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

INITIAL BRIEF OF

SOUTHERN MISSOURI GAS COMPANY, L.P.

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NON-PROPRIETARY (NP) VERSION

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COMES NOW the Southern Missouri Gas Company, L.P. ("SMGC" or "Company") for its Initial Brief in this matter states as follows:

INTRODUCTION

This case is not like any other ACA proceeding that the Commission has reviewed. There are no allegations by Staff or Public Counsel that the Company has acted imprudently in its gas purchasing activities, or that the Company's ratepayers have been harmed financially because of SMGC's actions. There is no dispute that SMGC found a solution to the problem of high PGA rates for two large industrial customers that were on the verge of leaving the SMGC natural gas system during the winter of 2000-2001 in favor of a lower-priced propane alternative source of energy. Nor is there any dispute that all of SMGC's other ratepayers benefited from the fact that SMGC was able to keep two industrial customers on SMGC's natural gas system.

Notwithstanding the fact that SMGC implemented an apparent "win-win" solution to a difficult market problem that had the potential to negatively impact all of SMGC's ratepayers, SMGC has now faced costly litigation with Staff and Public Counsel in this proceeding over whether the solution found by SMGC was a "violation" of SMGC's tariffs. Staff has not alleged that SMGC violated a specific provision in its tariffs, but instead has made the nebulous assertion that SMGC is "operating outside its tariffs." As the remedy for this alleged "violation," Staff has

recommended that the Commission impose an ACA disallowance that is the equivalent of 64% of the Company's net utility operating income (before interest costs) for 2001! In addition, two business days before the evidentiary hearings commenced in this matter, Staff filed a separate formal Complaint involving the same alleged "violation" seeking authority to impose statutory penalties on SMGC. (Tr. 197)

For the reasons stated herein, the Commission should reject the proposed adjustment of Staff and Public Counsel in this proceeding, and specifically find that SMGC has not violated its tariffs.

I. EXECUTIVE SUMMARY

This proceeding involves SMGC's Actual Cost Adjustment (ACA) filings for the 2000-2001 ACA period. SMGC, Staff, and Public Counsel filed a Unanimous Partial Stipulation and Agreement on March 29, 2003, which settled all, but two issues, in this case. The remaining issues involve Staff's proposed adjustment to reduce the Company's ACA balance by $99,199[1] in order to impute theoretical revenues that Staff alleges would have accrued to the Company if SMGC had not entered into Gas Supply Agreements and Transportation Service Agreements with two large industrial customers that were on the verge of accepting lower-priced bids from propane suppliers. This adjustment itself would represent approximately 64% of SMGC's total net utility operating income of $155,703, before interest charges, for 2001.[2] (Tr. 194; Ex No. 6, p. 15-16).

The Company strongly disagrees that there should be a reduction of $99,199 to the firm sales ACA balance in this proceeding. If the Company had not taken the steps necessary to

[1] Staff originally proposed an ACA adjustment of $105,809. However, Staff modified its position in the Surrebuttal Testimony of Annell Bailey. (Tr. 185)(Ex No. 12, p. 2)

[2] When interest charges are considered, SMGC actually lost $1,808,226 in 2001. Staff's proposed adjustment, if adopted by the Commission, will make it more difficult for SMGC to earn a positive return on its investment in the future.

compete with lower-priced alternative fuels, it is extremely likely that two industrial customers, **_____,** would have left the SMGC system, or substantially reduced their throughput.

When these customers complained to SMGC regarding skyrocketing prices for natural gas during the winter of 2000-2001, SMGC discussed with them the possibility of providing transportation service with a third party marketer providing them with gas supplies. However, these customers were not comfortable dealing with a third-party marketer to obtain their gas supplies, and they did not have the in-house expertise to acquire their own gas supplies.

As a result of the large industrial customers' unwillingness to deal with a third party marketer, SMGC also discussed the possibility of providing transportation service with SMGC itself selling them the gas supplies. Given the industrial customers' unwillingness to deal with a third party marketer, SMGC determined that this option was the only viable option for keeping the large industrial customers on the SMGC system.

By entering into standard Gas Transportation Agreements and Gas Supply Agreements with these customers, SMGC was able to keep these customers on the SMGC natural gas system, and the remaining ratepayers benefited. In fact, Staff agrees that the remaining ratepayers benefited by nearly $40,000 since the profits from the sale of the gas to the industrial customers were used to reduce the ACA balance which otherwise would have been paid for by the Company's remaining customers. If the industrial customers had left SMGC's system, then the remaining ratepayers would also have been adversely impacted since there would been fewer volumes over which to spread the remaining fixed transportation costs. However, as a result of SMGC's willingness to enter into the Gas Supply and Gas Transportation Agreements with these

customers, all customers, including SMGC's residential, commercial and industrial customers, benefited.

As previously discussed, SMGC has given the benefit of the gas sales profits entirely to SMGC's other ratepayers through the ACA process. However, Staff's proposed adjustment would also provide the remaining ratepayers with an additional $99,199 in ***theoretical revenues***, even though these revenues would not have existed if SMGC had attempted to collect the full large volume service rate from these customers. If SMGC had refused to work with its customers to find a solution that would make natural gas competitive with propane, these customers would have exited SMGC's natural gas system in favor of lower priced alternative sources of energy, as did **_____** (a smaller customer who did not meet the minimum usage threshold required for eligibility for transportation service) when the lower priced transportation option was not available to it.

In this proceeding, the Staff has alleged that SMGC created a "new class of customers," "Internal Transport Customers," in violation of its tariffs, and that SMGC is "operating outside its tariffs" when it provided gas supplies to these customers.

As explained herein, SMGC has not created a "new class of customers" and it is not operating "outside its tariffs," as suggested by Staff. After reviewing all available options for keeping these industrial customers on SMGC's natural gas system, SMGC agreed to provide existing transportation service to these industrial customers at the rates approved by the Commission in SMGC's Transportation Service Tariffs. As a result, these customers are properly characterized as "transportation service customers" under SMGC's existing transportation service tariff. In addition, because the customers were unwilling to enter into contracts with a third party marketer for gas supplies, SMGC also agreed to obtain gas supplies

for these customers, pursuant to Gas Supply Agreements and the various rules, regulations and orders of the Federal Energy Regulatory Commission (FERC) that created an unregulated market for gas supplies. Under FERC's "blanket marketing certificate program," any entity, except an interstate pipeline, is authorized by the FERC to make sales of gas at negotiated rates in interstate commerce. *See* 18 CFR §284.402. SMGC exercised this authority under federal law to make gas sales to **_____** Although the sale of gas by SMGC to transportation customers is not specifically addressed in SMGC's Missouri tariffs, it is incorrect to suggest that SMGC is "operating outside its tariffs" since this activity is an **unregulated activity** that is authorized by federal law. *See also* ***Re Laclede Gas Company***, Case No. GR-96-181, 8 Mo. P.S.C.3d 120, 194 P.U.R.4th 284 (1999)(Off-system sales is an unregulated activity not addressed in the LDC's tariffs).

Legal Standard For ACA Adjustments and Burden of Proof

The Missouri courts have established a two-pronged test that must be met before an ACA adjustment may be made: (1) there must be a showing that a utility's actions or decisions were imprudent; and, (2) there must be a showing that such actions had a detrimental impact on the utility's customers in the form of excessive costs. *See* ***Re Western Resources, Inc.***, 3 Mo.P.S.C.3d 480, 489 (1995); ***State ex rel. Associated Natural Gas Company v. Public Service Commission***, 954 S.W.2d 520 (Mo.App. 1997).

The Commission and the courts have held that the public utility's costs are presumed to be prudently incurred. Where some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the public utility has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent. *Id.*

Based upon this case law, it is clear that the Staff and Public Counsel have the burden of proof and the burden of persuasion regarding any proposed disallowances in this ACA case. As discussed herein, no party has raised any serious doubt regarding the prudence of the Company's expenditures during the ACA period, nor has any party demonstrated with competent and substantial evidence that the Company's ratepayers were financially harmed by the Company's actions. In addition, the Staff and Public Counsel have failed to produce any shred of evidence that the industrial customers would have stayed on the SMGC system and paid the large volume service tariffed rates if SMGC had not agreed to provide them with gas supplies and transportation service at prices that were competitive with the propane alternative.

