of Office of the Public Counsel ("Public Counsel") witness Busch regarding treatment of capacity release revenues in the revenue requirement of this case. In addition, I respond to the recommendations made by Public Counsel witness Busch and Missouri Public Service Commission Staff ("Staff") witness Wallis regarding imputation of off-system sales revenues in Missouri Gas Energy's ("MGE's" or "Company's") revenue requirement in this case.

1. CAPACITY RELEASE

Q. PLEASE DESCRIBE WHAT IS MEANT BY THE TERM "CAPACITY RELEASE".

A. Missouri Gas Energy (MGE), as do most local distribution companies ("LDCS"), holds contracts on upstream interstate pipeline systems for capacity within the pipeline that is used to transport its natural gas supplies from production areas to its distribution systems for ultimate consumption by its customers. These contracts provide a designated amount of "capacity" within the pipeline that is always available to the LDC for use in moving its gas supplies to its service territory. The Federal Energy Regulatory Commission ("FERC"), as a result of FERC Order 636, began allowing LDCs, and other customers on the interstate pipeline systems who hold firm capacity, to release this capacity to others for their use if such capacity is not immediately needed to meet requirements. Because natural gas loads vary substantially for LDCs as a result of weather, all of the contracted capacity which they hold on upstream pipelines is not fully utilized at all times. Therefore, capacity release provides the LDCs and other customers the ability to release any such unused capacity and to receive credits that off set the reservation charges paid to the upstream pipeline for such contracted capacity.

Q. PLEASE OUTLINE YOUR UNDERSTANDING OF THE POSITION TAKEN BY PUBLIC COUNSEL WITNESS BUSCH REGARDING THIS ISSUE.

A. Mr. Busch recommends that the Commission use $1,000,000.00 as an increase to revenues, and a reduction in the revenue requirement for base or margin rates, to account for revenue generated by capacity release activities. Recognizing that MGE's current purchase gas adjustment ("PGA") mechanism contains a capacity release mechanism pursuant to which MGE's system sales customers share in the revenues derived from such transactions, Mr. Busch also recommends that MGE's current PGA mechanism be modified to remove the capacity release incentive mechanism.

Q. DOES MGE AGREE WITH THESE RECOMMENDATIONS BY MR. BUSCH?

A. No.

Q. WHAT ARE YOUR PRIMARY CONCERNS WITH MR. BUSCH'S RECOMMENDATIONS?

A. Capacity release revenues are derived as a result of specific FERC-approved tariff provisions for the upstream interstate pipelines systems which allow for such transactions. Once these transactions are implemented, the revenues generated by such transactions are not paid directly to MGE. These revenues are paid, by the company that acquires the released capacity from MGE, to the upstream pipeline company. The upstream pipeline then "credits" the invoices that it otherwise sends to MGE for payment of upstream capacity amounts reserved on the pipeline. Therefore, MGE does not "generate revenue" from these capacity release transactions but instead these transactions result in a reduced expense for its transportation cost for upstream transportation capacity.

Q. HOW ARE THESE UPSTREAM TRANSPORTATION COSTS RECOVERED?

A. These upstream transportation costs are clearly deemed and defined as part of the overall gas costs included and recovered in the Company's PGA filings. It is not appropriate to break out the "credit amount of upstream capacity cost" when the transportation capacity cost from which these release transactions arre derived continue to be included in the PGA account. In order to best match the expense as off set by the revenues, these costs should continue to be included in the PGA tariffs.

Q. HAS THE STAFF RECOMMENDED A SIMILAR CHANGE IN THE TREATMENT OF CAPACITY RELEASE REVENUES?

A. No.

Q. DOES MGE HAVE ADEQUATE INCENTIVE TO GENERATE CAPACITY RELEASE REVENUES?

A. Yes. Public Counsel witness Busch has correctly outlined the history of the development of capacity release incentive mechanisms, which have operated for MGE since the Case No. GR-94-318 incentive mechanism case. The Commission has previously approved a specific capacity release incentive sharing mechanisms, which have changed in various dockets, with the most recent change being effected in Case No. GO-2000-705, effective August 31, 2000.

