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September 5, 2002

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Missouri Public
Service Commission

Mr. Dale Hardy Roberts
Executive Secretary
Missouri Public Service Commission
200 Madison Street, PO Box 360
Jefferson City, MO 65102-0360

RE: In the Matter of the Tariff Filing of Missouri Gas Energy - Case No. GT-2003-0033
Tariff No. JG-2003-0049

Dear Mr. Roberts:

Enclosed please find the original plus eight (8) copies of the Direct Testimony of Louie R. Ervin to be filed on behalf of Missouri School Boards' Association in the above-captioned matter.

If you should have any questions concerning the enclosed filing, please do not hesitate to contact me. Thank you.

Very truly yours,

HENDREN AND ANDRAE, L.L.C.

Richard S. Brownlee, III

RSB\s
Enclosures
All Counsel of Record
Melissa Randol

Exh. No. _____
Louie R. Ervin - Direct
MSBA
Case No. GT-2003-0033

**BEFORE THE PUBLIC SERVICE COMMISSION**

**OF THE STATE OF MISSOURI**

| | | |
|---|---|---|
| In the Matter of the Tariff Filing Of Missouri Gas Energy, a Division of Southern Union Company | ) ) ) ) | **Case No. GT-2003-0033** Tariff No. JG-2003-0049 |



# DIRECT TESTIMONY

OF

LOUIE R. ERVIN

**Exh. No. _____**
**Louie R. Ervin - Direct**
**MSBA**
**Case No. GT-2003-0033**

# AFFIDAVIT OF LOUIE R. ERVIN

STATE OF IOWA )
)ss.
COUNTY OF LINN )

Louie R. Ervin, of lawful age, on my oath states, that I have participated in the preparation of the foregoing direct testimony in question and answer form, consisting of 17 pages, to be presented in this case; that the answers in the foregoing testimony were given by me; that I have knowledge of the matters set forth in such answers; and that such matters are true to the best of my knowledge and belief.

Louie R. Ervin

Louie R. Ervin

Subscribed and sworn to before me this 3 day of September, 2002.

MARILYN L. WILSON
NOTARIAL SEAL - STATE OF IOWA
COMMISSION NUMBER 712460
MY COMMISSION EXPIRES SEPT. 10, 2004

Marilyn L. Wilson

Notary Public

My Commission Expires: 9/10/04

STATE OF MISSSOURI
BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION

| | | | |
|---|---|---|---|
| IN RE: | Missouri Gas Energy, a Division of Southern Union Co. ) ) ) | CASE NO. TARIFF NO. | GT-2003-0033 JG-2003-0049 |

**DIRECT TESTIMONY OF LOUIE R. ERVIN**

**Q. Please state your name and business address.**

A. My name is Louie R. Ervin and my business address is 150 First Avenue, NE, Suite 300, Cedar Rapids, Iowa 52401.

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

A. I am a partner in the firm of Latham & Associates, Inc., Cedar Rapids, Iowa and hold the position of Executive Vice President.

**Q. Please describe your educational background.**

A. My academic background includes a B.S. and M.S. in Electrical Engineering from the University of Missouri-Columbia and an M.B.A. from the University of Iowa. I have also taken executive utility management courses at the University of Michigan and other utility-related courses at Indiana University, University of Wisconsin and Iowa State University.

**Q. Please describe your professional experience.**

A. Since July 1996, I have been employed as an energy advisor with Latham & Associates. Prior to joining Latham & Associates, I was employed from June 1985, to July 1996, by IES Utilities Inc. (IES) in a number of executive positions with responsibilities including rates, engineering and operations. While employed at IES Utilities, I received Gas Industries magazine 1993 Outstanding Manager of the Year Award. Before my employment with IES, from January

1983 to July 1985, I was Associate Director of Utilities for the Lafayette Utilities System, a Louisiana municipal utility. From June 1971 to January 1983, I was employed by Missouri Utilities Company, a natural gas and electric utility, which is now part of the AmerenUE system. My responsibilities at Missouri Utilities included rates, engineering and operations.

