Exhibit No.:
Issue: *Capacity Release and Purchasing Practices*
Witness: *David M. Sommerer*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Rebuttal Testimony*
Case Nos.: *GR-2001-382, GR-2000-425, GR-99-304 and GR-98-167 (Consolidated)*
Date Testimony Prepared: *March 18, 2003*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

DAVID M. SOMMERER

MISSOURI GAS ENERGY

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

Jefferson City, Missouri
March 2003

Exhibit No. 10
Case No(s). GR-2001-382
Date 5-12-03 **Rptr** XF

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 DAVID M. SOMMERER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

David M. Sommerer, being of lawful age, on his oath states: that he has participated in the preparation of the following rebuttal testimony in question and answer form, consisting of 11 pages to be presented in the above case; that the answers in the following 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.

David M. Sommerer

Subscribed and sworn to before me this 14th day of March 2003.

Toni M Charlton

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

TONI M. CHARLTON NOTARY SEAL NOTARY PUBLIC STATE OF MISSOURI

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MISSOURI GAS ENERGY

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

Q. Please state your name and business address.

A. David M. Sommerer, P.O. Box 360, Jefferson City, Mo. 65102.

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

A. I am the Manager of the Procurement Analysis Department with the Missouri Public Service Commission.

Q. Are you the same David Sommerer who filed direct testimony in this case?

A. Yes.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to respond to the direct testimony of Missouri Gas Energy witnesses Michael T. Langston and John J. Reed related to Staff's proposed adjustments for Missouri Gas Energy (MGE or Company), Case No. GR-2001-382. Specifically, I will be addressing the capacity release issue and part of the purchasing practice issue.

CAPACITY RELEASE

Q. Do you agree with Mr. Reed's statement on page 51, lines 10 through 12 that, "...Staff has provided no evidence to support its statement that MGE's action (or inaction in this instance) has raised serious doubt."?

A. No. The evidence supporting the Staff's May 31, 2002 recommendation was presented in my direct testimony in this case. This evidence includes MGE data responses that establish MGE's failure to post or market its capacity on KPC. Given the relatively high pipeline rates associated with capacity on KPC, MGE should have made every effort to release this capacity. The fact that MGE did not, should raise a serious doubt about its actions.

Q. How do you address Mr. Reed's comments on page 53, lines 6 and 7 that "...it (staff) made absolutely no other attempt to evaluate the viability of MGE releasing capacity on KPC."?

A. The Staff's position in this case is that it was MGE's role to evaluate the viability of capacity on KPC. Only after the staff raised concerns did MGE decide to assess this alternative.

Q. Do you have a comment with regard to Mr. Reed's testimony on pages 55 and 56?

A. Yes. Mr. Reed's comments on lines 15 through 28 on page 55 and lines 1 through 18 on page 56 merely summarize Mr. Langston's direct testimony and provides Mr. Reed's opinion on the prudence of MGE actions with regard to this issue. I will further discuss these points during my discussion of Mr. Langston's direct testimony.

Q. On page 10, lines 4 through 14, Mr. Langston states why he believes it is uneconomic for third-parties to obtain released capacity from KPC's firm shippers. What is your comment with regard to that testimony?

A. Mr. Langston has pointed out that KPC's commodity rates are higher than competing pipelines in the area. I do not disagree. In fact, Mr. Langston's Schedule 1 illustrates the fact that KPC's charges are much greater than competing pipelines in the area. This fact alone does not mean a prospective third-party shipper would not be interested in a non-recallable capacity release deal. To illustrate this concept, power plants require capacity during the summer months for electric generation needs. The value of released capacity might be maximized by marketing the capacity as not only non-recallable but as a long-term summer transaction that does not require renewal every 30 days. Even though MGE did not attempt such an inquiry, MGE criticizes the Staff for not conducting a detailed market evaluation and relies on its after-the-fact communications to try and justify why it did not attempt to market this capacity.

Q. Do you have a comment with regard to Mr. Langston's statement at the bottom of page 11 and top of page 12 that capacity of KPC's firm shippers is effectively unmarketable?

A. Yes. One aspect of Mr. Langston's analysis is based upon a review of affiliated interruptible transportation transactions during the ACA period. These transactions are not for firm capacity and appear to be short-term in nature; therefore, they are not comparable to the firm transportation that could be offered under a longer-term non-recallable capacity release deal.

Q. What is another aspect of Mr. Langston's view that KPC's firm shippers' capacity is unmarketable?

A. On page 12, lines 15 through 21, Mr. Langston makes the claim that KPC is less desirable as compared to capacity offered for release by shippers on other pipelines with lower commodity rates. This ignores the fact that MGE is already paying high fixed reservation fees on KPC during months that MGE is not sourcing gas on KPC. If MGE sourced gas on KPC and released capacity on the cheaper pipelines, it would only need to overcome the difference in commodity rates to achieve a net benefit.