Q. DID THE PUBLIC COUNSEL AND STAFF AGREE TO THIS CAPACITY RELEASE MECHANISM IN THIS PREVIOUS CASE?

A. Yes.

Q. PUBLIC COUNSEL WITNESS BUSCH STATES I HIS DIRECT TESTIMONY THAT "OFF SYSTEM SALES ARE USUALLY BUNDLED WITH THE SALE OF EXCESS PIPELINE CAPACITY" (PAGE 4, LINES 22-23). IS THIS STATEMENT TRUE FOR MGE?

A. No. MGE has conducted capacity release transactions wholly separate and apart from all off-system sales transactions.

Q. IS THE BELIEF THAT THESE ARE "BUNDLED" TRANSACTIONS THE BASIS OF PUBLIC COUNSEL'S PROPOSAL?

A. I believe it is. In his direct testimony (page 7, line 17-18) Public Counsel indicated that the off-system sales and capacity release revenues were two functions he believes are interdependent and should not be treated differently. Because these two activities function totally separately for MGE, the basis for this proposal is not valid in the case of MGE.

Q. DOES CAPACITY RELEASE AFFECT OFF-SYSTEM SALES?

A. No. Public Counsel witness Busch indicates on page 8, lines 12-13 of this testimony, that he feels this is the case. He indicates that engaging in capacity release would lower off-system sales. MGE does not utilize excess capacity in conjunction with off-system sales transactions. Therefore, the release of all excess capacity would in no way affect MGE's ability to make off-system sales.

Q. CAN YOU SUMMARIZE MGE'S POSITION ON CAPACITY RELEASE?

A. Yes. MGE's position on capacity release would be summarized as follows:

1. Capacity release credits should continue to flow through the PGA, where the capacity-related expenses are incurred;
2. Capacity release functions separately from off-system sales activities and the two are not interdependent; and

3. The Commission has previously dealt with capacity release incentive mechanisms in many dockets dating back to Case No. GR-94-318, with the most recent decision in Case No. GR-2000-705, approximately nine (9) months ago. No further change is needed.

2. OFF-SYSTEM SALES

Q. PLEASE EXPLAIN WHAT IS MEANT BY "OFF-SYSTEM" SALES".

A. An off-system sales transaction is a sale whereby MGE takes excess gas supplies which it has purchased in the production area, and resells such gas supply to a third party in the production area. The third party then takes such gas supply for use or resale at locations other than in MGE's distribution system.

Q. DO THESE TRANSACTIONS OCCUR WITHIN THE STATE OF MISSOURI?

A. No.

Q. HOW ARE OFF-SYSTEM SALES PROFITS REALIZED BY MGE?

A. If MGE sells the gas to such third party at a price higher than what it paid for it, then a positive margin is generated. Conversely, if MGE sells gas at prices below what it paid for it, then MGE would have a loss.

Q. IS MGE PROPOSING TO RETAIN BOTH PROFITS AND LOSSES FROM OFF-SYSTEM SALES?

A. Yes.

Q. Has MGE generated a loss in these types of transactions?

A. Yes.

Q. PLEASE EXPLAIN WHEN MGE WOULD NORMALLY ENGAGE IN AN OFF-SYSTEM SALES TRANSACTION.

A. MGE engages in off-systems sales when the supplies which it has under contract for delivery into the upstream interstate pipeline grid are in excess of its flowing requirements including requirements for its storage operations. In such cases, the Company may engage in off-system sales. Such sales are generally utilized in order to match operational requirements for flowing gas volumes.

Q. PLEASE GIVE SOME EXAMPLES OF WHEN OFF-SYSTEM SALES MAY BE APPROPRIATE.

A. For example, during the summer, if customer demand is lower than expected, then scheduled supply volumes may lead to excess gas being injected into storage. In such an example, we might then exceed our allowed injection quantities and, therefore, be subject to penalties from the upstream pipeline for violating the limitations that are included in their FERC tariffs for storage operations. Similarly, during the winter period, during periods of warm weather, scheduled flowing volumes may exceed customer demands.