Staff's entire case is based upon two erroneous conclusions: (1) that SMGC "violated its tariffs" when it sold gas supplies that could be transported by these customers using the Company's tariffed transportation service; and (2) the two industrial customers would have purchased the same volume of gas at the substantially higher PGA-rate, if SMGC had not entered into Gas Supply Agreements and Transportation Service Agreements with them. Since both conclusions are fatally flawed, the Commission should decline to accept Staff's proposed adjustment in this case.

Since Staff and Public Counsel have failed to meet either of the required tests for an ACA adjustment, the Commission should decline to adopt Staff's proposed adjustment in this proceeding. Notwithstanding the required tests for an ACA adjustment, it would simply be unfair to adopt the proposed adjustment since the unrefuted evidence demonstrates that SMGC's transportation service and sale of gas supplies to these large customers benefited the Company's remaining ratepayers, and there was no financial harm to the Company's ratepayers. As noted in

SMGC's opening statement in this proceeding, SMGC should not be penalized for finding a "win-win" solution to a difficult market problem. (Tr. 4-24)

For these reasons and the additional reasons explained below, the Staff's proposed adjustment should be rejected.

II. STATEMENT OF FACTS

During the winter of 2000-2001, natural gas wholesale prices skyrocketed to unprecedented levels. The wellhead price of natural gas had been relatively low with an average of around $2/Mcf since this price was deregulated in the 1980s. The commodity price of natural gas began to rise above historic highs in the summer of 2000 when it went above $4/Mcf in June, $5/Mcf in September, and then in November it went over $6/Mcf. At the end of 2000, after two months of extraordinarily cold weather and continued reports of extreme storage withdrawals, the commodity price of natural gas spiked to near $10/Mcf in late December.[3] As explained in the Commission's Task Force Report, "[t]he increase in commodity cost was due to a number of factors but the primary factor was the record cold in November and December 2000 that affected most of the states east of the Rockies. This record cold occurred when the commodity price had already eclipsed $5/Mcf and led to the first sustained increase in space heating demand for natural gas nationally in five years. This increased demand caused nine weeks of sustained or increasing commodity prices from $4.50/Mcf the last week in October 2000 to $9.98/Mcf the last week of December 2000."[4] (Ex No. 6, pp. 7-8)

When SMGC increased its gas supply rates on February 1, 2001, to reflect these dramatic market changes, SMGC's PGA rate, including its under-collected ACA balance from previous ACA periods, resulted in a total PGA rate of $ 0.8989 per Ccf (or $ 8.989 per Mcf). After

[3] Final Report of the Missouri Public Service Commission's Natural Gas Commodity Price Task Force, pp. 63-70)("Task Force Report").
[4] Id. at 70.

SMGC's customers received the bills that reflected the PGA rate increase, three large volume service(LVS)customers,**_____

_____

_____

_____** contacted SMGC expressing concerns over SMGC's rates, and indicated to Mr. William A. Walker, SMGC's Gas Control Manager, that they were strongly considering switching to alternative sources of energy. (Ex No. 5 HC, pp. 8-10; Ex No. 9, pp.62-63, 85-87) At this time, the equivalent price for propane was approximately $0.71 per gallon, or $7.75 per MMBtu. (Tr. 7-9, 18, 163)

Since the loss of this load would negatively impact SMGC and its remaining customers, SMGC began reviewing its options for competing with the alternative sources of supply for these customers. SMGC personnel reviewed the following 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 ("flex down option"); (3) Put the industrial companies in touch with third-party marketers for their gas supply, and SMGC would provide transportation service only; and (4) Provide the industrial companies with transportation service and SMGC also provide the gas supply. (Ex No. 3, pp. 4-5).

SMGC concluded that Option 1 ("do nothing and risk losing customers") was not a viable option for retaining the industrial customers on its natural gas system. It was clear to SMGC personnel that the industrial customers would accept the lower-priced propane bids if SMGC did nothing to make natural gas prices competitive with propane. (Tr. 163) As a result,

SMGC rejected the Option 1 of doing nothing to compete with propane suppliers since the Company expected to lose the customers under this option. (Ex No. 3, p. 5)

Upon review of the Option 2 ("flex down option "), SMGC concluded that it could not compete with propane under Option 2 since this option would allow SMGC to reduce its natural gas rates by only $0.50 per Mcf. (Tr. 162) Under this Option 2, natural gas prices would have continued to be priced substantially above the propane equivalent price. (Tr. 162-63). As a result, SMGC concluded that Option 2 was not a viable option for retaining the industrial load on its natural gas system. (Ex No. 3, pp. 7-8)(Tr. 163)

Option 3 ("transportation service with a third party marketer providing gas supplies") was also evaluated. Prices for natural gas had begun to drop precipitously beginning in mid-winter, 2001. SMGC determined that natural gas supplies could be acquired by a third party marketer at considerably less than its existing PGA rate of $8.989 per Mcf. More specifically, SMGC determined that natural gas supplies could be acquired for these customers for **_____**. (Ex No. 5HC, p. 8) Since gas supplies could be acquired at a price that was substantially less than the PGA rate, the possibility existed that gas supply could be obtained at a more attractive rate than the existing PGA rate, and the customers could transport the gas supplies utilizing SMGC's transportation service, pursuant to the transportation service tariff. (Ex No. 6, p. 8)

_____ met the minimum usage thresholds in SMGC's transportation tariff, and therefore SMGC could provide transportation services to these customers. However, **_____** did not qualify for transportation service since it did not meet the minimum usage threshold contained in SMGC's existing transportation tariff. Since **_____** did not qualify for transportation service, SMGC was unable to provide

the transportation service option to this customer. (Ex No. 9, pp. 62-63). As a result, SMGC lost **_____** since this customer accepted the lower-priced bid from the propane supplier. (*Id.*).[5]

SMGC discussed the possibility of providing transportation service with a third party marketer providing the gas supplies with **_____**. However, these customers were not comfortable dealing with a third-party marketer to obtain their gas supplies, and they did not have the in-house expertise to acquire their own gas supplies. (Ex No. 9, p. 78).[6]

As a result of the large industrial customers' unwillingness to deal with a third party marketer, SMGC evaluated Option 4 ("transportation service with SMGC selling the gas supplies").[7] Given the industrial customers' unwillingness to deal with a third party marketer, SMGC determined that Option 4 was the only viable option for keeping the large industrial customers on the SMGC system. (Tr. 133, 163)

SMGC entered into contracts with these customers which are included in the record in Ex No. 5HC, Rebuttal Schedule No. 2-HC. **_____

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[5] In November, 2001, SMGC requested that the Commission approve a modified minimum usage threshold for its Transportation Service. Following the approval of the modified minimum usage threshold, **_____** qualified for transportation services. This customer entered into a Transportation Agreement and Gas Supply Agreement with SMGC and returned to the SMGC natural gas system as a transportation customer.

[6] Mr. Walker also testified in his deposition regarding the unwillingness of **_____** to negotiate with a third party marketer:

> "They later communicated to me that they didn't understand what the marketer was telling them, they weren't comfortable dealing with him, they didn't know him, and that they preferred to deal with me because they could come into my office and ask me direct questions and get direct answers in a language and vernacular they understood." (Id.)
> * * *
> "He [third party marketer] told me that he couldn't understand why he wasn't able to close the deal. He was frustrated and was at a point where he wasn't going to talk to or even approach the customer anyway, because he had shown the customer where he could save a substantial amount of money over the price that he was currently paying for propane or the price that we could give him as a large volume customers, and he couldn't get the customer to commit to anything." (Ex No. 9, p. 79).

[7] This Option was referred to in SMGC's initial work papers supplied to Staff in this proceeding as "Internal Transport Activity." (Ex No. 20; Tr. 214-15)

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_____** (Ex No. 5 HC, p. 9)

Bill Walker, Gas Control Manager, in SMGC's Mountain Grove office memorialized the events surrounding the ** _____ _____** in a memorandum to the file (drafted July 18, 2001). He also discussed the fixed price purchase related to these contracts in a memorandum to the file dated April 30, 2001. In addition, Mr. Walker memorialized the events surrounding the **_____** in a hand-written memorandum dated August 10, 2001. These documents are included in the record in Ex No. 5HC, Rebuttal Schedule No. 3-HC.

Since SMGC purchased the gas supplies for **_____** and sold the gas supplies to **_____** for **_____**, there was a profit of **_____** from the transactions. The total profit from the natural gas sales (i.e. $39,986.49) was treated by SMGC as a gas cost recovery item for development of the ACA

factor, and the profit was used to reduce the amount that other ratepayers would have to pay for the uncollected ACA balance by $39,986.49. (Ex No. 3, p. 10) As a result, SMGC's remaining customers directly benefited by nearly $40,000 from the fact that SMGC was able to negotiate a contract that recovered its variable costs and made a contribution to the fixed costs of the system. In addition, if the load of these industrial companies had left SMGC's natural gas system, then the fixed transportation costs for remaining customers would have increased to approximately $0.132 per Ccf, or a 19% increase in fixed transportation costs. The impact on a typical residential customer using 750 Ccfs annually would have been an additional cost of approximately $16 per customer. (Ex No. 3, p. 6) Although SMGC's remaining ratepayers directly benefited from this contractual arrangement, SMGC's owners did not directly benefit since SMGC did not retain any of the revenues from the gas supply contract as a fee for providing this service. (Ex No. 6, p. 10). SMGC did, however, receive the revenues associated with providing transportation service to these customers under the Company's transportation tariff.

III. ISSUES REQUESTED TO BE ADDRESSED BY THE COMMISSION

At the conclusion of the hearing, Commissioner Murray requested that the parties brief the following legal issue: What disallowances are permitted in the ACA review process, and for what reasons is the Commission permitted to make disallowances? (Tr. 276). In addition, Commissioner Gaw requested that the parties address the following legal issue: Is there a burden of proof or burden of persuasion regarding disallowances in the ACA process, and if so, what party has the burden of proof and persuasion? (Tr. 276-77) Since the legal issues raised by the Commissioners Murray and Gaw go directly to the heart of the issues that need to be resolved in this proceeding, SMGC will initially brief the legal issues raised by the Commissioners, and will

conclude by briefing two remaining issues identified on the List of Issues submitted by the parties.

A. WHAT DISALLOWANCES ARE PERMITTED IN THE ACA REVIEW PROCESS, AND FOR WHAT REASON IS THE COMMISSION PERMITTED TO MAKE DISALLOWANCES?

SUMMARY OF SMGC POSITION: Historically, the issues to be reviewed during the ACA review are: (1) the prudence of the public utility's gas purchasing practices during the ACA period; and (2) whether there are any discrepancies between the Purchased Gas Adjustment (PGA) amounts which were prospectively billed to the gas company's customers and the actual costs which, in retrospect, the Company actually incurred in obtaining gas from its suppliers. (i.e. true-up of actual costs). Disallowances, if any, in the ACA process have been authorized when imprudence has been found in the public utility's gas purchasing practices, or when the estimated costs of providing gas to its customers included in the PGA rates exceeded the actual costs of providing gas to the customers during the ACA period. In addition, there must be competent and substantial evidence to demonstrate that ratepayers were financially harmed by the Company's actions. *See* ***State ex rel. Associated Natural Gas Company v. PSC,*** 954 S.W.2d 520 (Mo.App. 1997). SMGC has found no precedent that would support an ACA adjustment based upon an allegation that a gas company was "violating" its tariff provisions.

CASE LAW RELATED TO THE PURPOSES OF THE ACA PROCESS

In ***State ex rel. Associated Natural Gas Company, v. Public Service Commission***, 954 S.W.2d 520, 523 (Mo.App. 1997), the Missouri Court of Appeals succinctly described the scope of ACA reviews as follows:

> ANG [Associated Natural Gas Company] is a public utility operating a natural gas distribution system in a number of locations in Missouri. Pursuant to the statutory provisions in Chapter 393, RSMo 1994, the PSC has jurisdiction over the rates and charges which ANG imposes upon its retail customers in

> Missouri, and the PSC is responsible for ensuring that such rates and charges are "just and reasonable." In part, this case involves the reasonableness of certain charges which ANG has sought to pass on to its Missouri customers, and the procedure for evaluating such charges can be briefly described as follows.
>
> In addition to the basic rates which ANG charges its customers, ANG can also recover from its customers the costs which it incurs in obtaining gas from its own suppliers. These additional charges are recovered through a two-part mechanism known as a purchased gas adjustment/actual cost adjustment (PGA/ACA) process. In the first half of this process, which is known as the PGA, ANG files annual tariffs in which it estimates its cost of obtaining gas over the coming year. This part of the process is prospective or forward-looking, and the PGA amounts are then included in the customers' bills over the ensuing twelve months. In the second half of the process, ANG submits ACA filings, which are meant to correct any discrepancies between the PGA amounts which were prospectively billed to ANG's customers and the costs which, in retrospect, ANG actually incurred in obtaining gas from its suppliers.
>
> The ACA filing procedure also provides the PSC with an opportunity to review the reasonableness of ANG's cost-recouping charges by evaluating ANG's gas acquisition practices during the relevant time period. If the costs have been appropriately incurred, the PSC allows ANG to pass them on to the customers. In order to determine if the costs can be passed through to customers as reasonable charges, the PSC employs a "prudence" standard, which will be more thoroughly described in our discussion of ANG's initial points on appeal. (*emphasis added*)

In ***State ex rel. Midwest Gas Users' Association v. Public Service Commission***, 976 S.W.2d 470, 473 (Mo.App. 1998), the Missouri Court of Appeals elaborated upon the historical purpose of the ACA process:

> While the technicalities of Missouri's PGA clause have varied over the years, the clause's basic function has remained the same: a PGA clause allows a local distribution company to automatically adjust the rates it charges its customers in proportion to the change in the rate the local distribution company is charged by its wholesale suppliers. At the end of every twelve-month period, the local distribution company then makes an actual cost adjustment ("ACA") filing with the PSC so that the PSC can determine whether the estimated amount previously charged customers accurately reflects the actual cost to the utility of the gas supplied.

As discussed in more detail below, the allegation of Staff and Public Counsel that SMGC has "violated its tariffs" is beyond the scope of an ACA proceeding. It should therefore be dismissed from this case.

B. IS THERE A BURDEN OF PROOF OR BURDEN OF PERSUASION REGARDING DISALLOWANCES IN THE ACA PROCESS, AND IF SO, WHAT PARTY HAS THE BURDEN OF PROOF AND PERSUASION?

SUMMARY OF SMGC POSITION: The Commission and the courts have held that the public utility costs are presumed to be prudently incurred. Where some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the public utility has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent. Based upon this case law, it is clear that the Staff and Public Counsel have the burden of proof and the burden of persuasion regarding any proposed disallowances in this ACA case. As discussed herein, no party has raised any serious doubt regarding the prudence of the Company's expenditures during the ACA period, nor has any party demonstrated with competent and substantial evidence that the Company's ratepayers were financially harmed by the Company's actions. In addition, the Staff and Public Counsel have failed to produce any shred of evidence that the industrial customers would have stayed on the SMGC system and paid the large volume service rates if SMGC had not agreed to provide them with gas supplies and transportation service at prices that were competitive with the propane alternative.

On the other hand, SMGC has introduced convincing evidence that these two industrial customers were on the verge of converting to a lower-priced energy source, and would have done so if SMGC had not entered into the transportation and gas supply contracts at issue in this case.

CASE LAW REGARDING THE BURDEN OF PROOF IN ACA CASES

In ***State ex rel. Associated Natural Gas Company, v. Public Service Commission***, 954 S.W.2d 520, 523 (Mo.App. 1997), the Missouri Court of Appeals discussed the presumption of prudence and the burden of proof and persuasion in ACA cases:

All charges for gas service must be just and reasonable. Section 393.130.1, RSMo 1994. The PSC has employed a "prudence" standard to determine whether a utility's costs meet this statutory requirement. If a utility's costs satisfy the prudence standard, the utility is entitled to recover those costs from its customers. The PSC has defined its prudence standard as follows:

> [A] utility's costs are presumed to be prudently incurred.... However, the presumption does not survive "a showing of inefficiency or improvidence."
> ... [W]here some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent. (Citations omitted).

Union Electric, 27 Mo. PSC (N.S.) 183, 193 (1985) (quoting 529 Fed. Energy Reg. Com'n, 669 F.2d 799, 809 (D.C.Cir.1981)).

