Exhibit No.:
Issue: Prudence of Contracts
Witness: John B. Adger, Jr.
Type of Exhibit: Surrebuttal
Sponsoring Party: Mid-Kansas Partnership/ Riverside Pipeline Company, L.P.
Case No.: GR-96-450
Date Testimony Prepared: July 11, 2001

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

CASE NO. GR-96-450

SURREBUTTAL TESTIMONY
OF
JOHN B. ADGER, JR.

Table of Contents

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Gas Cost Adjustment Tariff Revisions to be reviewed in Its 1996-1997 Annual Reconciliation Adjustment Account	)))	Case No. GR-96-450

SURREBUTTAL TESTIMONY OF
JOHN B. ADGER, JR.

I. Introduction

Q. Please state your name and business address.

A. My name is John B. Adger, Jr. My business address is P. O. Box 237, Quentin, Pennsylvania 17083-0237.

Q. Are you the same John B. Adger, Jr. who presented Rebuttal Testimony in this proceeding?

A. Yes, I am.

Q. Have your training and work experience changed since your earlier testimony?

A. Not in a major way. I have spent much of the past two years serving as an extension of the staff of the Connecticut Department of Public Utility Control. An updated summary of my professional history is attached to this testimony as **Schedule JBA 14**.

Q. What is the purpose of your testimony?

A. The Rebuttal Testimonies of Staff Witnesses Sommerer and Shaw make clear that the real issue for them in this matter is Missouri Gas Energy's (MGE's) decision to enter into the Firm Gas Purchase Contract, dated February 24, 1995, generally referred to as "Mid-Kansas II". Witness Sommerer summarizes the Staff's position as follows:

- The May 2, 1996 Stipulation and Agreement in Case No. GR-94-101 and GR-94-228 does not preclude a prudence disallowance in this case;

- The reservation charges paid by MGE under its contracts with Riverside/MKP are excessive as compared to the traditional pipeline in the area;

- The excessive charges paid by MGE were imprudently incurred.

(Sommerer Rebuttal Testimony at page 3).

Shaw concedes that the decision to enter Mid-Kansas II has to be evaluated based on information known and available at the time, and lists the following information as bearing on the decision at issue:

- Staff and MPSC concerns in historical dockets involving the excessively high delivered cost-of-gas under the Mid-Kansas/Riverside contracts.

- Pending litigation in the Western District Court of Missouri.

- Mid-Kansas/Riverside rate increases pending before the Kansas Corporation Commission.

- Available pipeline alternatives and rates.

- Framework for pending gas cost incentive mechanism.

(Shaw Rebuttal Testimony at page 6).

The Unanimous Stipulation and Agreement, filed on May 2, 1996 in Case Nos. GR-94-101 and GR-94-228, and approved by the Missouri Public Service Commission (MPSC) on June 11, 1996, suggests to me that the prudence of the Mid-Kansas II decision was settled there. I will leave the arguments about what that stipulation says to those who participated in negotiating it, however, and focus my testimony on the decision itself.

My testimony speaks first to Mr. Sommerer's points, and then addresses Mr. Shaw's. In my Rebuttal Testimony, I presented the basis for my view that the decision was prudent and reasonable under the circumstances.[1] In this Surrebuttal Testimony, I present some facts and circumstances that I believe Mr. Shaw overlooked in his analysis, and then I address his points. As stated in my Rebuttal Testimony (pages 29-30), I believe that, by entering into Mid-Kansas II and the other agreements entered at that same time, MGE improved its customers' situation considerably relative to what it was when MGE took over responsibility for those customers from Western Resources, Inc. (WRI) through acquisition of most of WRI's gas distribution operations in Missouri.

II. Response to Staff Witness Sommerer

Q. Please proceed.

A. With regard to Mr. Sommerer's second point (that Mid-Kansas/Riverside's charges are excessive), I would remind him that a pipeline's charges are not excessive just because they are different from those of another, even a competing, pipeline.[2] In fact, it rarely happens that pipeline reservation charges are exactly the same for two pipelines serving the same city gates.

---

[1] See pages 5-13.

[2] Staff Witness Shaw concedes that a pipeline's charges are not unreasonable/imprudent just because they are different from another pipeline's. See Deposition Transcript of Thomas Shaw, page 76, lines 12-16, attached herewith as **Schedule JBA 15**.

Moreover, it is not unusual for pipeline reservation charges for the same city gates to be quite different. In my Rebuttal Testimony, I provided an example from my recent experience, in Connecticut. There, the producing-area-to-city-gate capacity reservation charges for two pipeline systems connecting the Gulf Coast Producing Region to Southern Connecticut Gas Company are only about half as much as the counterpart charge for the systems connecting Western Canada to Connecticut. The systems connecting the Western Canadian supply are newer than the "traditional pipeline(s) in the area", to use Mr. Sommerer's phrasing;[3] consequently, they have much higher capacity reservation charges.

Q. But aren't Mid-Kansas/Riverside's charges "excessive"?

A. No. What Mr. Sommerer fails to acknowledge is that Mid-Kansas/Riverside's charges were reviewed and approved by relevant Federal and State regulatory authorities, the U. S. Federal Energy Regulatory Commission (FERC) and the Kansas Corporation Commission (KCC). Regulation by both of those bodies is cost-based. Thus, if Mid-Kansas/Riverside's rates are higher than another pipeline's, it is because Mid-Kansas/Riverside's costs are higher.

Q. Since MGE had access to a pipeline with lower rates, weren't the charges paid for the more expensive pipeline imprudently incurred?

3 Rebuttal Testimony of David M. Sommerer, page 3.

A. Again, the answer is no. A key point here is the "filed-rate" doctrine.[4] Under that structure, a company taking service from a regulated company must pay the rate for that service that is determined by the appropriate regulatory authority. The choice is not what rate to pay, but whether to take the service. That point brings me to the question of whether MGE should have entered into the Mid-Kansas II contract, which is the focus of Mr. Shaw's Rebuttal Testimony. As previously noted, I disagree with Mr. Shaw's conclusion that MGE's decision to enter into that contract was imprudent.

III. Background of MGE's Relationship with Mid-Kansas/Riverside

Q. How did MGE begin the relationship that became Mid-Kansas II?

A. MGE entered a relationship with Mid-Kansas/Riverside through the acquisition by its parent company, Southern Union Company, of most of the Missouri gas distribution operations of WRI. Part of that acquisition was assumption by MGE of the gas-supply resources – contracts for pipeline and storage capacity, and for commodity supply – that WRI had used to serve the requirements of its customers in that service territory. One of those gas-supply resources was a set of agreements between WRI and the Bishop Group companies[5] which provided a bundled sales service to MGE's distribution system at a location in the Riverside area of Kansas City, Missouri. The agreements that comprise this service are referred to hereinafter as "Mid-Kansas I".

[4] How the filed rate doctrine applies in this instance is discussed by MGE Witness Langston in his Direct Testimony, at pages 5-6.

[5] The Bishop Group companies were the parent of Mid-Kansas/Riverside at that time..

Q. Why did MGE assume WRI's obligations under Mid-Kansas I?

A. Mid-Kansas I was part of the supply portfolio that was being used to serve the customers that MGE had acquired from WRI. MGE still needed supply resources, such as Mid-Kansas I, to provide those customers with gas supply. Secondly, an outside consultant to WRI had found that

> Maintaining and/or enhancing [WRI's] relationship with Bishop is desirable from a supply diversification standpoint and with respect to fostering competition for interstate system supplies.[6]

Also, the supply relationship that was the basis for Mid-Kansas I had been endorsed by the KCC and the MPSC,[7] and by the FERC.[8] Finally, Mid-Kansas I was among the obligations for which MGE proposed to accept assignment as part of the acquisition transaction as it was presented to the MPSC for approval. The Unanimous Stipulation and Agreement filed by the parties to the acquisition proceeding makes no mention of Mid-Kansas I, and the MPSC said nothing about the contract in its order approving the transaction. In those circumstances, there was simply no reason for MGE not to accept assignment of the contract.

