

LAW OFFICES
BRYDON, SWEARENGEN & ENGLAND

PROFESSIONAL CORPORATION

312 EAST CAPITOL AVENUE

P. O. BOX 456

JEFFERSON CITY, MISSOURI 65102-0456

TELEPHONE (573) 635-7166

FACSIMILE (573) 635-3847

E-MAIL: DUFFY@BRYDONLAW.COM

DAVID V.G. BRYDON
JAMES C. SWEARENGEN
WILLIAM R. ENGLAND, III
JOHNNY K. RICHARDSON
GARY W. DUFFY
PAUL A. BOUDREAU
SONDRA B. MORGAN
CHARLES E. SMARR

DEAN L. COOPER
MARK G. ANDERSON
GREGORY C. MITCHELL
BRIAN T. MCCARTNEY
BRIAN K. BOGARD
DIANA C. FARR
JANET E. WHEELER

OF COUNSEL
RICHARD T. CIOTTONI

July 11, 2002

FILED³

JUL 11 2002

Missouri Public
Service Commission

Executive Secretary
Public Service Commission
P. O. Box 360
Jefferson City, MO 65102

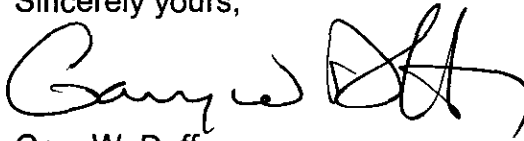
RE: Case No. GR-2001-382

Good morning:

Enclosed for filing in the above-referenced proceeding please find an original and eight copies of Missouri Gas Energy's Response to Staff Recommendation and Motion to Dismiss or Strike.

If you have any questions, please give me a call.

Sincerely yours,


Gary W. Duffy

Enclosures

cc w/encl:

Doug Micheel, Office of Public Counsel
Tim Schwarz, Office of the General Counsel
Jeff Keevil
Jim Deutsch
Chris Kaitson
Rob Hack
Mike Langston

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

FILED³

JUL 11 2002

Missouri Public
Service Commission

In the matter of Missouri Gas Energy's)
Purchased Gas Cost Adjustment tariff)
Revisions to be reviewed in its 2000-)
2001 Actual Cost Adjustment.)

Case No. GR-2001-382

**MISSOURI GAS ENERGY'S RESPONSE
TO STAFF RECOMMENDATION
AND
MOTION TO DISMISS OR STRIKE**

Comes now Missouri Gas Energy ("MGE" or "Company"), a division of Southern Union Company, and for its response to the recommendation of the Staff of the Missouri Public Service Commission ("Staff"), respectfully states the following:

1. On or about May 31, 2002, the Staff filed its recommendation herein. By order dated June 5, 2002, the Commission directed that MGE respond to the Staff's recommendation no later than July 12, 2002.

2. In its recommendation, the Staff proposed four adjustments: A) Refunds; B) the Mid-Kansas Partnership/Riverside Pipeline Company ("MKP/RPC") adjustment; C) Capacity Release on Kansas Pipeline Company ("KPC"); and D) Purchasing Practices. The Staff also recommended that the Commission order MGE to undertake certain analysis of peak day capacity and gas supply requirements ("Peak Day Requirements Study Recommendation").

A. Refunds

3. As indicated in the Staff Recommendation, MGE agrees with, and has

already made, this adjustment.

B. MKP/RPC Adjustment

4. MGE opposes this Staff disallowance. Without limiting any arguments it may make in the future as this case moves forward, MGE offers the following as its initial response to this Staff disallowance. The Staff's MKP/RPC adjustment in this case of approximately \$5.34 million is based on the same rationale as the MKP/RPC adjustment proposed by the Staff in Case No. GR-96-450. Various parties, including MGE, opposed the MKP/RPC adjustment proposed by the Staff in GR-96-450. The Commission rejected the Staff's MKP/RPC adjustment in Case No. GR-96-450 by Report and Order dated March 12, 2002, which order is now subject to appeal and, as such, is not yet final. Although MGE generally opposes the MKP/RPC adjustment proposed by the Staff in this case on all of the same grounds that it has expressed in Case No. GR-96-450, the time period presented in this case (July 2000-June 2001) presents at least one additional basis for opposing the Staff's proposed MKP/RPC adjustment in this case. Specifically, the MKP/RPC rates which represent the starting point of the Staff's adjustment first took effect under the auspices of the Federal Energy Regulatory Commission ("FERC") on May 11, 1998. *See, generally, Kansas Pipeline Company, et al.*, 83 FERC, ¶ 61,107 (1998), reh'g denied 87 FERC, ¶ 61,020 (1999). These FERC-jurisdictional MKP/RPC rates are therefore not subject to disallowance under the filed rate doctrine. *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 90 L.Ed. 943, 106 S.Ct. 2349 (1986). In the interest of making efficient use of the scarce resources of the Commission and the parties, MGE suggests that the Commission should take no evidence pertaining to the substance of the Staff's

proposed MKP/RPC adjustment in this case until after having first been fully apprised of how the filed rate doctrine bars that Staff adjustment; then, only if the Commission believes the filed rate doctrine does not bar the proposed Staff adjustment, the Commission should proceed to take evidence on the substance of the MKP/RPC adjustment proposed by the Staff in this case. Subject to the matters set out in this paragraph and in the paragraphs below, MGE asserts that this case should remain open but without a procedural schedule pending a final, non-appealable Commission decision on the MKP/RPC adjustment in Case No. GR-96-450.