Q. Mr. Langston complains on page 14, lines 20 through 23, that Staff has effectively performed no due diligence about the capacity release market on KPC. Do you believe it is necessary for the Staff to conduct such due diligence to evaluate the probability of capacity release on the KPC system?

A. No. The Staff has made inquiry of MGE regarding its attempts to market KPC capacity during the summer months. This information was provided in my direct testimony. It would be unusual and probably inappropriate for the Staff to conduct inquiries of regulated and unregulated third parties about capacity proposals on MGE's system. The Staff was able to establish the extent of capacity release transactions on KPC's system more directly based upon data requests to MGE.

Q. Please discuss the operation limitations Mr. Langston cites on page 15, lines 7 through 15 of his testimony.

A. Mr. Langston references the TransOk Lease as having very specific operational limitations on how gas must be delivered into the TransOk system. MGE however is clearly able to deal with these alleged impediments. In fact, it appears to Staff that as an entity attempting to market available capacity MGE would do everything in its control to ease the administrative tasks associated with nominating supply on the KPC system. Also, the operational concerns cited by Mr. Langston, would not be an issue under the Staff's second alternative of releasing capacity on a different pipeline and sourcing the MGE supply on KPC when economically appropriate.

Q. Mr. Langston discusses some correspondence with Duke on page 15, lines 20 through 23, and page 16, lines 1 through 15 of his direct testimony. What are your comments with regard to that discussion?

A. A review of the dates on that correspondence clearly indicates that Duke was asked to document its opinion well after the ACA period was over, i.e. April of 2002. The Staff had previously asked MGE for all documentation regarding both pre-arranged and posted KPC capacity release offers related to the ACA period. Based upon the information provided, MGE has no concurrent documentation of what the terms of the verbal discussions were. It is not stated whether the release was non-recallable or for a relatively short term or a longer term. Duke merely indicates that it did not have a use for that capacity.

Q. Mr. Langston, indicates on page 17, lines 6 through 10 of his direct testimony that MGE has been more successful in negotiating capacity release transactions with third-parties rather than posting capacity for bid on a pipeline bulletin board. Could you respond to this?

A. Yes. I do not doubt that pre-arranged deals might be the normal procedure for MGE, and a possible way to maximize value. If this is the case, MGE still was not precluded from marketing this capacity on a non-recallable basis. The Company has carefully navigated the additional question of why it did not seek to negotiate a non-recallable release of KPC capacity with potential buyers.

Q. How has Mr. Langston addressed the Staff's alternative suggestion that MGE could have sourced gas on KPC and performed a non-recallable release on the Williams system?

A. Mr. Langston indicates that in the summer, interruptions are so infrequent as to eliminate any possible additional value from a non-recallable release. As support for this, Mr. Langston has subsequently posted Williams capacity on a non-recallable basis. However, Mr. Langston has previously argued that posting will not yield the highest value on MGE's system. KPC capacity is unique in that it is available on a long-term non-recallable basis. This capacity, or an alternative capacity deal on another pipeline, is not being marketed that way by MGE. MGE has tested the market subsequent to this ACA period, but in a very controlled fashion. It has cited the lack of liquidity in the *posted* capacity release market and then uses that illiquid market as proof of the undesirability of releasing KPC capacity. It cites the lack of compelling evidence regarding the value of firm capacity versus interruptible capacity but then makes a dissimilar comparison between a negotiated recallable release versus a posted non-recallable release.

Q. Does Mr. Langston discuss any additional concerns about the Staff's adjustment?

A. Yes, finally on page 27 of his direct testimony, Mr. Langston indicates that it had an economic reason for maximizing capacity release. That may be true, but other factors may impact MGE's ability or willingness to market such capacity.

Mr. Langston himself discusses just such a situation on page 22, line 21 and page 23, lines 1 through 3 where the resignation of personnel in MGE's gas control department during the December 2000 time frame resulted in a failure to post Williams' capacity from at least January 2001 through June 2001.

PURCHASING PRACTICES

Q. Do you agree with Mr. Langston's contention on page 28, lines 16 through 21, that MGE's Fixed Commodity Price (FCP) PGA tariff constituted a well-documented hedging program?