Q. What happened in late April, 1994 to change those circumstances?

[6] See "KPL Gas Service, Blueprint for Gas Supply Management", Deloitte & Touche Management Consultants, August, 1991, at page 72. This study and another are referenced (at page 24) in the Rebuttal Testimony of Mid-Kansas/Riverside Witness Dennis M. Langley. These studies would have been available to Southern Union when it was considering whether to acquire WRI's gas distribution operations in Missouri.

[7] See "Joint Answer of Missouri Public Service Commission and Kansas Corporation Commission to Request of Williams Natural Gas Company for Stay and Joint Motion of Missouri Public Service Commission and Kansas Corporation Commission to Afford Parties an Opportunity to Address Issues Presented by Williams' Request for Rehearing", FERC Docket No. CP89-485, July 21, 1989, at page 9.

[8] See "Order Issuing Certificate and Approving Abandonment", FERC Docket No. CP89-983-000, issued September 18, 1989, at pages 7-8.

A. On April 29, 1994, the MPSC Staff filed its Recommendation in MPSC Case No. GR-93-140. That proceeding was to consider WRI's purchased-gas costs for the period July 1, 1992 through June 30, 1993. The Staff argued that certain amendments to the Mid-Kansas I contract, which had been agreed to in October, 1991, were not acceptable. Staff recommended that the MPSC disallow recovery of $ 1.3 million of purchased-gas costs for that ACA period.

Q. What did MGE do then?

A. On June 1, 1994, less than five weeks after the Staff filed its Recommendation in Case No. GR-93-140, MGE's parent, Southern Union Company, filed suit in U. S. District Court against WRI and the Bishop Group. A number of aspects of the relationship with the Bishop Group that had been assumed as part of the acquisition transaction were at issue in that proceeding; Mid-Kansas I was one of those aspects.

Q. Why didn't MGE simply terminate Mid-Kansas I?

A. Mid-Kansas/Riverside Witness Dennis Langley has testified that, because of Mid-Kansas/Riverside's financing, termination of the contract was not an option for the Company.[9] MGE Witness Michael Langston has also testified that, even if the litigation had been pursued further, he did not think that Mid-Kansas I could have been terminated;

[9] Rebuttal Testimony of Dennis M. Langley, page 23. See also pages 28-30 of Mr. Langley's deposition on October 28, 1998. (An excerpt from that deposition, including those pages, is attached to MGE Witness Michael T. Langston's Rebuttal Testimony as **Schedule MTL-12.**)

rather, he expected that it would be renegotiated.[10] The reason was that Mid-Kansas/Riverside had been financed with debt, and the revenue stream provided by its contracts had been pledged as collateral for the debt.[11] Consequently, Mid-Kansas I did not have a termination option.

Q. How could MGE have ended the relationship if it had wanted to?

A. My experience tells me that MGE would have had to buy out the Mid-Kansas I contract in order to end its relationship with Mid-Kansas/Riverside, or breach the contract and expose itself to a considerable liability for damages. In his Rebuttal Testimony, Mid-Kansas/Riverside's Witness Putman presented some estimates of the present value of the revenue stream committed under Mid-Kansas I. That number provides a sense of how much it would have cost MGE to buy out the contract, assuming that Mid-Kansas/Riverside and its lenders had been willing to accept a buy-out. Simply stated, a settlement payment of that magnitude would have been more costly than continuing to take service from Mid-Kansas/Riverside. Moreover, terminating the relationship with Mid-Kansas/Riverside and returning to the Williams Natural Gas Company pipeline system (WNG) would have negated prior efforts to diversify the Kansas City load center away from WNG, after those efforts had been endorsed by the KCC, the MPSC and the U. S. FERC. Finally, MGE would have incurred additional costs to replace the service that it had been receiving from Mid-Kansas/Riverside.

---

[10] *Rebuttal Testimony of Michael T. Langston, page 8. See also pages 12-13.*

[11] These arrangements are discussed in the Rebuttal Testimony of Mid-Kansas/Riverside Witness Wendell C. Putman, at page 11.

Q. What is the significance of the timing of MGE's lawsuit?

A. The point that I would emphasize is that, if MGE had decided that litigation was necessary to accomplish the adjustments to its relationship with the Bishop Group that it felt were necessary, including responding to Staff's concerns about Mid-Kansas I, it is hard for me to imagine more prompt action than five weeks after Staff's comments were filed in Case No. GR-93-140. As noted at the beginning of this testimony, I believe that MGE's actions in this matter clearly were prudent, both in their results, and in the process by which the Company reached those results. MGE's promptness in responding to concerns about its relationship with the Bishop Group companies, including the concerns expressed by the Staff, are a key point in my assessment of MGE's process.

Q. Then what happened?

A. An important development from my perspective is MGE's internal finding that it needed additional peak-day supply capacity to serve its customers' requirements in the Kansas City market area.

IV. MGE's Need for Additional Peak-Day Supply Capacity

Q. When did MGE realize that it needed additional peak-day supply capacity?

A. In his Rebuttal Testimony (at pages 8-9), MGE Witness Langston reported that MGE initiated a study of the adequacy of its peak-day supply resources as soon as the acquisition closed. That study revealed that MGE needed an additional 100,000 to 150,000 MMBtu/day of peak-day capacity in order to provide the needed level of supply reliability.

Notice that this evaluation was in progress during the time between the completion of the acquisition, on January 31, 1994, and the Staff's Recommendation in Case No. GR-93-140, on April 29, 1994. Mr. Langston's Rebuttal Testimony reports (at page 8) that the results of MGE's peak-day analysis were "shared with" the MPSC Staff in June, 1994.

Q. What do you expect would have happened next?

A. With a finding of a need for additional capacity in June, 1994, I would expect that MGE was exploring alternatives for provision of that capacity in the succeeding months; *i.e.*, in the summer and fall of 1994. The amount of additional capacity required – 150,000 MMBtu/day – is substantial. Notice that it is more than three times the supply capacity available under Mid-Kansas II. Thus, I expect that, at that time, that much capacity would not have been available without a substantial commitment, which would have been developed through fairly extensive discussions/negotiations with potential providers.

Q. *Is there evidence that MGE engaged in such discussions/negotiations?*

A. Yes. Internal documents provided by MGE suggest that such discussions did occur during that time frame. MGE Witness Langston refers (at page 9 of his Rebuttal

Testimony) to a study in early 1995 by an outside consultant of alternatives for obtaining the desired additional peak-day capacity. Indeed, as reported in my Rebuttal Testimony (pages 24-26), that consultant study built on work that MGE had done internally.

The consultant study concluded

> Of the options available to meet these additional requirements, the construction of a lateral in 1997 by [Mid-Kansas/Riverside] to interconnect MGE's Kansas City distribution system with the Panhandle Eastern system appears to offer the greatest net benefit to MGE and its ratepayers. This lateral would permit MGE to phase in contracts for upstream capacity as required, and would provide the Company with increased supply and transportation reliability and flexibility, as well as with greater bargaining leverage with its existing gas suppliers and with WNG for discounted firm transportation service. "Assessment of the Various Pipeline Expansion Alternatives Available to Serve MGE's Kansas City, Missouri Market", attached to the Rebuttal Testimony of MGE Witness Michael T. Langston as **Schedule MTL-10**, at page 12.

