

Exhibit No.:
Issue: Agency and Sales Agreements,
Transportation Agreements
Witness: Clark C. Smith
Sponsoring Party: Missouri Gas Company, LLC and Missouri
Pipeline Company, LLC
Type of Exhibit: Rebuttal Testimony
Case No.: GC-2006-0491
Date Testimony Prepared: October 6, 2006

**MISSOURI GAS COMPANY, LLC
MISSOURI PIPELINE COMPANY, LLC**

REBUTTAL TESTIMONY

OF

CLARK C. SMITH

CASE NO. GC-2006-0491

****HC denotes HIGHLY CONFIDENTIAL INFORMATION****

October 6, 2006

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REBUTTAL TESTIMONY

OF

CLARK C. SMITH

MISSOURI GAS COMPANY, LLC**MISSOURI PIPELINE COMPANY, LLC**

CASE NO. GC-2006-0491

Q. Please state your name and business address.

A. Clark C. Smith, 700 Louisiana, Suite 1100, Houston, Texas 77002.

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

A. I am the Managing Director of Engage Investments, L.P. a private equity investment company. In addition to seeking investments, Engage provides advisory and consulting services.

Q. Please describe your educational background.

A. I received my BBA and MBA degrees from the University of Texas at Austin, in 1976 and 1978, respectively.

Q. Please describe your work experience.

A. I have spent 28 years in the energy industry most of which was spent in the executive management of companies engaged in the buying, selling and transportation of natural gas to markets across North America. I also served as Executive Vice President of an interstate pipeline which included responsibility for state regulatory affairs. My biography is attached as Appendix T.

Q. Have you previously filed testimony before this Commission?

1 A. No. I have previously testified at the FERC and various state legislative and
2 regulatory hearings.

3 **Executive Summary**

4 **Q. Please provide an “executive summary” of your testimony in this case.**

5 A. The purpose of my testimony is to explain my review of the testimony of Staff
6 witnesses, Mr. Imhoff and Mr. Shallenberg relating to several contracts, including the
7 Agency and Sales Agreement between the City of Cuba (Cuba) and Omega Pipeline
8 Company, LLC (Omega) effective July 1, 2003, (Cuba Sales Agreement or Sales
9 Agreement) and the transportation agreements between Missouri Pipeline Company,
10 LLC (MPC) and Cuba (MPC/Cuba Transport Agreement) and between Missouri Gas
11 Company, LLC (MGC) and Cuba both effective July 1, 1999. I will collectively refer
12 to the MPC/Cuba Transport Agreement and the MGC/Cuba Transport Agreement as
13 Transportation Agreements. I will also address the validity and appropriateness of
14 the following Omega gas sales and transportation agreements:

- 15 - G-P Gypsum Sales Agreement (G-P Gypsum) effective August 1,
16 2003;
- 17 - Willard Asphalt Paving, Inc. Sales Agreement (Willard) effective
18 April 1, 2004;
- 19 - Emhart Glass Manufacturing, Inc. Sales Agreement (Emhart Glass)
20 effective December 1, 2004;
- 21 - City of Cuba Transportation Agreement (Omega/Cuba Transportation
22 Agreement) effective July 1, 2003;

- 1 - MPC Transportation Agreements effective March 1, 1999 and
2 February 1, 2005, respectively; and
3 - MGC Transportation Agreements effective January 1, 1995 and
4 February 1, 2005, respectively.

5 **Q. After receiving the testimony of Staff witnesses, Imhoff and Shallenberg, the**
6 **Sales Agreements and the Transportation Agreements, can you please**
7 **summarize your conclusions?**

8 A. Based on my review and my 28 years of experience in the regulated and non-
9 regulated side of the pipeline and marketing industries, I conclude as follows:

- 10 1. The Sales Agreement (Appendix I) between Cuba and Omega is an
11 independent, valid and binding agreement between Cuba and Omega, wholly
12 separate and distinct from the Transportation Agreements.
- 13 2. The obligations, rights, and duties between Omega and Cuba under the Sales
14 Agreement were independent of the obligations of MPC and/or MGC and
15 Cuba under the Transportation Agreements between MPC/MGC and Cuba
16 (Appendices G & H).
- 17 3. The recommendations or suggestions by Staff witnesses that the discounts to
18 transportation provided by MGC to Cuba under the MGC/Cuba Transport
19 Agreement were actually discounts to Omega are unfounded and without any
20 legal or other basis.
- 21 4. The Sales Agreements by which Cuba designated Omega as its agent to sell
22 gas to Cuba and by which Omega administered the contracts of Cuba
23 including the Transportation Agreements are normal and customary in the

1 industry. The Sales Agreement did not afford Omega any advantage over
2 other marketing or shippers solely related to Omega's affiliated relationship to
3 MPC and/or MGC.