A. No. Staff Consultant John Herbert has discussed the various features of a documented hedging program in his direct testimony and related Schedules. Mr. Langston is referring to a regulatory incentive mechanism that had a fixed price feature. Obviously, this plan could do nothing to protect customers from price increases unless the trigger mechanism was activated. This involved a tremendous amount of risk if this was the only tool MGE was relying on to hedge gas costs. The Staff viewed that MGE was still responsible for the reasonable hedging of its gas supply portfolio. This is directly evident by the fact that the Staff made sure that MGE would still be held accountable for a prudence review of its gas supply decisions in the event MGE did not provide a fixed commodity price. Paragraph F of the May 15, 2000 Stipulation and Agreement (FCP Stipulation) says in part that … "Until such time as the fixed commodity price component of the PGA takes effect, the Staff shall, and Public Counsel may, conduct prudence reviews, and may propose such adjustments as it deems appropriate, for the commodity cost component of the PGA as well as for the transportation/storage cost component of the PGA and all other cost components…" (See Sommerer Direct Schedule 5-15)

Q. Do you agree with Mr. Langston's argument about MGE's proposal to increase the trigger price as found on page 31, lines 19 through 23 and page 32, lines 1 through 3 of his direct testimony?"

A. No, if Mr. Langston is implying that MGE was offering to fix the price of gas at \$3.75. MGE's proposal to increase the trigger was far from an offer to lock in gas prices at that amount. It merely would have raised the trigger price in the event that gas prices fell dramatically. Gas prices eventually fell long after the winter in question. MGE's proposal to increase the trigger would have done nothing to protect the winter of 2000-2001.

Q. Did Mr. Langston address other communications between the Staff and the Company?

A. Yes. Mr. Langston discusses a September 26, 2000 letter to Staff. The letter generally states that MGE was willing to fix a price of gas for the winter of 2000-2001. It however is silent as to what the price would be, when it would be fixed, and what rights the Staff would have to review such decisions. It is clear however based upon the discussion in the letter that MGE expected prudence guarantees regardless of what the various decisions were and when those decisions might be made.

Q. Was there another aspect of the FCP Stipulation that Mr. Langston discussed?

A. Yes. Mr. Langston discussed the fact that MGE was authorized to operate under its traditional price stabilization program until an expiration date of September 30,

2000. Mr. Langston discusses various aspects of this program on pages 34 through 38 of his direct testimony.

Q. Do you agree with Mr. Langston's statement on page 35, lines 16 through 22?

A. If Mr. Langston's statement is meant to imply that MGE was not authorized to hedge its gas supply portfolio because of the Price Stabilization Program working in concert with the FCP Stipulation, then I must disagree. The price stabilization program authorized certain activity but in no way precluded hedging. The Staff's understanding of the price stabilization programs was that MGE was offered certain safe harbors as long as it operated under very flexible parameters. Prudence reviews with regard to the $3 million funding level (the amount that had been pre-approved for hedging) were very limited. Since there was a guaranteed funding level, and pre-approval of many decisions under the program, certain financial instruments were specified and authorized. The programs were so flexible, that MGE was not even required to obtain price protection under the original programs. The obvious explanation for such flexibility is that MGE still had authority to enter into fixed price gas supply contracts, capped gas supply contracts, and even financial hedging instruments outside the context of the price stabilization program. The Staff communicated this to MGE in 1999 (See Sommerer Direct Schedule 8-2).

Q. Do you have a comment with regard to Mr. Langston's conclusion on page 36, lines 6 and 7 that the price stabilization program could not be implemented.

A. Yes. Because of volatility in the call options market, I do not believe the $4.40 price was achievable by MGE at the specific funding level authorized after early

March of 2000. Therefore, MGE had willingly entered into an agreement that it knew was unachievable. In my opinion, the Staff would have been willing to consider altering the terms of the price stabilization program when it was under negotiation in March and April of 2000. MGE did not avail itself of this opportunity at that time.

Q. What evidence do you have that the Staff would have considered a raising of the $4.40 cap?

A. This price had been raised before in recognition of market conditions under previous price stabilization programs.

Q. Why then, did the Staff not support MGE's September 27, 2000 filing to alter the parameters of the price stabilization fund?

A. The price stabilization program was analogous to obtaining price insurance for the customers at a specified premium. MGE's late September 2000 filing was, in essence, a filing made to acquire regulatory pre-approvals for buying "flood" insurance while the floodwaters lapped against the front door. The price of the insurance was high, and the deductibles (or strike prices) had reached relatively high levels.

Q. What comment to you have with regard to Mr. Langston's statement on page 43, lines 22 and 23, that the Staff never communicated the hedging "standard" of 30% of normal requirements?

A. MGE has mischaracterized the 30% hedging level as some sort of new and unannounced prudence standard conjured up by the Staff after-the-fact. The 30% level is in fact a measurement (or estimate) of the damages resulting from MGE's failure to hedge sufficient volumes for each heating season month. A measurement of damages is required in any disallowance, and by its very nature may involve some range of reasonable damages. The Staff has stated that this was a "minimal" level. The level is very minimal, is readily achievable, but it must be stressed that this level is not a "standard" that the Staff would suggest as providing adequate protection in all circumstances.

Q. Does this conclude your rebuttal testimony?

A. Yes.