The lateral mentioned became the Riverside II arrangement.[12]

Q. Did Mid-Kansas/Riverside's alternative for providing the required peak-day supply capacity provide another reason for MGE to re-negotiate Mid-Kansas I, rather than trying to terminate it?

A. Yes. I noted above that, having assumed Mid-Kansas I as part of the acquisition of the WRI properties, MGE could not have terminated that agreement without a contract buy-out, the cost of which would have overturned any transportation-cost advantage that WNG might have had over Mid-Kansas I. The Bishop Group's attractive alternative for additional peak-day capacity was a second reason for MGE to resolve any concerns that it

[12] After construction had begun, Riverside II was sold to K N Energy. It is now providing service to MGE as part of K N's Pony Express system.

might have had with Mid-Kansas I through re-negotiation, rather than terminating the contract.

Q. Was MGE's evaluation of its options for the additional peak-day capacity going on at about the same time as its efforts to resolve the status of its relationships with the Bishop Group?

A. Yes. As previously noted, MGE identified its requirement for additional peak-day capacity between the time that the acquisition was finalized (January 31, 1994) and the time that the MPSC Staff filed its Recommendation in Case No. GR-93-140 (April 29, 1994), or shortly thereafter. As also noted above, that Recommendation could have been taken by MGE as a strong suggestion that the terms of Mid-Kansas I should be re-visited. MGE Witness Langston has testified that the requirement for additional capacity obliged the Company to seek resolution of other agreements with the Bishop Group that dealt with Bishop's possible role in providing that capacity.[13] As also noted, both of these matters (and perhaps others) were addressed in the lawsuit that was filed by MGE's parent on June 1, 1994. MGE's analysis of its alternatives in both matters proceeded through the summer and fall of 1994, in parallel with the litigation, and both matters were resolved through several contracts dated February 24, 1995. Again, it is difficult for me to imagine a group of issues, with the magnitude and complexity of these, being resolved more expeditiously than that.

[13] See page 9 of Mr. Langston's Rebuttal Testimony.

V. Response to Staff Witness Shaw

Q. What about Mr. Shaw's point that MGE should have known of Staff and Commission concerns about the Bishop Group relationship that had been expressed in earlier cases?

A. The most important point here is that the MPSC's decision in Case No. GR-93-140 was not issued until well after MGE's decision to enter into Mid-Kansas II. MGE was aware of the Staff's concerns about Mid-Kansas I; indeed, as I noted earlier, MGE filed suit to force its renegotiation on June 1, 1994, very soon after the Staff filed its Recommendation (April 29, 1994). Notice, however, that by the time the Hearing Memorandum was filed in that proceeding six months later (December 16, 1994), the question had been narrowed to removal of the price cap that was in that contract prior to the 1991 amendment. That issue was one of five to be addressed by the MPSC. Recall also that the old price cap could not be reimposed, as WNG had unbundled its rates and services pursuant to orders by the FERC.

At least two factors that, in my judgment, would have been important to MGE's decision regarding Mid-Kansas II are not mentioned in Mr. Shaw's analysis. First, MGE had an obligation under Mid-Kansas I that it could not ignore. (Recall Mid-Kansas/Riverside Witness Putman's testimony that buying its way out of that obligation would have been prohibitively expensive for MGE.) Second, MGE had discovered a peak-day supply-capacity deficit that it wanted to address. After exploring its options over the summer of 1994, MGE had concluded that an arrangement with Mid-Kansas's parent was the best available solution to that problem.

Mr. Shaw seems to suggest that MGE should have breached the contract because the MPSC Staff objected to it. I would remind Mr. Shaw that contract breach is an option with quite serious consequences, particularly in the context of utility companies who have obligations to provide service with a high degree of reliability. Contract breach is simply not a reasonable option.

What MGE did instead was to renegotiate the contract. As noted in my Rebuttal Testimony, and as conceded in the depositions of all three Staff witnesses, that renegotiation produced improved terms in many important respects.[14] In fact, when Mr. Shaw was asked whether there was any respect in which Mid-Kansas II was not better for ratepayers than Mid-Kansas I, he replied "I can't think of one, no." (Deposition Transcript of Thomas Shaw, October 28, 1998, page 58, line 25.)

Q. MGE's parent's Complaint to the District Court sought termination of Mid-Kansas I. Why didn't MGE continue to pursue the litigation?

A. Litigation is a costly, time-consuming process. No one can predict what the outcome will be. As has been discussed by MGE Witness Langston, there were a number of complex matters at issue in that litigation.[15] In those circumstances, the reasonable course was to try to settle, which is what MGE did.

[14] Deposition Transcript of Michael Wallis, October 26, 1998, page 38, lines 12-16; Deposition Transcript of David Sommerer, October 27, 1998, page 21, line 14, through page 22, line 20; Deposition Transcript of Thomas Shaw, October 28, 1998, page 28, lines 7-20; page 55, line 14, through page 56, line 23; page 58, lines 21-25. Pertinent segments of these transcripts are attached to this testimony as **Schedule JBA 16**.

[15] Rebuttal Testimony of Michael T. Langston, pages 7-9.

Q. But what about Mr. Shaw's point that the settlement allows the Bishop Group pipelines to charge maximum rates at a time when those pipelines were requesting significant rate increases?

A. In making this argument, Mr. Shaw overlooks several important points. First, the revisions agreed to in Mid-Kansas II were a considerable improvement over Mid-Kansas I. I presented a comparison between the two contracts in my Rebuttal Testimony,[16] so I will not repeat it here.

The second point is that Mid-Kansas/Riverside was not the only one seeking a rate increase at the time in question. WNG had a rate case in progress at the time that Southern Union acquired what became MGE. Moreover, in late January, 1995, WNG announced its intention to file another rate case. I discussed this point in further detail in my rebuttal testimony on page 25. Indeed, the record shows that a major reason for MGE to seek an accommodation with Mid-Kansas/Riverside was to gain some leverage over WNG in order to forestall additional rate increases in the future.[17]

Finally, Mr. Shaw's point implies that MGE should not have relied on regulators in Kansas and at the Federal level to do their respective jobs. Such an argument is disingenuous on Mr. Shaw's part. Would he have the MPSC believe that regulators in Kansas and at the Federal level either are not as diligent or not as effective as those in Missouri? As a regulated company, MGE has to assume that regulators in each jurisdiction will do their respective jobs, and that regulators in "downstream" jurisdictions -- such as Missouri in this case -- will respect the work of their "upstream"

[16] Pages 9-11. See especially **Schedule JBA-5**.
[17] See, *e.g.*, the discussion on this point in the Reed Study at pages 11-12. (**Schedule MTL-10**, pages 12-13.)

counterparts. Even if Mr. Shaw would wish to second-guess the decisions of his upstream counterparts, MGE cannot conduct its business as though it expects that to happen.

Q. What about Mr. Shaw's point about funding regulatory disallowances and the "keep-whole" provision?

A. Provisions such as Paragraph 4.4(a) in Mid-Kansas II, which I refer to as "regulatory-out" provisions, are quite common in gas-purchase contracts used by gas distribution companies (local distribution companies, or "LDCs"). Such provisions reflect the fact that, given the financial structure of most LDCs, those companies simply cannot afford to pay gas costs that they cannot recover.

