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Gas Supply Incentive Plan
Witness: *David M. Sommerer*
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Case No.: *GT-2003-0117*
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

DAVID M. SOMMERER

LACLEDE GAS COMPANY

CASE NO. GT-2003-0117

Jefferson City, Missouri
November 2002

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

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BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In The Matter of the Tariff Filing of Laclede)
Gas Company to Implement An Experimental)
Low Income Assistance Program Called Catch-Up/)
Keep-Up)) Case No. GT-2003-0117

AFFIDAVIT OF DAVID M. SOMMERER

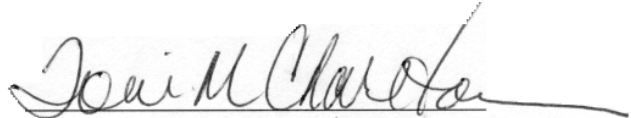
STATE OF MISSOURI)
)
COUNTY OF COLE) ss.

David M. Sommerer, being of lawful age, on his oath states: that he has participated in the preparation of the following Direct Testimony in question and answer form, consisting of 11 pages to be presented in the above case; that the answers in the following Direct 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 18th day of November 2002.





TONI M. CHARLTON
NOTARY PUBLIC STATE OF MISSOURI
COUNTY OF COLE
My Commission Expires December 28, 2004

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DIRECT TESTIMONY
OF
DAVID M. SOMMERER
LACLEDE GAS COMPANY
CASE NO. GT-2003-0117

Q. Please state your name and business address.

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

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

A. I am the Manager of the Procurement Analysis Department with the Missouri Public Service Commission.

Q. How long have you been employed with the Commission?

A. I have been employed with the Commission since August 1984.

Q. Please describe your educational background and experience.

A. In May 1983, I received a Bachelor of Science degree in Business and Administration with a major in Accounting from Southern Illinois University at Carbondale, Illinois. In May 1984, I received a Master of Accountancy degree from the same university. Also, in May 1984, I sat for and passed the Uniform Certified Public Accountants examination. Upon graduation, I accepted employment with the Commission.

Q. What has been the nature of your duties at the Commission?

A. From 1984 to 1990 I assisted with audits and examinations of the books and records of public utilities operating within the State of Missouri. In 1988 the responsibility for conducting the Actual Cost Adjustment (ACA) audits of natural gas utilities was given to the Accounting Department. I assumed responsibility for planning and implementing these

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1 audits and trained available Staff on the requirements and conduct of the audits. I
2 participated in most of the ACA audits from early 1988 to early 1990. On November 1,
3 1990, I transferred to the Commission's Energy Department. Until November of 1993, my
4 duties consisted of reviews of various tariff proposals by electric and gas utilities, Purchased
5 Gas Adjustment reviews, and tariff reviews as part of a rate case. In November of 1993, I
6 assumed my present duties of managing a newly created department called the Procurement
7 Analysis Department. This Department was created to more fully address the emerging
8 changes in the gas industry especially as they impacted the utilities' recovery of gas costs.
9 My duties have included managing the five member staff, reviewing ACA audits and
10 recommendations, participating in the gas integrated resource planning project, serving on
11 the gas project team, serving on the natural gas commodity price task force, and participating
12 in matters relating to natural gas service in the State of Missouri.

13 Q. Have you previously testified before this Commission?

14 A. Yes. A list of cases in which I have filed testimony is included as Schedule 1
15 of my testimony.

16 Q. What is the purpose of your testimony in this case?

17 A. I am reviewing Laclede Gas Company's (Laclede's, Company's) Catch-
18 Up/Keep-Up proposal as it relates to the proposed funding mechanism. I conclude that the
19 up to \$6 million adjustment that the Company proposes to its Purchased Gas Adjustment
20 (PGA) and Actual Cost Adjustment (ACA) process is not appropriate nor is the pipeline
21 discount methodology a properly structured gas supply incentive feature that will produce
22 benefits in excess of its costs.

FUNDING MECHANISM

Q. Please describe the Company's proposed funding mechanism.

A. The Company proposes to fund the program by using the PGA and ACA procedure to charge customers for gas costs in excess of costs actually incurred.

Q. Please describe how the PGA and ACA process works.

A. The Company's tariffs contain a clause that authorizes it to estimate natural gas costs and separately file, outside the context of a general rate case, periodic changes to the PGA rates during the course of the year. The ACA is meant to ensure that the Company collects no more than its actual cost of gas by requiring an annual reconciliation between what Laclede collects through the PGA and what it expends for actual gas purchases.

Q. What types of costs are subject to PGA recovery?

A. Typically, PGA costs are limited to natural gas costs necessary to bring the commodity from the production areas to the Company's city-gate. The city-gate is the point of interconnection between the delivering pipelines and the Company's local distribution facilities. City-gate delivered costs include the cost of the commodity itself, interstate pipeline transportation charges, both upstream and downstream, interstate pipeline storage charges and intrastate pipeline transportation charges. Upstream pipeline charges indicate costs for pipelines that are closer to the production side or feed into other "downstream" pipelines that eventually interconnect with the Company's city-gate. All these charges are ultimately subject to a prudence review.

In contrast, margin expenses such as payroll, depreciation, income taxes, customer service and billing expenses are considered in the context of a general rate case and are not subject to an adjustment process.

1 Q. Do you believe the funding mechanism proposed by Laclede is appropriate?

2 A. No. Under current tariffs, Laclede's PGA customers (firms sales and firm
3 transporters) pay an allocated share of pipeline reservation charges. This is the case whether
4 Laclede pays discounted transportation rates or whether it pays Federal Energy Regulatory
5 Commission (FERC) maximum transportation rates. Laclede's proposal of charging
6 customers a portion (30%) of discounts contained in current contracts for years is actually no
7 different than adding a \$6,000,000 line item to the cost of gas to fund the Catch-Up/Keep-Up
8 program. In addition, burdening the PGA with "non-gas costs" sets a bad precedent, and per
9 Staff Counsel, of questionable legality, that is likely to lead to additional requests to include
10 other types of non-gas costs that are best and appropriately considered in a general rate case.
11 The practice of adding more types of costs to the PGA would likely be used by other Local
12 Distribution Companys (LDCs) in the state to bypass the rate case process.

13 Q. Please explain the concern about burdening the PGA with the addition of non-
14 gas costs.

15 A. One of the major reasons why there continues to be a PGA clause, despite
16 objections by various parties over the years, is that gas costs are considered unique in the
17 regulatory field. Gas costs can exceed 50% of a LDC's cost of service. The wellhead (the
18 gas field price) commodity cost of gas comprises a major portion of gas costs. These costs
19 have been deregulated at the wellhead since 1993 and can be extremely volatile. Also, the
20 FERC still regulates a significant portion of the cost of gas relating to interstate pipeline
21 transportation charges. These unique characteristics and the limited nature and number of the
22 costs that are subject to the process have served to provide the foundation stones that the
23 PGA process is built on. Removing non-gas cost issues from the general rate making process

1 and moving them into an automatic adjustment clause is a poor policy and may be the
2 undoing of a process that has been in place since 1962.

3 Q. Is the Company proposing to consider a non-gas cost issue in the context of
4 the PGA/ACA mechanism?

5 A. Yes. What Laclede characterizes as the funding amount is in essence placing
6 a \$6,000,000 charge to the ACA account for the cost of the program. The funding is related
7 to bad debt expense and arrearages, cost items that are evaluated in a general rate case and
8 for Laclede were reviewed in their most current case. Elements of management control such
9 as collection policy, implementation and adherence to the cold weather rule, write-off policy,
10 disconnect policies, customer notice policy, payment plans, integration of low income
11 funding sources, reconnection policy, billing policies and other customer service issues are
12 not and should not be considered in the PGA process.

13 **GAS SUPPLY INCENTIVE PLAN**

14 Q. Do you believe the Laclede proposal to reward it for pipeline discounts
15 constitutes a Gas Supply Incentive Plan (GSIP)?

16 A. No, it is not properly structured and should be rejected.

17 Q. Why is it difficult to structure a GSIP that actually achieves savings for
18 customers?

19 A. I will summarize the difficulties below and then provide further clarification
20 following the summary.

- 1 • When maximum FERC rates are used as a benchmark, the Company achieves
- 2 gains when FERC rates increase, which would not encourage an LDC to keep
- 3 FERC rates low.
- 4 • The way savings from discounts are measured, an LDC could achieve greater
- 5 savings by merely transferring some existing capacity to a pipeline that has higher
- 6 maximum FERC rates but offers the same transport rate as the original pipeline.
- 7 • Without reasonable benchmarks, an LDC could show significant savings by
- 8 merely continuing practices in place under traditional regulation.
- 9 • Without conducting an extensive cost benefit review of the effects on the
- 10 delivered cost of gas, savings can be achieved in the transportation discount
- 11 element of a GSIP at the expense of increasing costs elsewhere.
- 12 • The “gold standard” of firm transportation might be compared to firm
- 13 transportation of lesser quality, i.e. firm transportation without the same
- 14 characteristics, resulting in apples to oranges comparison of pipeline savings.
- 15 • Captive versus non-captive shipper status can affect levels of discounts but could
- 16 be ignored under savings calculations.

17 Q. What do you mean by the statement, “when maximum FERC rates are used as

18 a benchmark, the Company achieves gains when FERC rates increase which would not

19 encourage an LDC to keep FERC rates low?”

20 A. This is a fairly straightforward concern. It is reasonable to expect large LDCs

21 to participate in the FERC rate-setting process. If a reward system is designed to compensate

22 an LDC when FERC rates increase (by increasing the amount of discount dollars that will be

23 contributed to the CU/KU fund), the LDC will not have the desire to keep FERC regulated

1 maximum rates lower. It will actually give the LDC the perverse incentive to desire and
2 support higher pipeline maximum rates that other pipeline customers will have to pay.

3 Q. Please explain what you mean by the statement, “an LDC could achieve
4 greater savings by merely transferring some existing capacity to a pipeline that has higher
5 maximum FERC rates but offers the same discount achieved on the original pipeline?”

6 A. Assume that pipeline A has a maximum FERC rate of \$10.00 and an LDC
7 pays a discounted rate of \$5.00 for its capacity. Then assume that pipeline B has a maximum
8 FERC rate of \$15.00 and the LDC transfers capacity from pipeline A to pipeline B and pays
9 the same discounted rate on pipeline B of \$5.00. By merely moving to a pipeline with a
10 higher FERC rate, artificial savings are created.

11 Q. Please explain the statement, without reasonable benchmarks, “an LDC could
12 show significant savings by merely continuing practices in place under traditional
13 regulation.”

14 A. A problem with the Company’s prior GSIP (a GSIP that was ultimately
15 rejected by the Commission) was the lack of a representative benchmark. The benchmark
16 used to calculate savings in the more recent GSIP was \$13,000,000, a level well below
17 discounts achieved during, and even prior to, the original GSIP. The level was not based
18 upon what the Company was already achieving prior to incentive regulation but a Company
19 study that attempted to isolate various discounts achieved by selected shippers on the
20 multiple pipelines that serve the Company. In Case No. GR-2001-329, the Staff found that
21 the study was not updated for current shipper activity and was therefore outdated, and
22 resulted in a calculation well below discounts that were already achieved prior to the GSIP.

1 Q. What do you mean by the statement, “[w]ithout conducting an extensive cost
2 benefit review of the effects on the delivered cost of gas, savings can be achieved in the
3 transportation discount element of a GSIP at the expense of increasing costs elsewhere?”

4 A. This has been a long-standing staff concern. It is possible to source gas
5 supply on a pipeline that offers extensive discounts from FERC maximum transportation
6 rates, but because of high “supply” costs at the well-head, or an inability to fully use the new
7 transportation path, the ultimate delivered cost of gas could rise. Using another simple
8 example, assume that pipeline A offers a discount rate of \$1.00 for transportation. Pipeline B
9 offers a \$.50 rate for discounted transportation. Unfortunately, gas supply delivered into
10 pipeline B is typically \$1.00 higher for gas supply from the well into pipeline B as compared
11 to gas delivered into pipeline A. True savings are not achieved although “calculated” savings
12 under a discount sharing mechanism do result.

13 Q. Please explain the statement, “[t]he ‘gold standard’ of firm transportation
14 might be compared to firm transportation of lesser quality, i.e. firm transportation without the
15 same characteristics, resulting in apples to oranges comparison of pipeline savings.”

16 A. A review of Laclede’s proposed tariffs make it clear that the Company
17 intends to continue, if not expand, a historical GSIP practice of comparing year-round
18 maximum FERC transportation rates to an entire menu of various transportation services.
19 Capacity release is viewed as a capacity of lesser value than the primary firm transportation
20 available from the pipeline. This could be because of recall provisions, duration of the
21 capacity contract or restrictions to receipt or delivery points. Capacity that is bundled as a
22 “delivered deal” is very difficult to value based upon different contractual provisions that
23 affect the embedded delivery capacity. Seasonal capacity (pipeline fixed charges not paid

1 year round) is also problematical. It is very difficult to make a determination on whether this
2 type of capacity is truly unique on a pipeline system or simply represents another situation
3 where one shipper needs the capacity for 12 months out of the year or is captive to the
4 pipeline where another seasonal capacity shipper is not captive or simply has no need for the
5 capacity. Even if a capacity deal is put together for a couple of months on a short term basis
6 at maximum FERC rates, savings would be calculated if compared to the year round
7 hypothetical capacity that is used as a benchmark in the savings calculation.

8 Q. Please explain the statement, “[c]aptive versus non-captive shipper status can
9 affect levels of discounts but could be ignored under savings calculations.”

10 A. An analysis of whether a shipper is captive to a particular pipeline is critical in
11 determining whether achieved discounts are typical or extraordinary. Many factors can
12 affect the level of discount obtained, including the type of shipper, the specific transportation
13 segment chosen, the supply that is accessible upstream of the pipeline, the capacity available
14 on the pipeline and the size and nature of the shipper load. Because of its size, multiple
15 pipelines have attached to Laclede’s system. If a shipper has such delivery choices, as
16 Laclede does, it is reasonable to assume that more leverage can be exerted and high discounts
17 achieved, versus other shippers that don’t have access to different pipelines. Although
18 smaller LDCs also have to deal with uncollectible accounts, they would not be able to have
19 such a program because they are likely captive and will not be able to obtain discounts. With
20 its proposal, Laclede seeks to take credit for its non-captive status.

21 Q. Do you have other concerns about the proposal in terms of the ACA effect?

22 A. Yes. A review of the proposed tariffs leads me to believe other transportation
23 agreements may be waiting in the wings to dramatically increase the calculated level of

1 transportation discounts. The Mississippi River Transmission (MRT) agreements ** HC
2 HC ** These
3 agreements have not been included in any current calculations that I have reviewed from
4 Laclede; calculations that tend to already generate about ** HC
5 HC ** Even though Laclede has proposed to cap the funding level at \$6,000,000,
6 ** HC ** that the necessary \$20,000,000
7 level is achieved. Furthermore, the MRT contract creates a situation where even if the
8 Commission tried to raise the historical benchmark to \$20,000,000, “new” savings would be
9 brought to the table. MRT savings were traditionally removed from any discount calculation
10 on the grounds that the contracts pre-dated the GSIP and/or that discounts were system-wide.

11 Q. What are your other ACA-related concerns?

12 A. Laclede’s proposed tariff language appears to allocate all the costs of funding
13 the program to firm sales customers. Firm Transportation customers are allocated a portion
14 of pipeline discounts since they pay a share of all pipeline reservation charges. By taking
15 away discounts from only the firm sales customers, some PGA classes continue to enjoy the
16 fully discounted pipeline rates while other PGA classes carry the entire financial burden of
17 the program.

18 Finally, Laclede’s proposed accounting as described in the tariffs is somewhat
19 vague in how the Low-Income Funding (LIF) Account and the Low-Income Deferred Credit
20 Account will be cleared by various transactions such as increasing the expense in the ACA
21 account and accounting for disbursements out of the escrow account.

22 Q. Is there a funding method other than the one proposed by Laclede that the
23 Staff could support?

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1 A. Yes. This funding method is discussed in the testimony of Staff witness
2 Thomas M. Imhoff.

3 Q. Please summarize your testimony.

4 A. My review of the catch-up/keep-up funding mechanism shows that PGA firm
5 sales customers are required to pay additional costs, in excess of their actual gas costs, to
6 fund this program. Firm transportation customers, who also receive an allocation of pipeline
7 reservation charges, are not required to fund this program. I also reviewed the difficulties
8 associated with the transportation discount mechanism used to fund the program.

9 Q. Does this conclude your direct testimony?

10 A. Yes.

CASES WHERE TESTIMONY WAS FILED

DAVID M. SOMMERER

COMPANY	CASE NO.
Missouri-American Water Company	WR-85-16
Great River Gas Company	GR-85-136
Grand River Mutual Telephone	TR-85-242
Associated Natural Gas Company	GR-86-86
Empire District Electric Company	WR-86-151
Grand River Mutual Telephone Company	TR-87-25
Great River Gas Company	GM-87-65
KPL Gas Service Company	GR-89-48
KPL Gas Service Company	GR-90-16
KPL Gas Service Company	GR-90-50
Associated Natural Gas Company	GR-90-152
United Cities Gas Company	GR-90-233
United Cities Gas Company	GR-91-249
Laclede Gas Company	GR-92-165
United Cities Gas Company	GR-93-47
Western Resources Inc.	GR-93-240
Union Electric Company	GR-93-106
Missouri Public Service	GA-95-216
Missouri Gas Energy	GO-94-318
Missouri Gas Energy	GO-97-409
United Cities Gas Company	GO-97-410
Missouri Gas Energy	GR-96-450
Missouri Gas Energy	GC-98-335

Laclede Gas Company	GO-98-484
Laclede Gas Company	GR-98-374
Laclede Gas Company	GC-99-121
Laclede Gas Company	GT-99-303
Laclede Gas Company	GR-98-297
Laclede Gas Company	GT-2001-329
Laclede Gas Company	GO-2000-394
Laclede Gas Company	GR-2001-629
Laclede Gas Company	GR-2002-356
Laclede Gas Company	GR-2001-387