C. Capacity Release on KPC

5. MGE opposes this Staff disallowance. Without limiting any arguments it may make in the future as this case moves forward, MGE offers the following as its initial response to this Staff disallowance. The Staff's Capacity Release on KPC adjustment imputes approximately \$1.14 million in revenues based on the assumption that posting such capacity for the months of April through October could generate a credit equal to 75% of the maximum rates of Williams Gas Pipeline Central. This assumption by the Staff has no foundation whatsoever. First, no inquiry or solicitation for such KPC capacity has ever been made of MGE. Second, MGE has learned that no inquiry or solicitation for such KPC capacity has ever been made since the KPC system came under FERC jurisdiction in May of 1998. Third, the unavoidable fees for use of KPC capacity (i.e., commodity and fuel rates) exceed those of all other pipelines into the MGE market area, making KPC capacity less attractive on the capacity release market. Fourth, during this ACA period, MGE operated under a capacity release incentive mechanism pursuant to which any such revenues generated would have been

shared between customers and shareholders. As such, if revenues could conceivably have been generated by releasing such capacity, MGE would have benefitted financially by taking the steps necessary to do so. MGE did not take such steps for KPC capacity because no market existed for such capacity. To confirm this, upon learning that the Staff was considering a disallowance of this nature, MGE posted (on March 28, 2002) KPC capacity for release on a non-recallable basis for April through October 2002. To date, such posting has yielded no release of such capacity and no revenues.¹

D. Purchasing Practices

6. This Staff disallowance is actually comprised of two components: i) alleged failure to hedge adequately; and ii) alleged unreasonable use of storage inventory. MGE opposes both components of this disallowance.

i) Alleged Failure to Hedge Adequately

7. Without limiting any arguments it may make in the future as this case moves forward, MGE offers the following as its initial response to this Staff disallowance. This Staff disallowance of approximately \$0.6 million is based on the Staff's so-called "reasonable expectation" that MGE should have hedged (via storage, fixed prices, financial instruments, etc.) at least 30% of normal requirements for November 2000 through March 2001. A fundamental problem with this approach is that the Staff's so-called "reasonable expectation" was not disclosed until approximately

¹ In fact, MGE has never released capacity, and generated associated revenues, through any electronic posting it has made on any interstate pipeline. All such transactions, and associated revenues, have resulted from direct contact between MGE and the purchaser of such capacity.

twelve months after the conclusion of the winter of 2000-2001. Even more problematic is that the Staff's so-called "reasonable expectation" was not revealed in advance of the winter of 2000-2001, given the fact that MGE has worked diligently with the Commission and its Staff on the issue of gas price volatility since 1997 and was particularly active on such matters in the months leading up to the beginning of the winter of 2000-2001. The Staff even goes so far as to state that MGE "did not have a documented, formal plan" to address gas price volatility for the winter of 2000-2001. MGE vehemently disputes this assertion. MGE's plan to address gas price volatility for the winter of 2000-2001 was comprehensively documented in the *Amended Stipulation and Agreement* filed on or about May 15, 2000, in Case No. GO-2000-705 and approved by Commission order dated August 1, 2000. This Staff disallowance also violates the Commission's long-standing prudence standard by assessing MGE's decisions on the basis of hindsight. MGE expects that further analysis and discovery will produce additional significant problems with this Staff disallowance.

ii) Alleged Unreasonable Use of Storage Inventory

8. Without limiting any arguments it may make in the future as this case moves forward, MGE offers the following as its initial response to this Staff disallowance. This Staff disallowance of approximately \$8.05 million is based on the Staff's allegation that MGE unreasonably relied too heavily on storage inventory gas in November and December 2000, and therefore unreasonably relied too heavily on market-priced gas in January, February and March 2001. This Staff allegation ignores the fact that the purpose of storage for the MGE system is reliability (i.e., peak day deliverability) and not price protection. This Staff allegation also fails to accurately

recognize the fact that November and December 2000 were the coldest in recorded history. This Staff adjustment also violates the Commission's long-standing prudence standard by assessing MGE's decisions on the basis of hindsight. MGE expects that further analysis and discovery will produce additional significant problems with this Staff adjustment.

Additional Comments Regarding Staff Disallowances

9. MGE fully recognizes that the gas price spikes during the winter of 2000-2001, coupled with the extreme cold weather of November and December 2000, posed extreme difficulties for natural gas customers.² MGE also fully recognizes that the public outcry occasioned by the gas price spikes during the winter of 2000-2001, coupled with the extreme cold weather of November and December 2000, posed a significant problem for regulators.³ Without in any way attempting to diminish the difficulties of customers or the problems of regulators resulting from the gas price spikes during the winter of 2000-2001, and without any concession that MGE's actions or inactions caused that national situation, MGE respectfully suggests that its shareholders have already incurred at least \$8,000,000 in unrecoverable losses due to those phenomena, as explained below. To add further to those significant losses by approving the Staff's disallowances, when no imprudent conduct by MGE has been demonstrated, is patently unfair and unlawful.