Such higher levels of flowing gas are generally required to make sure that we are able to meet peak weather generated demand. In such an example, typically the upstream interstate pipeline may impose an operational flow order as a result of excess gas on the system and, subsequently, require customers to limit their gas supplies flowing into the system in order to balance their supply with their demand on a daily basis. In such cases, MGE will often engage in off-system sales to reduce the amount of supply flowing into the upstream pipeline system, in order to balance the overall flowing supply with the demand on the distribution system. In these cases, the objective is to eliminate the potential for any penalty provisions that may be incurred on the upstream pipeline system.

Q. IF VARIATIONS IN CUSTOMER DEMAND WILL DRIVE MGE'S DECISION FOR MAKING OFF-SYSTEM SALES, ARE MGE'S DECISIONS TO ENTER INTO OFF-SYSTEM SALES DRIVEN BY WEATHER?

A. In many cases, yes. When the weather is very warm, as it was during the winter of 1999-2000, MGE will engage in substantial off-system sales revenues in order to avoid the potential of incurring pipeline balancing penalties. In the case when the weather is normal or colder than normal, MGE may engage in no off-system sales.

Q. DID MGE DERIVE ANY REVENUE FROM OFF-SYSTEM SALES DURING THE TRUED-UP TEST YEAR?

A. No. The last off-system sales transaction made by MGE occurred at the end of the 1999-2000 winter, in May of 2000. Current market conditions, as well as experience, indicate that MGE will make no off-system sales between now and June 30, 2001. The trued-up test year is the twelve months ended June 30, 2001, during which MGE will have total off-systems sales revenues of zero.

Q. WHEN DID MGE FIRST BEGIN GENERATING OFF-SYSTEM SALES TRANSACTIONS?

A. MGE undertook its first off-systems sales transaction in February 1998.

Q. HAVE OFF-SYSTEM SALES REVENUES BEEN REVIEWED IN MGE'S 1998 ACA CASE?

A. Yes, in Case No. GR-98-167, off-system sales revenues information was provided to Staff.

Q. DID THE STAFF RECOMMEND ANY ADJUSTMENT TO MGE'S PGA, COST OR REVENUES AS A RESULT OF OFF-SYSTEM SALES TRNASACTIONS IN CASE NO. GR-98-167?

A. No. Staff made no recommendation regarding off-system sales.

Q. DID MGE HAVE OFF-SYSTEM SALES REVENUES IN ITS 1999 AND 2000 ACA YEARS?

A. Yes, similarly in 1999, Case No. GR-99-304, the Staff did not make any recommendation or adjustment for off-system sales revenues. The Staff has yet to file its recommendation in the 2000 ACA Case, Case No. GR-2000-425.

Q. WHAT LEVEL OF OFF-SYSTEM SALES REVENUES HAS MGE HAD?

A. For the 1998-1999 ACA years, MGE's sales revenues were in the $200-250,000 range. For the fiscal year ending June 30, 2000, with the last off-systems sales revenues occurring in May 2000, MGE had approximately $1.5 million of off-systems sales revenues. For the fiscal year that will end June 30, 2001, MGE's off-system sales revenues will be zero.

Q. WHY IS THERE SUCH A SUBSTANTIAL DIFFERENCE IN THE AMOUNT OF THESE OFF-SYSTEM SALES REVENUES?

A. Off-system sales are substantially generated as a result of excess system supplies and are strongly dependent upon the weather. The demand of system sales customers varies considerably depending upon the weather incurred within MGE's service territory. Under the current regulatory framework where MGE performs the merchant function for system sales customers, MGE must contract for sufficient supply to meet potential demand associated with extremely cold weather conditions. Therefore, when weather conditions are considerably warmer than normal, as was the case during the winter of 1999-2000, it is to be expected that supplies under contract will exceed demand. In addition, in many such cases MGE is subjected to operational flow orders which require the Company to balance its flowing supplies with its expected demand. In such cases, the use of these off-systems sales transactions have served to reduce and/or eliminate balancing penalties that would otherwise be incurred as additional costs from our upstream pipelines.

Q. DOES MGE AGREE WITH THE RECOMMENDATIONS OF THE STAFF AND PUBLIC COUNSEL REGARDING COMPUTATION OF OFF-SYSTEM SALES REVENUES?