Regulatory-out provisions have been common at least since the issuance of the FERC's Order 436, in 1985. Prior to that time, gas costs were allowed to flow into LDCs' rates more-or-less automatically, through purchased-gas-cost adjustment mechanisms. LDCs' purchased-gas costs came in the form of bundled charges for supply and transportation, billed pursuant to FERC Gas Tariffs. The pipelines had bought the gas, and the FERC had presumably determined the prudence of those purchases by authorizing the pipelines to recover their gas costs through their own rates and charges.[18]

After Order 436, however, the LDCs were responsible for purchasing at least a portion of their gas supplies directly. The LDCs' purchased-gas costs were then subject to a review for prudence by their State public utility commissions (PUCs). As noted

[18] In fact, most pipelines' gas-purchase contracts had regulatory-outs in them, as well, since the gas costs under a given contract were subject to adjustment for things like changes in NGPA categories.

above, the LDCs could not afford to pay gas costs that they could not recover. Thus, the regulatory-out provision enabled them to go back to the supplier for an adjustment in the event that some cost was disallowed.

The "keep-whole" provision in Mid-Kansas II is typical of a provision that is necessary for the party on the other side – the supplier side -- of the regulatory out. Projects with a committed revenue stream are often financed with a high proportion of debt in their capital structures. If, as in the case of Mid-Kansas/Riverside,[19] the revenue stream is used as collateral for repayment of the debt, a lender will finance a project on the basis of that revenue stream even if the project's sponsor is not expected to service the debt without that revenue.

A feature of financings of this type, however, is that an event that interferes with the project's revenue stream can trigger an event of default, which typically causes the entire loan to become due and payable immediately. To forestall this possibility, contracting parties put in a "keep-whole" provision, under which the duration of the revenue stream – and the schedule for repayment of the debt – is simply extended. Indeed, in a circumstance like the Mid-Kansas contracts, first with WRI and then with MGE, Mid-Kansas's lenders may well have insisted on a keep-whole provision.[20]

Q. What about Mr. Shaw's point that this language is similar to language in the Mid-Kansas I contract that had been found to be imprudent?

[19] See the Rebuttal Testimony of Wendell C. Putman, at page 11.

[20] Mid-Kansas/Riverside Witnesses Dennis Langley and Wendell Putman both mention the role of debt financing in the development of the Mid-Kansas/Riverside system, and the limits that the debt placed on their available courses of action. See Rebuttal Testimony of Dennis M. Langley, at page 10, and Rebuttal Testimony of Wendell C. Putman, at page 11.

A. First, we have to remember that the MPSC's decision in Case No. GR-93-140 was not issued until some months after the testimony and hearings in that case. Also, recall that the change which was found to be imprudent was the removal of the price cap, not the regulatory-out or the keep-whole provisions, nor was the MPSC's finding about the prudence of the entire contract. Thus, even if MGE had known what the MPSC was going to do about the price cap, the MPSC's decision did not end MGE's obligations under the contract. A finding of imprudence does not void the contract; rather, it limits the costs that MGE can recover under the contract. The contract itself was binding until it was changed. Moreover, as noted earlier, the price cap could not be reinstated because the FERC had required all pipelines, including WNG, to unbundle their rates and services.

MGE knew that it needed to make some changes in the Mid-Kansas contract. MGE also knew that it needed additional peak-day delivery capacity, and that the Bishop Group offered the most attractive alternative for meeting that need. The regulatory-out and keep-whole provisions were in Mid-Kansas I. As an entity with lots of experience in contracting for gas supplies and for gas transportation services, MGE was in a position to know that regulatory-out and keep-whole provisions were common features of gas-supply and transportation-service contracts (respectively). MGE also would have known from the representations of Mid-Kansas/Riverside personnel of the role of debt in the financing of Mid-Kansas/Riverside. MGE obtained a number of improvements to the contract, as all of the Staff witnesses have conceded. Mr. Shaw's concerns notwithstanding, MGE's action on the regulatory-out and keep-whole provisions was perfectly reasonable.

Q. What about Mr. Shaw's argument that capacity on WNG was available at a much lower price?

A. Mr. Shaw's argument benefits from hindsight. Mr. Shaw reports that, in early 1995, WNG's reservation charge was proposed to be $9.6832 per MMBtu/day. Mr. Shaw fails to mention that the quoted rate was the result of an increase of almost 20 percent, on top of a similar increase the year before. What MGE agreed to in Mid-Kansas II was a reservation charge of $15.5860 per MMBtu/day, subject to adjustment for the outcome of ongoing rate proceedings at the KCC and the FERC. After those adjustments and only those adjustments, however, the contract provided that Mid-Kansas/Riverside's transportation rates would increase by only two percent every three years for the remainder of the contract, with no other changes. Looking at the comparison from MGE's perspective in early 1995, WNG's rates were increasing so fast that it would have appeared that WNG's rates would soon catch up with Mid-Kansas/Riverside's, and then pass them.

Even with the Mid-Kansas II supply, MGE was looking at paying WNG's rates for over 90 percent of its supply, no matter how fast those rates went up. Under Mid-Kansas II, on the other hand, once the initial rate had been set through the pending rate cases, further increases were limited by the contract, regardless of what happened to Mid-Kansas/Riverside's costs. The only way that MGE was ever going to get any leverage over WNG's rate increases was to get in a position to divert a significant portion of its load away from WNG. And that diversion possibility is exactly what MGE accomplished with Riverside II.

The Riverside II agreement, concluded at the same time as Mid-Kansas II, provided for construction of a high-capacity lateral from the heart of MGE's service territory south to an interconnection with Panhandle. Once the Riverside II lateral was completed, MGE would be able to divert almost 25 percent of its peak day away from WNG, rather than only about ten percent. As noted by MGE's consultant,[21] this additional bargaining leverage could have yielded considerable discounts in the transportation charges that MGE had to pay to WNG.[22]

Q. What about Mr. Shaw's concern that the benefit of access to lower-priced gas via Mid-Kansas II expired when the FERC accepted jurisdiction over the Mid-Kansas/Riverside system?

A. MGE's access to lower-priced gas comes from having a physical connection to a different supply basin. That connection is provided by the Mid-Kansas/Riverside pipeline system. That connection did not go away with Mid-Kansas/Riverside's conversion to transportation service. MGE can still buy gas from Oklahoma when prices are favorable, and my understanding is that it is continuing to do so.

Q. What is Mr. Shaw's concern about the gas-cost incentive mechanism authorized by the MPSC in Case No. GO-94-318?

[21] This consultant was the Reed Consulting Group, and its report was attached to MGE Witness Langston's Rebuttal Testimony as **Schedule MTL-10**.
[22] See, especially, pages 12-13.

A. His point seems to be that Mid-Kansas II would help MGE's performance under a commodity-cost-only incentive mechanism, whereas it would hurt MGE's performance if the incentive mechanism worked off of total delivered costs (including transportation charges). Mr. Shaw's point overlooks the fact that most gas-cost incentive mechanisms do not include capacity-reservation charges because the companies have so little control over those charges. I have recently done some work on gas-cost incentive mechanisms. The approaches that I am familiar with do not blend capacity costs and commodity costs into a delivered-cost mechanism, such as Mr. Shaw seems to favor, for the reason given (inability of the companies to influence capacity-reservation charges). It is my understanding, based on my own work and on conversations with colleagues who also do studies in this area, that no gas-cost incentive mechanism in use anywhere in the U. S. works off of a delivered-cost parameter, such as Mr. Shaw seems to be suggesting.