In the same case, the PSC noted that this test of prudence should not be based upon hindsight, but upon a reasonableness standard:

> [T]he company's conduct should be judged by asking whether the conduct was reasonable at the time, under all the circumstances, considering that the company had to solve its problem prospectively rather than in reliance on hindsight. In effect, our responsibility is to determine how reasonable people would have performed the tasks that confronted the company.

Union Electric, 27 Mo. P.S.C. at 194 (quoting Consolidated Edison Company of New York, Inc. 45 P.U.R. 4th 331 (1982)).

The Commission itself has also previously addressed the burden of proof and burden of persuasion in ACA cases. In its Order Denying Motion to Strike Testimony in ***Re Western Resources, Inc.***, Case No. GR-93-140, the PSC stated:

> WRI must show that its rates are reasonable. Conversely, Staff's burden is to show that WRI acted imprudently in making gas supply arrangements which caused higher gas costs than if prudent decisions had been made. A determination as to whether a particular decision was prudent involves consideration of the facts and circumstances in hand at the time the decisions were made. (*Emphasis added.*)

In the same case, the Commission also made the following statements in its Report and Order, in ***Re Western Resources, Inc.,*** 3 Mo.P.S.C.3d 480, 489 (1995):

> To test the reasonableness of WRI's gas costs, the Commission uses a standard of prudence.
>
> * * *
>
> The Commission is of the opinion that a prudence review of this type must focus primarily on the cause(s) of the allegedly excessive gas costs. 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. ... In addition, evidence about the particular controversial expenditures is needed for the Commission to determine the amount of the adjustment.... In addition, it is helpful for 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.... The amount of the proposed adjustment must be based on excessive expenditures incurred during the particular ACA period involved.[8,9, 10]

It is clear from the foregoing, that a two-pronged test must be met before an ACA adjustment may be made: (1) there must be a showing that a utility's actions or decisions were imprudent; and (2) there must be a showing that such actions had a detrimental impact on the utility's customers in the form of excessive costs.

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[8] *See also,* ***Re Kansas Power and Light,*** 30 Mo.P.S.C. (N.S.) 76, 83 (Dec. 29, 1989)("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.")

[9] Similarly, the Commission has always held that the complainant, as the moving party, in complaint proceedings has the burden of proof to prove its allegations. ***See Tel-Central of Jefferson City, Missouri v. United Telephone Co.***, 29 Mo.P.S.C. (N.S.) 584 (May 12, 1989)("Tel-Central has elected to proceed by complaint and by so doing assumes the burden of proof and the risk of nonpersuasion."). ***See also CyberTel Cellular Telephone Co. v. Southwestern Bell Telephone Co.***, 94 PUR4th 120 (January 12, 1988)("The Commission determines that CyberTel has not met its burden of proof to show that the rates in question are unjustly and unreasonably applied.");***Summers v. Laclede Gas Company***, 23 Mo.P.S.C. (N.S.) 533 (July 15, 1980)("Where Complainant does not sustain the burden of proof, the complaint will be dismissed."); ***Staff of the Missouri Public Service Commission v. Union Electric Co.***, 29 Mo.P.S.C. (N.S.) 305 (The Commission held that Staff and Public Counsel, as Complainants, had the burden of proof)

[10] *See also* Section 386.430 places the burden of proof on the adverse party in any trials, actions, suits or proceeding arising under the provisions of Chapter 386:

> In all trials, actions, suits and proceedings arising under the provisions of this chapter or growing out of the exercise of the authority and powers granted herein to the commission, the burden of proof shall be upon the party adverse to such commission or seeking to set aside any determination, requirement, direction or order of said commission, to show by clear and satisfactory evidence that the determination, requirement, direction or order of the commission complained of is unreasonable or unlawful as the case may be.

These required elements of an ACA adjustment have also been recognized and strictly enforced by the courts of this state. In ***State ex rel. Associated Natural Gas Company v. PSC,*** 954 S.W.2d 520 (Mo.App. 1997), for example, the Missouri Court of Appeals, Western District, held that the Commission exceeded its statutory mandate to ensure that all charges of a gas utility are just and reasonable when it disallowed in an ACA proceeding half of the premium paid by a gas company under a gas supply contract with its affiliate. (*Id.* at 530). In reaching this conclusion, the court first noted that the Commission had adopted a prudence standard for purposes of determining whether a gas utility's rates are just and reasonable. As the court stated:

> All charges for gas service must be just and reasonable. Section 393.130.1 RSMo. 1994. The PSC has employed a "prudence" standard to determine whether a utility's costs meet this statutory requirement. If a utility's costs satisfy the prudence standard, the utility is entitled to recover those costs from its customers. (*Id.* at 528)

The Court went on to note that the first prong of the two-part test necessary to support an ACA adjustment under this prudence standard had, in fact, been met by the Commission. That is, sufficient evidence had been introduced to overcome the presumption that the utility's actions had been prudent. (*Id.* at 529). The Court nevertheless found that the Commission's adjustment was unlawful because the Commission had failed to satisfy the second part of the test, i.e., it had failed to show that ratepayers were financially harmed by the imprudent actions of the utility. (*Id.* at 529-30). According to the Court, such a showing was absolutely essential to any lawful adjustment:

> ANG is not alone in suggesting that, in order to disallow a utility's recovery of costs from its ratepayers, a regulatory agency must find both that (1) the utility acted imprudently and (2) such imprudence resulted in harm to the utility's ratepayers.
>
> * * *
>
> Ultimately, the PSC's standards for the recoverability of ANG's costs arise from the statutory mandate that all charges made by a gas company be just and

reasonable. Section 393.130.1. It would be beyond this statutory authority for the PSC to make a decision on the recoverability of costs, based upon a prudency analysis of gas purchasing practices, without reference to any detrimental impact of those practices on ANG's charges to its customers, such as evidence that the costs which ANG is seeking to pass on to its customers are unjustifiably higher than if different purchasing practices had been employed. Therefore the PSC's decision denying recovery of half the premium of the SEECO contract must be deemed unlawful. (*Id.* at 529-30)(*emphasis added*).

As discussed below, the Commission should not adopt the proposed ACA adjustment of Staff and Public Counsel in this case since neither of the two-pronged tests required for such ACA adjustments has been met. In the instant proceeding, no party has challenged the prudence of SMGC's gas purchases or other activities during the ACA period, and no party has demonstrated with competent and substantial evidence that SMGC's ratepayers were financially harmed by SMGC's decisions. Since the Staff and Public Counsel have failed to meet the requirements of Missouri law for supporting an ACA adjustment, the Commission should reject the proposed adjustment.

IV. REMAINING ISSUES ON THE LIST OF ISSUES

In addition to the issues requested to be briefed by the Commissioners, SMGC will also address the remaining issues on the parties' List of Issues that have not been resolved by the Unanimous Partial Stipulation And Agreement filed on March 29, 2003.

ISSUE NO. 1: 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?

SUMMARY OF SMGC POSITION: No. SMGC acted lawfully and prudently by selling gas supplies to these transportation customers, and SMGC's ratepayers benefited by such activities. The transportation service provided to the two large customers is authorized under SMGC's Transportation Service Tariffs, Sheet Nos. 6-18, inclusive. The sale of gas supplies to

transportation customers is an unregulated activity that is authorized by law, and provided pursuant to Gas Supply Agreements and the rules, regulations and orders of the FERC.

A. STAFF HAS NOT ALLEGED THAT SMGC HAS VIOLATED A SPECIFIC TARIFF PROVISION AND THE COMMISSION SHOULD REJECT THE NEBULOUS ALLEGATION THAT SMGC IS "OPERATING OUTSIDE ITS TARIFFS".

Staff witness James Russo testified that "Staff cannot identify a specific tariff section that is being violated by SMGC. . . " (Ex No. 16, p. 3). During cross-examination, Mr. Russo re-iterated this position:

[Fischer]: There you say the Staff could not identify a specific tariff section that is being violated by Southern Missouri Gas Company because the company is operating outside the approved tariff; is that right?

[Russo]: That is correct.

* * *

[Fischer]: Is it correct to conclude from your statement that Staff has not identified a specific tariff sections that is being violated by Southern Missouri Gas Company?