A. No. First, MGE conducts its off-system sales in a way that does not involve any material use of customer-funded assets. Put another way, MGE incurs no incremental cost in order to make off-system sales transactions, and no cost is generated that is funded by our rate payers. In addition, any off-system sales that MGE makes occur well beyond the borders of Missouri. As a consequence of these factors, MGE's off-system sales and associated revenues are beyond the scope of the Commission's lawful jurisdiction. Second, whether or not any off-system sales will occur in the period when rates set from the proceeding will be effective, is a speculative proposition at best. This is a result of the substantial uncertainty surrounding the price of natural gas that presently exists as well as the simple fact that off-system sales are largely driven by the weather, which cannot be predicted with any degree of accuracy.

Q. WHAT DO YOU THINK HAS BEEN THE COMMISSION'S DRIVING FACTOR IN DETERMINATION OF THE APPROPRIATENESS OF ITS JURISDICTION OVER OFF-SYSTEM SALES REVENUE?

A. The Commission has clearly utilized the test of determining whether or not the cost of producing off-system sales revenues was borne by rate payers. An example of this can be found in the Order in the last rate case filed by the Missouri Public Service Company, a division of UtiliCorp United, Case No. ER-97-394. In this case, the Commission found that UtiliCorp's ratepayers had funded costs that were ultimately utilized in generating off-system sales and, therefore, such off-system sales revenues fell under Commission jurisdiction.

Q. HAS A SIMILAR FINDING BEEN MADE FOR LACLEDE GAS COMPANY ("LACLEDE")?

A. In the Commission's Order in Laclede's Gas Company Case No. GR-99-315, the Commission ordered that a level of off-system sales revenue be included in rate case revenues. The basis for including these revenues was the fact that Laclede's rate payers, again, were paying supply and transportation related-demand costs that were incurred in generating such revenues.

Q. IS THIS NOT THE CASE FOR MGE?

A. No. No additional supply or transportation related costs are generated or paid by rate payers as a result of MGE's off-system sales activities.

Q. PLEASE EXPLAIN THE DIFFERENCES BETWEEN MGE AND LACLEDE'S OFF-SYSTEM SALES TRANSACTIONS.

A. It is my understanding, that there are substantial differences in the over all supply and upstream transportation portfolio of MGE and that of Laclede. First, as I understand, Laclede has supply contracts which contain demand/commodity components. These demand based components are flowed through Laclede's PGA on a monthly basis, with a commodity cost incurred only as natural gas is purchased for resale. Therefore, if Laclede enters into off-systems sales transactions, the difference between the sales price and the commodity price would generate "off-system sales revenues". However, since Laclede's rate payers have funded the demand-related cost component, then Laclede's rate payers are effectively supporting the underlying cost of generating off-systems sales revenues. In MGE's case, the Company purchases natural gas on a commodity price basis only. Therefore, whether or not more or less gas is purchased by MGE under its purchase contracts, there is no per unit cost change to MGE's rate payers for the amount of gas that is actually purchased and consumed for their benefit. For example, if MGE purchases 100,000 MMBtus per day of natural gas supply, and then, as a result of reduced demand, sells 20,000 MMBtus per day of this supply in an off-system sales transaction, the unit price on the remaining 80,000 MMBtus is the same both before and after the off-system sales transaction. In fact, as noted previously, in many cases such transactions reduce potential downstream balancing penalties on the interstate pipeline system.

Secondly, Laclede holds substantial upstream pipeline capacity which is in many cases is utilized or bundled by Laclede with off-system sales transactions. In other words, Laclede may have a sale of off-system gas at a point downstream of its actual purchase in the production field location, at a point of interconnect into another pipeline system. In such case, Laclede's rate payers have funded the demand cost incurred to hold such upstream pipeline capacity, and, therefore, have indirectly supported the cost of such off-system sales transaction. MGE does not engage in these types of transactions, and any excess pipeline capacity is simply sold on the open market, if there is a market for such a capacity, and such actions generate capacity release revenues. Such capacity release revenues are currently credited, and serve to reduce the cost, to system sales customers under MGE's existing PGA mechanism.