Even if Mr. Shaw's concern about the structure of MGE's proposed incentive mechanism were valid, which I don't think it is, it would have nothing to do with the question of whether MGE acted prudently in entering into Mid-Kansas II. The two questions are unrelated because, as Mr. Shaw acknowledges,[23] MGE could not have known what the MPSC was going to do about the incentive mechanism at the time that it entered into Mid-Kansas II.

VI. Conclusion

Q. So what do you conclude regarding Mr. Shaw's concerns?

[23] Rebuttal Testimony, at page 12 (lines 14-16).

A. As noted at the beginning of his testimony,[24] Staff Witness Shaw concedes that MGE's decision in entering into Mid-Kansas II has to be evaluated on the basis of information known and available at the time that the decision was being made. But then Mr. Shaw's arguments fail that test. In late 1994 and early 1995, MGE could not have known how the following matters were going to turn out:

- The pending ACA proceeding in Case No. GR-93-140;
- The pending litigation in the Western District Court of Missouri;
- Whether WNG's rates were going to keep rising as rapidly as they had in the time that MGE had been dealing with that pipeline; or
- What the MPSC was going to do about a gas-cost incentive mechanism.

Things that MGE did know at that time, and that were at least as important in MGE's decision-making processes as the factors listed above, included the following:

- The only way that MGE was ever going to gain any possibility of limiting WNG's rapidly-increasing rates was by threatening to divert a significant portion of its load to another pipeline(s);
- MGE had an immediate need for 100,000 to 150,000 MMBtu/day of additional peak-day supply capacity;
- The most cost-effective option available at the time for obtaining the additional supply capacity involved a gas-supply lateral, to be built by the Bishop Group, which would connect MGE's system to Panhandle's;
- The Mid-Kansas/Riverside pipeline system offered access to a supply region with lower gas prices than those available through the other pipelines serving MGE's city gates.

In these circumstances, MGE took what is, to me, the logical option, namely to negotiate a set of arrangements with the Bishop Group that both a) provided the additional peak-day supply capacity that MGE needed, and b) improved the terms of its

[24] Ibid., at page 6 (lines 2-4).

existing supply relationship with the Bishop Group. Trying to put myself in MGE's position at that time, Mr. Shaw's preferred option, ending the contract with Mid-Kansas/Riverside, would be inferior because it would have increased costs in at least three ways:

1. MGE would have had to make a large settlement payment in order to terminate its contract with Mid-Kansas/Riverside (assuming that Mid-Kansas/Riverside's lenders would permit termination of the contract);

2. MGE would have lost access to the Oklahoma supply region. That access would have been replaced by increased reliance on supply regions where field prices are higher;

3. MGE would have lost bargaining leverage with WNG, which would almost certainly have resulted in higher prices for the very large proportion of its requirements that have to be delivered by WNG, even after exercising its Mid-Kansas II and Riverside II options.

VII. MGE's Decision Process

Q. What is the role of MGE's decision process in the determination of prudence?

A. I notice in the MPSC's decision in Case No. GR-93-140 that the Commission stated that

> The Commission is of the opinion that evidence relating to the decision-making process is relevant to the extent that the existence of a prudent decision-making process may preclude the adjustment. Report and Order, dated July 14, 1995, in Case No. GR-93-140, at page 15.

Q. What evidence is there regarding MGE's decision-making process in deciding to enter into Mid-Kansas II?

A. In his Rebuttal Testimony (at pages 7-13), MGE Witness Langston discusses the events and decision processes that led up to MGE's entering into Mid-Kansas II and the related agreements, and to the simultaneous settlement of the District Court litigation. The only item that I would add to that discussion is that MGE clearly did considerable analysis of its alternatives internally, as well as having a consultant analyze those alternatives. Evidence of that internal work is contained in an internal analysis memorandum, dated January 25, 1995, that I referred to on page 25 of my Rebuttal Testimony. (See Footnote 35.)

Q. And what is your opinion of MGE's decision-making process in this matter?

A. My opinion is that MGE did everything that it is reasonable to expect them to have done to develop options and to analyze those options prior to entering into the Mid-Kansas II contract. Even if I had questions about the results of MGE's decision-making in the case of Mid-Kansas II, which I do not, I would advise the MPSC that the process used to evaluate this decision was prudent.

VIII. Overall Conclusions

Q. Please summarize your testimony.

A. While Staff Witness Shaw concedes that MGE's decision to enter into Mid-Kansas II has to be evaluated on the basis of information known and available at the time the decision was made, he proceeds to find fault with that decision on the basis of information that I believe that MGE could not have known at the time that it made the decision. Moreover, Mr. Shaw ignores factors that were important to MGE's decision at the time, and the analysis that the Company did of its available options. That analysis supported the decision that MGE reached.

I also find the process by which MGE reached its decision to be prudent and reasonable. On the basis of my analysis, I recommend that the MPSC reject the Staff's recommendation for a disallowance, find that MGE's decision to enter into Mid-Kansas II was prudent and reasonable, and authorize MGE to recover all of the costs incurred under that contract through its purchased-gas-adjustment mechanism.

Q. Does that conclude your Surrebuttal Testimony?

A. Yes, it does.

Areas of Specialization

Strategic analysis and business planning; gas supply and procurement strategy; gas marketing strategy; U.S. and Canadian gas industry regulation. Also, management studies for public utility commissions.

Relevant Experience

Strategic Analysis and Business Planning

Consultant on a merger-benefits study performed for an electric distribution cooperative and a local farmers' cooperative.

Lead consultant on a business-enhancement project for a Rocky-Mountain-area electric cooperative. Responsible for diversification-planning task.

For an investment banking group, identified themes for enhancing the value of gas distribution and transmission/storage business segments through acquisitions, and used those themes to develop criteria for acquisitions.

Co-directed a project to develop a comprehensive unbundling strategy for a gas distributor with operations in 12 states.

Directed a project to assist an electric utility in exploring opportunities in related businesses. Options considered included gas pipeline and storage projects; distribution of other fuels including natural gas, propane and heating oil; and ventures in telecommunications.

For a combination electric and gas utility company in the midwest U.S., participated in a major re-evaluation of its strategy for its gas business unit.

For a major Canadian pipeline company, prepared an analysis of strategic factors in U.S. pipeline industry mergers. Subsequently presented findings of the study to the company's Corporate Strategy and Policy Committee.

For an investor group, evaluated three gas-gathering systems and an intra-state pipeline for possible acquisition. One gathering system was acquired, and a workout plan was developed. Now serve as Chairman of companies formed to own and operate the acquired system.

For two gas distribution companies, consulted on strategy development for non-utility subsidiaries.

For a syndicate of U.S. and Canadian commercial banks, evaluated financing and tariff restructuring for a major U.S. interstate pipeline company.

For a major Canadian pipeline company, prepared a study of possible changes in rate design and capacity planning with decontrol of the Canadian gas market. Also researched pipeline capacity allocation problems and their relationship to rate design.

Conducted several assignments in business strategy development for gas distribution companies: market segmentation, cost allocation, structuring tariffs and service contracts, *etc.*

Evaluated several U.S. pipeline companies for possible acquisition by investor groups.

Participated in evaluation of the economic viability of gas-fired cogeneration projects for equity investors and banks. Evaluations included the impact of possible regulatory change.

Natural Gas Supply Strategy

For two municipal electric power systems, directed an evaluation of capacity availability on a pipeline-system segment serving a large number of gas-fired electricity-generating facilities. The results of that evaluation were used to develop alternative approaches to gas-supply contracting for a generating facility owned by the cities.

For Kansas Pipeline Operating Company, evaluated certain gas supply contracts entered into by Western Resources' KPL Gas Service Company, and Southern Union's Missouri Gas Energy. Presented testimony to the Kansas Corporation Commission, and to the Missouri Public Service Commission.

Performed gas supply evaluations as part of a general work process improvement study for a power-supply cooperative in the southeast U. S.

For a steam utility in Pennsylvania, solicited offers for gas supply, and helped evaluate the responses.

For the Potomac Electric Power Company, assisted in the development of comprehensive policies and procedures for fuels procurement. Responsible for gas acquisition policies and procedures.

Directed development of a gas supply strategy for a power-supply cooperative's first combustion turbines. (Coop's generation previously all coal-fired.)

For Delmarva Power & Light Company, assisted an internal review of gas supply planning for electric power generation.

Served as gas supply consultant to two major Midwestern gas distributors. In that capacity, directed development of long-term supply plans, short-term contracting strategies, and peak-load management plans. Also provided staff support to teams formed to negotiate with producers regarding long-term gas supply contracts, and with pipelines regarding conditions of service.

Directed quantitative analysis of particular supply decisions, and did documentation projects.

For an investment banking group, explored the influence of the Midland Cogeneration Project's gas supply contracts on the Project's economic viability.

For the Interstate Natural Gas Association of America (trade association of gas pipeline companies), participated in a comparative study of supply contracting practices for gas, coal, and fuel oil. Developed recommendations for gas supply contracting.

For the Wisconsin Distributors Group, directed an analysis of gas supply alternatives for the State of Wisconsin. Directed a similar study of gas supply alternatives for the municipal Gas Department of the City of Charlottesville, Virginia.

Natural Gas Marketing Strategy

Assisted a production-area storage developer in identifying prospective users of a proposed storage facility, and in marketing interests in the project.

For National Fuel Gas Supply Corporation, analyzed potential markets for gas storage and pipeline capacity in particular sectors and particular geographic areas. Also recommended opportunities in electric utility industry restructuring for consideration by NFGS management.

For an offshore supplier of LNG, participated in an evaluation of North America as a potential market for its gas.

For the municipal Gas Department of the City of Charlottesville, Virginia, directed a rate design study. Also recommended modifications to customer service agreements.

For the Canadian Petroleum Association and the Independent Petroleum Association of Canada, participated in an analysis of regional markets for Canadian gas in the U.S.

For various U.S. and Canadian gas producers, evaluated particular regional and sectoral gas markets in the U.S. Also developed strategies for market penetration.

For U.S. and Canadian producers and pipeline companies, directed analyses of alternative gas transportation systems. Also for U.S. gas distribution companies.

For U.S. and Canadian gas pipelines and marketers, participated in preparation of a multi-client study of the market for residual fuel oil. Also developed strategies for gas sellers to use in competing with residual oil.

U.S. and Canadian Gas Industry Regulation

Currently serving as an extension of the Staff of the Connecticut Department of Public Utility

Control for its consideration of the winter 2000/2001 purchased-gas adjustments of the three gas distributors in Connecticut, Connecticut Natural Gas Corporation, The Southern Connecticut Gas Company and Yankee Gas Services Company.

Currently serving as an extension of the Staff of the Connecticut Department of Public Utility Control for its consideration of an audit of the affiliate relationships of The Southern Connecticut Gas Company.

Currently serving as an extension of the Staff of the Connecticut Department of Public Utility Control for its consideration of proposed incentive rate plans for The Southern Connecticut Gas Company and Connecticut Natural Gas Corporation. Principal responsibilities are gas-cost reduction incentives, and comparative analysis of plans used in other jurisdictions.

Served as an extension of the Staff of the Connecticut Department of Public Utility Control for its consideration of Consolidated Edison Company's proposed acquisition of Northeast Utilities. Principal responsibilities included affiliate relationships and evaluation of the effects of the transaction on gas supply.

Presented expert witness testimony on FERC rate-design policy to a pipeline-rates proceeding before the Railroad Commission of Texas.

Served as an extension of the Staff of the Connecticut Department of Public Utility Control for two distribution-company rate cases (The Southern Connecticut Gas Company and Connecticut Natural Gas Corporation), and one facilities-certification proceeding.

For the staff of a regulatory commission in the northeast U.S., evaluated a gas-service and capacity-release project that was proposed by a jurisdictional utility.

Directed Liberty's analysis for the Georgia Public Service Commission of the impacts of FERC's Order 636 on gas rate structures in Georgia.

Prepared and presented a seminar on U.S. regulation of oil and gas pipelines for staff members of the Argentina Task Force on Privatization of the Oil Industry.

For a syndicate of U.S. and Canadian commercial banks, prepared an analysis of the influence of certain FERC Gas Tariff issues on pipeline cash flow. Also provided technical support to a "due diligence" investigation for project-type financing.

For a major U.S. pipeline company, prepared an analysis of certain Federal (FERC, Council on Environmental Quality) and State (California) regulatory issues.

Directed an evaluation of the marginal costs of the District of Columbia Natural Gas Company, a division of the Washington Gas Light Company, for the Public Service Commission of the District of Columbia.

For Yankee Gas Marketing (now Enron Access Energy), directed an analysis of line-of-business restrictions as applied to the gas industry. This analysis was attached to Yankee's filing in the FERC's rule-making proceeding regarding rules of conduct for pipeline-affiliated marketers (proceeding resulted in the issuance of FERC Order 497).

For the U.S. Department of Energy, financial institutions, pipelines, and distribution companies, prepared various studies exploring the impacts of regulatory change on segments of the gas industry and on specific firms.

For the U.S. Department of Energy, participated in a study of Canadian gas export policies, and the potential influence on U.S. policies toward gas imports.

Served as Director of the U.S. Federal Energy Regulatory Commission's Alaska Gas Project Office. Evaluated financing and tariff aspects of gas transportation system proposals. Responsible for policy development, managing FERC proceedings, representing the FERC to government and industry, and liaison with counterpart officials in the Government of Canada.

Served as Director of the U.S. Federal Energy Administration's Office of Energy Project Operations. Evaluated legislative and regulatory impediments to energy project development. Recommended changes and prepared testimony.

As a Policy Analyst for the Federal Energy Administration, produced research, analysis, writing, and recommendations in oil and gas exploration and production, price control and allocation programs for crude oil and petroleum products, and the international petroleum market.

Management Studies for Public Utility Commissions

Lead Consultant on Liberty's examination of cost allocation issues at Arkansas Western Gas Company for the Arkansas Public Service Commission. Responsible for the review of staffing levels.

Lead Consultant on Liberty's management audit of The Southern Connecticut Gas Company for the Connecticut Department of Public Utility Control. Responsible for reviews of gas supply and marketing activities, and coal tar remediation activities.

Lead Consultant on Liberty's management audit of Connecticut Natural Gas Corporation for the Connecticut Department of Public Utility Control. Responsible for reviews of gas supply and marketing activities.

Managed Liberty's audit of the gas purchasing and supply management policies and practices of K N Energy, Inc. for the Wyoming Public Service Commission. Responsible for the reviews of gas acquisition, gas transportation and storage, relationships with affiliates, and response to regulatory change. Conducted supplemental evaluations in response to Liberty's initial findings, and presented testimony to the Commission in the proceeding to consider K N's pilot program for unbundling its services in Wyoming.

Lead Consultant on Liberty's management audit of Yankee Gas Services Company for the Connecticut Department of Public Utility Control. Responsible for the review of gas supply activities and coal tar remediation activities.