[Russo]: That is correct. (Tr. 218)

However, Mr. Russo asserted that SMGC was "operating outside its tariffs" since there is no tariff provision that specifically addresses the provisioning and/or sale of gas supplies by SMGC to transportation customers. SMGC must respectfully disagree with Staff's conclusion. Apparently, Staff is concerned that the Company's tariffs do not specifically reference the

provisioning and/or sale of gas supplies by SMGC for transportation customers, and has incorrectly concluded that SMGC is not be authorized to make such gas sales.[11]

In ***Re Laclede Gas Company***, Case No. GR-96-181, 8 Mo. P.S.C.3d 120, 194 P.U.R.4th 284 (1999), the Commission addressed a similar situation where Laclede's PGA/ACA tariffs did not specifically address how off-system sales would be treated in the ACA review process. Staff and Public Counsel recommended that Laclede's ACA balance be adjusted by including $3,569,843 in additional revenue to reflect off-system sales of gas. As the Commission noted, **"Nowhere in Laclede's tariffs was the revenue from off-system sales expressly mentioned."** (*emphasis added*)(*Id.* at 121). Unlike the position taken by Staff and Public Counsel in this proceeding, Staff and Public Counsel did not allege in the ***Laclede*** case that it was a "violation" of Laclede's tariff for the company to make off-system sales of gas, even though such off-system sales were not specifically authorized in Laclede's tariff. Instead, Staff and Public Counsel suggested that the profits from the off-system sales should be used to lower the ACA balance, thereby benefiting Laclede's other customers. Applying the traditional prudence standard, the Commission rejected the proposed adjustment, stating at page 123:

> No party has argued that Laclede was imprudent in entering into these contracts, in reserving the volumes of gas covered by the contracts, or in making the sales that generated the revenue at issue, and the Commission finds that Laclede acted prudently both in entering into the contracts and in making the off-system sales. . . Laclede did not treat these profits as revenue to be flowed through the PGA/ACA process, but retained them as earnings.

In this case, no party has argued that it was imprudent for SMGC to provide gas supplies to the industrial customers to keep them on the natural gas system. Unlike the situation in the

[11] During cross-examination, Mr. Russo also seemed to embrace Public Counsel's argument in his opening statement that SMGC's Tariff Sheet No. 15 may prohibit SMGC from participating in the sales of gas to transportation customers. (Tr. 214) This argument will be addressed in a later section of this Brief in reference to Public Counsel's specific arguments.

Laclede case, however, SMGC used all the profits from the gas sales to its industrial customers to lower the ACA balance, thereby benefiting SMGC's other ratepayers. Ironically, the approach taken by SMGC in this case is the same approach that was being advocated by Staff and Public Counsel in the ***Laclede*** ACA case. In the ***Laclede*** case, the Commission allowed Laclede to keep the profits from the off-system sales for the benefit of its shareholders since the Laclede tariffs did not specifically address how those profits should be treated.

In this proceeding, while SMGC has given the benefit of the gas sales profits entirely to SMGC's other ratepayers, as advocated by Staff and Public Counsel in the ***Laclede*** case, Staff and Public Counsel now suggest that the Commission find SMGC's other ratepayers should be entitled to not only the benefit of all of the profits from the sales of the gas (as SMGC has proposed), but also **an additional $99,199 in theoretical revenues that did not exist!**

B. STAFF'S CONTENTION THAT SMGC CREATED A NEW CLASS OF CUSTOMERS IS MISPLACED.

In this proceeding, the Staff has also alleged that SMGC created a new class of customers, "Internal Transport Customers" in violation of its tariffs. (Staff Position Statement, p. 1). SMGC must respectfully disagree. From the Company's perspective, these customers were transportation service customers which were taking transportation service, pursuant to the terms of SMGC's transportation tariff.

There is no dispute among the parties that **_____** qualified as transportation customers under the Company's tariff (Tr. 227-28). Both customers entered into standard Gas Transportation Agreements which are signed by all of the Company's transportation customers. (Tr. 176) Each of the standard Gas Transportation Agreements specifically stated that:

**_____

_____

_____**

(Ex No. 15C, Schedules 2-10 and 2-17)(Tr. 222-25).

The rates contained in the Gas Transportation Agreements were the same rates that have been authorized by the Commission for SMGC transportation service. (Tr. 226) The Gas Transportation Agreements also specifically stated that they are subject to the provisions of the Company's tariffs approved by the Missouri Public Service Commission. (Ex No. 15C, Schedules 2-11 and 2-18).

Unfortunately, the Company probably created some confusion on this issue when it referred to these two industrial customers in the original work papers submitted to the Staff in this case as "Internal Transport Activity." (Ex No. 17). This heading on the Company's work papers was merely a shorthand way of identifying the activity associated with these customers and aggregating the revenues and costs of these contracts under one heading. It was never intended to convey that the Company had created a "new class of customers." (Ex No. 6, p. 6) In fact, as Bill Walker, the Company's primary contact with these customers, testified in his deposition, he never used this "internal transport" term himself, did not know where it originated, and did not ever indicate to these customers that anyone considered them to be "internal transport" customers. (Ex No. 9, p. 38).

Based upon the competent and substantial evidence on the whole record, there can be little question that **_____** received transportation service under the Company's transportation tariff, and should therefore be classified as "transportation customers." Merely because the company segregated the revenues and costs associated with these contracts under the

heading "Internal Transport Activity" in its work papers does not transform these transportation customers into a "new class of customers." The argument of Staff and Public Counsel on this issue is specious and should therefore be rejected.

C. STAFF'S SUGGESTION THAT SMGC MUST REGISTER AS AN ENERGY SELLER UNDER SECTION 393.299 RSMO SHOULD BE REJECTED SINCE LOCAL DISTRIBUTION COMPANIES LIKE SMGC ARE EXEMPTED BY STATUTE FROM THIS REGISTRATION REQUIREMENT.

In the hearings in this case, Staff witness James Russo suggested that SMGC may be required to file for a certificate under Section 393.299 RSMo. in order to provide "energy services." SMGC must respectfully disagree. Section 393.299 specifically exempts a "distributor"[12] (defined as a "gas corporation") from the requirement to be certified by the Commission as a "seller", pursuant to Section 393.299. Since SMGC is a "gas corporation" and a "distributor" under 393.298(3)[13], it is not necessary to be certified as a "seller" under Section 393.299(1).

Section 393.299(1) states:

> 1. **No person, *other than a distributor* or a political subdivision operating within its territorial limits, shall provide energy services** in a political subdivision which has business license taxes in effect pursuant to section 66.300, RSMo, section 71.610, RSMo, section 92.045, RSMo, section 94.110 or 94.360, RSMo, on persons who sell energy services **unless the person is certified by the commission as a seller and files its agreement with the commission to pay to the political subdivision all applicable business license taxes**. All retail sales of energy shall be made by a distributor, seller or a political subdivision operating within its territorial limits. No distributor or political subdivision shall provide energy services to any person on behalf of any seller unless the seller has been certified as a seller and filed its agreement with the commission to pay all applicable business license taxes and the commission has furnished such

[12] Section 393.298(3) defines "distributor" as an ... gas corporation as defined by section 386.020, RSMo, which is authorized by the commission under this chapter, to provide or distribute energy services

[13] SMGC's predecessor company, Tartan Energy, L.C. d/b/a Southern Missouri Gas Company, was certificated as a local distribution company in the Commission's Report and Order in Case No. GA-94-127 (September 16, 1994)(Ex No. 24)(Tr. 241)

distributor or political subdivision with evidence of such certification. (*emphasis added).*

Section 393.298(10) also specifically exempts a "distributor" from the definition of a "seller" when it states:

> (10) "Seller", any person who uses, leases or controls the distribution system of a distributor or a political subdivision or any part thereof to sell energy services at retail within the political subdivision *other than a distributor* or a political subdivision which uses its own distribution system. (*emphasis added).*

It is therefore incorrect to suggest that SMGC is not in compliance with Section 393.299 since Section 393.299 contains a specific statutory exemption for local distribution companies such as SMGC. This interpretation is also supported by the fact that no other local distribution company has been certified by the Commission under Section 393.299 as a "seller" of energy services. (Tr. 237; Ex No. 22).

D. THE PUBLIC COUNSEL'S SUGGESTION THAT SMGC PROVIDED "BUNDLED" SERVICE IS ALSO MISPLACED.

During the opening statement of the Public Counsel, the Public Counsel suggested that "[w]hat Southern Missouri did is they provided, for lack of a better term, a bundled transportation customer rate." (Tr. 35) This is simply incorrect.

