

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
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

ANNE M. ALLEE

FILED

JUL 13 2004

Missouri Public
Service Commission

MISSOURI GAS ENERGY

CASE NO. GR-2004-0209

Jefferson City, Missouri
June 2004

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Case No(s) GR-2004-292
Date 6-28-04 Rptr XF

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

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BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

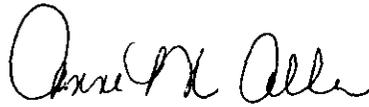
In the Matter of Missouri Gas Energy's)
Tariffs to Implement a General Rate)
Increase for Natural Gas Service)

Case No. GR-2004-0209

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

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





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

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**TABLE OF CONTENTS OF
SURREBUTTAL TESTIMONY
ANNE M. ALLEE
MISSOURI GAS ENERGY
CASE NO. GR-2004-0209**

Gas in Inventory..... 1
Capacity Release/Off-System Sales..... 3

Surrebuttal Testimony of
Anne M. Allee

1 reflects MGE's actual weighted average cost of gas of \$5.68/MMBtu for the twelve months
2 ending April 30, 2004. Schedule 1 attached to my surrebuttal testimony shows the
3 calculation of the inventory value Staff proposes to use in this case.

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

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

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

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

16 Q. How reliable are the strip prices when it comes to predicting
17 what actual prices will be?

18 A. Strip prices reflect the cost of gas in the future based upon
19 today's marketplace. No one can predict the future. Economic
20 growth, natural gas storage levels, and weather patterns are always
21 changing. The strip price will change with these events going higher
22 or lower in price.

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

25 A. Yes. As an alternative to its proposed use of the NYMEX strip price, the
26 Company does suggest the Commission use an average of the twelve-month ending

1 inventory balance as of April 30, 2004, (Noack rebuttal, p. 9, ll. 18-20). Thus, one of MGE's
2 alternative proposals is identical to Staff's recommendation.

3 **Capacity Release/Off-System Sales**

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

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

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

22 A. No. If MGE wishes to receive an incentive to maximize capacity release
23 revenues, then capacity release/off-system sales revenues should continue to be reflected, as

Surrebuttal Testimony of
Anne M. Allee

1 they presently are, in base rates. Including capacity release as a revenue item in the cost of
2 service gives MGE an incentive to maximize the use of its idle pipeline capacity. By
3 capturing capacity release/off-system sales revenues in base rates, MGE's ratepayers receive
4 all of the benefits up to the amount of revenues included in base rates. Stated another way,
5 MGE must at least accomplish a minimum level of capacity release to recover the capacity
6 release/off-system sales imputed in the rates, thus the incentive to have a minimum level of
7 performance. On the other hand, the shareholders will also receive all of the benefits of
8 capacity release revenues achieved above the amount included in base rates.

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

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

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

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

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

22 A. Yes. With the exception of Laclede and MGE, capacity release/off-system
23 sales flow through the PGA mechanism with 100% of the benefit passed on to the ratepayers

Surrebuttal Testimony of
Anne M. Allee

1 for all other Missouri LDCs. These LDC PGAs do not contain capacity release/off-system
2 sales revenue sharing grids, such as the one MGE has proposed.

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

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

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

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

Surrebuttal Testimony of
Anne M. Allee

1 achieved greater capacity release dollars since the Kern River expansion than it has in the last
2 three years.

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

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

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

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

Surrebuttal Testimony of
Anne M. Allee

1 the Staff's intent to allow MGE to acquire an unlimited amount of capacity to the benefit of
2 its shareholders and a detriment to its ratepayers.

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

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

16 Q. Please summarize your testimony.

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

21 **Capacity Release** - In the Staff's opinion, MGE's capacity release/off-system sales
22 should be treated for rate purposes consistent with Laclede. The Staff recommends
23 continuing MGE's current ratemaking treatment of capacity release with a revenue

Surrebuttal Testimony of
Anne M. Allee

1 adjustment of \$1,340,400 added to cost of service. However, if the Commission decides that
2 capacity release/off-system sales should be handled through the PGA, then the Staff
3 recommends that 100% of this item should be flowed through to the ratepayers.

4 Q. Does this conclude your surrebuttal testimony?

5 A. Yes, it does.

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

<u>Month/Year</u>	<u>Gas Stored Underground</u>		<u>Total Underground Storage</u>
	<u>Southern Star Central</u>	<u>Panhandle Eastern</u>	
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
HAS BEEN
DEEMED
HIGHLY CONFIDENTIAL
IN ITS
ENTIRETY