**Q. Please describe your experience as an expert utility witness.**

A. While employed at the Missouri Utilities Company, I testified on rate design matters in a number of natural gas, water and electric cases before the Missouri Public Service Commission and the Federal Energy Regulatory Commission. I have testified in federal and state court regarding electric utility matters. While employed at IES Utilities, I testified on rate design matters in natural gas and electric cases before the Iowa Utilities Board.

**Q. Please describe your business.**

A. Latham & Associates is an independent adviser to primarily midwestern purchasers of natural gas and electricity. Our clients include schools, colleges, universities, industrials, hospitals, smaller municipal electric utilities and associations. Our primary activities are the negotiation of short-term and long-term electric supply and natural gas supply agreements, preparation of class cost of service studies and rate designs, aggregation of clients into larger purchasing pools, oversight of the administration of energy supply contracts, advice on strategic energy investments in electric generation capacity, consultation on general energy strategies, and energy policy advice on legislative and regulatory affairs. In this business, we are constantly involved in energy pricing and cost of service issues, energy market transactions and advice based on market conditions. We are independent consultants to school natural gas aggregation programs in Illinois, Iowa, Kansas and Missouri. Our firm bids energy supply for clients and is not a supplier.

**Q. On whose behalf do you present this testimony?**

A. This testimony is prepared on behalf of the Missouri School Boards Association (MSBA) and the Cooperating School Districts of St. Louis (CSD).

**Q. Please describe MSBA's and CSD's interest in this docket.**

A. MSBA's membership consist of approximately 400 public school districts with approximately 2,000 individual school locations throughout the State of Missouri. CSD's membership consists of 51 school districts with 900 individual school locations in the St. Louis area. The MSBA and the CSD are not-for-profit corporations, which serve as trade associations for the member school districts. They also sponsor and organize joint purchasing of numerous school commodities, from school busses to floor wax. The MSBA and CSD are interested in aggregating natural gas purchases for schools.

**Q. Please describe the purpose of your testimony.**

A. The purpose of this testimony is to recommend tariff requirements, which will satisfy the subject statute and will provide a reasonable opportunity for schools to successfully aggregate natural gas purchases. My testimony will address:

1. Schools' experience with and the legislative history regarding natural gas aggregation.
2. Implementation of the proposed tariff will not have a negative financial impact on the gas corporation, its other customers, or local taxing authorities.
3. The aggregation charge in the tariff is sufficient to generate revenue at least equal to incremental costs caused by the experimental program.
4. The proposed tariff meets the legislative requirements, including: aggregate purchasing, opportunities for schools to purchase supplies through a not-for-profit

school association, purchasing of utility pipeline capacity at utility's cost, and no telemetry except for school meters using over 100,000 therms annually.

5. Other tariff requirements necessary for aggregate purchasing of natural gas by Missouri schools.

**Q. Has Missouri previously had any program dealing with aggregate natural gas purchasing for schools?**

A. Yes. Beginning in 1999, the MSBA and the CSD began jointly sponsoring aggregate natural gas purchasing for Missouri schools. The MSBA and CSD aggregate purchasing program is very similar to school programs in Kansas, Iowa and Illinois, with one major difference. Adjacent states have natural gas utility transportation tariffs that are designed for smaller users. Missouri transportation tariffs, for the most part, were designed over fifteen years ago for the industrial and larger user. While school programs in adjacent states have grown significantly over the past few years, the MSBA and CSD school program remains at less than 10 % of its potential because of tariff barriers for smaller users.