SMGC entered into two separate contracts with each of its customers: (1) a standard Gas Transportation Agreement used by all SMGC's transportation customers which addressed the provision of the transportation service, pursuant to SMGC's Transportation Tariff (Ex No. 15HC, Schedules 2-3, 2-10, 2-17, 2-24), and (2) a Gas Supply Agreement which provided for the sales of natural gas at the Williams-SMGC interconnect in Greene County, Missouri. (See Ex No. 15HC, Schedules 2-1, 2-8, 2-15, 2-22) SMGC billed for the transportation services, pursuant to the terms of its transportation service tariff and the Gas Transportation Agreement. A separate

bill was also sent to the industrial customers for the provision of the gas supplies, pursuant to the terms of the Gas Supply Agreements. The rate for the transportation service was established by the rate provisions contained in SMGC's transportation service tariff. The price for the gas supplies was determined by an arms-length negotiation between SMGC and the industrial customers. The customers received legal title (or ownership) of the gas supplies at the Williams-SMGC interconnect in Greene County, Missouri, and then used SMGC's transportation service to transport their gas supplies to their production facilities in West Plains, Missouri. (Tr. 120)

Contrary to Public Counsel's suggestion, the provision of gas supplies and the provision of transportation services are separate and distinct activities, and are not "bundled" large volume services. Under SMGC's "bundled" large volume service, there is a single bill for the natural gas service that contains a single LVS rate for the service. In contrast, under the "unbundled" transportation service and gas supply agreements, the customer receives two separate bills, one for the gas supplies, and another for the transportation service. (Tr. 108). In addition, under a traditional "bundled" large volume service, the title (ownership) to the natural gas does not pass to the customer until the natural gas reaches the customer's meter at the customer's facility (*e.g.*, West Plains, Missouri), not at the Williams-SMGC interconnect in Greene County, Missouri, as is the case with the "unbundled" transportation service provided by SMGC to these customers.

The Commission should therefore reject any suggestion that SMGC is providing "bundled" service that is somehow in violation of its transportation service tariff. To the contrary, SMGC's Gas Supply Agreements and Transportation Service Agreements provide for unbundled activities consistent with those provided to other transportation customers. The only real difference between the services provided to **_____** and other transportation customers is that SMGC, rather than a third party marketer, is the entity that sold the gas to

** _____ ** at the Williams-SMGC interconnect. In both situations, the customers are receiving separate and distinct "unbundled" services for gas supplies and transportation services.

E. THE PUBLIC COUNSEL'S CONTENTION THAT SMGC'S TARIFF SHEET NO. 15 PROHIBITS SMGC FROM SELLING GAS TO TRANSPORTATION CUSTOMERS IS INCORRECT.

In his opening statement, Public Counsel erroneously suggested that the following provision contained in SMGC's Tariff No. 15 prohibits SMGC from selling gas directly to customers for transport on SMGC's system:

> Nominations
>
> Upon mutual written agreement, and at no additional charge to customer, the Company will act as customer's agent with regard to nominating transportation volumes. In no event will the Company, in its role as agent, purchase transportation volumes on behalf of a customer.

As Mr. Klemm explained during questioning from Commissioner Forbis (Tr. 137-39), the above-referenced tariff provision applies in the very limited situation **where SMGC has mutually agreed with a customer to serve as the customer's agent with regard to nominating transportation volumes.** In the situation where SMGC is the customer's agent for nominating transportation volumes, SMGC would determine the appropriate daily nominations of gas on behalf of the customer. If additional volumes are needed for a daily nomination, then SMGC would nominate the gas, as the customer's agent, but it would be solely the customer's responsibility, not SMGC's responsibility, to purchase the gas, if needed.

The nomination provisions of Sheet No. 15 do not apply to the contractual arrangements between SMGC and ** _____ ** since SMGC has not agreed in writing or otherwise to serve as the agent for ** _____ ** for nominating

transportation volumes. (Tr. 167) In fact, there is no mention of an "agency" relationship in any of the contracts between SMGC and these transportation customers. (Tr. 172, 176) As a result, the nominations provisions of Sheet No. 15 are inapplicable to these contractual arrangements at issue in this case.

If, hypothetically, SMGC had agreed in writing to be the customer's agent for the nomination of transported volumes (which it has not), then the above-quoted tariff provision would protect SMGC from any financial responsibility or other requirement that it purchase additional gas for the transportation customer. This tariff provision states in no uncertain terms that SMGC would not be responsible for purchasing additional gas for the customer when SMGC has agreed to act as an agent for the customer in nominating volumes. Otherwise, without this tariff protection, SMGC could be financially liable for the additional gas that it nominated on behalf of the customer.

However, Tariff Sheet No. 15 does not prohibit SMGC from selling gas to a transportation customer, pursuant to a Gas Supply Agreement. As Mr. Klemm testified, there is no SMGC tariff provision that prohibits SMGC from selling gas to a transportation customer. (Tr. 139) The Commission should therefore reject Public Counsel's suggestion that Tariff Sheet No. 15 would in any way restrict SMGC from entering into the Gas Supply Agreements with **_____**

ISSUE NO. 2: **SHOULD THE COMMISSION ADOPT STAFF'S PROPOSED ADJUSTMENT TO DECREASE THE FIRM SALES ACTUAL COST ADJUSTMENT (ACA) BALANCE BY $105,809 (OR $99,199 AS REVISED) 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 POSITION: No. The Company strongly disagrees that there should be a reduction of $99,199 to the firm sales ACA balance related to transportation service and gas supply to these customers. If the Company had not taken the steps necessary to compete with alternative fuels for two industrial customers, it is extremely likely that the two industrial customers would have left the SMGC system, or substantially reduced their throughput. In fact, **_____** did leave SMGC's natural gas system when SMGC informed the industrial customer that it was not eligible for transportation service. (Ex No. 9, pp. 85-86) **_____** also substantially reduced its throughput after the expiration of the contract in October 2001 by switching much of its production load to an alternative energy source. (Ex No. 9, pp. 88-89). Based upon the competent and substantial evidence on the whole record, it is clear that SMGC faced a substantial competitive threat from alternative sources of energy during the winter of 2000-2001. It was lawful and reasonable for SMGC to attempt to meet this competitive threat by entering into gas supply agreements and gas transportation agreements with these customers to bring a competitively priced natural gas product to the industrial customers' facilities.

A. THE PROPOSED ADJUSTMENT OF STAFF AND PUBLIC COUNSEL SHOULD BE REJECTED SINCE THESE PARTIES HAVE NOT ALLEGED THAT THE COMPANY ACTED IMPRUDENTLY IN THIS ACA PERIOD, AND AS A CONSEQUENCE, DOES NOT SATISFY THE FIRST PREREQUISITE FOR AN ACA ADJUSTMENT.

In this proceeding, Staff witness Annell Bailey agreed that the purpose of the ACA audit process is to determine if the company acted prudently in incurring the costs that it is seeking to recover. And, in this case, Staff found no evidence of imprudence on the part of SMGC:

[Commissioner Murray]: Q. Okay. And is it your understanding that the audit is designed to or should be looking at whether the company acted prudently in incurring the costs that it's seeking to recover?

[Ms. Bailey]: That is one of our major goals, yes.

[Commissioner Murray]: Do you think that the company acted imprudently?

[Ms. Bailey]: No. (Tr. 200)

Since the Staff and Public Counsel have not alleged that SMGC acted imprudently in incurring any of its gas costs during this ACA period, the first essential prerequisite for making an ACA adjustment has not been met. Therefore, the Commission should reject Staff and Public Counsel's proposed adjustment in this ACA case.

B. THE PROPOSED ADJUSTMENT OF STAFF AND PUBLIC COUNSEL SHOULD BE REJECTED BECAUSE THESE PARTIES HAVE FAILED TO SHOW THAT RATEPAYERS WERE FINANCIALLY HARMED BY SMGC'S EFFORTS TO KEEP ITS INDUSTRIAL CUSTOMERS ON THE SMGC NATURAL GAS SYSTEM, AND AS A CONSEQUENCE, DOES NOT SATISFY THE SECOND PREREQUISITE FOR AN ACA ADJUSTMENT.