Consultant on Liberty's management audit of the Tennessee operations of United Cities Gas Company for the Tennessee Public Service Commission. Responsible for reviews in system operations, marketing, and affiliate relationships.

Lead Consultant on Liberty's audit of gas purchasing policies and practices at Pike Natural Gas Company and Eastern Natural Gas Company for the Public Utilities Commission of Ohio. Responsible for the reviews of gas acquisition, gas transportation services, and response to regulatory change.

Consultant on Liberty's audit of the affiliate relationships of Public Service Enterprise Group (holding company for Public Service Electric & Gas Company) for the New Jersey Board of Regulatory Commissioners. Responsible for reviews of systems and processes, affiliate relationships, and transaction analysis with regard to (a) the purchase of gas from the Group's gas-producing subsidiary, (b) the purchase of electric power from the Group's IPP subsidiary, and c) the Group's real estate subsidiary.

Led the evaluation of gas supply activities as part of Liberty's management audit of New York State Electric & Gas Corporation for the New York Public Service Commission.

Lead Consultant on a general management audit of the Peoples Natural Gas Company, a subsidiary of Consolidated Natural Gas Corporation, for the Pennsylvania Public Utility Commission. Responsible for the review of gas-supply activities.

Other Experience

As a geologist for Mobil Oil Corporation, conducted oil and gas exploration activities in Libya and Indonesia.

Education

M.S., *cum laude*, Geology and Geophysics, The Massachusetts Institute of Technology
B.S., *cum laude*, Earth Sciences and Chemical Physics (double major), The Massachusetts Institute of Technology

Publications and Conference Presentations

Presented a paper entitled "The Alaska Gas Pipeline: Déjà Vu All Over Again" to the Deutsche Banc Alex. Brown 2001 Global Energy Perspectives Conference. February 2001.

Presented a paper entitled "Regulatory Perspectives on Performance-Based Rate-Making" to a meeting of the Rates and Strategic Issues Committee, American Gas Association. April 2000.

Presented a paper entitled "Capital Budgeting for the New Millenium" at the Conference on Gas Company Productivity and Management, sponsored by the Institute of Gas Technology. November 1999.

Presented a paper entitled "Can the Conflict Between Maintenance/Replacement Projects and Expansion/Upgrade Projects Be Mitigated by Using a Different Approach to Capital Budgeting?" at the Conference on Gas Company Management Under Limited Budgets, sponsored by the Institute of Gas Technology. October 1998.

Presented a paper entitled "Skills for Effective Competition" at the IGT Technical Business Forum on Enhancing Corporate Performance, sponsored by the Institute of Gas Technology. September 1997.

Panelist on Contract Abandonment at a public seminar entitled "Natural Gas: The Regulatory Crisis Now," sponsored by *The Energy Daily*. July 1987.

Presented a paper on the natural gas pipeline industry to *The Energy Week* Conference, held annually by The First National Bank of Chicago. April 1987.

Presented a paper entitled "New Approaches to Gas Supply Strategies" at a symposium entitled The Outlook for Gas Distributors in the New Market Place, sponsored by the Institute of Gas Technology. November 1986.

Presented a paper entitled "Diversification Issues in the Natural Gas Industry" to the Williamsburg Conference on the Institute of Public Utilities. December 1984. Later published in *The Impact of Deregulation and Market Forces on Public Utilities: The Future Role of Regulation*, edited by Patrick C. Mann and Harry M. Trebing (MSU Public Utilities Papers, 1985).

Presented a paper entitled "International Competition in the California Gas Market" at the Annual North American Conference of the International Association of Energy Economists. November 1984.

Presented a paper on the Alaska Natural Gas Transportation System entitled "The Intersection of 'Public' and 'Private': Studies in Energy Decision Making" to a panel at the Annual Meeting of the American Political Science Association. August 1984.

PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Gas Cost Adjustment Tariff Revisions to be Reviewed in its 1996-1997 Annual Reconciliation Adjustment Account.	Case No. GR-96-450 October 28, 1998 Jefferson City, Mo.

DEPOSITION OF THOMAS SHAW,

a witness, produced, sworn and examined on the 28th day of October, 1998, between the hours of 8:00 a.m. and 6:00 p.m. of that day at the law offices of Brydon, Swearengen & England, 312 East Capitol, in the City of Jefferson, County of Cole, State of Missouri, before

KELLENE FEDDERSEN, CSR, RPR
ASSOCIATED COURT REPORTERS, INC.
714 West High Street
P.O. Box 1308
JEFFERSON CITY, MO 65109
(573) 636-7551

and Notary Public within and for the State of Missouri, commissioned in Cole County, in the above-entitled cause, on the part of MGE, taken pursuant to agreement.

Q. I assume it's not your testimony that you expect an LDC to have transportation rates with various suppliers that are always identical; is that a safe assumption?
A. It would be a very rare occasion that they all would be identical, yes.
Q. So more often than not there is some differences between the transportation rates paid by the same LDC for -- or to different pipelines for firm transportation service?
A. That is not uncommon at all.
Q. So it's not your testimony that's imprudent, the fact that there is a difference, by itself that there are differences in reservation charges paid by the LDCs?
A. That's correct.
Q. Okay. Can you describe for me at what level you -- a difference becomes imprudent? Is it when there's a 10 percent difference, 15 percent difference, 20 percent? Where do you draw the line?
A. I think what we attempted to do when I was in the Procurement Analysis Department was any time a -- because if we hadn't challenged the contract when it was executed, and a lot of times we came in and some of the contracts were in like the fourth year of

PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Gas Cost Adjustment Tariff Revisions to be Reviewed in its 1996-1997 Annual Reconciliation Adjustment Account.	Case No. GR-96-450 October 26, 1998 Jefferson City, Mo.

DEPOSITION OF MICHAEL WALLIS,

a witness, produced, sworn and examined on the 26th day of October, 1998, between the hours of 8:00 a.m. and 6:00 p.m. of that day at the law offices of Brydon, Swearengen & England, 312 East Capitol, in the City of Jefferson, County of Cole, State of Missouri, before

KELLENE FEDDERSEN, CSR, RPR
ASSOCIATED COURT REPORTERS, INC.
714 West High Street
P.O. Box 1308
JEFFERSON CITY, MO 65109
(573) 636-7551

and Notary Public within and for the State of Missouri, commissioned in Cole County, in the above-entitled cause, on the part of MGE, taken pursuant to agreement.

COPY
Associated Court Reporters, Inc.
Jefferson City, MO (573) 636-7551

there was this opportunity to get out of the 1990 contract?

A. That's possible. I haven't seen the document.

Q. I understand that. I don't understand a lot of other things you're saying, but I understand you haven't seen the document.

MR. DUFFY: Let's take a five-minute or ten-minute break.

(A BREAK WAS TAKEN.)

BY MR. DUFFY:

Q. Mr. Wallis, would you agree that after the January '95 renegotiation of the Mid-Kansas contract, that MGE got more favorable gas pricing terms as a result of those negotiations?

A. I think that's correct.

Q. Do you have any evidence that MGE would have been able or had the opportunity to take that favorable pricing for the gas and simply switch delivery vehicles from Mid-Kansas to Williams?

A. No.

Q. Did you read Mr. Langston's direct testimony in this case?

A. I did. It's been some time ago, but yes, I did read that.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Gas Cost Adjustment Tariff Revisions to be Reviewed in its 1996-1997 Annual Reconciliation Adjustment Account	)	Case No. GR-96-450

DEPOSITION OF DAVID SOMMERER,

a witness, sworn and examined on the 27th day of October, 1998, between the hours of 8:00 a.m. and 6:00 p.m. of that day at the law office of Brydon, Swearengen & England, 312 East Capitol Avenue, in the City of Jefferson, County of Cole, State of Missouri, before

KRISTAL R. MURPHY, CSR, RPR, CCR
ASSOCIATED COURT REPORTERS, INC.
714 West High Street
Post Office Box 1308
JEFFERSON CITY, MISSOURI 65102
(573) 636-7551

Notary Public, within and for the State of Missouri, in the above-entitled cause, on the part of the MGE, taken pursuant to agreement.

change in the contractual relationship with Mid-Kansas at that time.

And so although we don't have any direct evidence to say that they could have gotten away from the contracts without penalty, we don't have any evidence saying that they would have had any penalties had they renegotiated the contracts with Mid-Kansas. In fact, we didn't see any penalties when they renegotiated the 1990-'91 agreements.

Q. Did the term of the '90-'91 agreement change in the renegotiation in 1995, in other words, the expiration date of the contract?

A. Not to my knowledge.

Q. There was a reduction in the gas commodity portion, was there not --

A. I --

Q. -- the price of the gas commodity?

A. I think that's correct.

Q. And you would presume that that was a good thing, because that would lower the ultimate price of gas to the ratepayers of Missouri Gas Energy?

A. That's correct.

Q. And so you would applaud MGE's efforts in that regard, I assume?

A. I think that was a beneficial aspect of the renegotiation.

Q. What other major changes took place in that 1995 renegotiation?

A. I don't know that this is all-encompassing or totally comprehensive, but MGE agreed to a 2 percent escalation factor as part of that '95 agreement. I think that was something that was new.

They may have had a little bit more flexibility with the way they took gas pursuant to the agreement.

There were some specific references to KCC cases, Kansas Corporation Commission cases, in the agreement that I don't believe were referred to in the 1990 or '91 agreement.

There was a discussion of how to handle the TRANSOK lease in the 1995 agreements. I don't believe that there was anything specific in the 1990 or '91 agreements regarding the TRANSOK lease.

Off the top of my head, that's all I can remember.

Q. Of the major changes we've just discussed, what ones or combinations of those things lead you to believe that MGE could have negotiated a complete termination of the '90-'91 contract?

A. I don't think any of those changed

PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Gas Cost Adjustment Tariff Revisions to be Reviewed in its 1996-1997 Annual Reconciliation Adjustment Account.	))))))	Case No. GR-96-450 October 28, 1998 Jefferson City, Mo.

DEPOSITION OF THOMAS SHAW,

a witness, produced, sworn and examined on the 28th day of October, 1998, between the hours of 8:00 a.m. and 6:00 p.m. of that day at the law offices of Brydon, Swearengen & England, 312 East Capitol, in the City of Jefferson, County of Cole, State of Missouri, before

KELLENE FEDDERSEN, CSR, RPR
ASSOCIATED COURT REPORTERS, INC.
714 West High Street
P.O. Box 1308
JEFFERSON CITY, MO 65109
(573) 636-7551

and Notary Public within and for the State of Missouri, commissioned in Cole County, in the above-entitled cause, on the part of MGE, taken pursuant to agreement.

COPY
Associated Court Reporters, Inc.
Jefferson City, MO (573) 636-7551

willing to agree to when it settled these cases.

Q. What else?

A. I think probably that's it.

Q. Is it true that you're being paid $50 an hour for your services, your consulting services?

A. That's true.

Q. Do you believe that MGE achieved any benefits for the ratepayers under the '95 contract?

A. Yes.

Q. What were those?

A. A reduction in the commodity cost, which we've talked about before, and then there is a limitation on the amount that the reservation charges can increase. I'm not sure if that's 2 percent every three years or 3 percent every two years.

But on a going forward basis it was set at the KCC, and now I think it's been FERC rates, and it was only allowed to escalate based on that specified percentage rather than potential cost of service rates that could come out of further regulatory review.

Q. What evidence do you have that MGE could have achieved further benefits in that '95 negotiation?

A. Again, I'm not aware of all of the facts or knowledge that MGE had during this period of time, do a comparison of the Mid-Kansas 1 contract and the Mid-Kansas 2 contract?

A. No, I've not made such a comparison.

Q. Are you intending to do so in your testimony?

A. No, I don't believe.

Q. Have you read Mid-Kansas 1?

A. Yes, I have read it.

Q. You answered some questions, I believe, that Mr. Duffy had asked regarding the lower commodity costs and fixed transportation rates. Do you recall those questions?

A. Yes.

Q. Do you recall indicating that the commodity price and transportation terms were more favorable to MGE under Mid-Kansas 2 than under Mid-Kansas 1?

A. I did make that statement.

Q. I don't recall if Mr. Duffy asked this question. Are you familiar with the fact that under Mid-Kansas 1 there was a buying limitation of takes to 4 BCF a year, but under Mid-Kansas 2 that volume limitation was eliminated and MGE had the right to take 46,332 MMBtu every day?

A. I'm aware of that fact, yes.

Q. Will you agree that is a favorable provision for MGE as the LDC to have the buying limitation lifted?

A. Certainly since they had access to a cheaper gas supply, a historically cheaper gas supply, it made sense to transport as much of that cheaper gas supply as you possibly could to offset the cost of the reservation.

Q. And that historically cheaper gas you're referring to is the gas off the TRANSOK system, correct?

A. That's right.

Q. When you say historically low cost supply, is that -- would you agree that TRANSOK supplies has historically been cheaper than, say, the Williams supply or Panhandle supply or Mid-Continent supply in general?

A. Certainly through the time where I testified on the gas supply incentive case, that was the case. I have not kept up with any differential in the indices after that point in time.

Q. It wouldn't surprise you, then, would it, if that historical trend continued forward?

A. No, that would not surprise me.

Q. Are you intending to do a comparative analysis of those commodity prices for your testimony?

to the Mid-Kansas 1 contract that was less favorable to MGE and -- rather than more favorable?

Let me clarify. Is there any provision in the Mid-Kansas 2 contract that was to the detriment of MGE that wasn't in the Mid-Kansas 1 contract?

A. I need to qualify my answer and the fact that when I read the Mid-Kansas 2 contract, that was subsequent to the ACA period that was under review and that we were discussing settlement of.

Although I was aware, generally aware of the changes that were made from prior to February '95 to subsequent to February of '95, we were aware that there was ratepayer benefits associated with that compared to the previous contract that was in effect.

Can I go back and say -- go through every provision and say it is detrimental to the ratepayer? I don't have that type of familiarity with the contract. I've not even, I don't believe, looked at the contract to any great extent subsequent to the settlement negotiations.

Q. So sitting here today, you cannot think of one single detriment to the ratepayers that's embodied in the Mid-Kansas 2 contract compared to the Mid-Kansas 1 contract?

A. I can't think of one, no.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Gas Cost Adjustment Tariff Revisions To Be Reviewed in its 1996-1997 Annual Reconciliation Adjustment Account.	))))	Case No. GR-96-450

County of MONTGOMERY)
State of MARYLAND)

AFFIDAVIT OF JOHN B. ADGER, JR.

John B. Adger, Jr., being first duly sworn, deposes and states that he is the witness who sponsors the accompanying testimony and schedules entitled surrebuttal testimony; that said testimony and schedules were prepared by him or under his direction and supervision; that if inquiries were made as to the facts in said testimony and schedules, he would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his knowledge, information and belief.

John B. Adger, Jr.

Subscribed and sworn to before me this 11th day of July, 2001.

Notary Public

My Commission expires:

6/1/05