THIS IS MGE's PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

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 et al.

REPORT AND ORDER

I. Findings of Fact

A. Procedural History

This is a review of four Actual Cost Adjustment (ACA) periods of Missouri Gas Energy (MGE), a division of Southern Union Company. The years under review are 1997-1998, 1998-1999, 1999-2000, and 2000-2001 and are represented by Case Nos. GR-98-167, GR-99-304, GR-2000-425 and GR-2001-382. The Staff of the Missouri Public Service Commission (Staff) filed its recommendation for the 2000-2001 ACA period on May 31, 2002. The Commission ordered the four cases consolidated by its order dated September 10, 2002, and set a procedural schedule by order dated November 4, 2002. Hearings were held both in May and November 2003.

In each of the consolidated cases Staff has questioned the cost of MGE's transportation contract with Riverside Pipeline/Mid-Kansas Pipeline (KPC contract issues). In the 2000-2001 ACA period Staff has raised questions about MGE's decision not to post unused KPC capacity for release; the adequacy of MGE's hedging levels; MGE's use of its storage gas volumes; and the adequacy of MGE's 20000 Reliability Report.

The Commission stayed consideration of the KPC contract issues pending judicial resolution of an appeal by KPC of the Commission's decision in Case No. GR-96-450 but decided to proceed to hearing with the other issues. As a result, the only issues for consideration by the Commission at this time in this case are the four issues raised in the 2000-2001 ACA period and reflected in the Statement of Issues. The Commission recognizes that because it is not disposing of all issues in this case at this time as a result of its previous order bifurcating the issues, this Report and Order does not qualify as a final order for purposes of appellate review.

MGE is a public utility engaged in the provision of natural gas service to the general public in the state of Missouri and, as such, is subject to the general jurisdiction of the Commission pursuant to Chapters 386 and 393, RSMo 2000.

B. General Nature of the Staff's Proposed Disallowances

The Staff is currently proposing that the gas costs reflected in MGE's ACA rate be reduced by a total of $3,912,693 to account for allegedly imprudent actions by MGE during the applicable ACA period, which is July 1, 2000 through June 30, 2001. This is a substantially lower amount than originally proposed by Staff. This total does not include allegations concerning the KPC contract issues, discussed previously.

Specifically, Staff proposes a disallowance of $858,158 to measure the alleged ratepayer harm because MGE did not post its temporarily idle KPC capacity for release or take other steps to market it during the ACA period (KPC Capacity Release issue). Staff proposes a disallowance of $130,137 to measure the alleged ratepayer harm for MGE not having a formal and documented hedging plan for the ACA period (Hedging issue). Finally, Staff proposes a disallowance of $2,924,398 to measure the alleged ratepayer harm arising from MGE's use of its storage gas during the period (Storage issue). The Staff also raised an issue regarding the alleged need for more information pertaining to MGE's 2000 Reliability Report. There is no dollar disallowance proposed for this issue (Reliability Report issue). MGE opposes each of the Staff's proposals.

The Missouri Public Service Commission makes the following findings of fact:

C. KPC Capacity Release

MGE is served by several interstate pipelines. These include Williams, Kinder Morgan, Panhandle Eastern and KPC. MGE reserves capacity on these pipelines in order to meet peak customer demands in the winter. Staff pointed out that MGE did not use its reserved capacity on KPC in the summer months of the 2000-2001 ACA period (i.e., July through October 2000 and April through June 2001). MGE agrees that it did not post the idle KPC capacity for release during the ACA period. MGE contends that it knew such an action would have been pointless and that its knowledge was the result of factors specific to the KPC system that make any such release virtually impossible. MGE proved that there has never been a capacity release on the KPC system during its existence as an interstate pipeline.

The issue raised by Staff is whether MGE should have advertised or marketed that idle capacity. Specifically, Staff stated in its May 31, 2002, Memorandum that MGE could have released its Riverside I contract on KPC on a non-recallable basis, thereby allegedly maximizing the capacity's value. Alternatively, Staff argued that MGE could have released an equal amount of capacity on the Williams pipeline but shipped an equivalent volume of gas on KPC.

A capacity release transaction is where someone who contractually holds capacity for shipping natural gas on a pipeline sells that capacity to a third party for some period of time. The Federal Energy Regulatory Commission (FERC) requires interstate pipelines to have capacity release procedures in place. Capacity release can come about either through a privately-negotiated transaction or as a result of an open posting on each pipeline's electronic bulletin board.

MGE uses its contracted KPC capacity in the winter in order to bring natural gas to Kansas City to serve MGE's customers. KPC, like most other interstate pipelines, requires shippers to purchase capacity for the entire year rather than selected time periods. There are times of the year, specifically during the summer months, when demand for natural gas by customers is at its lowest level. This produces pipeline capacity that is temporarily not needed. Thus, idle pipeline capacity exists sometimes due to the combination of the way the FERC has set the rates for some interstate pipelines and the usage patterns of customers.

As noted, there are essentially two methods by which capacity can be "released" to a third party. Under the private negotiation method, a shipper can negotiate directly with the third party to establish the quantity of capacity to be transferred, the price, the

length of time for the temporary transfer, and other specific conditions such as load factor and whether or not the capacity may be recalled by the shipper under certain specified conditions. In contrast, the open bidding process involves a posting on the electronic bulletin board of the interstate pipeline that a certain amount of capacity is available from the shipper and the general terms and conditions under which the shipper is willing to make the release. Some of the applicable FERC-approved rates are subject to discounting and some are not. Third parties can then electronically place a bid in response to the computer posting. A bidder who offers the highest price for the transportation gets the capacity. The successful bidder and the pipeline will then enter into a contract to document the transaction to take place. Once the pipeline has received payment for the capacity release transaction from the third party, then the demand charge portion paid by the third party is credited against the shipper's bill for demand charges from the interstate pipeline. In this manner, the shipper is able to offset at least some of the on-going demand charges with revenue from the third party.

MGE contractually reserves the right to ship 46,332 dekatherms (Dth) per day on KPC. While the *amount* of capacity reserved is usually a matter of contract between the shipper and the pipeline, the pipeline's FERC-approved tariff sets the *rate* to be charged by the pipeline for each quantity of capacity reserved. That amount, multiplied by the specific charge per Dth found in KPC's FERC-approved tariff for reserving such capacity, produces the amount MGE must pay KPC each month.