4 5. The G-P Gypsum Sales Agreement (Appendix K) and Omega/Cuba
5 Transportation Agreement (Appendix U) were independent of the obligations
6 of MPC and/or MGC and are customary natural gas service agreements
7 between a gas marketing company and its customers and/or transporters.

8 6. The sales agreement between Omega and Willard (Appendix J) is a standard
9 gas marketing agreement with common terms and conditions. Once again, the
10 Willard agreement was entered into separate and apart from the upstream
11 transportations agreements on MPC and MGC.

12 7. The sales agreement between Omega and Emhart Glass (Appendix L) is a
13 standard gas marketing agreement with common terms and conditions. This
14 agreement is also independent of the upstream and downstream transportation
15 agreements involving MPC , MGC or the Ameren UE distribution system.

16 8. The MPC and MGC transportation agreements with Omega (Appendices V
17 and F-1) are standard agreements and do not reflect any discriminatory
18 treatment in the terms and conditions. It is very common for marketing
19 companies, including affiliates, to enter into these types of transportation
20 agreements to supply the local distribution company and industrial markets.
21 In particular, the inclusion of multiple receipt and delivery points is a standard
22 operating practice of pipelines across the U.S.

City of Cuba Sales Agreement Was Independently Entered Into

Q. Please explain your reasons, conclusion and opinion that the Sales Agreement between Cuba and Omega was independently entered into by Cuba.

A. There are several reasons for my conclusion:

1. Cuba had choices. There are literally hundreds of marketing companies across North America that provide the sales/agency services that Omega is providing to Cuba, i.e. selling natural gas and acting as agent for administering the ancillary services such as transportation to the point of delivery. Cuba is a municipally owned LDC capable and free to select the marketer of its choice based on a variety of factors including price, quantity and quality of services. ONEOK Marketing, the marketing arms of Ameren, Panhandle, MRT and Aquila, among many others were all choices, available at the time Omega and Cuba entered into the Sales Agreement. Cuba independently chose Omega. In fact, Cuba has exercised its right of choice. In prior years, Cuba had used Ameren Energy Fuels and Services Company an Affiliate of Ameren UE (Ameren) to do what Omega does for Cuba, now namely sell gas to Cuba using Cuba's transportation capacity on MPC and MGC to deliver gas to the Cuba City Gate. (See Appendix M). It appears from those documents provided by Staff in response to DRs by MPC and MGC, that Cuba had used Ameren as its marketing agent in the period 1999 to 2003 when Cuba exercised its independent choice and made Omega its sales agent. My point is Ameren, as sales agent, had the obligation to sell gas to Cuba, delivered to Cuba's City Gate just like Omega and like Omega also had

1 to nominate the volumes, pay MPC/MGC on behalf of Cuba for Cuba's use of
2 transportation capacity and other administrative functions. I do not see in the
3 testimony of Staff witnesses, Imhoff or Shallenberg, where they acknowledge
4 the existence of any agency and sales agreement between Cuba and Ameren,
5 despite the records being in Staff's files. The fact remains there is nothing
6 extraordinary about the Sales Agreement between Cuba and Omega, any more
7 than there was in the similar contract between Ameren and Cuba during the
8 years preceding the Cuba/Omega Sales Agreement.

9 2. Staff witnesses, Imhoff and Shallenberg, offer no evidence Cuba was coerced
10 to sign the Sales Agreement, so the only conclusion possible is that Cuba's
11 selection of Omega was based on other market factors, price, services, etc. In
12 fact in the emails and other documents produced by Staff (see Appendix W) it
13 appears Cuba was seeking bids from Ameren for sales services prior to
14 selecting Omega. Cuba has a choice and appears to have compared the offers
15 of Omega and Ameren and selected Omega.

16 3. The Sales Agreement between Omega and Cuba has only a one year term and
17 can be cancelled by either party with a 90 day written notice prior to an
18 anniversary date and the fact Cuba has had three opportunities to terminate the
19 Sales Agreement, but has not, indicates Cuba is satisfied with the terms and
20 performance by Omega. If Omega's price for gas or quality of service had not
21 met Cuba's satisfaction, Cuba would have terminated the agreement, but has
22 not done so.

1 4. Most importantly, Cuba specifically acknowledges it has choices in its
2 procurement of gas supply. In paragraph 16 of the “Terms and Conditions” of
3 the Sales Agreement (Appendix I), Cuba specifically says: **_____
4 _____
5 _____** In paragraph 18 of the “Terms and
6 Conditions” of the sales agreement, Cuba states: **_____
7 _____
8 _____
9 _____** These two provisions alone put to rest unambiguously any
10 assertion or implication by Staff that the Sales Agreement was not valid and
11 binding between Omega and Cuba.