In the instant case, the Staff and Public Counsel have failed to meet the second prerequisite for making an ACA adjustment. These parties have not produced competent and substantial evidence to show that ratepayers were harmed financially by the actions of SMGC during this ACA period. Quite to the contrary, the competent and substantial evidence shows that, if the Company had not acted to keep the industrial customers on its natural gas system, the Company's remaining ratepayers would have been financially harmed. (Ex No. 3, p. 10; Ex No. 6, pp. 11-12; Tr. 192). Staff apparently agrees that it was reasonable and prudent for the Company to attempt to retain the customers on SMGC's distribution system. In fact, Staff witness James Russo included the following analysis in his direct testimony (Ex No. 13, pp. 3-4):

> SMG and its customers may benefit through a retention of existing customers that otherwise may be lost to alternative markets, by serving qualifying customers at a market competitive rate. SMG's customers benefit by SMG keeping existing customers by spreading its costs over a larger volume, thereby lowering all customers overall cost of service. Also, there are no additional customer classes requiring additional record keeping and data review by the Company and Staff in the PGA and rate case processes.

By entering into Gas Supply Agreements and Gas Transportation Agreements with these customers, SMGC was able to keep these customers on the SMGC system, and the remaining ratepayers benefited. Staff witness Annell Bailey clearly testified that all of SMGC's ratepayers benefited from the fact that SMGC was able to retain these industrial customers on its natural gas system. (Tr. 187-88):

[Fischer]: Would you agree that the company's remaining customers directly benefited from the fact that Southern Missouri Gas Company was able to keep these two industrial customers on the system during the ACA period?

[Ms. Bailey]: In that the ACA balance was reduced by the 39,900, yes, they benefited.

[Fischer]: And would you also agree that if these customers had not stayed on the system, there would have been other fixed costs, like fixed transportation costs, that would have been spread over the remaining customers?

[Ms. Bailey]: Yes, that is true.

* * *

[Fischer]: Would you also agree that both the large industrial customers are better off . . . and so were the company's remaining ratepayers as a result of the fact that Southern Missouri was able to sell gas to these industrial customers under the contracts that are contained in Mr. Russo's schedules?

[Ms. Bailey]: In terms of the ACA balance, I believe so.

[Fischer]: And, of course, these customers stayed on the system because they were able to get a competitive natural gas alternative; is that right?

[Ms. Bailey]: That's right. (Tr. 187-88).

In this proceeding, neither of the essential prerequisites for an ACA adjustment has been met. No party has challenged the prudence of any of SMGC's expenditures. In fact, Staff witness Bailey testified that she believed that SMGC acted prudently. (Tr. 200). Ms. Bailey also testified that SMGC's remaining customers directly benefited from the fact that SMGC was able to keep **_____** on its natural gas system by entering into Gas Supply and Transportation Agreements with them. As a result, the essential elements necessary to support an ACA adjustment have not been established, and the Commission should therefore reject the proposed adjustment. ***State ex rel. Associated Natural Gas Company v. PSC,*** 954 S.W.2d 520 (Mo.App. 1997).

C. THE PROPOSED ADJUSTMENT OF STAFF AND PUBLIC COUNSEL SHOULD BE REJECTED SINCE THESE PARTIES HAVE PRODUCED NO COMPETENT AND SUBSTANTIAL EVIDENCE THAT SHOWS THAT THESE CUSTOMERS WOULD HAVE PURCHASED THE SAME VOLUME OF GAS AT A SUBSTANTIALLY HIGHER PGA-RATE, IF SMGC HAD NOT ENTERED INTO GAS SUPPLY AGREEMENTS AND GAS TRANSPORTATION AGREEMENTS WITH THEM.

Based upon this case law discussed herein, it is clear that the Staff and Public Counsel have the burden of proof and the burden of persuasion regarding any proposed disallowances in this ACA case. However, Staff's adjustment is based upon the unsupported assumption that, absent the measures taken by the Company to retain two industrial customers on the system, there would have been an increase of revenues of $105,809 [subsequently modified by Staff to $99,199], "if the gas had been sold at the authorized PGA-adjusted rate." (Staff Recommendation, App. A, page 6 of 8). However, Staff has not produced competent and substantial evidence that shows that these customers would have purchased the same volume of gas at a substantially higher tariffed rate for large volume service, or that these customers would have stayed on the SMGC system at all.

During questioning by Commissioner Murray, Ms. Bailey acknowledged that she did not have an opinion as to whether these industrial customers would have stayed on the system. (Tr. 199):

[Commissioner Murray]: Okay. So you don't have an opinion as to whether the special contract customers would have stayed on the system?

[Ms. Bailey]: I don't know one way or the other.

Yet, as Ms. Bailey explained to Commissioner Gaw, Staff's calculation of the adjustment has a built-in assumption that the two customers would have behaved exactly the same even though the price that they would have been charged under Staff's scenario (i.e. the full-tariffed rate for Large Volume Service) was different from the lower prices they actually paid under the Gas Supply Agreements and Gas Transportation Agreements. (Tr. 203) Staff's built-in assumption is simply not a realistic assumption that is in any way supported by competent and substantial evidence on the whole record.

In fact, Ms. Bailey testified that she had no reason to assume that these customers would have purchased gas at the tariffed rates. (Tr. 189-90):

[Fischer]: Would you agreed with me, Ms. Bailey, that your statement on those lines contains an assumption when it states that, if the gas had been sold to those customers at tariff authorized rates?

[Ms. Bailey]: I would not say that is an assumption. I would say that is a –one condition that may have happened. I would not say that I was assuming that would happen.

[Fischer]: **Okay. You had no reason to assume that it would have; is that right?**

[Ms. Bailey]: **That's right.**

[Fischer]: **And you haven't included in your testimony any evidence that's designed to show that these large industrial customers would have paid those unusually high natural gas rates; is that right**?

[Ms. Bailey]: **I have no way of knowing what people might have done.**

[Fischer]: Did you or anyone on the Staff contact these customers to determine if they would have paid these tariff-authorized rates when they had lower priced bids available to them?

[Ms. Bailey]: I don't know about other staff. I did not. (*emphasis added*).

The evidence in the record shows that it is much more likely that the industrial customers would have left the SMGC natural gas system, or at least substantially reduced their production throughput. Bill Walker, SMGC's Gas Control Manager, testified that he personally discussed with representatives of **_____** their options for lower priced energy sources. (Ex No. 8HC, pp. 85-88) He concluded that these customers would not have remained on SMGC's system if SMGC had refused to enter into the Gas Supply Agreement with those customers. (Ex No. 9, p. 88):

[Fischer]: Do you have an opinion about whether they would have remained on your system if you had refused to enter into a supply agreement with those two customers [**_____**]?

[Mr. Walker]: **They wouldn't have, in my opinion, no, sir.** (*emphasis added*).

In addition, Mr. Scott Klemm, SMGC's Vice-President, testified that it is probable that these two industrial customers would have left the SMGC system, or substantially reduced their throughput, if the Company had not taken the steps necessary to compete with alternative fuels for these two industrial customers. (Ex No. 3, p. 3)

Even Ms. Bailey acknowledged that she would expect prudent management of these industrial companies to look for the most reasonably priced sources of energy. (Tr. 190) Since propane was selling for price of $.71 per gallon, (or $7.75 per MMBtu), and the large volume service tariff rate, including the PGA factor, was approximately $10.00 per MMBtu (Ex No. 6, p. 12; Ex. No. 9, p. 14; Tr. 10), it is clear that propane was priced substantially below SMGC's large volume service rates for natural gas. Therefore, it would be reasonable to expect that prudent management of these companies would have taken the opportunity to convert to a more reasonably priced energy alternative.[14]

As Staff witness Annell Bailey testified, Staff's adjustment is based upon the premise that the proposed adjustment would ". . . restore the customers and the ACA balance to where they would have been if this violation had not taken place and *if the gas had been sold.*" (emphasis added)(Tr. 202). However, Staff has produced no evidence to support the premise that the large industrials would have stayed on the SMGC system and used the same volume of gas at the much higher price, if SMGC had refused to provide transportation service and sell them the necessary gas supplies.

