BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Southern Missouri Gas Company, L.P.'s Purchased Gas Adjustment Factors to be Reviewed in its 1999-2000 and 2000-2001 Actual Cost Adjustment	)))))	Case No. GR-2001-388

STAFF'S BRIEF

DANA K. JOYCE
General Counsel

Robert V. Franson
Senior Counsel
Missouri Bar No. 34643

Attorney for the Staff of the
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102
(573) 751-6651 (Telephone)
(573) 751-9285 (Fax)
robertfranson@psc.state.mo.us

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BACKGROUND

This case deals with two separate Actual Cost Adjustment (ACA) periods. Case Number GR-2001-39 deals with the 1999-2000 Actual Cost Adjustment of Southern Missouri Gas Company, L.P. (SMGC), while GR-2001-388 deals with the 2000-2001 Actual Cost Adjustment of SMGC. On April 3, 2001, the Parties in Case Numbers GR-2001-39 and GR-2001-388 filed a Proposed Procedural Schedule. The Parties to both of these cases are SMGC, the Staff of the Public Service Commission (Staff) and the Office of the Public Counsel (OPC). On April 11, 2001, the Parties filed a Joint Motion to Consolidate in both of these cases.

On April 12, 2001, the Missouri Public Service Commission (Commission) issued an Order Consolidating Cases and Order Establishing Procedural Schedule. The Commission consolidated the cases and designated GR-2001-388 as the lead case. The Commission also ordered a Procedural Schedule.

Pursuant to the Procedural Schedule, Staff filed its Staff Recommendation regarding Case Number GR-2001-39 on July 2, 2001. SMGC timely filed its Response to Staff's Recommendation on August 1, 2001. On August 13, 2001, the Commission issued its Order Establishing a Protective Order.

The Procedural Schedule was modified by the Commission's Second Order Adopting Amended Procedural Schedule and Order Modifying Caption. On October 31, 2002, Staff filed

its Recommendation regarding Case Number GR-2001-388. On November 26, 2002, SMGC filed its Response to Staff's Recommendation.

On December 5, 2002, the Commission issued an Order Directing Filing. This Order directed SMGC, by March 3, 2003, to comply with the provisions of paragraphs 5 and 6 of the Recommendations section of the Appendix of the Staff Memorandum. SMGC did subsequently provide this information.

On January 9, 2003, Staff filed a Motion to Set Technical Conference. This Motion was granted on January 10, 2003. A technical conference was held on January 16, 2003, commencing at 1:30 p.m.

Staff and SMGC filed Direct Testimony on January 9, 2003, Rebuttal Testimony on January 30, 2003, and Surrebuttal Testimony on February 20, 2003. The Parties filed an Issues List on February 6, 2003, and their respective Position Statements on February 13, 2003. OPC was granted leave to late file its Position Statement on February 19, 2003.

On March 7, 2003, the Parties filed a Unanimous Partial Stipulation and Agreement. This Stipulation settled all issues in the case except those found in the Issues List.

A hearing was held on March 11, 2003, commencing at 8:30 a.m. Scott Klemm testified for SMGC. Annell Bailey and James Russo testified for Staff. The transcript was filed on March 25, 2003. On March 12, 2003, the Commission issued Notice of Briefing Schedule.

COMMISSION ISSUES RAISED AT HEARING

1. Who has the burden of proof in an ACA proceeding that gas costs have been prudently incurred, the Local Distribution Company (LDC) or the Staff?

Commissioners Murray and Gaw wanted the parties to address specific issues regarding what type of disallowances can be made in ACA cases and who has the burden of proof or burden of persuasion in this regard (Tr. 276, line 16 through p. 277, line 1).

This case is one to determine the rates to be charged by SMGC for natural gas. In a rate case, the burden of proof that the proposed increased rate is just and reasonable is on the gas company, Section 393.150.2 RSMo Supp. 2002, consistent with Purchased Gas Adjustment (PGA) rates being interim, subject to refund. In the instance of an ACA[1] hearing the Commission has noted:

> The Commission has approved tariffs for WRI that allow WRI to alter the rates for the cost of gas outside the context of a general rate case. These PGA/ACA tariffs establish a process whereby WRI may periodically file estimated changes in its cost of gas from suppliers of natural gas. The ACA filing is made to ensure that gas costs passed on to customers reflect the utility's actual expenditures for gas rather than the PGA estimated costs. In addition, the ACA filing provides interested parties an opportunity to review the prudence of decisions underlying gas costs passed on to ratepayers by gas utilities through the use of the PGA provisions.
>
> It is well settled that the utility (WRI in this instance) has the burden of showing that the gas costs passed on to ratepayers through operation of the PGA tariff are just and reasonable. WRI has the burden of showing the reasonableness of gas costs associated with its rates for natural gas, including rates resulting from application of the WRI's PGA tariff.
>
> To test the reasonableness of WRI's gas costs, the Commission uses a standard of prudence. This standard has been discussed in previous Commission reports and orders in connection with nuclear power plant costs as well as gas costs. ***RE: Union Electric Company,*** 27 Mo. P.S.C. (N.S.) 183, 192 (1988); ***RE: Kansas City Power & Light Company,*** 28 Mo. P.S.C. (N.S.) 228, 280 (1986). The standard is that when some participant in a proceeding creates a serious doubt as to the prudence of an expenditure, then the company has the burden of dispelling those doubts and proving that the questioned expenditure was prudent.
>
> The Commission will take this opportunity to elaborate upon the prudence standard as applied to gas purchasing practices. 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 excess gas costs.

[1] The annual reconciliation and review of gas costs incurred by SMGC is noted as "Annual Reconciliation Adjustment" in the case below. It will be referred to here as an Actual Cost Adjustment, or ACA, for purposes of convenience.