12 **The Sales Agreement is Independent of and Distinct from the Transportation**
13 **Agreements**

14 **Q. Why do you conclude the Sales Agreement and Transportation Agreements are**
15 **separate and distinct and not tied to each other?**

16 A. There are a number of very self evident reasons to arrive at the conclusion that the
17 Sales Agreement and Transportation Agreements are independent and not tied to each
18 other.

19 1. MPC and MGC had contracts to transport gas for Cuba since at least 1999,
20 well before Omega and Cuba executed the Sales Agreement in July 2003.
21 This reason alone is sufficient to establish the contractual relationship between
22 Omega and Cuba is separate from and not tied to the contractual relationship
23 between MPC and MGC to transport gas to Cuba. As mentioned above,
24 Ameren had administered the pre-existing transportation agreements between

1 Cuba and MPC and MGC from 1999 to 2003, prior to any sales relationship
2 between Omega and Cuba in July 2003. As such, this provides critical
3 evidence that the Omega/Cuba Sale Agreement could not have been tied to the
4 Transportation Agreements, i.e., the Transportation Agreements were entered
5 into years before the Sales Agreement between Cuba and Omega.

6 2. Specifically, under the Sales Agreement, the obligations of Cuba to pay
7 Omega for services and gas supply is an obligation only between Cuba and
8 Omega. Likewise the obligations of Cuba to pay MPC and MGC for
9 transportation capacity under the Transportation Agreements are solely
10 between Cuba and MPC/MGC. Staff witness offers no evidence to refute the
11 plain meaning of the Sales Agreement between Cuba and Omega
12 Transportation Agreements between Cuba and MPC/MGC. In other words,
13 while Omega may be the agent of Cuba to administer the contracts of Cuba,
14 Omega is doing so solely as Cuba's agent on behalf of Cuba. The ultimate
15 obligated party is Cuba. Nothing in the Sales Agreement obligates Omega to
16 pay MPC or MGC for Cuba's obligations under the Transportation
17 Agreements. The Sales Agreement between Ameren and Cuba in the years
18 preceding the Omega/Cuba Sales Agreement had similar provisions, whereby
19 Ameren acted as Cuba's agent to administer Cuba's obligations under the
20 Cuba Transportation Agreements with MPC and MGC.

21 3. The Sales Agreement offered no advantage to Omega solely by virtue of the
22 affiliated relationship between Omega and MPC/MGC. Omega's rights under
23 the Sales Agreement with Cuba were no greater or no less than the rights any

1 other marketer would have had. Omega had the obligation to buy gas and sell
2 it to Cuba. The price for the gas sold by Omega to Cuba was set by the Sales
3 Contract. Omega's ability to buy gas at a low enough price to ensure that
4 when it sold the gas to Cuba, Omega did not lose money, was a business risk
5 Omega took. This business risk of buying gas from third parties and
6 delivering it to Cuba at the Cuba City Gate was a risk that was no greater or
7 less than it would have been had a marketer undertook the same contract
8 obligations. It was the same risk Ameren took as Cuba's agent from 1999 to
9 2003.

- 10 4. All three reasons above are sufficient to establish that Cuba's Sales
11 Agreement with Omega was not tied to its Transportation Agreements with
12 MPC and MGC. However, we need look no further to the Sales Agreement
13 itself for uncontroversial proof. In Section 16 of the "Terms and Conditions"
14 of the Sales Agreement, Cuba agrees it had a choice, understood the affiliated
15 relationship of MPC/MGC to Omega and the Sales Agreement and Transport
16 Agreements were not tied to each other.

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Again, this straight forward contract language disproves Staff's implication that the Cuba/Omega Sales Agreement should be disregarded or that it was improperly tied to the MPC/MGC transportation agreements with Cuba. When Cuba specifically acknowledges that there was no improper tie between the contracts and that Cuba had choices, Staff's assertion to the contrary is unambiguously proven false.

11 **Omega's Relationship to Cuba was Normal in the Industry**

12 **Q. Please explain why you conclude the agency relationship Omega had with Cuba**
13 **to sell gas and administer the transportation was normal.**

14 A. The relationship of Omega to Cuba in the Sales Agreement was normal within the
15 industry. In fact, it is quite customary and becoming more common for small cities
16 like Cuba, with small gas delivery needs, to require the assistance of an experienced
17 marketer. It would be uncommon if the small LDC customer segment (as well as
18 small industrial customers) would have the necessary internal gas purchasing and
19 transportation expertise. Many cities like Cuba simply cannot afford to hire an
20 experienced gas purchasing agent to both purchase the gas supply for the city and
21 administer the contracts, including negotiating the gas supply purchases and
22 monitoring the nomination process. In my experience, I have seen many of these
23 sales/agency structures just like Cuba and Omega have entered into. In addition,