The essence of the Staff's proposed disallowance on this issue assumes that MGE would have been able to achieve such a capacity release for its reserved capacity on KPC. Staff's argument for a disallowance is essentially that MGE should have

advertised the temporarily unused KPC capacity as being for sale as a capacity release transaction. In making its primary argument, Staff has inherently assumed that MGE's act of posting its idle summer capacity on KPC's electronic bulletin board would have resulted in a party purchasing that capacity at the price Staff suggests. Thus, it presents two fact questions for the Commission to examine: (1) What is the likelihood that some third party would have bought MGE's idle KPC capacity if it had been posted, and (2) What is the likelihood that that entity would have paid the amount the Staff assumes?

The evidence shows that MGE obtains capacity release revenues on both the Williams and Kinder Morgan pipelines. MGE obtained capacity release revenues on Williams by the private negotiation method. MGE also sought to obtain capacity release revenues by open postings on Williams by the open posting method, but it received no bids for such open postings. This demonstrates that MGE does pursue and does engage in capacity release transactions. MGE generally does not have capacity available for release on Panhandle Eastern since, unlike other pipelines serving MGE's service territory, Panhandle Eastern allows its shippers to contract on a seasonal rather than annual basis. Therefore, MGE can and does routinely engage in postings of capacity releases and does create revenues from capacity release transactions when others temporarily purchase the capacity.

KPC presents a different situation from the other pipelines serving MGE when it comes to the topic of capacity release. KPC is like Williams and Kinder Morgan in that it has a year-round fixed demand charge. Theoretically, then, it would be possible for capacity releases to take place on KPC. But there has never been a single capacity

release on KPC by any shipper, whether through an electronic posting or a negotiated sale. The evidence shows this is because of the FERC-approved rate structure of KPC and the structures of the other interstate pipelines with which KPC competes. These external factors have apparently combined to make it nearly impossible for MGE or any of KPC's other shippers to find anyone willing to accept the release of their KPC capacity. No one has ever expressed a willingness to purchase idle KPC capacity from MGE, even at the FERC-required minimum price.

It is undisputed that KPC has relatively high FERC-mandated commodity rates compared to other pipelines serving Kansas City. This is the rate applied to actual volumes shipped on the pipeline, as opposed to the fixed demand charge that is assessed whether or not any volumes are shipped. While fixed capacity charges may be discounted by the shipper in a capacity release transaction under the FERC procedure, the variable commodity charges cannot, thus establishing a "price floor." The undisputed testimony is that KPC's FERC-authorized commodity rate is three times higher than Kinder Morgan's and 2.4 times higher than Williams'. Therefore, a third party considering the purchase of released capacity would necessarily consider how much it will have to pay to actually transport its gas on KPC, even with a discounted capacity charge. With a relatively high KPC commodity rate, the evidence shows it is comparatively uneconomic for third parties to obtain released capacity from shippers on KPC. This is documented by the fact that MGE is not the only shipper with firm capacity on KPC that has capacity available for release. United Cities Gas Company and Kansas Gas Service, both of which are local distribution companies such as MGE, are also firm shippers, but neither has ever had a capacity release on KPC.

The evidence shows that MGE also competes directly with KPC itself when it comes to the availability of capacity on the pipeline. This is because FERC gives the pipeline the ability to offer *interruptible* service. With that service comes the pipeline's unique ability to discount *both* the demand and commodity rates. This means KPC is authorized by FERC to sell *interruptible* capacity on its pipeline at a much cheaper rate than released *firm* capacity can be obtained from MGE or other firm shippers on KPC.

Staff's proposed disallowance is premised on the sale of idle *summer* capacity. This means that someone wishing to purchase that capacity would only be able to use it during the summer. During the summer, the evidence shows that interruptible service is nearly as effective as firm service since demand on the pipeline is at its lowest level and the likelihood of interruption is consequently very low.

The lowest price at which MGE could release capacity on the KPC system would be $0.0625 per dekatherm, plus fuel charges. MGE presented evidence that KPC itself can, and does, offer interruptible service at rates lower than that. The evidence shows that KPC has sold interruptible capacity at prices that are only one-third of the absolute lowest level for which MGE could have lawfully released its firm capacity.

Additionally, there are other interstate pipelines that serve the same market area as KPC. Therefore, there are shippers on those other pipelines that can offer capacity going into the same market. Those other pipelines have substantially lower commodity rates compared to KPC, which would make them more attractive economically compared to shipping on KPC. As a result of the FERC-approved rate structure of KPC, firm capacity on KPC held by MGE and others is the least attractive alternative to anyone seeking capacity into Kansas City.

MGE also presented evidence of operational limitations that are inherent with MGE's capacity on KPC and that make it administratively and operationally difficult, and thus costly, for other parties to utilize it.

The net result of all these factors is that it is uneconomic for third parties to obtain released firm capacity from shippers on KPC at all, much less from MGE in particular. The facts clearly show it is more economical for third parties to either purchase interruptible capacity directly from KPC because the price is lower, or, if the third party needs firm capacity into the Kansas City market area, to purchase released capacity on other pipelines that also serve Kansas City but have lower variable costs. These facts justify MGE's belief that there is no market for MGE's idle summer capacity on KPC.

The Staff included an alternative approach to its allegation of imprudence on this issue. Staff alleges that MGE could have utilized its KPC capacity in the summer but posted an equivalent amount of capacity for release on the Williams pipeline, and presumably generated revenue that way. The contention is that by marketing idle Williams capacity and using the KPC capacity, MGE could presumably "achieve enough of a credit in that market to overcome the additional cost you would have by flowing replacement gas on KPC."

The Staff quantified this issue by assuming that MGE would have found a buyer willing to pay 75% of the Williams maximum reservation charge rate for such released capacity. In other words, the Staff assumed that a third party would be willing to buy the capacity at a 25% mark-down or discount from the full Williams tariff capacity charge.

MGE contended that there was simply "no way" MGE could have obtained 75% of the maximum Williams rate in any such transaction on Williams. MGE provided a

schedule showing the weighted average reservation rates actually charged for all capacity releases on the Williams pipeline for the ACA period. This document shows the weighted average rate actually obtained by shippers on Williams was only 14% of the maximum tariff rate. In other words, the actual transactions took place at an average 86% mark-down or discount from the maximum. MGE presented calculations showing that if the actually-achieved rate of 14% is substituted for the 75% assumed by Staff, the result is that Staff's proposal would not have produced any savings. Instead, it would have cost the MGE ratepayers $600,000 in additional costs. Staff conceded that if the hypothetical transaction were priced at 14%, it would not be economic.

MGE was successful in arranging some privately-negotiated releases of Williams capacity during this ACA period. MGE also made postings on the Williams electronic bulletin board during this ACA period in an attempt to release its Williams capacity. Those open posting were made on both a recallable basis during the ACA period and on a non-recallable basis in later periods after MGE became aware of the Staff's position. No one bid on MGE's Williams capacity in response to the open postings, even at rates below those proposed by the Staff.

The Staff did not produce evidence of any comparable capacity sales on Williams that would tend to prove MGE could have released the equivalent of its 46,332 Dth/day KPC capacity on Williams and also received revenue for that capacity equal to 75% of the maximum Williams rate. Mr. Sommerer admitted during the May 2003 hearing that he could not point to any actual transactions that would be comparable to what he was suggesting for MGE.

D. Hedging

The Staff's allegation of imprudence with regard to this issue was that MGE did not have a "formal, documented hedging plan" in place for the winter of 2000-2001. The Staff then said "It is the Staff's policy that if an LDC did not have a reasonable plan in place to address price volatility for the winter of 2000-2001 and did not meet an absolute minimum of 30% hedging for each month of the heating season (either through storage or fixed prices) a disallowance would be quantified."

The Staff considered volumes of natural gas that MGE had previously purchased and placed in storage, and volumes obtained under fixed price natural gas purchase contracts, as being "hedged" for purposes of this case. Volumes that were purchased by MGE at "indexed" prices were not considered "hedged."

Concluding MGE had no such formal, documented hedging plan, and comparing MGE's planned hedged volumes with 30% of Staff's calculation of "normal" customer requirements in each winter month, Staff initially proposed a disallowance of $614,365 for MGE not meeting the 30% threshold in January and March of 2001. When Staff filed supplemental direct testimony in October 2003, the Staff continued to use the 30% per month test but changed its approach to how it calculated MGE's "normal" demand. That change moved the amount of the proposed disallowance downward to $130,137. This revised amount results from MGE not meeting Staff's 30% of normal demand test for only the month of March 2001.

There is no explicit or implied requirement by Commission rule or statute applicable to the ACA periods under review here that MGE develop or have a "formal, documented hedging plan." The Commission's own *Natural Gas Commodity Task*

Force stated in its final report on the commodity price spikes in the winter of 2000-2001 that "neither the state of Missouri nor the Commission had any formal policy of broad applicability in place regarding the use of financial instruments for gas supply cost hedging purposes prior to the winter of 2000-01 beyond the application of the prudence standard."

The Staff admitted there was no requirement by rule or statute that MGE have a formal, documented hedging plan in place prior to the winter. There was no evidence of any recognized standard in the utility industry that established 30% of normal demand per month hedging as minimally prudent conduct. The evidence shows that there is a wide range of opinions among the various states on the amount of hedging, if any, that is considered appropriate.

The Staff admitted that it never communicated to MGE or any other gas company in Missouri, prior to the winter of 2000-2001, that the company should have in place a formal, documented plan that called for hedging at a minimum level of 30% of normal demand in each winter season month. The Staff did not create its 30% test until after the winter of 2000-2001 was over, it being the product of an internal Staff meeting sometime in the spring of 2002. The Staff strongly implied in its May 31, 2002, memorandum that the 30% test had an arbitrary basis and would not be appropriate as a permanent standard by stating that it "should not be viewed as an optimal level nor as precedent for future hedging levels." The Staff stated at the hearing that it may come up with a totally different standard for the next ACA period.

Staff acknowledged during cross-examination that the Commission's recent rulemaking, 4 CSR 240-40.018, is the first general pronouncement by the Commission

regarding hedging that is applicable to all LDCs in Missouri, and that it contains no such 30% standard. That new rule took effect December 30, 2003. The new rule contains no provisions stating that it will be applied retroactively to the ACA periods under review here.

MGE had a Commission-approved hedging plan in place prior to the winter of 2000-2001. MGE worked with the Staff and Office of Public Counsel over many months to establish that. A settlement designed to establish the plan was filed in May 2000, and approved by the Commission August 1, 2000. It included two separate price protection plans: a Fixed Commodity Price PGA plan which would have resulted in hedging of 100% of all gas purchases, and a Price Stabilization Fund.

There was an unprecedented rise in natural gas commodity prices from the time the stipulation was filed in May until the Commission approved it. Natural gas prices continued to rise after Commission approval. The high level of those prices prevented MGE from implementing either of the price protection mechanisms in accordance with the terms approved by the Commission because the market prices then being experienced exceeded the allowed parameters in the stipulation.

MGE acted when it became known that neither price protection mechanism in the settlement could be implemented prior to the onset of the winter season because of those higher natural gas prices. MGE contacted Staff and OPC and attempted to modify the approved mechanisms to allow a fully-hedged portfolio to be in place prior to the winter. This is because the stipulation provided that any modifications to the price protection mechanisms required Staff approval. MGE proposed modifications to the hedging settlement designed to reflect then-current market conditions. MGE proposed

increasing the trigger price of the Fixed Commodity Price PGA to reflect then-current market prices. MGE also proposed shortening the term of the Fixed Commodity Price PGA so that it only covered the winter of 2000-2001 (the original term was for a two-year period). MGE also proposed modifying the Price Stabilization Fund to purchase call options to cover 70% of volumes for only December through February (originally November through March).

Staff stated that it did not support modification of the hedging settlement's price protection mechanisms which would have permitted a greater level of financial hedging for the winter of 2000-2001 because Staff was afraid that by doing so, it would be locking in high natural gas prices, only to have the prices fall later.

Prior to the winter of 2000-2001, the Commission had specifically authorized MGE to utilize financial instruments to hedge its natural gas supply portfolio for several years. Those authorizations came with very specific parameters as to how much money could be spent, the specific amount of volumes to be hedged, and a specific price cap for the price of the financial instruments. As part of the hedging settlement submitted to the Commission in May 2000, it was agreed that MGE would seek to re-implement the Price Stabilization Fund that had previously been supported by Staff, approved by the Commission, and utilized by MGE in the prior three winters. This mechanism would have been consistent with those previously approved by the Commission and it also contained strict language on the amount of money and volumes and other terms that were permitted.

The Commission issued an order on October 26, 2000, in Case No. GO-2001-215, denying re-implementation of the Price Stabilization Fund. That order directed

regarding hedging that is applicable to all LDCs in Missouri, and that it contains no such 30% standard. That new rule took effect December 30, 2003. The new rule contains no provisions stating that it will be applied retroactively to the ACA periods under review here.

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MGE to do what it considered to be "reasonable" with regard to hedging and the Commission would look at those actions later in a prudence review. That order contained no specifics as to how much MGE was authorized to spend for financial hedging or how much in the way of volumes MGE was authorized to hedge.

According to the Staff's calculations, MGE actually hedged between 38 and 40 percent of its normal demand over the 2000-2001 winter season. It is only when Staff applies its 30% test on a calendar month basis that it shows a proposed disallowance for MGE.

There were no shortages of supply experienced on MGE's system in the face of record cold temperatures in the months of November and December 2000. MGE made its natural gas purchases in arms-length transactions at prevailing market prices. The Staff has not objected to any specific MGE natural gas purchase contracts as being imprudent.

When Staff first calculated its recommended disallowance on this issue, it determined that MGE had hedged 29.5% of normal demand for January 2001. The shortfall of one-half of one percent produced over 65% of the original proposed disallowance amount. Similarly, the first time it was calculated, the Staff said MGE missed the 30% test by 2.3 percentage points in March of 2001, having hedged 27.7% of normal demand. That shortfall was responsible for the other $212,167 of the original disallowance proposal of $614,365. Staff's recalculated disallowance proposal of $130, 137 shows it is based on MGE having hedged 27.9% of Staff's calculation of normal demand in March 2001.

In contrast, MGE's planned hedge volumes for February 2001 were calculated by Staff as being over 48% of normal demand. But the way the Staff applied its 30% test, this produced no credit or offset for MGE. This is because Staff gave MGE no credit if the amount of volumes hedged went above 30% in any month. It only sought a disallowance if it dropped below 30%. Exhibit 27 HC shows that, using Staff's original approach, if MGE had been given credit for months in which it exceeded Staff's 30% test, not only would there have been no disallowance proposed, there would have been a $3.34 million savings to customers as a result of MGE's hedging plan.

A Staff witness admitted that if MGE had known of the proposed 30% standard before it was announced in Staff testimony in this case, MGE could have avoided the proposed disallowance altogether simply by changing its planned monthly numbers without changing the total amount hedged.

As indicated earlier, the Staff revised its calculation of the disallowance as the case progressed. When it filed supplemental direct testimony in early October 2003, Staff modified the disallowance proposal to a new number: $130,137. The reason given by Staff was that, during the period in which the hearing was in recess so the Staff could verify the result of actual numbers substituted into the Staff's spreadsheet, the Staff determined there were errors in its approach and it decided to change the basis on which it calculated MGE's normal monthly natural gas demands.

Staff's change in approach to calculating monthly normal demands had an effect on Staff's calculations under the Storage Use issue. It also had the effect of changing Staff's calculation of how much MGE hedged for the ACA period. It caused the amount of volumes considered to be hedged as a percentage of normal demand to increase.

Where it showed that MGE had hedged approximately 38% of normal winter volumes under the original approach, the Staff's change in October 2003 had the effect of increasing that to nearly 40%.

The Staff created estimates of normal demand for purposes of its test used to calculate alleged damages on this issue. In its original approach, the Staff relied upon usage figures it obtained from the 2000 Reliability Report filed by MGE in another case. In its approach revealed in October 2003, the Staff said it relied upon two years worth of actual demand data from MGE winter seasons and a regression analysis to arrive at its estimates.

MGE challenged the validity and applicability of both sets of "normal" demand estimates used by Staff. MGE presented evidence that the estimates varied significantly from actual usage, and that when "back-cast" upon history they had a less than desirable predictive effect. MGE also argued that the demand levels used by Staff assumed a much greater level of flowing supplies in the month of November than experience showed would likely be consumed by MGE's customers. MGE claimed that this excess level of flowing gas could present it with potentially serious operational problems and the prospect of imbalance penalties from its supplying pipelines.

E. Storage Use

MGE typically draws on stores of natural gas that it purchases in non-winter months to provide service to its customers. Typically stored in underground caverns that are geologically suitable to allow gas to be injected and withdrawn from them, MGE contracts to use facilities owned and operated by and connected to interstate pipelines.

Pursuant to the tariffs of those pipelines and individual contracts, MGE has the right to a specific amount of storage capacity in the caverns and the right to inject or withdraw gas into or out of these facilities at specific times of the year. Natural gas is normally injected into storage facilities during the summer months (April through October) and then withdrawn as needed during the winter months (November through March). Generally, then, "storage gas" is gas that has been previously purchased and injected into storage for withdrawal as needed in the winter.

There are four primary reasons that local gas distribution companies contract for natural gas storage service: reliability, operational flexibility, price stability and economics. Storage is purchased to provide reliable natural gas supplies during times when supplies from other sources are difficult or impossible to obtain due to weather, excess demand, or *force majeure* conditions. Therefore, storage gas can supplement flowing volumes to maintain reliability. It also provides flexibility in dealing with the swings in customer demand, both up and down, that can be experienced from day to day. In that sense, it can act as a "shock absorber."

Storage gas can also function as a "physical hedge" against what can be high winter prices for natural gas since the normally lower priced gas injected into storage earlier can be withdrawn during the winter. It also is economic in that it allows a utility to reduce the amount of pipeline capacity it otherwise might need.

First of month (FOM) "flowing supplies" is a term used to describe supplies of natural gas MGE purchases to serve the current month's expected consumption and represents volumes that will <u>not</u> be withdrawn from storage. These supplies, generally flowing from natural gas wells through the interstate pipelines (and <u>not</u> through storage

facilities), are nominated (i.e., contract details are finalized and put in place) prior to the start of a calendar month for delivery on a *consistent* daily basis over the entire month. An example would be a contract entered into at the end of May in which MGE obtains a steady flow of 10,000 dekatherms of gas each day for the entire month of June.

MGE starts each winter with a "baseline" plan for storage withdrawals assuming normal temperatures, but that plan will necessarily change as actual temperatures vary above and below that normal level. No storage utilization plan can be followed exactly due to the numerous external factors a company will face throughout a winter heating season.

MGE's "baseline" storage utilization and flowing supply plan going into the winter of 2000-2001 was generally the same plan that MGE had utilized the two previous winters (i.e., 1998-1999 and 1999-2000). MGE has been providing those plans to the Staff. Although the plans have essentially been the same since 1998, and the Staff has conducted yearly ACA audits in which they were presumably examined, the Staff never indicated to MGE prior to filing its recommendation in this case in 2002 that MGE's baseline storage plan was unreasonable.

The plans MGE has historically used all show the highest level of planned storage withdrawals taking place in the month of November. The next-highest level of planned storage withdrawals would be in January. MGE does this intentionally because MGE experiences significant temperature variability in November. When 30 years of heating degree data are examined, November experiences the greatest range of heating degree day variation from coldest to warmest weather within any of the winter months.

Storage gas provides the needed flexibility to appropriately manage this variability. The normal operational use for storage in November is for withdrawals since substantial additional gas volumes cannot be injected into storage facilities that are essentially full at the first of November. Typically, MGE has very little ability to inject more gas into storage in November.

Because contracted FOM flowing supplies come into the system at a constant daily volume, the overall concept is to schedule of a certain amount of flowing supplies that will generally cover the level of demand on most or all of the days, and then let the storage gas act as the "shock absorber" to pick up larger usage necessitated by weather-induced demand. MGE's tariff provisions generally allow it to withdraw large amounts from storage as needed. Actual storage utilization will never match the storage utilization plan because weather causes changes in demand which change from year to year, month to month, and day to day. In most years recently, MGE's actual storage utilization in November turned out to be less than the planned volumes due to warmer than normal weather.

The Staff challenged the storage withdrawal plan of MGE, contending it was "unreasonable." Staff generally argued that MGE's plan should follow the distribution of heating degree days (HDDs), which means that if the largest number of HDDs are in January, then MGE should plan to make its greatest withdrawals in January, and so forth.

There was no evidence that there is any nationally-recognized standard approach to storage utilization, and there was no evidence that this Commission has ever made any findings or rulings about how storage should be utilized throughout the

winter months. The Staff created its own gas supply management plan for this case to use as a standard against which MGE's conduct would be measured. This plan of Staff's was developed after the winter of 2000-2001. Its existence was not communicated to MGE prior to that winter.

Staff initially claimed that a plan for November, December and January FOM flowing supplies should be based on "warmest month" requirements. Specifically, with regard to November 2000, Staff criticized MGE by saying that it did not plan on and nominate enough FOM flowing supplies "to cover even warm month requirements (natural gas requirements for warmest November weather.)" Staff claimed that if MGE *instead* had planned on using more flowing supplies, "then less storage withdrawals would have been necessary in November 2000, leaving storage gas for the normally colder months to come." Staff made a similar analysis and recommendation for December and January as well, alleging that MGE should have ordered FOM flowing supplies to cover warm month requirements. These statements clearly demonstrate Staff's underlying motive is to serve anticipated customer load with FOM supplies each month and thus conserve storage gas for use later in the winter.

MGE identified several significant problems with Staff's approach on ordering FOM flowing supplies. MGE contends that the approach is too simplistic in that it disregards the daily demand variability that is experienced within a month. MGE indicated that Staff's approach incorrectly based the level of FOM flowing supplies on average monthly demand which significantly overstates the level of FOM supplies that should be scheduled. In addition, MGE challenged the numbers Staff used to represent

average demand. The numbers the Staff initially used came from the 2000 MGE Reliability Report.

MGE presented evidence that Staff's approach assumed that MGE would contract for a much higher and potentially harmful level of FOM flowing supplies than needed. MGE graphed the Staff's approach to scheduling FOM flowing supplies for the years 1999, 2000 and 2001. This shows MGE's level of planned FOM supplies for November is much lower than either Staff's original or revised levels. It also shows that Staff's FOM flowing supply proposal would have resulted in MGE having more gas than it needed for its customers in the vast majority of days. Only in November 2000, the coldest November ever experienced on MGE's system, would Staff's proposed level of FOM flowing supplies *not* have resulted in having gas in excess of MGE's customers' needs a majority of the days in the month.

MGE contended that there was a real-world impact to the scheduling of excessive flowing supplies. MGE could not count on being able to inject it into storage in November, because the idea is to have storage essentially full in November in case the weather turns out to be colder than normal. So MGE would have to try to sell this excess gas in the spot market. Unfortunately, this would effectively be "dumping" gas into a market that does not want it. MGE would likely lose money on such sales because logically, if the weather is warm enough to produce the excess gas, the spot market prices for the gas are going to be lower than the price at the first of the month, when it was purchased. Lower demand means lower prices. If MGE couldn't find buyers and couldn't arrange for emergency storage through the pipeline, it would be liable for pipeline imbalance penalties. Imbalance penalties are assessed by the

interstate pipelines for violation of tariff provisions. They can occur when a shipper puts more gas into the system than it takes out, or when it takes more gas out of the system than it has put in. There can be substantial penalties associated with both an "overrun" and an "underrun." One of the reasons that distribution companies such as MGE need to have the "shock absorber" effect of storage gas available in November is to allow them to avoid incurring these imbalance penalties. As noted previously, FOM flowing supplies are at a constant, fixed volume by contract. Storage withdrawals are not, so they present greater flexibility.

Although the Staff claimed that it was utilizing "warmest month" demand figures for its analysis, MGE showed that Staff was not doing that. MGE pointed to demand figures contained in its direct testimony for a month which was recognized as being "warmest" and demonstrated that the demand estimates used by Staff were substantially higher than actually experienced. This discrepancy between what the Staff claimed was a warmest month demand and what actually occurred had a substantial effect on the quantification of damages the Staff made. MGE demonstrated that by substituting actual usage from just two months in the original spreadsheet Staff used, and not changing anything else, it dropped the calculation of damages from over $8 million down to less than $200,000. MGE also contended that the figures Staff was relying upon from the 2000 Reliability Report did not represent "warmest month" demand figures.

The Staff filed supplemental direct testimony in October 2003. In it, Staff changed its approach to how it calculated normal demands. Staff came up with all-new estimates of "warmest month" demands for all five winter months using a regression

analysis that looked at two years (July 1998 – June 2000) of monthly HDDs and volume data. This formed the foundation upon which Staff's current level of a $2.9 million disallowance is premised.

MGE claimed that Staff's new monthly demand estimates were inaccurate. MGE did not object to the use of a regression analysis, *per se*, but contended that Staff had misapplied the analysis and not used appropriate data. To demonstrate its concerns, MGE backcast Staff's approach against an historical period to see how well it would have performed in an actual situation. That is something the Staff did not do to test the reasonableness of its regression analysis results. Schedule MTL-41 to Exhibit 29 to illustrates the problems raised by MGE. It compares MGE's actual demand over the past five years to the estimated demand that would be produced by Staff's new approach. It shows there are five months in which Staff's regression equation would have estimated a level of demand that varied from MGE's actual demand by at least ten percent. In other words, twenty percent of the time, Staff's regression analysis produces significantly inaccurate results. Three of the five months in which Staff's estimates are off by more than 10% are in November. Thus, the approach is also the *most inaccurate* when the weather is *most extreme.*

It was uncontested that the warmest November of the past 40 years occurred in November 1999. MGE demonstrated that Staff's estimated demand for a warmest November of 5,114,047 MMBtu is nearly 16% greater than the warmest month demand that was actually experienced. The same type of discrepancy occurs for Staff's estimated demand for March as well.

Another significant drawback to the storage utilization approach recommended by Staff and held up by Staff as the standard for measuring damages in this case is that it only plans on utilizing 79 percent of MGE's contracted storage in a winter with normal weather.

MGE followed its storage utilization plan to the extent possible in the winter of 2000-2001, but there were significant factors beyond its control which had an impact on that. November 2000 was the second coldest November in the past 40 years in MGE's service territory. December 2000 was the second coldest December in the past 40 years. November and December 2000 together were the coldest consecutive November and December on record, a 1-in-355 year occurrence. Due to that unprecedented cold weather, MGE withdrew more storage gas than it planned in both months.

MGE's reliance on storage in November and December 2000 was consistent with the way storage was utilized by other gas companies across the country, a fact not disputed by the Staff. Many other LDC's withdrew greater levels of storage as a result of the extreme weather and the record high and volatile gas prices being experienced at that time. MGE's levels of storage withdrawals in November and December 2000 were consistent with, or below, the broader experience in the United States. National statistics show that withdrawals were 70% greater than the historical average for that period. Withdrawals in December were greater than ever previously recorded, and 25% greater than the previous record.

In its storage plan, MGE estimated that it would withdraw 7.6 billion cubic feet (Bcf) of natural gas from storage for November and December 2000. The actual amount

was 12.4 Bcf. So for those two months, actual withdrawals were 63% greater than planned, compared to the 70% greater than planned experienced nationally.

MGE presented evidence that there was also an unusual situation in which Williams, the major interstate pipeline on the MGE system and the operator of the storage facilities, made a significant revision to MGE's storage withdrawal numbers in mid-December. At the end of November 2000, the numbers MGE had from Williams showed that MGE had withdrawn about 4.5 Bcf from storage, compared to a planned withdrawal volume for the month of 4.15 Bcf. This caused MGE to believe that it was reasonably close (350,000 MMBtus) to its plan, especially considering the colder than normal temperatures experienced in November 2000.

However, the previously reported November storage withdrawal number was substantially revised by Williams in the middle of December 2000. This was characterized by MGE as a "a bust in the measurement numbers they were reporting to us." The revision showed that MGE's customers had used a lot more gas from storage than previously reported.

But before MGE received this new information from Williams in mid-December, it had to make decisions at the end of November about what plan it would follow in December. Given that the numbers available to MGE on November 27, 2000 showed that MGE was within 350,000 MMBtus of its storage plan, MGE said it made a decision not to make any adjustments on the basis of its storage inventories.

MGE also made a decision at that time to order 20,000 MMBtus less of FOM flowing supply gas in December in an attempt to get lower gas prices for its customers. The Staff has criticized this supply decision and characterized it as speculation by MGE.

MGE contends that decision was based on the fact that high prices of natural gas were then being experienced in the market and MGE's expectation, based on weather and price forecasts then available, was that prices would likely decline later in December from the first of the month price. MGE's approach was to avoid purchasing higher-priced FOM gas, utilize lower-priced storage gas in the interim, and then at a later date either repurchase that gas at a lower cost to save the net difference or, depending on the weather, rely on storage volumes. MGE said that it believed at the end of November, based on the information available to it at that time, that it was within 350,000 MMBtu's of its original storage plan, which was a small percentage of its overall storage, and therefore, it considered that it had adequate storage at the end of November.

When MGE was told by Williams in mid-December that Williams was making a measurement revision such that the storage levels were actually lower than previously reported by Williams, combined with the fact that market prices for gas continued to climb in December and the temperatures were colder than normal or previously predicted, MGE purchased 20,000 MMBtus of gas per day for the rest of the month.

MGE made the same type of supply decision in February 2001. In that instance, though, MGE's belief that prices would fall after the first of the month – based on information it had at the time -- turned out to be correct, and as a result MGE saved money for the ratepayers by avoiding purchases of higher cost FOM gas. The Staff did not offset "savings" from this situation against "costs" from the November decision to do the same thing; neither has Staff criticized this attempt to save customers money since it turned out to benefit MGE's customers.

The facts known at the time show that natural gas prices were at record high levels at the end of November 2000. Price forecasts from industry experts just a short time before were already incorrect and needed to be readjusted. Weather forecasts for the central United States for the first portion of December 2000 indicated above normal temperatures. Weather forecasts for the United States as a whole for the first half of December indicated normal temperatures. Most of the current projections available at the time would have reasonably contributed to a buyer expecting a decline from the prices available during bidweek for FOM volumes for December. Many other LDC's apparently followed the same strategy as MGE and tried to avoid paying the seemingly too high price available during bidweek, which was both volatile, and in many cases, substantially above then available projections.

F. Reliability Report

The Staff has requested that the Commission order MGE to produce additional information based on concerns the Staff raised about information contained in MGE's 2000 Reliability Report. The information is of a general nature and is similar to information that the Staff is apparently seeking from all of the gas distribution companies. It has been the subject of informal rulemaking discussions on which the Staff has sought comments from the industry.

MGE pointed out that it filed the 2000 Reliability Report in a case that is not under consideration here and that if produced, the information does not tend to prove or disprove any of the other issues in this case. Further, MGE's obligation to produce the 2000 Reliability Report was due to a stipulation that, by its terms, is no longer in effect.

There also has not been a showing that the Staff has attempted but is unable to obtain the information through other means in other active cases.

II. Conclusions of Law

The Missouri Public Service Commission has arrived at the following Conclusions of Law:

Missouri Gas Energy is a division of Southern Union Company which is an investor-owned public utility engaged in the provision of natural gas service in the State of Missouri and, therefore, is a "gas corporation" as defined under section 386.020(18), RSMo 2000, subject to the jurisdiction of the Commission under Chapters 386 and 393, RSMo 2000.

Orders of the Commission must be based upon competent and substantial evidence on the record. Section 536.140, RSMo 2000. Under the provisions of its applicable tariffs, MGE is allowed to collect certain gas costs on an interim, subject to refund basis, contingent upon the findings of the Commission in Actual Cost Adjustment proceedings that the costs incurred and the revenues received by MGE were just and reasonable.

A. Discussion of Prudence

The Commission has embraced the following standard[1] of judging the prudence of the actions of a utility:

> The company's conduct should be judged by asking whether the conduct was reasonable at the time, under all the circumstances, considering that the company had to solve its problem prospectively rather than in reliance on hindsight. In effect, our responsibility is to determine how reasonable people would have performed the tasks that confronted the company.

[1] ***Re Consolidated Edison Company of New York, Inc.***, 45 PUR 4th 182.

The Commission issued a decision in 1995 in which it articulated the standard it seeks to apply in the particular type of case presented here:

> The incurrence of expenditures or accrued liabilities on the part of local distribution companies in exchange for the physical delivery of natural gas results from action or inaction on the part of individuals in the employ of the local distribution company at some point in time. It appears to the Commission that it needs to clarify the parameters of gas cost prudence reviews. The Commission is of the opinion that a prudence review of this type must focus primarily on the cause(s) of the allegedly excessive gas costs. Put another way, the proponent of a gas cost adjustment must raise a serious doubt with the Commission as to the prudence of the decision (or failure to make a decision) that caused what the proponent views as excessive gas costs. The Commission is of the opinion that evidence relating to the decision-making process is relevant only to the extent that the existence of a prudent decision-making process may preclude the adjustment. ... The critical matter of proof is the prudence or imprudence of the decision from which the expenses result. (Emphasis supplied).

In Re Western Resources d/b/a Gas Service, 3 Mo.P.S.C.3d 480 at 489. Therefore, the task of the Commission is to focus on the decisions that were made by MGE and what was known or reasonably knowable to MGE at the time the decisions were made, rather than the results of those decisions. The Commission does not demand perfection and the Commission recognizes that there can be a range of decisions that are considered prudent.

B. KPC Capacity Release

The Commission has the ability to determine the appropriate level of expenses for a utility's cost of service. The Commission concludes that the record evidence does not demonstrate that MGE was imprudent in failing to post its idle summer capacity on the KPC system for release on KPC's electronic bulletin board. The Commission makes this conclusion based on the facts as to what was known or reasonably

knowable by MGE's management at the time the decision was made not to post the KPC capacity.

The evidence clearly shows there has never been a capacity release on KPC by anyone and that MGE's management was aware of that. The evidence clearly shows that capacity in the summer on KPC, when viewed in conjunction with the costs of actually shipping the gas, is considerably more expensive than readily available alternatives either on other pipelines or through interruptible transportation by KPC itself. These facts corroborate and justify MGE management's perception at the time that making open postings on the KPC bulletin board would have been fruitless.

The task of the Staff in ACA proceedings, if it decides to propose a disallowance, is to present evidence that creates a serious doubt about the prudence of decisions made by a utility's management. The Staff has not done that in this proceeding. The Staff did not present any evidence which tended to show that management's perception of the potential for release transactions on KPC was anything other than what MGE said it was. No evidence in this case demonstrates that MGE was or should have been aware of any real opportunity to transfer its idle KPC summer capacity to a third party for any amount of compensation. The evidence was all to the contrary, including that MGE had had discussions with other parties about the capacity and those parties had uniformly expressed no interest in it.

As to the "alternative" proposed by Staff, namely that MGE release an equivalent amount of its KPC capacity on the Williams pipeline and then transport gas as necessary on KPC, the fundamental problem is two-fold. First, in order to convince the Commission of the merits of its proposed disallowance, the Staff was obligated to

produce evidence tending to show that a release of 46,332 Dth/day on Williams could be achieved by MGE, and second, that someone would have paid MGE 75% of the maximum Williams capacity rate for that capacity if it had been released. The Staff failed to produce evidence that either event was likely or even possible.

There were no release transactions in the summer of the ACA period comparable to 46,332 Dth/day. The only transactions were in the 500 Dth/day range and the Staff admitted those were not comparable. Further, the actual weighted average revenue obtained for the actual releases was 14% of the Williams maximum, which is not even close to the 75% level assumed by Staff for purposes of its calculations.

MGE did market some of its idle Williams capacity through privately negotiated transactions in the ACA period. It also made open postings on the Williams electronic bulletin board. This demonstrates that MGE's management was not lax in terms of trying to market the idle capacity. It apparently chose to focus its efforts on Williams where, as experience showed, it was able to achieve some success from private negotiations even though no one responded to the open postings for capacity. This actual experience on Williams also tends to validate the perception held by MGE's management that it was a waste of time to attempt to actively market the higher priced KPC capacity.

Applying the principles of the prudence standard to the facts presented, the Commission cannot conclude that MGE was imprudent under the circumstances. MGE's management made a rational and fact-based decision that an open posting of its idle summer capacity on the KPC electronic bulletin board would not produce any

results. The Staff did not produce any evidence that MGE's perception of the market for that KPC capacity should have been any different.

The Commission concludes that MGE was prudent in not following the Staff's suggested alternative approach of releasing an equivalent amount of its Williams capacity and using the KPC capacity. The Staff failed to produce evidence that indicates such a maneuver would have been successful since it could not show any comparable transactions on Williams during the relevant time period at the volumetric level it assumed. MGE made open postings on Williams during the ACA period and did not receive any bids. This certainly does not indicate that the Commission should assume a sale of 46,332 Dth/day of capacity would have taken place when, in fact, no one evidenced an interest in the capacity by responding to the open posting.

A review of actual transactions during the relevant period shows none of a comparable nature to the one the Staff assumes. The actual transactions also produced substantially less in revenue than Staff assumed, thus seriously calling into question whether MGE could have achieved such revenue even if a buyer of the capacity had materialized.

Given this disposition, the Commission considers it unnecessary to address MGE's claim that disallowance of these costs would violate the filed rate doctrine.

C. Hedging

The Commission concludes that there was no requirement in place prior to the winter of 2000-2001 that required MGE to have a formal, documented hedging plan for that winter. Further, absent a Commission order applying to a specific utility, there was no requirement for any particular level of hedging to be undertaken by a gas company.

The Commission concludes that the application of a 30% test in this case – whether applied seasonally or monthly -- is inconsistent with how the Commission applies the prudence standard. Under that standard, a utility's decision-making is to be judged on information available to the utility and the circumstances in existence at the time the decisions were made or the actions were taken. The Staff has failed to demonstrate that there was a statutory or Commission requirement, or that minimally prudent conduct, required that MGE have a formal, documented hedging plan in place prior to the winter and that a minimally prudent hedging standard equates to a minimum of 30% of normal natural gas volumes to be hedged each month. Further, the Staff has not produced evidence that demonstrates that the Commission's order of October 26, 2000, in which MGE was directed to engage in hedging as it deemed reasonable, has been violated.

The main problem with the use of the Staff's 30% test is that, even if it were considered as minimally prudent conduct, it was developed after-the-fact and therefore was unknown and unknowable by MGE at the time MGE was making decisions. As indicated by Staff's admission, MGE could have met the standard if it had known of it in advance by simply changing the amount it hedged each calendar month but without changing the overall quantity of volumes hedged. Further, the Commission cannot lawfully hold MGE to a previously undisclosed standard, especially in view of the evidence that other utility regulatory commissions vary considerably in terms of the amount of hedging, if any, they require for companies under their jurisdiction. With reported instances ranging from zero to 100 percent, there simply is no evidence in this record that there is any nationally recognized standard as to a minimal or optimal level

of hedging that is considered as prudent conduct. Furthermore, the evidence in this case was that the Commission approved a hedging plan for another utility for this same period that did not require a minimum level of hedging each month.

The evidence shows that MGE acted reasonably with regard to hedging for that winter based on what its management knew or reasonably could have known at the relevant times. There was a Commission-approved hedging plan in place for MGE before the winter but events beyond MGE's sole control made implementation of that plan impossible. Staff's refusal to support alteration of the plan to account for then-current market prices for natural gas made it impossible for MGE to implement the approved plan prior to the winter.

The Commission's only specific direction to MGE regarding hedging was to act reasonably. That is a very broad term and the Commission is unable to conclude on the basis of this record that MGE acted unreasonably. Moreover, the Staff has not identified any *specific* decisions MGE made with regard to hedging and has not alleged that any specific decisions were unreasonable given the facts and circumstances present at the time the decision was made.

Therefore, based upon the evidence, Staff's proposal to disallow $130,137 for MGE's alleged imprudence related to hedging is rejected.

D. Storage Use

The evidence clearly demonstrates that MGE has followed the same general storage utilization plan since 1998. The Staff has had the opportunity to review, and presumably has reviewed, MGE's plans in ACA proceeding for each of the years prior to

the winter of 2000-2001, including in context of the 1998 general rate case. The Staff did not raise any criticism of the plan until after the unprecedented winter of 2000-2001.

On an objective basis, MGE's actions and decisions with regard to storage in the winter of 2000-2001 did not produce any failures of service to its customers or any penalties from the interstate pipelines serving it. The worst that can be said is that MGE's customers had some limited exposure to the market price of natural gas in the latter part of the winter. The Commission is not convinced that a customer of MGE paying a market-based price for natural gas, absent some other compelling circumstance, is *per se* evidence of imprudence by MGE.

The evidence shows that no one projected the timing, level and duration of the extreme weather and natural gas price volatility that was experienced in the winter of 2000-2001. Similarly, it shows that MGE's actions with regard to storage use were in the mainstream of other local gas distribution companies across the nation at the same time. There was simply no evidence presented by Staff that showed, when faced with a particular decision regarding storage use, that MGE made a decision a reasonable person in the same circumstance would not have made.

The Staff claimed that MGE generally "overpulled" storage in November and December when it should instead have increased its FOM flowing supplies so that storage could be held for possible later use in January and February in an effort to protect customers against higher market prices for gas. There was no evidence that MGE knew in November and December that prices for natural gas in January would be higher. In fact, the evidence shows that the historical experience had been that November prices were usually higher than January prices. There was no evidence that

MGE intentionally relied more on storage gas than it should have. The facts show that at the end of November, MGE believed it was very close to its plan for storage gas. It turned out later that the information MGE had on November 27 was not accurate, but that was not because of anything that MGE did or did not do. It was because the Williams pipeline, the manager of the storage gas facilities, made a retroactive and substantial revision to the reported usage figures. This revision was not communicated to MGE until the middle of December 2000, though, so this information on storage gas actually used came too late to be utilized by MGE when it had to make decisions about purchasing FOM gas for December on November 27. There was no evidence that MGE made any type of unreasonable or reckless decision with regard to storage gas

The one specific decision that MGE made and that was subjected to criticism by the Staff, was MGE's decision on November 27, 2000, to purposely purchase 20,000 Dth/day less FOM flowing gas for December. The Commission has examined the information that was available to MGE at the time that decision was made. The Commission cannot conclude from that evidence that the decision MGE made, in an attempt to save its customers money, was unreasonable. MGE relied upon its experience and available weather forecasts to make a decision that was grounded in historical precedent and calculated to benefit the customers. Events beyond MGE's control resulted in that not coming to pass because the weather was much colder than either normal or predicted, and prices were higher than predicted. MGE made the same type of supply decision for the same amount of gas just two months later, on essentially the same type of information, and that time events came to pass as anticipated by MGE and MGE's customers therefore received a benefit. The Staff chose not to offset this

benefit against the claimed detriment of the November 27, 2000 decision, even though the decisions were essentially the same and made in the same context. Under the prudence standard, the Commission looks at the decision-making process, not the results. Decisions can be classified as imprudent, not results. We cannot justify a "cherry-picking" approach to decisions advocated by Staff here where the same decision made under the same circumstances would be treated as both prudent and imprudent when only the results are different. We can find no imprudent conduct in MGE's decision-making process and its attempts to benefit customers with lower gas prices. Given that there was no evidence that MGE clearly made an unreasonable decision based on the information MGE knew or reasonably could know at the time the decision was made, we cannot find that its supply decision at the end of November 2000 was imprudent.

The Commission was not presented with any recognized standard of conduct with regard to how storage should be utilized over a winter season. While the Staff's concept of planned storage use following normally experienced temperatures does not appear to be unreasonable on its face, neither does MGE's plan. MGE had a rational explanation for its planned greater use of storage in November as a "shock absorber" when the weather is highly variable and the operational consideration of storage being essentially full must be considered. On the other hand, Staff's proposed plans for storage utilization appear to have flaws both in concept and application. When they were tested for their predictive ability against known events, they are demonstrably lacking. The Commission is also extremely reluctant to endorse a plan that only contemplates the use of 79% of storage in a normal winter. Given the paucity of

evidence that Staff's latest plan should be considered the "reasonableness" standard against which MGE's actions are measured, the Commission simply cannot conclude there is enough evidence in this record to justify penalizing any MGE storage use decision under the Commission's prudence standard.

E. Reliability Report

The Commission concludes that it is not necessary for it to take action at this time in this proceeding on the Staff's request to order MGE to produce additional information relative to the 2000 Reliability Report.

F. Summary

Based upon its findings of fact and the conclusions of law, the Commission concludes that in order to set just and reasonable rates for MGE for this particular ACA period, the adjustments proposed by the Staff should not be made. MGE is authorized and required to file tariff sheets consistent with this order to make the ACA balances prior to Staff's proposed disallowances permanent.

IT IS THEREFORE ORDERED:

1. That the Commission hereby rejects the Staff's proposed adjustment concerning KPC capacity release.
2. That the Commission hereby rejects the Staff's proposed adjustment concerning hedging.
3. That the Commission hereby rejects the Staff's proposed adjustment concerning storage use.
4. That the Commission hereby rejects the Staff's proposal concerning additional information relating to the 2000 Reliability Report.

5. That MGE is hereby authorized to file proposed tariff sheets in compliance with this Report and Order.

6. That this Report and Order shall become effective on _____.

CERTIFICATE OF SERVICE

The undersigned certifies that a true and correct copy of the foregoing document was served this 20th day of February, 2004, upon counsel for all parties of record in this proceeding by either hand delivery or by placing a copy of same with the United States Postal Service, postage prepaid.

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