The strongest probative evidence of what would have happened if SMGC had not entered into gas supply agreements and gas transportation agreements with contracts with **_____ _____** was the fact that a similarly situated customer who was not eligible for transportation

[14] As Mr. Walker testified, these industrial customers may convert from natural gas to propane relatively easily (Ex No. 9, pp. 33-34).

service, **_____** did in fact leave SMGC's system in favor of a lower priced propane alternative when it could not qualify for transportation services under SMGC's tariff. (Ex No. 9, pp. 62-63; 85-86) It was only after the minimum usage threshold contained in SMGC's transportation service tariff was modified so that **_____** was eligible for transportation services, that **_____** returned to SMGC's natural gas system as a transportation customer. (Id. at 86-88). In addition, even after SMGC entered into the Gas Supply Agreement with ** _____

_____

_____** This customer's reaction to the natural gas price is also compelling evidence that SMGC's large volume service rate was not competitive with alternative sources of energy.

Staff has not produced competent and substantial evidence to support its assumption that the industrial customers would have purchased gas in the same volumes at the tariff-authorized rate if SMGC had not entered into the Gas Supply and Gas Transportation Agreements. The Commission should therefore reject Staff's proposed adjustment in this proceeding since this critical built-in assumption has no basis in fact or is otherwise supported in the record.

D. THE PROPOSED ADJUSTMENT SHOULD BE REJECTED SINCE SMGC HAS AUTHORITY TO PARTICIPATE IN SALES OF GAS PURSUANT TO FEDERAL LAW AND IT WOULD BE AN INTERFERENCE WITH INTERSTATE COMMERCE FOR THE COMMISSION TO ADOPT STAFF'S PROPOSED ADJUSTMENT IN THIS MATTER.

With regard to the Gas Supply Agreements, the Company acted under the authority of the various FERC Orders, including FERC Order Nos. 436 and 636, that restructured the natural gas markets in the 1980s, and created an unregulated market for the supply of natural gas for transporters. These FERC Orders are discussed at length by the Missouri Court of Appeals in

Midwest Gas Users' Association v. Public Service Commission, 976 S.W.2d 470 (Mo. App. 1998), and by the United States Court of Appeals (D.C. Circuit) in ***United Distribution Companies v. Federal Energy Regulatory Commission***, 88 F.3d 1105 (D.C. Cir. 1996), 170 PUR 4th 425 (1996). *See also* FERC Stats and Regs, CCH ¶24,979; 18 CFR §284.402 (FERC's blanket marketing certificate program)[15].

Under FERC's blanket marketing certificate program, any entity, except an interstate pipeline, is authorized by the FERC to make sales of gas at negotiated rates in interstate commerce.[16] SMGC exercised this authority under federal law to make gas sales to **_____**

Staff and Public Counsel seem to be suggesting that SMGC may not participate in this unregulated activity permitted by federal law without seeking prior approval from the Commission. The Commission should reject this suggestion. Like Laclede's off-system gas sales in Case No. GR-96-181, the sales of gas by SMGC to its transportation customers are authorized by the FERC's various orders that restructured the natural gas industry. No additional state authority is required for local distribution companies to participate in such sales of gas.

In addition, the sale of gas supplies to transportation customers is preempted by federal law, pursuant to the rules, regulations and orders of the Federal Energy Regulatory Commission

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[15] 18 CFR §284.402 states in part:
(a) Authorization. **Any person who is not an interstate pipeline is granted a blanket certificate of public convenience and necessity pursuant to section 7 of the Natural Gas Act authorizing the certificate holder to make sales for resale at negotiated rates in interstate commerce of any category of gas that is subject to the Commission's Natural Gas Act jurisdiction.** A blanket certificate issued under Subpart L is a certificate of limited jurisdiction which will not subject the certificate holder to any other regulation under the Natural Gas Act jurisdiction of the Commission by virtue of transactions under the certificate.
(b) The authorization granted in paragraph (a) of this section will become effective on January 7, 1993 except as otherwise provided in paragraph (c) of this section. (*emphasis added*).

[16] *See also* Regulations Governing Blanket Marketer Sales Certificates, 61 FERC P 61,281, 1992 WL 409181, Util. L. Rep. P 5803 9 (F.E.R.C., Nov. 30, 1992).

("FERC"), specifically the blanket marketing certificate program authorized in 18 CFR §284.402. Section 386.030 RSMo. 2000 also specifically states:

> 386.030. Neither this chapter [Public Service Commission Act], nor any provision of this chapter, except when specifically so stated, shall apply to or be construed to apply to commerce with foreign nations or commerce among the several states of this union, except insofar as the same may be permitted under the provisions of the Constitution of the United States and the acts of Congress.

The Commission therefore lacks jurisdiction over the sales of gas supplies to transportation customers in interstate commerce. SMGC would respectfully submit that the adoption of Staff's proposed adjustment in this proceeding would be an unlawful interference with interstate commerce. Therefore, SMGC would respectfully urge the Commission not to venture down this slippery slope at this time.

E. THE PROPOSED ADJUSTMENT SHOULD BE REJECTED SINCE THE ALLEGATION OF STAFF AND PUBLIC COUNSEL THAT SMGC "VIOLATED ITS TARIFFS" IS BEYOND THE ALLOWABLE SCOPE OF THE ACA PROCEEDING.

The Staff's proposed disallowance related to SMGC's sales of gas to two transportation customers exceeds the scope of a traditional ACA case. Based upon SMGC's research, it appears that this case is the first time that any party has ever alleged that a tariff violation is a legitimate basis for a disallowance in an ACA case.[17] SMGC believes that the Staff's proposed disallowance based upon an allegation that the Company is "violating its tariffs" and not imprudence, exceeds the scope of the traditional ACA proceeding, as outlined in SMGC's

[17] *See e.g.*, ***In re Laclede Gas Company***, 194 P.U.R.4th 284 (April 30, 1999); ***Re Laclede Gas Company,*** 4 Mo.P.S.C.3d 267 (December 8, 1995); ***Re Associated Natural Gas Company,*** 5 Mo.P.S.C.3d 169 (October 15, 1996); ***Re Gas Service, a Western Resources Company***, Case Nos. GR-94-101, GR-94-228, 5 Mo.P.S.C.3d 89 (July 31, 1996); ***Re Kansas Power and Light***, 30 Mo.P.S.C. (N.S.) 76, 77-83 (Dec. 29, 1989).

tariffs[18] and as historically applied by this Commission to other local distribution companies. As a result, the Commission should deny the Staff's proposed disallowance as beyond the allowable scope of this ACA case.

Although Staff's proposed disallowance is beyond the allowable scope of this ACA case, the Staff has filed a formal Complaint against SMGC in Case No. GC-2003-0314, making essentially the same legal arguments. It would be helpful and promote judicial economy if the Commission would address the merits of Staff's argument that SMGC has "violated its tariffs." The Commission should find that while the Staff's proposed disallowance is beyond the scope of an ACA case, the Staff's allegation that SMGC has violated its tariffs is without merit, and should be dismissed as a matter of law. Otherwise, these same legal issues may have to be revisited in another costly proceeding in Case No. GC-2003-0314.

IV. CONCLUSION

As discussed herein, the Commission should not adopt the proposed ACA adjustment of Staff and Public Counsel in this case since neither of the two-pronged tests required for such ACA adjustments has been met. In the instant proceeding, no party has challenged the prudence of SMGC's gas purchases or other activities during the ACA period, and no party has demonstrated with competent and substantial evidence that SMGC's ratepayers were financially harmed by SMGC's decisions. Since the Staff and Public Counsel have failed to meet the requirements of Missouri law for supporting an ACA adjustment, the Commission should reject the proposed adjustment.

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[18] The Company's Purchased Gas Adjustment Clause tariffs (included in their entirety in Exhibit No. 14, Schedule 1-34 to 1-42) also establish the parameters of the ACA review process. Based upon these tariffs, the ACA process should be limited to issues related to the prudence of gas purchasing practices, and "any over-recovery resulting from the operation of the Company's PGA procedure or debited for any under-recovery resulting from the same." (Ex No. 9, Sch. 1-40).

In addition, it would be unfair to adopt the proposed adjustment since the unrefuted evidence demonstrates that SMGC's provisioning of transportation service and gas supplies to these large customers benefited the Company's ratepayers. In reality, the only stakeholder that arguably did not benefit directly from this activity was SMGC. (Ex No. 9, p. 96) As noted in SMGC's opening statement in this proceeding, SMGC should not be penalized for finding a "win-win" solution for its customers to a difficult market problem. (Tr. 4-24).

Respectfully submitted,

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CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been hand-delivered, emailed or mailed, First Class, postage prepaid, this 22nd day of April, 2003, to:

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