Rebuttal Testimony of
Clark C. Smith

1 sales/agency structures outside of Omega exist today in Missouri. I served as
2 President of the unregulated marketing subsidiary of The Coastal Corporation from
3 1988 to 2003. We also entered into agency based agreements with small customers in
4 markets across the U.S. For example, Coastal Gas Marketing Company acted as
5 agent for Yankee Gas, a small LDC in Connecticut to manage both their
6 transportation and storage capacity as part of a bundled sales/agency agreement.
7 Another municipality that has been using sales/agency agreements for the past several
8 years is the Municipal Gas Authority of Georgia. By using a marketing company to
9 purchase gas supply and administer its transportation contracts, cities like Cuba can
10 end up with higher quality services at lower costs than if it tried to handle all of those
11 functions in house. Again, these agency relationships are normal and customary. I
12 disagree with Staff's implication that the agency relationship between Omega and
13 Cuba was inappropriate. The fact that Ameren provided Cuba with the same agency
14 and sales services in the four years prior to Cuba selecting Omega to perform the
15 same services should have enlightened the Staff that there was nothing extraordinary
16 about Omega's agency relationship to Cuba. Likewise it appears that ONEOK
17 Marketing provides similar bundled services to the towns of St. James, St. Robert and
18 Waynesville. I reviewed billings from MPC and MGC to those three towns and
19 discussed this with Mr. Ries. It appears ONEOK is nominating gas for these three
20 towns and administering the transportation agreements that each separately holds with
21 MPC and MGC. I have attached as (Appendix X) one example of the billings by
22 MPC and MGC to ONEOK for each town that indicate ONEOK was administering

1 the billings as agent for those three towns, similar to what Ameren and Omega did for
2 Cuba.

3 **Industrial Sales Agreements Were Independently Entered Into**

4 **Q. Is there anything unusual or discriminatory in the Omega Sales Agreements**
5 **with G-P Gypsum, Willard Asphalt or Emhart Glass?**

6 A. Not at all. These sales agreements are very standard across the natural gas industry.
7 Most small industry customers buy their gas supply in the form of a “bundled”
8 service, i.e. the supply is delivered to their plant and the supplier manages the
9 upstream transportation either through their own transportation agreements or through
10 an agency relationship that allows the seller to administer the necessary transportation
11 required to deliver the gas supply to the industrial clients. As mentioned above, most
12 small customers do not have the expertise or resources to manage gas supply
13 procurement on an “unbundled” basis.

14 **City of Cuba/Omega Transportation Agreement is Standard**

15 **Q. Is there anything unusual or discriminatory in Omega’s transportation**
16 **agreement (Appendix U) with the City of Cuba?**

17 A. No. Omega’s transportation agreement with the City of Cuba allows Omega to
18 complete the sale to G-P Gypsum delivered at their plant in order to provide a
19 bundled gas supply service. Omega by this transportation contract has a rate on
20 Cuba’s LDC system. The bundled service offered by Omega is very common in the
21 natural gas industry. The City of Cuba had the right to terminate the transportation
22 with Omega agreement after six months with only a 30 day notice. Both the City of
23 Cuba and G-P Gypsum had the flexibility in their respective agreements with Omega

1 to select alternative suppliers thus ensuring Omega must stay competitive to maintain
2 this business.

3 **Omega Transportation Agreements with MPC and MGC are Standard Agreements**

4 **Q. Is there anything unusual or discriminatory in the transportation agreements**
5 **between Omega and MPC and MGC?**

6 A. I reviewed all of the relevant transportation agreements between Omega and MPC
7 and MGC and found nothing but standard terms and conditions including receipt and
8 delivery point flexibility (Appendices V and F-1). All pipelines offer receipt and
9 delivery point flexibility subject to available capacity and so long as the capacity is
10 offered on a nondiscriminatory basis. For example, Transportation Agreements on
11 interstate pipelines regulated by the FERC have a “primary” and “secondary”
12 distinction to identify the level of firm capacity being reserved at the various receipt
13 and delivery points on a primary or firm basis. However, if the “secondary” points
14 have capacity available, the pipeline will accommodate these receipt and delivery
15 points on an interruptible basis. These Omega transportation agreements with MPC
16 and MGC reflect standard industry operating procedures.

17 **Q. Does that conclude your testimony?**

18 A. Yes it does.

Rebuttal Testimony of
Clark C. Smith

BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION

Staff of the Missouri Public Service Commission)	
)	
Complainant,)	
)	Case No. GC-2006-0491
v.)	
)	
Missouri Pipeline Company, LLC and)	
Missouri Gas Company, LLC)	
Respondents.)	

AFFIDAVIT OF CLARK C. SMITH

STATE OF TEXAS)	
)	ss.
COUNTY OF HARRIS)	

Clark C. Smith, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of ____ pages of testimony to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Clark C. Smith

Subscribed and sworn to before me this _____ day of October, 2006.

Notary Public

My Commission expires: