

Exhibit No.: _____
Issues: Imputed Revenues
and Misc. Issues
Witness: Scott F. Klemm
Type of Exhibit: Surrebuttal Testimony
Sponsoring Party: Southern Missouri Gas Company, L.P.
Case No.: GR-2001-388

MISSOURI PUBLIC SERVICE COMMISSION

SOUTHERN MISSOURI GAS COMPANY, L.P.

CASE NO. GR-2001-388

SURREBUTTAL TESTIMONY OF

SCOTT F. KLEMM

Jefferson City, Missouri

February 20, 2003

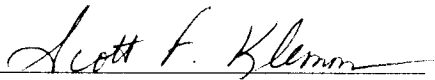
**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

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

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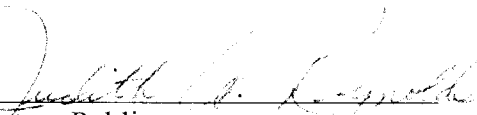
SCOTT F. KLEMM

Scott F. Klemm, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Surrebuttal Testimony of Scott F. Klemm"; that said testimony was prepared by him and/or under his direction and supervision; that if inquiries were made as to the facts in said testimony, he would respond as therein set forth; and that the aforesaid testimony are true and correct to the best of his knowledge, information and belief.



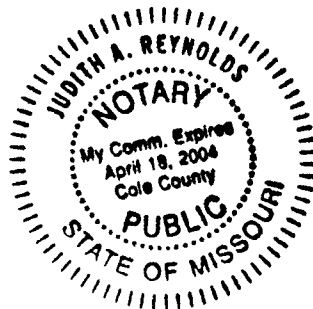
Scott F. Klemm

Subscribed and sworn to before me this 17th day of February, 2003.



Notary Public

My Commission expires _____



SURREBUTTAL TESTIMONY OF SCOTT KLEMM

CASE NO. GR-2001-388

February 20, 2003

1 **Q. WOULD YOU PLEASE STATE YOUR NAME AND BUSINESS ADDRESS?**

2 A. My name is Scott F. Klemm and my business address is 301 East 17th Street,
3 Mountain Grove, MO 65711.

4

5 **Q. ARE YOU THE SAME SCOTT F. KLEMM THAT PREVIOUSLY FILED**
6 **DIRECT AND REBUTTAL TESTIMONY IN THIS PROCEEDING?**

7 A. Yes.

8

9 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY IN**
10 **THIS PROCEEDING?**

11 A. The purpose of my Surrebuttal Testimony is to respond to the Rebuttal Testimony
12 filed by the Staff witnesses Annell G. Bailey and James M. Russo.

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1 REVENUE IMPUTATION ADJUSTMENT

2 Q. STAFF WITNESS ANNELL G. BAILEY ASSERTED THAT "THE
3 COMPANY SOLD NATURAL GAS IN VIOLATION OF ITS TARIFF."
4 (BAILEY REBUTTAL, P. 2). DOES SHE EXPLAIN THE BASIS FOR THIS
5 ASSERTION?

6 A. No. She refers "to the rebuttal testimony of Staff witness James M. Russo for details
7 on tariff authorization issues." (Bailey Rebuttal, p. 2). However, Mr. Russo's rebuttal
8 testimony does not explain the basis for Staff's assertion that SMGC sold natural gas
9 in violation of its tariff either. Instead, Mr. Russo contends that he did not "find
10 anything else in the tariff that would allow the new Internal Customer Class created
11 by SMG." (Russo Rebuttal, p. 2).

12
13 Q. DO YOU AGREE WITH STAFF'S ASSERTION THAT SMGC HAS
14 CREATED A NEW "INTERNAL CUSTOMER CLASS"?

15 A. No. SMGC has not created a "new internal customer class" as asserted by Mr.
16 Russo. (Russo Rebuttal, p. 2). As I have already explained in my direct and rebuttal
17 testimony, SMGC reclassified the two Large Volume Service (LVS) customers as
18 **transportation customers**, pursuant to SMGC's Transportation Tariff, when these
19 customers desired to take transportation service from SMGC. This is typically done
20 when LVS customers decide to become transportation service customers. In my
21 opinion, these customers are more properly referred to as "transportation customers."

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

1 the gas is an unregulated service performed pursuant to FERC Order Nos. 436 and
2 636.

3 The provisioning of gas by SMGC was necessary to protect SMGC's other
4 ratepayers from the adverse consequences that would have occurred to them if the
5 two large industrial customers had either switched to another energy source and left
6 the SMGC system, or secured the gas supplies from a third-party gas marketer.

