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Witness: *David M. Sommerer*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Surrebuttal Testimony*
Case No.: *GR-2008-0364*
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MISSOURI PUBLIC SERVICE COMMISSION
UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

DAVID M. SOMMERER

ATMOS ENERGY CORPORATION

CASE NO. GR-2008-0364

Jefferson City, Missouri
December, 2010

**** Denotes Highly Confidential Information ****

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DAVID M. SOMMERER**

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SURREBUTTAL TESTIMONY

OF

DAVID M. SOMMERER

ATMOS ENERGY CORPORATION

CASE NO. GR-2008-0364

Q. Please state your name and business address.

A. David M. Sommerer, P.O. Box 360, Jefferson City, MO. 65102.

Q. Are you the same David M. Sommerer who filed direct testimony in this case?

A. Yes.

Q. What is the purpose of your surrebuttal testimony?

A. The purpose of my surrebuttal testimony is to address the rebuttal testimony of Atmos Energy Corporation (AEC, Atmos or Company) witness Rebecca Buchanan. (References to AEC refer specifically to the regulated Local Distribution Company or LDC).

EXECUTIVE SUMMARY

Q. Please provide an executive summary of your surrebuttal testimony.

A. The Company provided an inaccurate assessment of Atmos Energy Marketing's (AEM or Affiliate) profit/losses associated with the affiliate transaction. In the final analysis, the Company was unable or unwilling to produce accurate records of AEM's cost of gas related to the affiliated transaction. ** _____

1 _____
2 _____
3 _____
4 _____
5 _____ ** This could have been avoided had AEC
6 taken reasonable and prudent precautions to ensure reliability and continuity of its gas
7 supplies.

8 **RESPONSE TO COMPANY REBUTTAL TESTIMONY**

9 Q. Ms. Buchanan states on page 1 lines 16 and 17 that “Mr. Sommerer’s
10 testimony has not raised any serious doubts about the prudence of the actual gas costs
11 incurred. Do you agree?

12 A. No. Items that raise serious doubt about the prudence of these transactions
13 include:

14 1) Atmos’ transaction was with an unregulated affiliate. Although not prohibited,
15 the Commission’s Affiliate Transactions Rule was created because of the inherent conflicts of
16 interest that may arise from the opportunity and incentive for self-dealing.

17 2) Atmos’ incentive pay structure is driven by Earnings Per Share. AEM profits
18 flow to Company earnings and reward Atmos employees who develop and implement the
19 RFPs.

20 3) ** _____

21 _____
22 **

23 4) Atmos had opposed efforts to review and explain AEM’s documentation.

1 5) The Staff identified a significant risk that AEM could use interruptible supply
2 to fulfill firm obligations. ** _____

3 _____
4 ** Did Atmos hold its affiliate accountable for additional costs and penalties
5 caused by the non-delivery of nominated supplies? Self-dealing among affiliates at less than
6 “arms length” creates both opportunity and incentive for forgiveness.

7 Q. Ms. Buchanan discusses on page 3 of her rebuttal testimony that “the rules do
8 not specify that a profit constitutes a financial advantage”. Do you agree?

9 A. Yes. However, I consider a marketing affiliate’s use of interruptible supply or
10 use of interruptible transportation to fulfill a firm obligation to be the same as giving a
11 financial advantage to the affiliate. It is self-evident that an affiliate may, under certain
12 circumstances, take risks not contemplated or reasonably available to a third party
13 unaffiliated supplier. If an independent unaffiliated supplier assumes the risk of offering firm
14 service backed only by interruptible sources, it may do so undetected for a time, but over the
15 long-term it will suffer occasions when it loses its interruptible supplies that it had promised
16 as firm, causing the supplier to lose its reputation in the market as a provider of firm service.
17 The Staff’s position in this case, is NOT to capture the profits of an affiliated marketer, like
18 AEM, solely because profits were made on the deal. Staff’s concern grows when the
19 marketing affiliate fails to disclose relevant supply contracts, invoices, and supporting
20 documentation needed for Staff to scrutinize the transaction. When the unregulated marketing
21 affiliate fails to disclose supporting documentation, it is reasonable and proper for Staff to
22 take the position that the affiliate’s full market value is the same as the LDC’s fair market
23 value. Although AEM would have some administrative overhead in obtaining the fair market

1 value of its supplies, Atmos has not quantified this cost to Staff. Furthermore, Atmos has
2 characterized its arrangement with AEM as simply involving a ** _____ **.