**Q. Could you describe the legislative history behind this current tariff filing?**

A. Beginning as early as 1999, the MSBA and CSD made requests to every Missouri investor-owned utility to file experimental small volume natural gas transportation tariffs for schools with the Commission. Ameren did receive Commission approval for a tariff change, which allowed smaller users to pay a monthly telemetry charge in lieu of an initial expenditure. The Missouri Public Service Company, now Aquila, received Commission approval for a small volume transportation tariff. The MSBA and CSD program currently has some schools transporting on the systems of Ameren, Aquila and the Missouri Gas Energy Company (MGE) system. However, neither the Ameren nor the Aquila tariffs fully meet the needs of Missouri

schools for small volume aggregation and the MGE large volume tariff is prohibitive for all but the largest school facilities. The MSBA and CSD proposed legislation and the Missouri 91st General Assembly, 2nd Regular Session, passed CCS for SCS for HB 1402 which provided, inter alia, that gas corporations certificated by the Missouri Public Service Commission are required to file experimental tariffs, which allow the aggregate combination of natural gas supply and transportation services, including balancing. The MSBA, as agent for schools, is offering aggregate natural gas purchasing to all eligible Missouri schools under the experimental tariffs.

**Q. Please describe the structure of the MSBA and CSD aggregate natural gas purchasing program.**

A. With regard to natural gas purchases, the MSBA is the contracting entity on behalf of the CSD and MSBA and is agent for participating school districts. Latham & Associates bids natural gas supply for schools to all known interested marketers. Daily operations and administration of the joint school natural gas purchasing program is currently contracted to a third-party administrator, TXU Energy Services (formerly Enserch Energy Services) with offices in Kansas City, Mo. Only the larger school facilities on MGE, AmerenUE and Aquila systems are currently jointly purchasing natural gas through the CSD and MSBA consortium.

**Q. Please describe barriers for smaller users in Missouri transportation tariffs.**

A. Because large users, particularly industrial process users, can create large unpredictable swings in flows on natural gas systems, special expensive telemetry is usually a standard provision in large volume transportation tariffs to record daily usage. Standard small-user meters are typically very low cost, do not have a phone connection and are read by the utility monthly. Initial installation costs for telemetry and a phone line are generally from $2,000 to $5,000 and the monthly phone charge is normally in the range of $50.00 per month. Over the

past few years, it has been successfully demonstrated in adjacent states and in other states around the country, that telemetry is unnecessary for smaller users with essentially only heating requirements. Forecast algorithms, based on weather and historic usage, have been developed to accurately determine daily usage for small users. Thus, a tariff requirement for telemetry is unnecessary for smaller weather-sensitive users.

**Q. What other small-user barriers exist in current Missouri tariffs.**

A. Conventional transportation tariffs typically require each meter to stand alone. Large user tariffs normally require individual nominations in advance for each meter as to volumes to be delivered each day of the month. If actual daily or monthly usage is out of balance with the volumes of natural gas nominated and delivered by a third-party marketer or supplier, then the customer is subject to penalties, which can be tremendously expensive. Within each utility natural gas system and on the same pipeline, small user tariffs typically allow multiple meter aggregate nomination and balancing. Although, projection of small weather-sensitive usage can be very accurate, there remains some over or under delivery, or imbalance, which the utility system must handle. Pipelines have some ability to absorb imbalances within acceptable operating pressures. Larger imbalances are generally handled through use of utility storage gas. Because there is some costs associated with the administration and balancing, small-users tariffs typically have an administration or aggregation charge and a balancing charge, or an "aggregation and balancing fee."

**Q. What benefits are expected from this experimental natural gas aggregation program?**

A. Benefits from this experimental program are expected for Missouri schools, other small natural gas consumers, utilities, natural gas marketers, regulators and legislators. The primary

benefit is for all to learn what works and what doesn't work with regard to small volume natural gas transportation in Missouri. As an experimental program, it is neither necessary nor desirable for all utility experimental tariffs to be identical. All tariffs can meet the legislated requirements while reflecting differences in utility systems. Of particular concern to schools are the utility costs to implement this experimental program. Utility costs can be minimized by working within existing utility procedures and systems, to the extent practical and in conformity with legislated directives. Existing nomination procedures and billing systems vary by utility and Missouri schools are prepared to work with utilities to minimize utility incremental program costs.

Certainly, the Missouri schools objective includes achieving aggregate purchasing savings similar to what schools are receiving in Kansas, Iowa and Illinois. Missouri schools also want to achieve greater budget certainty. Typically, schools under utility sales service have no ability to lock-in a price for natural gas. Although the utility PGA commodity price for sales service is fixed for specified periods, there is a true-up ACA factor, which effectively creates significant budget uncertainty for schools on prior period utility costs under recoveries.