Q. DO MGE'S CUSTOMERS FUND ANY COST INCREASES AS A RESULT OF MGE'S OFF-SYSTEM SALES TRANSACTIONS?

A. No.

Q. MAY MGE'S CUSTOMERS DERIVE BENEFITS FROM MGE'S OFF-SYSTEM SALES TRANSACTIONS?

A. Yes. MGE primarily engages in off-systems sales transactions to balance its flowing supplies with its downstream demand. In many cases, when the upstream pipelines have either too much gas or too little gas in their pipeline system, they will implement operational flow orders which require customers on the system to balance supplies with demand on a daily basis. Off-system sales transactions generally occur only when the pipelines have "too much gas" on the pipelines, and are seeking to have customers reduce the amount of gas nominated and transported across their interstate pipeline systems. In such cases, when the Company engages in off-system sales, the sales transactions reduce the overall total amount of natural gas flowing on the interstate pipeline systems, and assist MGE in avoiding balancing penalties that would otherwise be incurred on MGE's transportation invoices and paid by the rate payers as increased PGA costs. Therefore, off-system sales revenues have a beneficial effect on MGE's customers by eliminating and/or reducing the potential for upstream transportation balancing charges.

Q. DO YOU BELIEVE THE STAFF UNDERSTANDS THE DIFFERENCES BETWEEN THE WAY MGE OPERATES ITS OFF-SYSTEM SALES AND THE WAY LACLEDE OPERATES?

A. It is clear to me that the Staff does not understand that MGE does not utilize downstream capacity in order to make off-system sales. In its response to MGE Data Request No. 28, the Staff indicated that, "Staff, as part of its audit reviews of MGE's ACA filings, has found in the past that MGE, in order to make off-system sales transactions, does use capacity under contract to serve Missouri customers." This statement is completely wrong. MGE has never utilized downstream interstate pipeline capacity in order to make an off-system sales transaction.

Q. DO MGE'S CUSTOMERS FUND ANY INTERNAL STAFF COST INCREASES AS A RESULT OF GENERATING OFF-SYSTEM SALES?

A. To determine whether excess volumes may exist, MGE monitors its overall supply and demand daily, and the anticipated weather on its system. Each morning, if pipelines have issued operational flow orders that would require the Company to reduce its overall flowing supplies, and/or if supplies are otherwise substantially in excess of the Company's requirements, then an off-system sales transactions may be made. All these volume monitoring activities are normal and part of the overall jurisdictional activity. An actual off-system sales transaction takes a matter of a few minutes where a third party is called on the phone and a sales transaction is implemented verbally. As a result of upstream interstate pipeline nomination deadlines, generally off-systems sales occur within the first hour of the work day, across the industry. In MGE's case, only one or two off-system sales transactions may be necessary in order to reduce its flowing supplies on any particular day. In addition, off-system sales are not done every single day of every month. Therefore, if an average off-system sales transaction takes approximately five (5) minutes, the time utilized for this activity is clearly *de minimus*. The potentially avoided balancing penalties would clearly exceed any minimal time utilized for these transactions. Further, to the extent that MGE has not engaged in off-system sales during this trued-up test year, clearly no cost have been incurred in this regard.

Q. PLEASE SUMMARIZE YOUR POSITION REGARDING OFF-SYSTEM SALES.

A. MGE's position is as follows:

1. Off-system sales revenues do not impact costs to rate payers;
2. Off-system sales do not use transportation capacity held by MGE by contract;
3. Off-system sales, in general, help reduce and/or avoid pipeline balancing charges;
4. Off-system sales revenues during the trued-up test year in this case are zero (0);
5. Off-system sales transactions occur outside the State of Missouri; and

6. As no cost is incurred by MGE customers within the State of Missouri as a result of such transactions, and such transactions occur outside the State of Missouri, the Missouri Public Service Commission has no jurisdiction over these transactions.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Tariff Sheets Designed to Increase Rates for Gas Service in the Company's Missouri Service Area.	))))	Case No. GR-2001-292

AFFIDAVIT OF MICHAEL T. LANGSTON

STATE OF TEXAS)
) ss.
COUNTY OF TRAVIS)

Michael T. Langston, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

MICHAEL T. LANGSTON

Subscribed and sworn to before me this 30th day of May 2001.

DIANE BOOTHE
NOTARY PUBLIC
STATE OF TEXAS
EXPIRES
08-28-2004

Notary Public

My Commission Expires: 8-28-2004