3 Q. Ms. Buchanan discusses the Company's decision to use a bidding process to
4 acquire all gas supplies on the bottom of page 3 and top of page 4 of her rebuttal testimony.
5 Do you agree with her characterization that Atmos does not have the personnel with the in-
6 house expertise to perform gas buying services?

7 A. No. Ms. Buchanan's discussion is made within the context of whether the
8 Company has "explained" *the fully distributed cost* to provide those gas supplies to itself.
9 Based on this discussion, Ms. Buchanan appears to limit the way Atmos can buy gas by
10 requesting the entire requirements of a specific service area (i.e. Hannibal) be limited within a
11 single formal RFP. Ms. Buchanan asserts in her discussion that AEM brings to bear some
12 special skills, access to gas markets, and a unique scope of operation not found in Atmos' gas
13 supply department. When viewed in the context of the services AEM actually did perform for
14 its LDC affiliate, Ms Buchanan's conclusion that the LDC by itself doesn't possess sufficient
15 skills and experience to access the gas markets and to buy gas for its captive ratepayers is
16 not believable.

17 Q. Please explain.

18 A. The LDC knows the amount of its monthly requirements from the reviews it
19 conducts of its supply requirements. The LDC has the expertise to reasonably estimate
20 baseload supply needs for each month and to estimate the contractual volumes and flexibility
21 it requires from storage injections and withdrawals and swing and daily flowing supply for
22 various months and weather conditions. Thus, the LDC could reasonably acquire the
23 baseload volumes and swing volumes through direct contact with potential bidders or through

1 a more formal RFP process similar to that used to award its requirements to AEM. Indeed,
2 AEM's knowledge of Atmos's requirements can be no greater than Atmos' own knowledge of
3 its requirements. Smaller LDCs in Missouri order their own gas. AEC personnel assigned to
4 Missouri are part of the East Region and also manage gas supplies for other states. AEC may
5 not have access to gas buying platforms such as ICE (International Commodities Exchange)
6 because of the cost or the flexibility to bundle supply requirements of multiple parties, but
7 Atmos does have the expertise to issue RFP's, and to conduct phone or email bids.

8 Q. Ms. Buchanan believes that AEM brought special capabilities and knowledge
9 to this supply transaction. Do you agree?

10 A. Not in this transaction.

11 Q. Please explain.

12 For this ACA period, ** _____

13 _____

14 _____

15 _____

16 _____

17 _____

18 _____

19 _____

20 _____

21 _____

22 _____

23 _____

1 _____

2 _____

3 _____

4 _____

5 _____

6 _____

7 _____ **

8 Although the winter contracts between AEM and AEC clearly stated that the gas was

9 to be ** _____

10 _____

11 _____

12 _____

13 _____

14 _____

15 _____

16 _____

17 _____ **

18 AEM also had significant supply issues that created a critical reliability problem for

19 AEC. As noted later in my Surrebuttal, ** _____

1 _____
2 _____
3 _____
4 _____
5 _____
6 _____ **

7 Q. Do you agree that Ms. Buchanan's discussion on page 4, lines 13 through 20 of
8 her rebuttal testimony has correctly characterized my testimony?