> 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 to the extent that existence of a prudent decision-making process may preclude the adjustment. In addition, evidence about the particular controversial expenditures is necessary for the Commission to determine the amount of the adjustment. Specifically, the Commission needs evidence of the actual expenditure(s) incurred during the ACA period resulting from the alleged imprudent decision. In addition, it is helpful to the Commission to have evidence as to the amount that the expenditures would have been if the local distribution company had acted in a prudent manner. The critical matter of proof is the prudence or imprudence of the decision from which expenses result.

In the Matter of Western Resources, Inc., 3 Mo.P.S.C. 480, 488-89 (1995). See also, *State ex rel. Associated Natural Gas Company v. Public Service Commission*, 954 S.W.2d 520, 528-29 (Mo. App. W.D. 1997) (Citing *Union Electric*, 27 Mo.PSC (NS) 183, 193 (1985).

Thus, the burden of proving that the proposed charges for natural gas are reasonable remains on SMGC. Once SMGC makes a prima facie showing of reasonableness, the burden of going forward with evidence that the proposed charges are imprudent shifts to opposing parties. If, in the case of an ACA proceeding, a party raises a serious doubt as to the prudence of particular expenses, the burden of going forward with the evidence reverts to the rate applicant. The burden of proof, established by statute, never shifts from the rate proponent. *See, McCloskey v. Koplar*, 46 S.W.2d 557, 563 (Mo. banc 1932). (But during all this time the burden of proof, the risk of nonpersuasion, remains with the plaintiff, except as to affirmative defenses, etc. The burden of evidence is simply the burden of making or meeting a prima facie case.)

In the present case, the fact is that SMGC has the burden of showing that its actions were prudent. During the Hearing, Commissioner Murray asked Staff Witness Bailey, "Do you think the Company acted imprudently?" and Ms. Bailey answered "No" (Tr. 200, lines 7 through 8). Ms. Bailey meant that the Company may not have acted imprudently from a business standpoint. Staff has effectively shown that SMGC's actions were illegal since SMGC's actions violated

SMGCS's tariffs. Staff believes that illegal actions are imprudent. SMGC has not shown the opposite.

2. Does SMGC's provisioning of gas supplies and transportation for its Transportation Service-Internal consisting of two large customers constitute a violation of its Tariffs?

There are several facets of this question. The first important part is to understand that this is ultimately a legal issue. However, the nonattorney experts who work with these Tariffs on a daily basis, from a technical standpoint, correctly concluded that a tariff violation occurred. This is a legal issue because tariff construction is analogous to statutory construction.

A tariff that has been approved by the Public Service Commission becomes Missouri law and has the same force and effect as a statute enacted by the legislature. *A.C. Jacobs and Company v. Union Electric Company*, 17 S.W.3d 579, 581 (Mo. App., E.D. 2000); *State ex rel. St. Louis County Gas Co. v. Public Service Commission of Missouri,* 286 S.W. 84, 86, 315 Mo. 312 (Mo. 1926). In order to change its Tariffs, a regulated utility must file a written application to the Commission seeking such a change and obtain an order of the Commission to make the change. Section 393.140(11) RSMo 2002; *Decaconess Manor Association v. Public Service Commission of Missouri,* 994 S.W.2d 602, 611 (Mo. App., W.D. 1999). Tariffs can be modified by a regulated utility voluntarily with approval of the Commission or tariffs can be ordered, by the Commission, to be filed. *State ex rel. St. Louis County Gas Co.*, supra at 86.

Courts must give effect to a statute as written. *Boone County v. County Employees Ret. Fund,* 26 S.W.3d 257, 264 (Mo. App., W.D. 2000). The responsibility of a Court interpreting a statute is to ascertain the intent of the legislature from the language used and to consider the words used in their plain and ordinary meaning. *State v. Rousseau,* 34 S.W.3d 254, 259 (Mo. App., W.D. 2000). The legislature is presumed to have intended what the statute says;

consequently, when the legislative intent is apparent from the words used and no ambiguity exists, there is no room for statutory construction. *Id.*

The evidence clearly showed that SMGC wrote, sought and received Commission approval of the Tariffs on file with the Commission (Tr. 143, lines 21 through 25). These Tariffs are found in Schedule 1 of the Rebuttal Testimony of Staff Witness James M. Russo (Ex. 14, Russo Rebuttal, Schedule 1).

SMGC TRANSPORTATION SERVICE

The SMGC Transportation Tariff specifies that Natural Gas Transportation Service is available:

> Under Transportation Contract with Company to any customer whose average monthly natural gas requirement in a twelve-month period exceed 2,000 MMBtus at a single address or location. Such transportation is subject to interruption or curtailment as further explained in the Character of Service Section below…"

(Ex. 14, Russo Rebuttal, Schedule 1, p. 1 through 20). While the term "Transportation" is not defined in the Tariff (Ex. 14, Russo Rebuttal, Schedule 1, p. 47 through 48), Transportation clearly means transportation only on the SMGC system. SMGC provides no other service under its Transportation Tariffs. The end-user transportation customer buys its gas either on its own or through a third party marketer and arranging its own transportation over an interstate pipeline to the SMGC distribution system.

Furthermore, the actual terms of the Transportation Tariff contemplate three separate and distinct entities. Those three separate and distinct entities are: 1) the Company (in this case SMGC); 2) SMGC's transportation customer or transporter (receiving transportation services); and 3) a third party marketer obtaining natural gas and interstate pipeline transportation services on behalf of the transportation customer (Ex. 14, Russo Rebuttal, Schedule 1, p. 20 through 32). It is also possible that the transportation customer and third party marketer roles could be

combined into one, that is, the customer itself performing both roles (Ex. 14, Russo Rebuttal, Schedule 1-20-32; Tr. 123-124). However, the Tariffs do not contemplate nor authorize SMGC to act as a third party marketer or in any other capacity to purchase gas since all LDC Transportation Tariffs on file with the Commission only provide for the transportation of the commodity (Ex. 14, Russo Surrebuttal, p. 4, lines 3 through 6, Tr. 122, line 19 through p. 125, line 14).

TARIFF TRANSPORTATION SERVICE DIFFERENT THAN TRANSPORTATION SERVICE-INTERNAL

As part of his economic justification for the creation of Transportation Service-Internal, Mr. Scott Klemm, Vice-President of SMGC, stated that SMGC considered four options: 1) do nothing and risk losing the industrial companies as customers of SMGC; 2) lower the industrial companies' commodity charges but continue to classify the industrial companies as gas sales customers; 3) put the industrial companies in touch with third-party marketers for their gas supply; and (4) provide the industrial companies with transportation service and SMGC also provide the gas supply (Ex. 3, Klemm Direct, p. 4, line 19 through p. 5, line 7). SMGC rejected the first three options and chose option 4, the creation of Transportation Service-Internal (Ex. 3, Klemm Direct, p. 9, lines 8 through 9).

One of the specific options rejected by SMGC was to have a third-party marketer provide interstate pipeline service and gas supplies (Ex. 3, Klemm Direct p. 8, lines 3 through 6). Under SMGC's Tariffed Transportation Service, the third party marketer acquires the transportation capacity on the interstate pipeline and the gas while SMGC would provide Transportation Service only from its city gate to the customer (Tr. 93, line 18 through p. 94, line 8). SMGC has traditional Transportation Service customers that receive service in this way (Tr. 125, lines 8 through 14). SMGC clearly recognized this as Traditional or Normal Transportation as provided

under its Tariffs but specifically rejected it, and instead put a separate and distinctly different option, Transportation Service-Internal, in place (Tr. 93, line 18 through p. 94, line 8).

Staff Witness Annell Bailey described Transportation Service-Internal as follows:

> "Transportation Service-Internal" is an unauthorized service that SMGC began providing to one industrial customer in April 2001, and to a second industrial customer in July 2001. SMGC sells these customers gas at the Williams pipeline interconnect at a contractually agreed-upon rate. From that point, SMGC provides transportation service. Each month SMGC sends these customers two bills: one bill for transportation service at tariff-authorized rates and a separate bill for the gas commodity at the contractually agreed-upon rate.

(Ex. 10, Bailey Direct, p. 3, line 21 through p. 4, line 4).

Mr. Klemm agreed with this description of Transportation Service-Internal but disagreed that it was an unauthorized service (Ex. 6, Klemm Rebuttal, p. 4, lines 1 through 3). At the hearing, Mr. Klemm stated that Transportation Internal means to him, "…transportation customers in which their gas supply was provided by Southern Missouri Gas Company rather than a third-party transport marketer" (Tr. 63, lines 21 through 24). Mr. Klemm specifically stated that Transportation Service-Internal is "unique" and different from the normal Transportation in that SMGC purchases the gas (Tr. 128, lines 1 through 8). Transportation Service-Internal was only offered to two large industrial customers that were large volume sales customers prior to taking this untariffed service (Tr. 67, line 17 through p. 68, line 3; p. 73, lines 16 through 21). These two customers also met the volumetric thresholds to be Transportation customers (Tr. 68, lines 1 through 3). This service was not offered to any other class of customers and not to other large volume service customers (Tr. 67, line 23 through p. 68, line 3). In other words, the new customer class of Transportation Service-Internal was tailor-made to keep the two large industrial customers on the SMGC system.

Mr. Bill Walker, the Gas Control Manager for SMGC stated that he heard the term Transportation Service-Internal in the office (Ex. 9, Walker Deposition, p. 38 line 15 through p.

39 line 2). Mr. Klemm acknowledged that the use of the term Transportation Service-Internal came from SMGC (Tr. 78, lines 20 through 23). In fact, Mr. Klemm had to ask Staff what to do with revenues from this new class of customers (Ex. 18). In other words, it is clear that the term: "Transportation Service-Internal" was created and used by SMGC (Tr. 77 lines 20 through p. 79, line 2).

SMGC admitted that nothing in its Tariff specifically authorizes Transportation Service-Internal (Tr. 122, lines 19 through 22; Ex. 9, Walker Deposition, p. 71 line 21 through p. 72, line 2). Staff wholeheartedly concurs that nothing in SMGC's Tariff authorizes what it is doing and would add that Transportation Service-Internal is specifically prohibited (Exhibit14, Russo Rebuttal, p. 2, lines 4 through 11; Exhibit 13, Russo Direct, p. 2, lines 11 through 19). Where a statute limits (in this case the statute is a tariff) the doing of a particular thing in a prescribed manner, it necessarily includes in the power granted, the negative that it cannot be done otherwise. *State v. Ruch*, 926 S.W.2d 937, 939 (Mo. App., W.D. 1996). This is also accurately stated as settled law that the mention of one thing in a statute implies the exclusion of another. *Missouri Board of Registration for the Healing Arts v. Levine*, 808 S.W.2d 440, 443 (Mo. App., W.D. 1991).

From the foregoing, it is clear that SMGC knew that it had created a new class of customers separate and distinct from its Transportation Tariff. Furthermore, SMGC knew that if it wanted to create a new class of customers that it needed to come to the Commission to get permission to do so (Tr. 63, lines 2 through 6). SMGC's tariffs provided for the following classes of customers: General Service, Optional General Service, Large General Service, Large Volume Service (LVS) and Transportation Service (Tr. 63, lines 3 through 6; Ex. 14, Russo Direct, Schedule 1, p. 13 through 31). A review of the SMGC Tariffs in effect during the

applicable ACA periods reveals that there is no class of customers authorizing service for Transportation Service-Internal or any type of customer class that had the specific characteristics utilized by SMGC for this new class of customers. Accordingly, SMGC has created a new class of customers in direct violation of its tariff.

There is no question that service to a class called Transportation Service-Internal does not exist under the applicable SMGC Tariffs. Moreover, there is no contention, nor could there be, that this new class of customers is authorized by the General Service, Optional General Service, Large General Service, or LVS portions of the SMGC Tariff. The Company clearly, but unlawfully, established a new class of customers, not authorized by its Tariffs, when it created this new class of customers to avoid the PGA.

TARIFF PROVISION SPECIFICALLY PROHIBITING TRANSPORTATION SERVICE-INTERNAL

Furthermore, there is a provision in the Transportation Tariff that specifically prohibits the actions of SMGC in purchasing gas under its Transportation Tariff. While the Transportation Tariff specifically allows SMGC to act as an agent for Transportation customers, upon written agreement and at no additional charge, to nominate Transportation volumes, it also specifically prohibits SMGC, in its role as an agent, to purchase Transportation volumes on behalf of a customer (Ex. 14, Russo Rebuttal, Schedule 1, p.29). In other words, SMGC cannot buy gas while acting in this role as an agent.

SMGC Witnesses Klemm and Walker both conceded that SMGC purchased the gas supply and provided the transportation capacity for the Transportation Service-Internal customers (Tr. 117, lines 1 through 17; Ex. 9, Walker Deposition, p. 71, lines 4 through 20). SMGC Witness Scott Klemm stated that SMGC was not acting as an agent for the two

Transportation Service-Internal customers in purchasing their gas supply and providing transportation capacity for the two Transportation Service-Internal customers (Tr. 167, lines 12 through 23). Mr. Bill Walker, the SMGC employee who entered into and signed the contracts for SMGC for Transportation Service-Internal, stated that SMGC was, in fact, acting as an agent for the large industrial customers under Transportation Service-Internal in the purchasing of gas (Ex. 9 Walker Deposition, p. 17, lines 5 through 16; p. 69, lines 4 through 16). Furthermore, Mr. Walker prepared a handwritten note at the direction of Mr. Klemm (Ex. 9, Walker Deposition, p. 11 line 16 to p. 12 line 13. ** HC HC HC HC HC ** Mr. Klemm later tried to deny this agency relationship (Tr. 167, lines 16 through 23). ** HC HC ** Mr. Klemm's denial of the fact that SMGC was acting as an agent for Transportation Service Internal customers is not credible. The fact is that SMGC specifically violated its tariffs by acting in this agency capacity.

Clearly, Mr. Walker, who entered into the contract, signed the contract and helped invent the entire Transportation Service-Internal method of avoiding the PGA is more credible on this issue. Mr. Walker clearly and definitively understood and stated that he was acting as an agent. "An agent is a business representative who handles contractual arrangements between the principal and third persons." BRYAN GARNER, MODERN LEGAL USAGE 38 (Oxford University Press Second Edition 2000). Mr. Walker clearly acted as an agent for SMGC when he entered into the gas contracts and the supply contracts with the large industrial customers for SMGC

receiving service under Transportation Service-Internal (Ex. 9 Walker Deposition, p. 17, lines 5 through 16; p. 69, lines 4 through 16). Furthermore, Mr. Walker very correctly, appropriately, and accurately described the fact that SMGC was acting as an agent for the large industrial customers when it purchased gas and arranged interstate transportation for these customers. ** HC

HC **

Accordingly, there has been a direct violation of SMGC's Tariff and the Commission should so find.

TRANSPORTATION SERVICE-INTERNAL IS REALLY LARGE VOLUME SERVICE IN DISGUISE

LVS is firm gas service available to customers with an annual usage equal to, or greater than 150,000 Ccfs contracting for a minimum term of one year (Ex. 14, Russo Rebuttal, Schedule 1, p. 16 through 17). LVS is subject to the PGA (Ex. 14, Russo Rebuttal, Schedule 1, p. 16 through 17). In other words, under the Large Volume Service, SMGC provides three basic components of service to its customers. SMGC provides: 1) the commodity (natural gas); 2) interstate pipeline transportation from the production areas to the SMGC distribution system; and 3) delivery through the SMGC distribution system to the customer's premises. This is a bundled sales service, that Mr. Walker stated in his deposition, that Transportation Service-Internal customers also receive (Ex. 9, Walker Deposition, p. 69, line 21 through p. 71, line 20).

A review of the services provided to LVS customers and Transportation Service-Internal customers show that the only real difference between them is that LVS customers pay the PGA and Transportation Service-Internal customers do not. SMGC buys the gas for both LVS and Transportation Service-Internal customers (Ex. 9, Walker Deposition, p. 41, lines 7 through 21). The gas, after being purchased for Transportation Service-Internal customers, was then delivered

to the SMGC city gate utilizing SMGC's pipeline capacity pursuant to SMGC's transportation contracts (Ex. 9, Walker Deposition, p. 69, lines 17 through p. 72, lines 11 through 14). SMGC then used its distribution system to deliver the gas to the customers (Ex. 9, Walker Deposition, p. 70, line 17 through p. 71, line 10).

Transportation Service-Internal was only offered to two large industrial customers that were large volume sales customers prior to taking this new service under Transportation Service-Internal (Tr. 67, line 17 through p. 68, line 3; p. 73, lines 15 through 21). These two customers also met the volumetric thresholds to be Transportation customers (Tr. 68, lines 1 through 3). This service was not offered to any other class of customers and not to other large volume service customers (Tr. 67, line 23 through p. 68, line 3). In other words, the new customer class of Transportation Service-Internal was tailor-made to keep the two large industrial customers on the SMGC system. This was done to avoid paying the PGA. SMGC Witness Klemm clearly acknowledged that Large Volume Service and Transportation Service-Internal service are the same or very similar service (Tr. 109, lines 19 through 22). While SMGC tried to affix great significance to the fact that there were separate invoices for the commodity piece and the transportation part under Transportation Service-Internal (Tr. 110, lines 14 through 18), the service was the same (Tr. 110, lines 19 through 22), regardless of how SMGC chose to bill for Transportation Service-Internal.

From the aforementioned, it is clear that the only real difference between LVS customers and Transportation Service-Internal customers is that LVS customers pay the PGA and Transportation Service-Internal customers do not (Ex. 9, Walker Deposition, p. 42, line 16 through p. 43, line 1). SMGC candidly admitted that the net effect of creating Transportation Service-Internal was that the two customers under that class did not pay the PGA (Tr. 80, lines 2

through 6). SMGC lowered the gas costs of these Transportation-Service Internal customers by avoiding the PGA (Tr. 80, lines 7 through 23). Mr. Klemm asserted that this was done to make SMGC competitive with a propane alternative (Tr. 80, lines 2 through 6). SMGC was clearly worried about these customers switching to alternative fuels such as propane (Tr. 133, lines 5 through 7 and this is the stated economic justification that SMGC asserts in SMGC's opening statement Tr. 4, lines 22 through 23).

In essence, SMGC is asserting that economic facts authorize it to violate its Tariffs. This is an untenable position that must be rejected.

VIOLATION OF STATUTES

It is abundantly clear that SMGC has directly violated Commission rules. Mr. Klemm asserted in his Rebuttal Testimony that SMGC had reclassified these two large volume sales customers as "transportation customers" and that SMGC:

> In addition, has arranged the gas supplies for these customers in a similar manner as a gas marketer. This arrangement, in my opinion, does not create a new or additional customer class. What is new, or perhaps different, about this arrangement is the fact that SMGC took the unusual step of arranging gas supplies for these customers in addition to providing traditional transportation services."

(Ex. 6, Klemm Rebuttal, p. 6, lines 14 through 18).

This position is untenable for a number of reasons. First, if SMGC was acting as a marketer of gas it is required to be certified pursuant to Section 393.298 RSMo Supp. 2002. Mr. Klemm's opinion that SMGC need not be certified by the Commission to operate as a third party marketer is incorrect (Ex. 7, Klemm Surrebuttal, p. 4, lines 4 through 15). Mr. Klemm fails to grasp the purpose of the legislation and the fundamental distinction between a distributor such as SMGC and a seller that is required to register pursuant to Section 393.298 RSMo Supp. 2002. Clearly, SMGC is a distributor under the statute and offers regulated services as a gas corporation as defined in Section 386.020 RSMo Supp. 2002. See Section 393.298(3) RSMo

2002. In its Commission regulated capacity of providing gas service SMGC is not required to register as a seller under this section.

However, as Mr. Klemm asserts, SMGC stepped into the role as a "seller" under Section 393.299 RSMo 2002 and operated outside of its Commission regulated operations (Ex.6, Klemm Rebuttal, p. 6, lines 14 through 18). This is the exact situation that is in fact regulated by Section 393.298 RSMo Supp. 2002. Accordingly, SMGC did have to register as a third party marketer and failed to do so (Ex. 14, Russo Rebuttal, p. 3, lines 13 through 14). Mr. Klemm specifically admitted in the hearing that SMGC was acting as a third party marketer (Tr. 63, lines 21 through 24). Therefore, Mr. Russo is correct in his assertion and SMGC is in violation of this statute.

Furthermore, a third party marketer (seller under 393.299) sells gas to the industrial transportation customer who then pays to have it transported on a pipeline (Ex. 14, Russo Rebuttal, p. 3, lines 1 through 2). This includes the LDC's pipeline to the large volume industrial customer's business (Ex. 14, Russo Rebuttal, p. 3, lines 2 through 3). In this situation, under Transportation Service-Internal, SMGC sells the LVS customer the gas and transports the gas to the LVS customer's place of business (Ex. 14, Russo Rebuttal, p. 3, lines 4 through 5). Furthermore, a third party marketer would keep track of all of its expenditures related to third party marketing (Ex. 14, Russo Rebuttal, p. 3, lines 5 through 7). SMGC does not do this. (Tr. 104, lines 16 through 21).

In the second place, if SMGC were acting as an unregulated marketer it must observe the requirements of Section 393.140(12) RSMo Supp. 2002. That section specifically provides as follows:

> (12) In case any electrical corporation, gas corporation, water corporation or sewer corporation engaged in carrying on any other business than owning, operating or managing a gas plant, electric plant, water system or sewer system which other business is not otherwise subject to the jurisdiction of the

> commission, and is so conducted that its operations are to be substantially kept separate and apart from the owning, operating, managing or controlling of separate and apart from the owning, operating, managing or controlling of such gas plant, electric plant, water system or sewer system, said corporation in respect to such other business shall not be subject to any of the provisions of this chapter and shall not be required to procure the consent or authorization of the commission to any act in such other business or to make any report in respect thereof. But this subdivision shall not restrict or limit the powers of the commission in respect to the owning, operating, managing or controlling by such corporation of such gas plant, electric plant, water system or sewer system, and said powers shall include also the right to inquire as to, and prescribe the apportionment of, capitalization, earnings, debts and expenses fairly and justly to be awarded to or borne by the ownership, operation, management, or control of such gas plant, electric plant, water system or sewer system as distinguished from such other business. In any such case if the owning, operating, managing or controlling of such gas plant, electric plant, water system or sewer system by any such corporation is wholly subsidiary and incidental to the other business carried on be it and is inconsiderable in amount and not general in its character, the commission may by general rules exempt such corporation from making full reports and from the keeping of accounts as to such subsidiary and incidental business.

In other words, if SMGC wants to own and operate an unregulated business, then it must be kept separate and apart from the other regulated operations of SMGC. The undisputed evidence clearly shows that Mr. Bill Walker, the Gas Control Manager of SMGC, helped conceive, set up and operate services to Transportation Service-Internal customers (Ex. 9, Walker Deposition, p. 53, lines 11 through 15; Ex. 6, Klemm Rebuttal, p. 12, lines 1 through 23; Ex. 5HC, Klemm Rebuttal HC, Rebuttal Schedule No. 3HC). Mr. Walker used SMGC resources such as phone, office space, personnel, etc. to provide Transportation Service-Internal (Ex. 9, Walker Deposition, p. 26, line 6 through p. 27, line 17). In other words, SMGC was not segregating these costs nor allocating a percentage of expenses to a third party marketing function (Ex. 14, Russo Rebuttal, p. 3, lines 7 through 9). In fact, SMGC does not have a marketing affiliate (Ex. 14, Russo Rebuttal, p. 3, lines 8 through 9). SMGC signed the contracts as a regulated LDC, not a marketing affiliate (Ex. 14, Russo Rebuttal, p. 3, lines 9 through 10).

SMGC Vice-President, Scott Klemm, specifically admitted that SMGC viewed the provision of gas purchasing for Transportation Service-Internal to be unregulated and that SMGC provides unregulated services by purchasing gas for Transportation Service-Internal Customers (Tr. 104, lines 11 through 15). Mr. Klemm further admitted that no separation of things like phone usage for regulated and unregulated services occurred (Tr. 104, line 16 through p. 105, line 6). The SMGC regulated customers paid for unregulated services that provided gas procurement for Transportation Service-Internal (Tr. 105, line 7 through p. 107, line 2). SMGC had no other source of income besides regulated ratepayers to pay these expenses (Tr. 107, line 22 through p. 108, line 2).

VIOLATION OF COMMISSION RULES

SMGC specifically violated the Commission Affiliate Transaction Rules. As previously noted, SMGC is not certificated as an energy seller in Missouri (Ex. 16, Russo Surrebuttal, p. 2, lines 3 through 4). SMGC is not included in the stay from the affiliated transaction and, accordingly, is subject to 4 CSR 240-40.015 Affiliate Transaction and 4 CSR 240-40.016 Marketing Affiliate Transactions rules (Ex. 16, Russo Surrebuttal, p. 2, lines 4 through 7). SMGC is not maintaining its books of accounts and records completely separate and apart from the activities related to third party marketing affiliate (Ex. 16, Russo Surrebuttal, p. 2, lines 7 through 8). The requirements of the rule include allocating employee time, shared facilities and other mutually shared expense between non-regulated and regulated activities (Ex. 16, Russo Surrebuttal, p. 2, lines 8 through 10). Since SMGC is operating as a third party marketer, then SMGC's residential and other industrial customers are paying for non-regulated activities related to these two industrial customers via paying SMGC's rates (Ex. 16, Russo Surrebuttal, p. 2, lines 11 through 13; Tr. 104, line 11 through p. 108, line 6).

TARIFF COMPARISON

Assuming hypothetically, that SMGC might be correct in its assertion that its Transportation Tariffs allow it to also purchase gas for these customers, then SMGC still is not in compliance with its Tariffs.

SMGC's Transportation Tariffs specifically provide that service shall be subject to interruption or curtailment due to system capacity or supply constraints (Ex. 14, Russo Rebuttal, Schedule 1-22). Now, assuming that SMGC's current Transportation Tariffs allowed SMGC to purchase gas for customers, then the service would have to be exactly the same. ** HC

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that Transportation Service-Internal customers receive uninterruptible service (Ex. 9, Walker Deposition, p. 43, lines 2 through 9).

It is instructive to note that the LVS Tariff clearly provides for firm supply (Ex. 14, Russo Rebuttal, Schedule 1-22 and 2-22-23). In other words, SMGC clearly was creating this class of customers to be just like LVS customers.

The record is replete with clear and conclusive evidence that SMGC violated its Tariffs, statutes and Commission rules to allow these industrial customers to avoid the PGA.

The record clearly shows that Transportation Service-Internal is actually a continuation of LVS achieved through some cosmetic attempts to disguise it as Transportation Service. It is beyond question that all customers who receive Transportation Service-Internal were previously LVS Customers (TR. 73, lines 5 through 14) and that SMGC then transferred these customers over to Transportation Service-Internal (Tr. 73, lines 15 through 23). SMGC had to account for Transportation Service-Internal as a separate item in its accounting work (Tr. 74, line 4 through Tr. 78, line 15; Tr. 84, line 11 through Tr. 85, line 15, Exhibits 17, 18). In fact, Mr. Klemm had to inquire of Staff about recording and reporting Transportation Service-Internal revenues and learned Staff was not familiar with such a thing (Tr. 84, line 11 through Tr. 85, line 15, Exhibit 18). Staff and OPC had both informed SMGC of the need to get Commission approval of SMGC's creation of Transportation Service-Internal. Staff informed Mr. Klemm that he would need a variance for this new service (Tr. 82, lines 16 through 20). OPC Senior Counsel Doug Micheel specifically informed Mr. Klemm at an early meeting that Transportation Service-Internal was an illegal service (Tr. 149, lines 9 through 21). Thus, there can be no doubt that SMGC had notice of the problem.

Mr. Klemm concurred that the PGA was the problem and that this new Transportation Service-Internal lowered gas costs by avoiding the PGA (Tr. 79, line 22 through p. 80, line 23). Mr. Fischer's opening statement on behalf of SMGC explains the fact that this new system avoids the PGA (Tr. 10, lines 6 through 10). It clearly was a decision by SMGC to try to keep these customers on the system by creating a new class of customers with the benefit of lower gas prices being offered to the two large industrial customers by avoiding the PGA. As has been shown, SMGC did this by offering the exact same service as LVS to these select industrial customers and lowered the gas costs of these select industrial customers by avoiding the PGA. In other words, the other customers were subsidizing these select industrial customers.

SMGC is continuing to provide this service unlawfully and the Commission must order it to stop.

EVOLUTION OF SMGC'S ASSERTION THAT TRANSPORTATION SERVICE-INTERNAL IS AUTHORIZED BY ITS TARIFFS

SMGC's position has evolved to assert that this new service is authorized by its Transportation Tariffs. The two industrial customers, prior to being switched to Transportation Service-Internal customers, were LVS sales customers (Tr. 73, lines 5 through 11). These two customers continued to qualify as LVS sales customers while receiving Transportation Service under Transportation Service-Internal (Tr. 73, lines 12 through 21). SMGC did not initially assert that Transportation Service-Internal was authorized by its Transportation Tariffs.

In fact, in its Response to Staff Recommendation filed on November 25, 2002, SMGC disputed Staff's proposed disallowance of $105,809 related to the Transportation Service-Internal issue (SMGC Response to Staff Recommendation, p. 3, paragraph 2). SMGC then stated: "While SMGC may not have had a specific Tariff that addressed this situation (Creation of new class of customers Transportation Service-Internal), SMGC strongly believes the actions

taken by it at the time to maintain these two industrial customers upon its system were prudent and reasonable…." (SMGC Response to Staff Recommendation, p. 3, paragraph 2). However, this statement ignores the real issue of whether or not the creation of this new class of customers violated the SMGC Tariffs. It is beyond argument that SMGC cannot violate its Tariffs for mere economic expediency.

SMGC subsequently developed its theory that the creation of a new class of customers was authorized by its Transportation Tariffs. However, even in the direct testimony of SMGC Witness, Scott Klemm, SMGC does not directly and conclusively assert that Transportation Service-Internal is clearly authorized under its existing Transportation Tariffs. Instead, SMGC rather tentatively asserts that in providing Transportation Service-Internal service it was "…essentially providing service under the company's existing Transportation Tariffs" (Ex. 3, Klemm Direct, p. 8, lines 20 through p. 9 line 3).

This reluctance to assert that Transportation Service-Internal was authorized under SMGC's existing Transportation Tariffs is understandable, because SMGC clearly recognized the difference between what it created by providing Transportation Service-Internal and its existing Transportation Tariffs. According to the Direct Testimony of Scott Klemm, two large volume industrial customers contacted SMGC to express concern over high natural gas prices and to discuss the possibility that these two customers might switch to alternative sources of energy (Ex. 3, Klemm Direct, p. 4, lines 9 through 17). SMGC rejected the option of doing nothing (Ex. 3, Klemm Direct, p. 5, lines 9 through 20); SMGC also rejected the second option of lowering the industrial companies' commodity charges under SMGC's flex Tariffs (Ex. 3, Klemm Direct, p. 7, line 13 through p. 8, line 2). SMGC further rejected the third option of having a third-party marketer provide interstate transportation services and gas supplies to these

two industrial customers (Ex. 3, Klemm Direct, p. 8, lines 3 through 15). The evidence clearly showed, and Mr. Klemm readily acknowledged, that this is the traditional service that is provided to Transportation Customers (Tr. p. 93, line 18 through p. 94, line 8).

SMGC then adopted a fourth option of "…providing transportation service with SMGC also providing the gas supplies to these two industrial customers" (Ex. 3, Klemm Direct, p. 8, line 17 through p. 9, line 9). The fact that SMGC clearly recognized that it was providing service outside of its traditional Transportation Tariffs shows that even SMGC recognizes that this service is different and this explains why SMGC only tentatively suggested that this service is authorized under its existing Transportation Tariffs.

In the Rebuttal Testimony of Scott Klemm filed on January 30, 2003, SMGC continued its tentative argument that Transportation Service-Internal is merely service under its Transportation Tariffs. Mr. Klemm stated:

> …In effect, SMGC is providing transportation service, pursuant to its Transportation Tariff, and is also arranging for the gas supplies for these customers on a contractually-agreed upon basis.

(Ex. 6, Klemm Rebuttal, p. 4, lines 9 through 11). SMGC had to qualify any assertion that it is merely providing authorized service under its existing Transportation Tariff, because even SMGC did not believe this statement to be the whole truth.

In its Position Statement filed on February 13, 2003, SMGC's position had evolved to the following: "The transportation service provided to the two large customers is authorized under SMGC's Transportation Tariffs, Sheet Nos. 6-18, inclusive. The provisioning of gas supplies is authorized by law, pursuant to FERC Orders Nos. 436 and 636." (Position Statement of Southern Missouri Gas Company, L.P. p. 1, filed February 13, 2003). Actually, the transportation service provided to the two large customers is not authorized by SMGC's Transportation Tariffs because SMGC did not provide merely transportation service as

authorized by its Transportation Tariffs. Instead, SMGC placed itself in the role ordinarily performed by a third party marketer in order to purchase gas on behalf of its Transportation Service-Internal customers (Tr. 103, lines 18 through 22).

The reference to FERC Orders 436 and 636 is extremely vague. SMGC fails to explain what specific parts of FERC Orders 436 and 636 authorize it to violate its Transportation Tariffs on file with the Commission. SMGC also fails to explain how FERC Orders that deregulated and restructured the natural gas industry authorize it to violate its Transportation Tariffs on file with the Commission. Accordingly, this contention is without merit.

SMGC further acknowledged the "new," "different," and "unusual" step that it was taking of arranging gas supplies for these customers in addition to providing traditional Transportation Service (Ex. 6, Klemm Rebuttal, p. 6, lines 16 through 18). SMGC has already freely acknowledged that it had four options to deal with this perceived problem. SMGC specifically rejected option 3 that was traditional Transportation Service and instead chose Option 4 that is Transportation Service-Internal (Tr. 94, lines 5 through 11). Even when SMGC tries to explain the authority for its position that Transportation Service-Internal is authorized under SMGC's existing Transportation Tariff, it can only say it "believed" that it could create and operate Transportation Service-Internal (Ex. 6, Klemm Rebuttal, p. 13, lines 19 through 23).

In fact, at the hearing, Mr. Klemm admitted that nothing in SMGC's Transportation Tariffs authorize Transportation Service-Internal (Tr. 122, lines 19 through 22).

In order to explain what SMGC did, Mr. Klemm stated:

> No. SMGC has not created a "new internal customer class" as asserted by Mr. Russo. As I have already explained in my direct and rebuttal testimony, SMGC reclassified the two Large Volume Service (LVS) customers as **transportation customers,** pursuant to SMGC's Transportation Tariff, when these customers desired to take transportation service from SMGC. This is typically done when LVS customers decide to become transportation service customers. In my

opinion, these customers are more properly referred to as "transportation customers."

As I explained in my rebuttal testimony, SMGC also arranged gas supplies for these customers in addition to providing transportation service.

(Ex. 7, Klemm Surrebuttal, p. 2, lines 15 through 23).

This testimony lays bare the real problem with SMGC's position. These two large industrial customers were not offered Transportation Service under SMGC's Transportation Tariff. SMGC considered and rejected its tariffed Transportation Service as authorized by its Tariffs (Tr. 93, line 17 through p. 94 line 19) and then offered another option that SMGC dubbed Transportation Service-Internal (Tr. 78, lines 19 through 22).

3. Should the Commission adopt Staff's proposed adjustment to decrease the firm sales Actual Cost Adjustment (ACA) balance by $105,809 to include revenues for "Transportation Service - Internal" consisting of two large customers at the amount the revenues would have been if the gas had been sold at the authorized Purchased Gas Adjustment (PGA) adjusted rate?

SMGC violated its Tariffs by creating a new class of customers called Transportation Service-Internal. The evidence clearly shows that SMGC took LVS customers and put them into a new class called Transportation Service-Internal, for the express purpose of lowering gas costs for these customers by avoiding the PGA (Tr. 79, line 19 through Tr. 80, line 23). In other words, these customers received the exact same service as LVS customers, but without paying the Commission-approved LVS rate (Tr. 108, line 23 through Tr. 110 line 23). While it is true that SMGC added the cosmetic change of sending a bill for transportation and a bill for gas (Tr. 110, lines 8 through 18), it is still equally true that this doesn't, in any way, change the fact that these two industrial customers continued to receive LVS service except that they were now in a new class of customers. (Tr. 108, line 23 through Tr. 110, line 23).

Staff Witness Bailey computed the effect of disallowing the unauthorized PGA revenues, costs and net income for Transportation Service-Internal and adjusted the ACA balance to reflect

the PGA/ACA revenues and costs if those volumes of gas had been sold at a rate that complied with the SMGC Tariff (Ex. 10, Bailey Direct, p. 4, line 18 through p. 19, line 10). It was reasonable to impute the PGA/ACA revenues as if the existing LVS Tariff had been followed (Ex. 11, Bailey Rebuttal, p. 2, lines1 through 7). Ms. Bailey included the $39,987 that was actually credited toward the PGA by SMGC through its Transportation Service-Internal class of customers (Ex. 11, Bailey Rebuttal, p. 2, lines 13 through 20). It is clear that nothing in the PGA/ACA process required this sum of $39,987 to be contributed to the PGA/ACA process (Tr. 209, line 15 through 210 line 6). While Mr. Klemm was not sure if such a payment toward the PGA was legally required, he stated that it was "morally" required (Tr. 100, line 22 through p. 101 line 2). Of course, such a payment to the ACA process was not required because Transportation Service-Internal was specifically created to lower gas costs for two large industrial customers that did not pay the PGA (Tr. 79, line 22 through Tr. 80, line 23).

Furthermore, Transportation Service-Internal is the exact same service as LVS (Tr. 108, line 22 through Tr. 110, line 23) and it stands to reason that the only appropriate remedy is to impute the actual PGA/ACA amount that would have been paid. At hearing, Ms. Bailey agreed that the Staff's proposed adjustment to the ACA balance has been reduced to $102,137 (Tr. 185, lines 17 through 20), and the Refunds reported as passed on to customers should be increased by $2,938. This is correct and should be so ordered.

CONCLUSION

WHEREFORE, Staff respectfully requests that the Commission rule all points in Staff's favor as set forth in this brief.

Respectfully submitted,

DANA K. JOYCE
General Counsel

/s/ Robert V. Franson
Robert V. Franson
Senior Counsel
Missouri Bar No. 34643

Attorney for the Staff of the
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102
(573) 751-6651 (Telephone)
(573) 751-9285 (Fax)
robertfranson@psc.state.mo.us

Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile, or emailed to all counsel of record this 22nd day of April 2003.

/s/ Robert V. Franson