**Q. Please address how the proposed tariff will not have a negative financial impact on local taxing authorities.**

A. Local taxing authorities establish franchise taxes as a percentage of the actual total bill. The total bills, whether from utilities or from others, are always variable and depend on usage and price. Usage can vary significantly with weather, conservation efforts and other factors. Utility price varies depending on the PGA. The Act eliminates the potential of avoiding a franchise tax on the commodity because the natural gas supplier may be an out-of-state entity. It was not the intent to create a tax on an artificial bill, as if the utility were the supplier. To the

extent the tariff provides that the not-for-profit school association will collect the prescribe local tax percentage on the participating schools' actual total bill, including the commodity supply, and remit said taxes collected to the utility for payment to the respective local taxing authorities, there will be no negative impact to the local taxing authority.

**Q. Are there generally tax and/or Purchase Gas Adjustment (PGA) differences between large and small volume transportation tariffs?**

A. No, generally small and large volume transportation tariffs are the same with regard to taxes and PGA charges. However, because third-party out-of-state suppliers to transportation customers may not have a Missouri nexus, local taxing authorities may not collect franchise taxes on the commodity, as they do on utility sales service. Frequently, large-user transport customers are able to avoid local franchise taxes on all but the utility delivery service charges. With regard to Missouri PGAs, the ACA component is a true-up or reconciliation factor to collect or return previous period under or over collections for utility sales service customers. It is neither MSBA's nor CSD's objective to avoid local franchise taxes or charges associated with sales service to participating schools for the previous PGA period.

Q. **Please address how the proposed tariff will not have a negative financial impact on other customers.**

A. There will be no negative impact to other customers to the extent the tariff stipulates the utility will not propose charges to other tariffs because of this experimental program. Further, the Commission has the authority to disapprove any utility tariff charges that may be proposed for other customers because of this experimental program.

**Q. Please address how the proposed tariff will not have a negative financial impact on the natural gas corporation.**

A. There will be no negative impact to the natural gas corporation to the extent the tariff specifies charges equal to: (a) applicable sales service margins; (b) demonstrated costs for pipeline capacity release for up to one year; (c) previously incurred out-of-period ACA supply costs applicable during the first year a school begins transportation service, (d) an aggregation and balancing fee of $0.004 per therm during the first year, and thereafter a charge per therm as approved by the Commission, which is based on utility reporting of incremental **recurring** costs of aggregation and balancing charges from the first year of the experimental tariff.

**Q. Please provide a basis for finding that the aggregation charge in the tariff is sufficient to generate revenue at least equal to incremental costs caused by the experimental program.**

A. Utility incremental costs of the experimental program cannot be passed on to other customers. The Commission can order the utility to provide incremental recurring cost support data for any future proposed increase in the aggregation and balancing charges in excess of $0.004 per therm. Because utility accounting and reporting incremental **recurring** costs may be high relative to actual incremental costs of the program and because schools may be subject to paying for these utility accounting and reporting expenses, the utility should be allowed to elect continuance of $0.004 per therm through the end of the program without further cost support. By the utility electing not to conduct accounting and reporting activities and not to increase the $0.004 per therm charge, it has effectively deemed full cost recovery or has waived its right to recover any additional incremental costs.

**Q. Is there experience on how schools can be grouped for aggregation purposes?**

Yes. Experience in other states is that the utility can reasonably treat school purchases in aggregate by pipeline or rate zone. That is, for purposes of nominating and balancing deliveries,

all school volumes on a pipeline and within a rate zone will be summed to determine whether any monthly imbalances have occurred. As part of the aggregation and balancing fee, schools are paying the utility for the system to continue balancing daily deliveries with actual usage, as is currently being done for schools under sales service tariffs. Daily imbalance fees are needed because small customers do not have telemetry and only monthly total metered usage data is available. Although small customer imbalances may not have a material effect on the utility system reliability, the utility and schools need to agree on a reasonable algorithm to project usage based on forecasted weather. Forecast algorithms have been tested and proven accurate for schools in adjacent states. MidAmerican Energy Company of Des Moines actually installed some load research telemetry for small school accounts and determined their forecast algorithm was within metering accuracy. MSBA's third-party program administrator, TXU Energy Services, will either use its Kansas school forecast algorithm or it can provide experimental tests of a utility proposed forecast algorithm.

**Q. Please generally explain why pipeline capacity is an issue with regard to transportation tariffs.**

A. Utilities contract for interstate pipeline capacity to receive natural gas for its sales service customers. Large user transporters typically purchase supply from marketers, which contract for interstate pipeline capacity through which they arrange for commodity deliveries to the utility system at points called "town border stations" or "city gates." Some transportation tariffs provide a minimum notice period for a sales customer to transfer to transportation service, which allows time for the utility to plan and manage its contracted pipeline capacity. Absent giving the required notice, the customer may be subject to stranded costs. Typically, transportation tariffs limit the stranded cost obligation to a maximum of one year. Frequently, utility small-user

transportation tariffs allow the customer, or its agent, to take contractual responsibility for utility capacity for up to one year to avoid stranded costs. Federal Energy Regulatory Commission (FERC) jurisdictional pipeline tariffs specify procedures for electronically posting capacity for release. Some utilities want the capacity released permanently and others prefer temporary releases, depending on anticipated future system requirements.

**Q. What are your recommendations regarding capacity release?**

A. First, the tariff must meet the legislative mandate that pipeline transportation capacity be made available under the experimental program at the gas corporation's cost. The legislative mandate can be satisfied by experimental tariffs with capacity release guidelines. However, operations details should be left for individual utilities and the schools to experiment with effective capacity release procedures. The utility should annually file a report with the Commission outlining program implementation specifics, including: (a) process used for capacity releases; (b) method used to determine levels of capacity released; (c) amounts of capacity released on each pipeline at specific receipt and delivery points; (d) price and amount of revenue received for released capacity; (e) cost of released capacity; and (f) disposition of revenues for released capacity.

**Q. Should there be a uniform procedure for pipeline capacity release for all utility experimental tariffs?**

A. No. There should be a standard guideline for capacity release, but operating flexibility is needed for each utility system. Each utility system is different and may have different system capacity needs and different interstate pipeline operating requirements. Detailed operating procedures for capacity release should not be part of the initial experimental tariffs. If the

schools have a complaint concerning how an individual utility is handling capacity release or other operational matters, that complaint can be brought to the Commission's attention.

**Q. What guidelines do you recommend with regard to notification and term of capacity releases?**

A. Initial capacity releases should be through June 30th of each year. Typically, each utility will use the early summer months to forecast and arrange necessary capacity for the following heating season. Capacity releases should only be required at the beginning when schools enter the experimental program and only if the utility deems it would incur stranded capacity costs. To avoid stranded costs to anyone, the schools should be required to take released capacity at initial enrollment until the following June 30th. Prudent capacity planning contemplates annual variations in capacity requirements. The relatively small amount of capacity needed for this school experimental program should be very manageable by utilities. Under no circumstances should schools be required to take released capacity for more than one year. Because utilities currently are obligated to have capacity for schools and schools are obligated to pay for capacity, the school should have the right to retain that capacity for the full term of the program, particularly in cases of constrained pipelines where no alternative capacity may be available.

**Q. What other guideline do you recommend with regard to capacity releases?**

A. Tariff capacity release guidelines should include:

a. The release shall be temporary, unless permanently released by mutual agreement of the parties. If capacity is permanently released and schools wish to return to firm sales service, the utility shall accept such schools as a firm sales customer, provided the capacity needed to serve the schools also returns with the school, or alternative firm capacity can be acquired by the utility at a comparable cost.

b. Schools shall not be obligated to take the capacity release beyond the June 30th following initial participation in the experimental program.

c. Capacity release shall automatically continue and shall not be recalled by the utility during the term of the experimental tariff, unless a recall is requested by the schools.

d. The capacity shall be posted and released in accordance with FERC rules and at a price equivalent to the utility's capacity cost component of the current PGA. If a third-party bids and receives the capacity at a price higher than the posted price, or if the schools bid and receive the capacity at a price higher than the posted price, then the utility shall first credit the aggregation and balancing fee and any further capacity release revenue in excess of the utility's cost shall be credited to all customers through the PGA.

e. Capacity releases shall be on the predominate pipeline(s) serving the utility system from which the participant schools receive service.

**Q. Other than tariff requirements for capacity release, what other tariff requirements are necessary to meet the legislative mandate?**

A. Experimental tariffs must: (a) provide for aggregate natural gas purchasing through a not-for-profit school association; (b) treat school purchases in aggregate; and (c) not require telemetry, except for school meter usage over 100,000 therms annually.

**Q. How does MSBA propose to handle transportation contracts for this program?**

A. The MSBA is offering aggregate purchasing to all Missouri public schools and will consider offering the same service in years two and three to non-public eligible school entities. Each school district has the authority to enter into natural gas agreements by resolution of its board. MSBA has developed a standard form Membership and Participation Agreement, which

the school districts will approve and sign. The Membership and Participation Agreement designates the MSBA and/or its third-party administrator as agent to enter into utility contracts, receive historic usage data, pay all utility and supplier bills, pay all taxes, pay all other program expenses and to render a consolidated invoice to the school district. Aggregate natural gas purchasing through a not-for-profit school association can be accomplished with few modifications to utility standard transportation contracts. Standard utility transportation contracts for this program, if required by utility tariff, will be efficiently administered and executed for all school districts by their common agent.

**Q. Please address the 100,000 therms per year limitation for telemetry.**

It is important to note that tariffs must meet the legislative mandate for all school accounts, whether over or under 100,000 therms per year. The utility tariff must provide for aggregate school purchasing for school accounts with usage of over 100,000 therms annually under the same terms and conditions as for smaller usage accounts, with the exception that telemetry may be required. The legislative mandate for aggregate natural gas purchasing for all school accounts does not, in my opinion, prevent the utility from separately balancing telemetered and non-telemetered accounts, on the same pipeline and within the same rate zone.

**Q. How will the legislative mandate for resale of natural gas supplies and transportation services be accomplished?**

A. Resale is accomplished when the school association arranges for the natural gas supply from third-party gas marketers and it is resold to schools. I know of no transportation tariffs in the region or experimental school programs that provide for anything other than resale of natural gas from third-party marketers or suppliers to the end-user. The utility has no costs associated with third-party natural gas supply to the schools and has satisfied the law by charging its costs

for supplies, which are zero. The previously proposed capacity release guidelines effectively provide that the utility will release the capacity for resale to the schools at its cost.

**Q. Have you reviewed the tariff proposed by MGE in this docket?**

A. Yes.

**R. Q. Did you find the proposed MGE tariff in compliance with CCS for SCS for HB 1402, legislation requiring filing of experimental aggregation transportation tariffs for schools?**

A. Yes.

**Q. Did you find the other requirements of the MGE tariff to be reasonably workable for an experimental school aggregation program?**

A. Yes, I think the latest tariff is acceptable with the understanding that it is likely that all parties will learn something during implementation that may need to be addressed with a future tariff change. Unless something unexpected arises to my attention, my recommendation is for the Commission to approve the Atmos tariff and let's see how it works during year-1.

**Q. Do you have any further matters to bring to the attention of the Commission?**

A. Yes, I have a request. Schools need to have the Commission approve tariffs as soon as possible to enable the program to start-up and supplies to be delivered this heating season. The law recognizes its emergency nature. For the past three years, larger schools facilities on the MGE system have been successfully transporting under contracts negotiated by the MSBA and CSD natural gas consortium. Consideration is requested to approve the MGE tariff as requested effective September 24, 2002, or as early as practical prior to a November 1, 2002.

**Q. Does this conclude your testimony?**

A. Yes, it does. Thank you.