9 A. No. Ms. Buchanan states that I believe that fully distributed cost is less than
10 fair market price. The focus of my testimony has been on the fair market value of the service
11 provided by AEM to AEC. The statements made by Ms. Buchanan on page 5, lines 1
12 through 8, show her understanding that there exists a discrete cost that reflects AEM's fair
13 market value. In discussing AEM's fair market value she attributes to AEM some measure of
14 greater purchasing power and bundling of purchases (that may include non-utility customers)
15 or similar scale efficiencies. According to Ms. Buchanan, it is possible that AEM's fair
16 market value could be less than that of AEC. One possibility why AEM's fair market value
17 may be less than AEC's is that AEM obtains riskier supply. Or, AEM may have special
18 access to markets that AEC does not have. AEM's fair market value may be less than AEC's
19 because AEM is willing to take on far greater risks than AEC. Or, AEM's fair market value
20 may be less because it has expertise that does not reside in the smaller AEC gas supply
21 department. It may be that AEM's fair market value is less than AEC's because it has unique
22 access to upstream markets that are not readily available to AEC. All these factors may create
23 a difference in fair market value between AEM and AEC.

However, Staff has found that the one big reason explaining why AEM's fair market

** Ultimately through

the course of discovery, AEM and AEC did not provide Staff with any documentation that

would explain Atmos' contention that AEM did not exploit AEC for greater profit as a result

** This

reliability concern will be described in detail later in this testimony.

Q. On page 5 lines 18 through 23 and page 6 lines 1 and 2 Ms. Buchanan discusses the concept that additional overhead would be necessary if the LDC were to buy “such gas supply” itself. What is your response to this discussion?

A. Atmos already has a gas supply department and the cost of the gas supply function is built into general rates. I believe Ms. Buchanan is again referring to her assertion that the service provided by AEM was of such a unique nature that a small LDC such as Atmos could not replicate AEM's purchase of "such gas supply" on its own. Ms. Buchanan's assertion sounds an alarm with Staff because it is based on the idea that Atmos, but for AEM, has no extensive trading operations, no risk management operations, no access to more diverse markets, no skills in aggregating supply, and no gas traders with expertise in optimizing natural gas assets. Atmos' self professed inability to perform even the simplest gas supply functions is a big reason why Staff sought AEM documents explaining the nature of the service that AEM sold to Atmos. To date, Atmos has not provided sufficient documentation to explain the value that AEM supposedly brought to the deal.

1 Nor has AEM provided any documentation of the overhead costs it has incurred to provide
2 this service to the LDC.

3 During the course of Staff's arduous discovery, it became apparent that AEM did not,
4 or would not, produce: ** _____

5 _____
6 _____
7 _____
8 _____ ** Some of the contract documents provided to Staff by AEM were
9 inconsistent with previous ** _____

10 _____ **

11 Based upon the documents that AEM did provide, it is apparent that AEM
12 bought ** _____

13 _____
14 _____
15 _____
16 _____
17 _____
18 _____
19 _____
20 _____
21 _____ ** AEM rationalized this
22 practice by theorizing that the ** _____

____ ** AEM did not take this precaution.

Q. On page 7, lines 8 through 16 of her rebuttal testimony, Ms. Buchanan discussion concludes that the “utility’s open and competitive bidding process, as approved by the Commission, supplies the conditions required for competitive free-market dealings.” What is your response?

A. There is a benefit in having services subject to an open bidding process when dealing with independent third party suppliers. However, Staff’s inquiry does not stop at the RFP. A supply bid process and the resulting supply contracts must contain sufficient terms and conditions to assure firm supply, except in specific situations where the LDC may not require firm supplies, and must provide detailed explanation of penalties and consequences of failure to perform. If an unaffiliated supplier defaults, Atmos can seek and recover compensation for any resulting financial losses. But if an affiliated supplier, AEM, defaults (gas supplies do not show up per contract), the availability of a dollar remedy is questionable because the non-defaulting party, Atmos the LDC, would be put in a position of collecting from itself because AEM is a subsidiary of Atmos. Moreover, the incentive for the corporation is to hold its shareholder harmless. Additionally, when an LDC deals with its affiliate, the LDC must have clear assurances that its affiliate provides the same high level of service that is expected from non-affiliates. Equally as important, the LDC must take

1 appropriate action for an affiliate's non-performance, including the seeking of penalties that
2 would hold captive ratepayers harmless.

3 Q. Ms. Buchanan discusses the concept of an "arm's-length" transaction on
4 page 7 of her rebuttal testimony and she takes issue with Staff's statement that AEM and AEC
5 share limited credit resources on access to liquidity and counterparty credit exposures. What
6 is your response?

7 A. Any supplier to Atmos will have only a limited amount of financial authority
8 to enter into transactions with Atmos because Atmos and its subsidiary affiliates are viewed
9 as a single business entity. My observation is that if AEM has already executed the total
10 amount of business that counterparty is authorized to conduct with Atmos, then the available
11 pool of suppliers for the LDC will be limited. For example if producer ABC is limited to
12 \$1,000,000 of trades with Atmos as an entity, and if AEM has already acquired producer
13 ABC's business, then the pool of suppliers available to the LDC is reduced by supplier ABC
14 because AEM has swallowed all the available financial resources of that supplier.

15 Q. On page 8 of Ms. Buchanan's rebuttal testimony, Ms. Buchanan observes that
16 the profits related to this particular Missouri area are so small in relation to AEC's overall
17 earnings, their impact on any incentive compensation should be disregarded What is your
18 response?

19 A. Staff's point is that if AEM does well, then the employees responsible for
20 buying the gas at the LDC also stand to do well. If AEM suffered significant overall losses
21 that drive Atmos' EPS to zero, it is unlikely that bonuses would be paid to anyone in the
22 Atmos organization. It is the cumulative and additive effect of AEM's financial successes in

1 many different jurisdictions that materially impact the entire enterprise's EPS, not just
2 Hannibal/Bowling Green alone.

3 Q. Ms. Buchanan states on page 2 lines 10 through 12 that "Mr. Sommerer does
4 not demonstrate how these hypothetical situations are more likely to occur with respect to an
5 affiliated gas supplier than a non-affiliated gas supplier". Have you done so or do you have
6 information to explain your assertions?

7 A. In my Direct testimony, page 10, lines 3 through 8, I stated:

8 The chief reason why Staff has inquired into the fair market value of
9 the gas supplies that AEM provide to Atmos (the LDC) is that it is
10 possible for AEM to use high risk interruptible or spot gas, in addition
11 to interruptible transportation, to fulfill its firm service obligation with
12 Atmos the LDC. Staff cannot discern from AEM's analysis whether
13 AEM's obligations to Atmos were fulfilled by firm or interruptible
14 supplies to the LDC.

15 For the winter of 2007/2008, Atmos did not receive the entire ** _____
16 _____ ** and this created higher costs for
17 customers in the Consolidated area of Hannibal, Canton, Palmyra and Bowling Green.

18 ** _____
19 _____
20 _____
21 _____
22 _____
23 _____ ** (DR 132.1,
24 attached as Schedule 4)

25 ** _____
26 _____
27 _____

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_____ **

INFORMATION REQUESTED BY COMMISSION ORDER

Q. Do you have the information requested in the Commission Order dated November 15, 2010?

A. Yes. The Commission Order states, “Staff shall prepare an impartial analysis comparing the projected cost of the natural gas used in the bid evaluation of Atmos Energy Marketing with the price actually paid by Atmos Energy Corporation to Atmos Energy Marketing under the contract, and shall file that analysis as part of its surrebuttal testimony.”

The actual price paid by AEC to AEM is summarized in Schedule 6. The ACA period in this case is September 2007 through August 2008. There were two RFP’s issued that cover this ACA period. One was for supply for the months of April 2007 through March 2008 and the other is for supply for the months of April 2008 through March 2009. The volumes considered by Atmos in its bid evaluations, the summary of the bids, and the Atmos review of the total costs and rankings of the RFP bid responses are attached as Schedule 7. In both bid evaluations, ** _____

_____ **

There are several potential flaws in the Atmos' bid evaluation. Atmos' bid evaluation assumes that the LDC will ** _____

_____ ** as summarized in Table 1.

Table 1: Atmos Hannibal, Canton, Palmyra and Bowling Green, Winter Month RFP
Baseload Volumes Compared to Normal Requirements

**

**

Because storage is nearly full at the beginning of November (planned to be 94% full) and is planned to be 85% full at the end of November, ** _____

_____ ** If weather was warm, Atmos would not want to baseload more supply than it could reasonably use or inject in storage. A summary of monthly winter normal heating degree days (HDD), warmest month HDD, and coldest month HDD is shown in Table 2.

Table 2: Hannibal, MO Heating Degree Days

1971 - 2000 NOAA HDD, Hannibal, MO

	Normal Month HDD	Warmest Month HDD	Coldest Month HDD	Warmest Month as % of Normal	Coldest Month as % of Normal
November	684.4	405.1	906.0	59.2%	132.4%
December	1,101.8	868.0	1,553.1	78.8%	141.0%
January	1,254.0	847.5	1,689.5	67.6%	134.7%
February	980.0	716.8	1,352.4	73.1%	138.0%
March	734.9	509.5	982.7	69.3%	133.7%

1 A review of the recent actual baseload nominations for November and December 2006 and
2 2007, as shown in Chart 1, supports that Atmos had not ** _____

3 _____ ** with the exception of
4 December 2006. Also because of end of winter requirements for some of its storage contracts
5 that contain a ** _____

6 _____ ** Thus, if
7 Atmos would not normally nominate its normal requirements for baseload in some months,
8 its bid evaluation should not make ** _____

9 _____ **

10 Chart 1: Baseload Nominations as % of Planned Normal Requirements

11 **

12
13 **

1 Further, the Staff notes that because Atmos considers swing volumes as part of a
2 bundled baseload and swing agreement, ** _____
3 _____ ** Given how AEM priced
4 its bid to Atmos with a ** _____
5 _____
6 _____ ** This describes
7 the structure of the demand charge. With regard to the magnitude of the demand charge
8 adder, it is likely recognition by the supplier that it must transport the gas (baseload or swing)
9 on a firm basis to HAVEN. ** _____
10 _____
11 _____
12 _____ ** This distinction perfectly illustrates the extra permissiveness that
13 Atmos granted to AEM by allowing AEM to ** _____
14 ____ ** Atmos shows further deference to AEM by its easy willingness to make
15 ** _____ ** It is doubtful Atmos would have
16 so favored an independent third party supplier the way it favored AEM.

17 An additional concern about Atmos' Hannibal RFP that exists with or without an
18 affiliate is that the RFP process for the Hannibal system is ** _____
19 _____ ** (See Ms. Buchanan's Direct Schedule 2) A comparison of Butler
20 RFP results against Hannibal RFP results reveals ** _____
21 ____ **

22 Q. Ms. Buchanan's rebuttal testimony criticizes your reliance on AEM's P&L
23 document. What is your response?

1 A. The Company was originally asked to provide the profit & loss of AEM that
2 was associated with the affiliate transaction. The Staff was seeking an actual AEM document
3 that would have captured AEM's gross revenues and AEM's cost of gas directly related to the
4 transaction with its LDC affiliate. ** _____

5 _____
6 _____
7 _____
8 _____
9 _____
10 _____
11 _____ ** These inquiries were met with staunch
12 resistance by AEC. ** _____

13 _____
14 _____ ** The Staff concludes, based on the information provided by Atmos,
15 that ** _____

16 _____
17 _____ ** The disallowance
18 based upon AEM's fair market value of gas supply is approximately \$308,000. Butler is no
19 longer included in this disallowance based upon the additional information provided by AEC
20 and AEM. See attached Schedule 8.

21 Q. In what respects do you believe the Company to be imprudent?

22 A. The Company has not provided any support that its December 2007 actions
23 were reasonable. Its first-of-month baseload nominations were ** _____

_____ **

During the discovery process the Company has not cooperated with Staff's efforts to uncover the actual facts and circumstances surrounding the affiliate transaction. ** _____
_____ ** Atmos has repeatedly stated that AEM performed in every respect, providing firm gas without fail. The facts showed otherwise.

Q. Have you considered the level of damages from the Company's imprudent decision of ** _____ **

A. Yes. The Staff evaluated the impact of Atmos ** _____

_____ ** The Staff's calculation of damages reflects the fact that the Company could have reasonably avoided the ** _____

_____ ** Staff's calculation of damages uses the average price that the Company paid for those more expensive gas supplies. ** _____

_____ ** by only 1,900 MMBtu/day and yields a disallowance of \$52,572.

1 The Staff also calculated another scenario that reasonably assumed an increase over
2 actual ** _____ ** yielded a
3 disallowance of \$85,775. This second scenario takes the a conservative approach that
4 assumes AEC would have recognized that ** _____
5 _____
6 _____
7 _____
8 _____ ** This is important
9 because a more reasonable baseload nomination allows the Company greater flexibility in the
10 event there are supply issues later in the winter or gas prices rise later in the winter.

11 Both scenarios assume that the Company could reasonably have ** _____
12 _____ ** In summary,
13 Scenario 1 develops this ** _____ **
14 Scenario 2 develops this amount by covering ** _____
15 _____
16 _____ **

17 Q. Ms. Buchanan has repeatedly stated in both her direct and rebuttal testimony
18 that there were not any supply issues with AEM, and that AEC experienced no interruptions
19 from AEM. Do you believe this?

20 A. No. Based upon ** _____
21 _____
22 _____
23 _____

1 _____
2 _____
3 Q. ** _____
4 _____ **

5 A. ** _____
6 _____
7 _____
8 _____
9 _____
10 _____
11 _____
12 _____
13 _____
14 _____

15 ____ ** In conclusion, these points summarize the points previously discussed. AEM
16 increased its risk exposure and potentially increased its profits by misrepresenting to AEC that
17 its ** _____ **
18 [Attached as Schedule 9 is a PEPL list of customers filed with the FERC that shows that
19 AEC was somewhat unique in its lack of wintertime field-zone capacity. See page 15 of
20 that report, at reference number 23, where Atmos (United Cities) shows a receipt point of
21 “HT – Associated Gas Services”. This firm transportation contract and related receipt point
22 does not include field-zone capacity as most other Missouri LDC contracts do (see MGE,
23 Laclede, Empire District Gas and Ameren as examples)]

1 Q. Does this conclude your surrebuttal testimony?

2 A. Yes, it does.

3 **List of Schedules**

4 Schedule 1: Transaction Confirmations - HC

5 Schedule 2: Preliminary Transaction Confirmation – HC

6 Schedule 3: Atmos records of cuts – HC

7 Schedule 4: Atmos Explanation of Planned and Actual Nominations, DR No. 132.1 - HC

8 Schedule 5: DR No. 132.2 Excerpts - HC

9 Schedule 6: Actual price paid by AEC to AEM- HC

10 Schedule 7: Volumes considered by Atmos in its bid evaluations, the summary of the bids,
11 and the Atmos review of the total costs and rankings of the RFP bid responses - HC

12 Schedule 8: AEM Profit and Loss Adjustment - HC

13 Schedule 9: PEPL list of customers filed with the FERC - Public

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of PGA/ACA filing of Atmos Energy)
Corporation for the West Area (Old Butler), West)
Area (Old Greeley), Southeastern Area (Old)
SEMO), Southeastern Area (Old Neelyville),)
Kirksville Area, and in the Northeastern Area)

Case No. GR-2008-0364

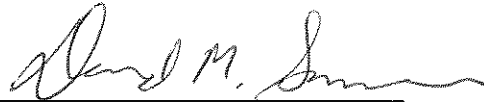
AFFIDAVIT OF DAVID M. SOMMERER

STATE OF MISSOURI)

) ss.

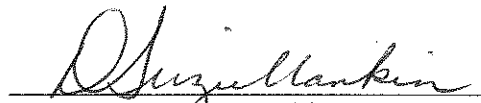
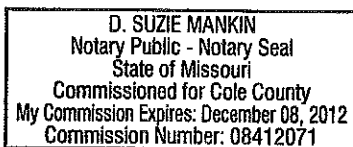
COUNTY OF COLE)

David M. Sommerer, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Surrebuttal Testimony in question and answer form, consisting of 22 pages to be presented in the above case; that the answers in the foregoing Surrebuttal 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.



David M. Sommerer

Subscribed and sworn to before me this 22nd day of December, 2010.



Notary Public