Prepared Testimony to Senate Utilities Committee
Regarding SB 522
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Good morning Chairman Clark and members of the Utility Committee. On behalf of Midwest Energy, Inc. I would like to thank you for the opportunity to discuss our concerns with the proposed Senate Bill No. 522. I am Bill Dowling, the Vice President of Energy Management and Supply for Midwest Energy, Inc. As you are well acquainted with our company, I won't spend any time giving you background on our organization except to say that we do provide natural gas transportation service to over 4,000 customers (out of our total of 42,500 gas customers) that have chosen to purchase their natural gas requirements from other suppliers while relying on Midwest to deliver that gas to them.

The provisions in the proposed Bill concern us on several levels. Before raising those concerns though, it might be helpful to give you a very brief overview of the transportation program at Midwest, and the role of the players involved.

Customers that elect to purchase their natural gas from other suppliers will enter into a contract with a gas marketer to provide that gas. In order to provide that gas to the customer, the marketer must make arrangements to have gas delivered from an interstate pipeline to our distribution system. Midwest fulfills the same role for those customers that purchase their gas directly from Midwest. Both Midwest and the marketer(s) serving customers inside our system must schedule (nominate) gas that the interstate pipeline will "ship" across the interstate pipeline system to our distribution system. Each "shipper" must make these nominations in advance, anticipating the volumes that will be required by all their respective customers in aggregate. Needless to say, this advance nomination seldom exactly matches the volumes actually consumed by the customers.

After the end of each month there will then remain some amount of imbalance that must be resolved, often through a process of "cashing out" that imbalance. On our system, the

imbalance cashout process really consists of two separate steps. First, the marketer (and Midwest) have an imbalance calculated for them individually by the interstate pipeline. For most of the interstate pipelines we work with, this imbalance is calculated as the difference between a shipper's nomination and the volume assigned to that shipper by the interstate pipeline as a proportion of the total amount of flowing gas. In other words, it is not tied to the volume of gas consumed by any specific customers; rather, it recognizes the imbalance only on the interstate pipeline incurred by each shipper. At the second step of the process, Midwest then balances individually all the marketers serving customers on our distribution system. This is done by calculating the difference between the volume allocated by the interstate pipeline and the sum of each marketer's customers' actual volumes.

With this as a background, I would like to express some concerns of Midwest Energy with several aspects of the proposed Bill.

1. The term "public utility" as specified in KSA 66-1,200 and 66-104 would seem to include interstate pipeline companies. If so, then there is a jurisdiction issue here in that all cashout provisions administered by an interstate pipeline are subject to the jurisdiction of the Federal Energy Regulatory Commission via a FERC-approved tariff. The supervision exerted on an interstate pipeline as to rates and terms of service by the Kansas Corporation Commission is somewhat limited compared to the Commission's supervision of local gas distribution utilities. The interstate pipelines use FERC-approved procedures that include provisions for both the rate at which imbalances are cashed out, and the timing under which this is accomplished.
2. The local distribution companies, or LDCs, like Midwest generally design their cashout provisions to fit logically with those of the interstate pipeline(s) from which they take delivery of natural gas into their distribution systems. Midwest has such provisions on file with the Kansas Corporation Commission that were designed to fit with those interstate pipeline practices. On our system, we work with several different interstate pipelines, and must have procedures in place that

will work with the different pipelines' balancing program. There have also been significant changes in the imbalance resolution provisions on several interstate pipelines serving Midwest over the past few months, and we must be able to adjust our processes and practices accordingly from time to time.

3. There is some question in my mind regarding the language of paragraph (1). It refers to a "cashout adjustment calculation for any nomination imbalances for a given month for such transportation customer". In our system we bill the gas marketer, not the individual customer, for any imbalance incurred, in aggregate, by the customers contracting with that marketer. To the extent a marketer bills the individual customer directly for any imbalance gas we are not involved. In essence this becomes an issue of transfer of risk and responsibility.
4. Also in paragraph (1) the requirement that a public utility "use a monthly average to determine such cashout rate for the month in which the imbalance occurred" is inconsistent with the balancing provisions a marketer or LDC faces on many interstate pipelines. Most of the pipelines base their cashout rates, except for so-called "operational flow orders" or "periods of daily balancing" on first-of-month indices, or on more specific index averages. (Kinder Morgan Interstate: Average of the weekly averages of several indices; Southern Star: First of month, tiered, with penalties for magnitude of deviation from a tolerance volume.) Midwest currently uses first-of-month prices for setting the cashout rates, and assesses penalties for volumes beyond the allowed tolerance. Perhaps more importantly, we also allow marketers to "swap" their imbalance with other marketers having an opposite position, thereby avoiding a cashout entirely in most cases. This seems to strike a reasonable balance among all the parties' interests.
5. Some interstate pipelines, and some LDCs like Midwest, use a penalty rate for some or all of the imbalance volumes. The idea is to provide an incentive for marketers to avoid "gaming the system" through the imposition of penalties. Absent this penalty structure, marketers may perceive an incentive to game the system by nominating low amounts during periods in which daily prices are high, and vice-versa. The result of such gaming is that captive customers, i.e.,

residential customers, end up paying more for gas because those gaming the system pay only the average price, not the actual price.

6. During the so-called "operational flow orders" or "periods of daily balancing" mentioned previously the interstate pipelines often switch to daily indices for cashing out imbalances. This keeps the cost of the imbalance consistent with prevailing market conditions, and again provides an incentive to avoid imbalances to the extent possible.
7. The language of paragraph (1) is not sufficiently specific in that it doesn't define the "monthly average". Is it an average of weekly averages, an average of daily averages, an average of daily "highs", etc.? This would seem to be a question better addressed by the regulatory commission having jurisdiction over an LDC or interstate pipeline.
8. We assume the intent of paragraph (2) is to provide notification in advance as to the precise beginning and ending date of each period over which balancing calculations will apply. In its simplest form, this implies advance notice of meter reading dates. In practice we read the meters for transportation customers as close to the end of the month as possible to approximately coincide with the billing period of the interstate pipeline, but we can not specify in advance a precise date that a specific customer's meter will be read each month. Since we read customer's meters nearly every day each month, a number of different factors cause the reading date for a specific customer to occasionally vary by a few days.
9. In order to specify in advance a precise meter reading date we would likely need to install electronic flow meters (EFM) at each transportation customer location. Given our large number of transportation customers, we have not yet made the investment to install EFMs, and therefore can not state precisely, in advance, when a specific meter will be read. Midwest would incur significant costs if it were required to install EFMs on all transport customers in order to meet the requirements in the proposed legislation.

The primary goal of an imbalance resolution process, through a cashout mechanism or other means, is to provide an incentive for all parties to schedule gas deliveries that are consistent with anticipated and actual demand. Because LDCs like Midwest deal primarily with the gas marketers, who in turn represent a number of end-use customers, our balancing transactions are with the marketers, not the individual customers. The issues surrounding this Bill seem to revolve around reasonable expectations of the market participants, and open lines of communications between the LDC, the gas marketers and the individual customers. The preferred solution to problems that arise would seem to be to improve gas transportation programs, based on realistic expectations, through the current regulatory framework if necessary, rather than through legislative mandates.

Midwest Energy, Inc. appreciates the opportunity to discuss our concerns regarding Senate Bill No. 522. Thank You.