7

8 **Q. DOES MR. RUSSO IDENTIFY ANY PROVISION OF SMGC'S**
9 **TRANSPORTATION TARIFF THAT STAFF BELIEVES WAS NOT**
10 **FOLLOWED?**

11 A. No. Although Mr. Russo attached SMGC's entire tariff to his rebuttal testimony, he
12 does not identify any specific tariff provision that Staff contends SMGC did not
13 follow in rendering its transportation service to these customers.

14

15 **Q. MR. RUSSO SUGGESTS THAT SMGC'S CONTRACTS WITH THESE**
16 **CUSTOMERS DIFFER FROM THIRD PARTY MARKETING CONTRACTS.**
17 **DO YOU HAVE ANY COMMENTS ON HIS TESTIMONY?**

18 A. Yes. The primary difference that Mr. Russo points out between a third party
19 marketer providing the gas to the transportation customer, and the situation in which
20 SMGC itself provides the gas to the transportation customer, is the obvious one. The
21 only difference is the identity of the entity which sells the gas to the customers—a
22 third party marketer, or SMGC, as the local distribution company. I agree that this is

1 the primary difference between the traditional third party marketer contract, and the
2 situation that is at issue in this proceeding.

3
4 **Q. MR. RUSSO SUGGESTS THAT SMGC IS NOT IN COMPLIANCE WITH**
5 **SECTION 393.299 RSMO SINCE SMGC IS NOT A CERTIFICATED**
6 **ENERGY "SELLER" IN MISSOURI. DO YOU AGREE?**

7 A. No. While I am not an attorney, my legal counsel informs me that Section
8 393.299 specifically exempts a "distributor" that provides energy services (defined as
9 a "gas corporation" under Section 386.020 RSMo) from the requirement to be
10 certified by the Commission as a "seller", pursuant to Section 393.299. Since SMGC
11 is a "gas corporation" and a "distributor" under 393.298(3), it is not necessary to be
12 certified as a "seller" under Section 393.299, RSMo.¹ In addition, the definition of a
13 "seller" contained in Section 393.298(10) RSMo² also specifically excludes a
14 "distributor" (such as SMGC) from its definition. I therefore do not understand Mr.
15 Russo's assertion that SMGC is not in compliance with Section 393.299.

16

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

² Section 393.298(10) also specifically exempts a "distributor" from being defined as 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*).

1 **Q. MR. RUSSO ALSO TESTIFIED THAT "SMG IS SUBJECT TO THE**
2 **AFFILIATE TRANSACTION RULES, AND MUST MAINTAIN SEPARATE**
3 **RECORDS BETWEEN ANY AFFILIATE AND THE REGULATED**
4 **ENTITY." DO YOU AGREE?**

5 A. I agree that SMGC is presently subject to the Commission's affiliated transaction
6 rules. 4 CSR 240-40.016(2)(K) requires that a regulated gas corporation "maintain its
7 books of account and records completely separate and apart from those of the
8 marketing affiliate." However, this provision would not be applicable to the current
9 situation since SMGC does not have a gas marketing affiliate. Therefore, I do not
10 believe that this provision is relevant to this case.

11

12 **Q. MR. RUSSO SUGGESTED THAT SMGC IS NOT SEGREGATING THE**
13 **EXPENDITURES RELATED TO THESE CUSTOMERS OR ALLOCATING**
14 **A PERCENTAGE OF EXPENSES TO A THIRD PARTY MARKETING**
15 **FUNCTION. DO YOU AGREE?**

16 A. I am not certain what Mr. Russo means by "segregating the expenditures" or
17 "allocating a percentage of expenses to a third party marketing function". However,
18 SMGC clearly is keeping track of the revenues and gas costs associated with
19 providing transportation service and the gas supplies to these customers. In fact, the
20 schedules containing such information were provided to Staff along with all other
21 workpapers, calculations, documents, etc., that supported the Company's 2000-2001
22 ACA filing. The calculation of the costs and benefits to SMGC's remaining
23 customers by SMGC keeping these large industrial customers on the SMGC system

1 (contained in my direct and rebuttal testimony) was based upon the revenues and
2 costs taken from SMGC's accounting system.
3

4 **Q. DOES MR. RUSSO IDENTIFY ANY PROHIBITION AGAINST SMGC**
5 **PROVIDING GAS TO A TRANSPORTATION CUSTOMER?**

6 A. No. Mr. Russo does not identify any Commission rule, or tariff provision that would
7 prohibit SMGC from participating in the unregulated activity of providing natural gas
8 to a transportation customer. To my knowledge, there is no statute, Commission rule
9 or other requirement that prohibits SMGC from selling gas to a transportation
10 customer, or requires that SMGC establish a separate "marketing affiliate" to sell gas
11 to a transportation customer.
12

13 **Q. MR. RUSSO TESTIFIED THAT SMGC DOES NOT HAVE A MARKETING**
14 **AFFILIATE. IS THIS CORRECT?**

15 A. Yes. However, the adverse impact on SMGC's remaining ratepayers would have
16 been the same if the two large industrial customers had utilized the services from such
17 a SMGC marketing affiliate, or from any unaffiliated third party marketing company.
18

19 **Q. DOES STAFF ASSERT THAT IT WAS IMPRUDENT OR NOT IN THE BEST**
20 **INTERESTS OF SMGC'S REMAINING RATEPAYERS FOR SMGC TO**
21 **ATTEMPT TO KEEP THESE LARGE INDUSTRIAL CUSTOMERS ON THE**
22 **SMGC SYSTEM?**

1 A. No. Staff apparently agrees that it was reasonable and prudent for the Company to
2 attempt to retain the customers on SMGC's distribution system. In fact, Mr. Russo
3 included the following analysis in his direct testimony (pp. 3-4):

4 SMG and its customers may benefit through a retention of existing
5 customers that otherwise may be lost to alternative markets, by serving
6 qualifying customers at a market competitive rate. SMG's customers
7 benefit by SMG keeping existing customers by spreading its costs over
8 a larger volume, thereby lowering all customers overall cost of service.
9 Also, there are no additional customer classes requiring additional
10 record keeping and data review by the Company and Staff in the PGA
11 and rate case processes.
12
13

14 **Q. MS. BAILEY STATES THAT "IN THE ABSENCE OF ANY TARIFF OR**
15 **RATE SCHEDULE AUTHORIZING 'TRANSPORTATION SERVICE—**
16 **INTERNAL' IT IS REASONABLE TO IMPUTE THE PGA/ACA REVENUES**
17 **AS IF THE EXISTING TARIFF HAD BEEN FOLLOWED." DO YOU**
18 **AGREE?**

19 A. Absolutely not. If the Company had not taken the steps necessary to compete with
20 alternative fuels for these two industrial customers, it is extremely likely that these
21 two industrial customers would have left the SMGC system, or substantially reduced
22 their throughput. As Mr. Russo pointed out, even with the provisioning of lower
23 priced gas by SMGC, one of these customers subsequently left the SMGC system for
24 its production load. It is quite obvious that if SMGC had done nothing, this customer
25 would have switched to an alternative source of energy much sooner than it did.
26 Staff's position on this issue is based upon the unrealistic assumption that, absent the
27 measures taken by the Company to retain two industrial customers on the system,
28 there would have been an increase of revenues of \$105,809, "as if the existing tariff

1 had been followed." (Bailey Rebuttal, p. 2) If the Company had not taken the steps
2 necessary to compete with alternative fuels for these two industrial customers, it is
3 probable that these two industrial customers would have left the SMGC system, or
4 substantially reduced their throughput. As a result, if the full-tariff rate for LVS
5 service had been applied to these customers (instead of the lower-price gas contract
6 negotiated by SMGC) and they left the SMGC system, the likely revenue from these
7 customers would have been zero (-\$0-) or certainly very minimal, rather than the
8 \$337,995 as contained on Schedule 1 of Ms. Bailey's Direct Testimony.

9
10 **Q. MS. BAILEY TESTIFIED THAT THE ADOPTION OF THE STAFF'S**
11 **PROPOSED ADJUSTMENT WOULD PREVENT OTHER CUSTOMERS**
12 **FROM "SUBSIDIZING" THE RATES OF THE TRANSPORTATION**
13 **CUSTOMERS. DO YOU AGREE THAT OTHER CUSTOMERS ARE**
14 **SUBSIDIZING THE TWO INDUSTRIAL CUSTOMERS' RATES?**

15 A. No. Even Ms. Bailey agrees that there was a positive contribution of \$39,987 above
16 the Company's costs at the agreed upon rate levels. Therefore, it is incorrect to
17 suggest that an adjustment is necessary to keep other customers from "subsidizing"
18 the two large industrial customers. In fact, if these customers had switched to a third
19 party marketer for their gas supplies, then there would have been no contribution
20 from these customers.

21 Furthermore, as I explained in my direct testimony, if the load of these
22 industrial companies were lost, then the fixed transportation costs alone for the
23 remaining customers would have increased to approximately \$0.132 per Ccf (i.e. a

1 19% increase). The impact on a typical residential customer using 750 Ccfs annually
2 would be an additional cost of approximately \$16 per customer. In addition, the ACA
3 charge would also have increased due to the reduced volumes, or the recovery of
4 these ACA costs would have to be extended for a longer period of time. Since these
5 large industrial customers were eligible for SMGC's transportation service, it is
6 simply wrong to suggest that the remaining customers are "subsidizing" these large
7 industrial customers merely because they exercised their right to become
8 transportation customers.

9

10 **Q. MS. BAILEY TESTIFIED THAT HER SCHEDULE 1 TO HER DIRECT**
11 **TESTIMONY SHOWS THAT IF THE GAS HAD BEEN SOLD TO THOSE**
12 **TWO CUSTOMERS AT TARIFF-AUTHORIZED RATES, THE**
13 **CONTRIBUTION WOULD HAVE BEEN \$142,825 INSTEAD OF \$39,987. DO**
14 **YOU AGREE?**

15 A. No. If SMGC had attempted to apply the "tariff-authorized rates" as Ms. Bailey
16 suggests, then these two customers would have accepted the services of alternative
17 fuel providers and left SMGC's system, or at least substantially reduced their
18 throughput. The contribution from customers who were no longer on the SMGC
19 system would have been zero (-\$0-) and not \$142,825, as contained in Schedule 1 of
20 her direct testimony.

21

22

23

1 **Q. MS. BAILEY TESTIFIED THAT SHE DID NOT MAKE ALTERNATIVE**
2 **COMPUTATIONS TO SHOW THE IMPACT IF THESE TWO CUSTOMERS**
3 **HAD LEFT THE SMGC SYSTEM OR REDUCED THEIR THROUGHPUT**
4 **BECAUSE SUCH COMPUTATIONS WOULD BE BASED UPON**
5 **GUESSWORK AND CONJECTURE. DO YOU AGREE THAT SUCH**
6 **COMPUTATIONS ARE BASED UPON GUESSWORK AND CONJECTURE?**

7 **A.** No, I do not. Ms. Bailey apparently did not consider the impact upon SMGC's
8 remaining customers if these large industrial customers would have left the system.
9 This impact upon other customers was critically important to SMGC. Since SMGC's
10 remaining customers would have been negatively impacted by the loss of these
11 industrial customers, it was important for SMGC to find a "win-win" solution that
12 would benefit the large industrial customers as well as SMGC's remaining customers.
13 Although Ms. Bailey chose to ignore the substantial probability that these customers
14 would have left the SMGC system, it is not difficult to calculate the impact on the
15 remaining customers if SMGC had lost more than 15% of its total load.

16

17 **Q. STAFF HAS SUGGESTED THAT THE ONLY APPROPRIATE COURSE OF**
18 **ACTION TO REMEDY THE ALLEGED TARIFF VIOLATION IS TO**
19 **INCLUDE THE REVENUES THAT WOULD HAVE OCCURRED IF THE**
20 **GAS HAD BEEN SOLD AT THE AUTHORIZED PURCHASED GAS**
21 **ADJUSTMENT ADJUSTED RATE. (STAFF'S POSITION STATEMENT)**
22 **DO YOU AGREE?**

1 A. First, SMGC does not believe that it has violated its tariff or done anything improper
2 in its attempts to keep its two large industrial customers on its system. However, if
3 the Commission finds that SMGC somehow violated its tariff, or needed to seek prior
4 regulatory approval of its contracts with these two industrial customers, SMGC
5 nevertheless would request that the Commission reject Staff's proposed remedy in this
6 proceeding. Staff's proposed remedy is inappropriate and unreasonable, given the
7 circumstances. As previously discussed, it was important for SMGC to find a "win-
8 win" solution that would benefit both the large industrial customers and the remaining
9 customers.

10 As I already have explained in my rebuttal testimony, a \$105,809 adjustment
11 is a very substantial adjustment for a small company of SMGC's size. **In fact, the**
12 **Staff's proposed disallowance would represent nearly 68% of SMGC's Net**
13 **Utility Operating Income for 2001.** This is a very substantial penalty, especially in
14 light of the fact that SMGC's efforts were designed to principally benefit SMGC's
15 other ratepayers rather than its owners. SMGC respectfully requests that the
16 Commission to reject the Staff's proposed disallowance for the reasons stated in my
17 testimony.

1 **DEFERRED CARRYING COST BALANCE**

2 **Q. IN HER REBUTTAL TESTIMONY, MS. BAILEY STATED THAT SHE**
3 **DOES NOT AGREE WITH YOUR CALCULATION OF THE DEFERRED**
4 **CARRYING COST BALANCE (DCCB). DO YOU HAVE ANY COMMENTS?**

5 A. Yes. After I filed my Direct Testimony in this proceeding, I discovered that other
6 Local Distribution Companies ("LDCs") used a different methodology from
7 calculating the DCCB than the methodology used by Ms. Bailey or me in our
8 respective testimonies in this proceeding. Based upon the discussions with other
9 LDCs, it is my understanding that the LDC industry in Missouri has historically based
10 the interest calculation for the DCCB on the PGA rate only, not including the ACA
11 factor, as I did in my original Schedule No. 2. To be consistent with LDC industry
12 practices in Missouri, as well as to ensure that current revenues and current costs are
13 taken into account, I have performed the interest calculation using only the PGA
14 factor. On February 13, 2003, I filed Supplemental Direct Testimony to replace
15 Schedule No. 2 in my Direct Testimony with a Revised Schedule No. 2.

16
17 **Q. WHAT DOES THE INTEREST CALCULATION ON REVISED SCHEDULE**
18 **NO. 2 SHOW?**

19 A. Revised Schedule No. 2 shows that the interest on the DCCB due SMGC is
20 \$21,810.81, rather than \$5,772.07, as originally filed. This revision is necessary to be
21 consistent with the approach used by other LDCs in Missouri when calculating the
22 interest on the DCCB. I would respectfully request that the Commission base its
23 decision on this revised calculation.

1 **Q. MS. BAILEY ALSO TESTIFIED THAT SMGC HAD NOT PROVIDED THE**
2 **UNDERLYING SUPPORT FOR YOUR ADJUSTMENTS FROM MMBTU TO**
3 **CCF. HAVE YOU PROVIDED ADDITIONAL SUPPORT TO STAFF ON**
4 **THIS CALCULATION?**

5 A. Yes. Although the conversion from MMBtus to Ccfs is a very standard calculation
6 used by regulatory agencies and other members of the natural gas industry, I have
7 provided Ms. Bailey with additional support for SMGC's methodology.

8

9 **GAS SUPPLY REALIGNMENT COSTS**

10 **Q. MS. BAILEY TESTIFIED THAT SHE DISAGREED WITH THE**
11 **COMPANY'S POSITION THAT CERTAIN GAS REALIGNMENT COSTS**
12 **SHOULD BE RECOVERED SINCE THEY WERE NOT INCLUDED IN THE**
13 **CURRENT OR PRIOR ACA CASES. DO YOU HAVE A RESPONSE?**

14 A. Yes. The Commission should allow SMGC to recover in this proceeding the amount
15 of \$113,512 related to Gas Supply Realignment Costs paid to Williams Pipeline from
16 May 1996 to September 1998. The Company recently discovered that Gas Supply
17 Realignment Costs paid to Williams Pipeline from May 1996 to September 1998
18 amounted to \$132,946. Of this amount, only \$19,434 has previously been included in
19 gas cost in prior ACA audits. The amount of \$19,434 was an adjustment proposed by
20 the Staff in the 1997-98 ACA Filing dated July 30, 1999. Thus, the net amount paid
21 to Williams but not collected is \$113,512. SMGC believes this amount should be
22 reflected in its rates.

23

1 **Q. ARE YOU REQUESTING THAT THE COMMISSION REOPEN PRIOR**
2 **YEAR CASES TO CONSIDER THESE GAS REALIGNMENT COSTS?**

3 A. No. SMGC is requesting that these realignment gas supply costs be included in the
4 Company's current ACA balance on a prospective basis. It is not necessary to re-
5 open past cases or attempt to retroactively change PGA rates in previous periods.

6

7 **Q. IF THE COMMISSION DECIDES THAT THE FULL GAS REALIGNMENT**
8 **COSTS SHOULD NOT BE INCLUDED, IS THERE A PORTION OF THESE**
9 **COSTS THAT SHOULD NEVERTHELESS BE CONSIDERED FOR**
10 **INCLUSION IN RATES IN THIS ACA PERIOD?**

11 A. Yes. Even if the Commission decides that it will not authorize the recovery of the
12 full amount of \$113,512 in this proceeding, it should nevertheless authorize the
13 inclusion of the \$62,345 (which is included in the full \$113,512 which was
14 inadvertently left out of the ACA audit process). Such amount was refunded to
15 customers, beginning in November 2000, which is included in the ACA periods
16 considered in this case. Since the original costs were never reflected in the ACA
17 audit process, SMGC has provided a windfall to its customers. This should be
18 corrected or otherwise rectified by authorizing SMGC to collect \$62,345 in the next
19 ACA period.

20

21 **Q. DOES THAT CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

22 A. Yes it does.