² These phenomena took place across the country, not just Missouri.

³ In an attempt to show some recognition of these factors, MGE proposed, in January of 2001, to re-allocate certain monies (federal refunds and unauthorized use penalties) to the benefit of lower-income MGE customers. **See**, Case No. GO-2001-393. In addition, MGE donated \$250,000 to the benefit of lower-income MGE customers.

10. For example, MGE experienced uncollectibles expense of approximately \$12.6 million for fiscal year 2001 (July 1, 2000, through June 30, 2001), which exceeded the uncollectibles expense included in MGE's rates by more than \$8,000,000. Moreover, because the Staff's recommended disallowance of \$15.2 million is greater than MGE's net income for fiscal year 2001, Commission adoption of the Staff's recommended disallowance would result in a net loss for MGE (e.g., negative earnings). What egregious conduct did MGE engage in to elicit such an extreme recommendation from the Staff? Apparently, MGE erred by obtaining an adequate supply of natural gas for its customer base and acting in accordance with the provisions of the *Amended Stipulation and Agreement* filed in Case No. GO-2000-705 on or about May 15, 2000, and approved by order of the Commission dated August 1, 2000. Given the circumstances prevailing when decisions were being made, MGE purchased gas prudently and made prudent use of storage resources. The disallowances recommended by the Staff are based on 20/20 hindsight, contrary to the Commission's long-standing prudence standard.⁴

Peak Day Requirements Study

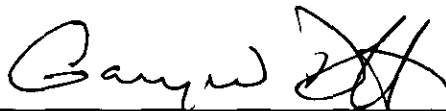
11. MGE asserts that the Staff's Peak Day Requirements Study Recommendation is not a proper topic for consideration in this ACA proceeding. As the style of this case indicates, the purpose of this proceeding is to review PGA adjustments for the 1999-2000 ACA year. Because the Peak Day Requirements Study proposed by the Staff is necessarily aimed at assessing future capacity and gas supply

⁴ See, *In Re: Union Electric Company*, 27 Mo.P.S.C. (N.S.) 183, 194 (1985).

requirements, it is absolutely irrelevant to the issues properly before the Commission in this case. If the Staff believes such studies are necessary to forecast peak day requirements, then such studies should be required of all natural gas local distribution companies, not just MGE. The information on which the Staff appears to be basing its Peak Day Requirements Study Recommendation is contained in the Reliability Report filed by MGE pursuant to the Stipulation and Agreement approved by the Commission in Case No. GO-2000-705. It is MGE's belief that the information it has provided in this Reliability Report, as agreed in Case No. GO-2000-705, is already much more extensive than is required of any other local distribution company in Missouri. Therefore, any additional requirements in this regard should be the subject of a rulemaking, wherein the Commission can consider the extent and timing of information it needs, including the obligation of the Staff to provide timely response to company filings. The appropriate regulatory mechanism to impose such requirements is the rulemaking process, not an ACA case. Therefore, MGE asks that the Commission dismiss or strike the Staff's Peak Day Requirements Study Recommendation from consideration in this ACA case.

WHEREFORE, MGE respectfully offers the foregoing response to the Staff's recommendation and moves that the Commission dismiss or strike the Staff's Peak Day Requirements Study Recommendation from consideration in this case.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Gary W. Duffy", is written over a horizontal line.

Gary W. Duffy MBE# 24905
Brydon, Swearengen & England P.C.

312 East Capitol Ave.
P.O. Box 456
Jefferson City, MO 65102-0456
Telephone: (573) 635-7166
FAX: (573) 635-3847
e-mail: Duffy@Brydonlaw.com

ATTORNEY FOR MISSOURI GAS ENERGY

Certificate of Service

I hereby certify that a true and correct copy of the above and foregoing document was either mailed or hand delivered this 11th day of July, 2002, to:

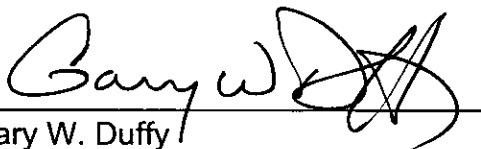
Douglas E. Micheel
Senior Public Counsel
Governor State Office Building
Jefferson City, MO

Jeffrey A. Keevil
Stewart & Keevil
1001 Cherry Street, Ste. 302
Columbia, MO 65201

Jim Deutsch/Henry Herschel
Blitz, Bardgett & Deutsch
308 E. High, Suite 301
Jefferson City, MO 65101

Thomas R. Schwarz, Jr.
General Counsel's Office
Governor State Office Building
Jefferson City, MO

Chris Kaitson, General Counsel
Kansas Pipeline Company
1100 Louisiana, Suite 2900
Houston, TX 77002



Gary W. Duffy