

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI**

In the Matter of Aquila Networks - MPS's	)	
Purchased Gas Adjustment factors to be reviewed	)	Case No. GR-2004-0539,
in its 2003-2004 Actual Cost Adjustment.	)	consolidated with GR-2004-0538

**RESPONSE TO SECOND ORDER DIRECTING FILING**

Comes now Aquila, Inc., and, states as follows in response to the Missouri Public Service Commission's ("Commission") Second Order Directing Filing:

**SUMMARY**

The PGA factor disparity associated with the Northern, Southern and L & P system increases is primarily due to differences in the interstate pipelines (a different pipeline serves each of the systems) and differences in storage capabilities. Recent changes in pipeline rates and a significantly lower level of available storage tends to drive the Southern System PGA factor higher than the other two systems during a time of rising gas prices. On the other hand, the L & P System's small size enables it to avoid certain pipeline charges applicable to the other systems and tends to drive its PGA factor lower.

**RESPONSE**

1. On November 16, 2004, the Commission issued its Second Order Directing Filing (Order) wherein it directed its Staff to file a response concerning the disparity in the percentage increases associated with the proposed Purchased Gas Adjustment (PGA) factors for Aquila's three systems. Although not ordered to do so, Aquila seeks to provide its own explanation for the Commission's consideration.

2. The Order repeats the statements found in the Staff Recommendation indicating that

the proposed PGA changes will increase a residential customer's bill for the winter season by approximately 24% on the Southern System, approximately 11% on the Northern System and approximately 5% on the L&P System, when compared to rates currently in effect.

3. These percentages primarily vary due to differences in the pipelines that serve the three systems and differences in levels of storage available to the three systems.

4. In fact, each of the systems is connected to a different interstate pipeline. The Southern System is connected to the Southern Star pipeline; the Northern System is connected to the Panhandle Pipeline; and, the L & P System is connected to the ANR Pipeline. The interstate pipelines operate under separate rates and rules. Most recently, the Southern Star Pipeline tariff changed, effective November 1, 2004, causing an increase in the reservation portion of the calculation that is not present in the other two systems.

5. A more significant impact results from the lower amount of storage that is available to the Southern System. The Northern and L & P Systems each have storage capabilities sufficient to cover 70-80% of their normal requirements. The Southern System, on the other hand, only has a storage capability that will cover 24-26% of its normal requirements. Thus, the Southern System is more sensitive to increases in natural gas prices and its PGA factor will increase at a greater rate than the other two systems anytime that gas prices are higher than the weighted average cost of gas (WACOG) of the storage for the other two systems.

6. Additionally, in order to hedge the Southern System to the 70% level usually targeted by Aquila, the Company must make use of various approaches, such as purchasing financial Swaps, Call Options and Participating Options. These hedging techniques provide an opportunity to cap gas prices, but also allow the Company to participate in a falling market (Call Options and Participating

Option). However, purchasing Call Options requires a payment of a premium, similar to insurance, that is borne by the Southern System, and is not borne by the Northern and L & P Systems.

7. On the lower end of the range, the L & P System is able to separate itself from the other two systems through lower prices because of its small size and special tariff provisions available on the ANR Pipeline. Its system characteristics allow the L & P System to take service from the ANR Pipeline without any demand charges. In other words, it only pays for the capacity it uses. This cost structure is unique to the L & P System and tends to drive its PGA factor lower than the Southern and Northern System factors.

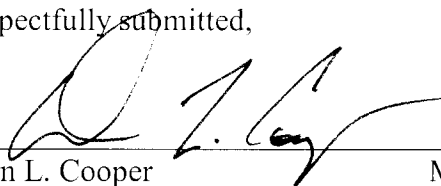
### **CONCLUSION**

8. It is believed that the percentage increase differences, about which the Commission inquired, are primarily due to the significant differences in the operating characteristics of the three Aquila systems. Therefore, Aquila asks that after considering this response, the Commission enter its Order Approving Interim Rates and Granting Waiver.

WHEREFORE, Aquila respectfully requests that the Commission approve the subject tariff

sheets and allow the proposed rates to go into effect on an interim basis, subject to refund.

Respectfully submitted,



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ATTORNEYS FOR AQUILA, INC.

### **CERTIFICATE OF SERVICE**

The undersigned certifies that a true and correct copy of the foregoing document was sent by electronic mail November 17<sup>th</sup>, 2004, to the following:

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