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Witness: Amanda C. McMellen
Sponsoring Party: MoPSC Staff
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MISSOURI PUBLIC SERVICE COMMISSION

COMMISSION STAFF DIVISION

AUDITING DEPARTMENT

SURREBUTTAL TESTIMONY

OF

AMANDA C. McMELLEN

SUMMIT NATURAL GAS OF MISSOURI, INC.

CASE NO. GO-2012-0322

Jefferson City, Missouri
August 2019

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1 **EXECUTIVE SUMMARY**

2 Q. Please summarize your surrebuttal testimony in this proceeding.

3 A. In conjunction with Staff witness Myers, I will explain in this testimony why
4 Staff disagrees with Mr. Schallenberg's assessment of Summit Natural Gas of Missouri, Inc.'s
5 ("SNGMO") currently proposed CAM. Staff continues to recommend that the Commission
6 approve the CAM, with the language suggestions included in Staff witness Myers rebuttal
7 testimony that SNGMO has agreed to, submitted in this docket on June 28, 2019, and attached
8 to the direct testimony of SNGMO's witness Steven E. Birchfield.

9 **SNGMO'S CAM**

10 Q. What are Mr. Schallenberg's reasons for not recommending approval of
11 SNGMO's proposed CAM?

12 A. OPC witness Schallenberg states his reasons for not recommending approval of
13 SNGMO's proposed CAM on page 7, lines 5 through 18 of his rebuttal testimony. First,
14 Mr. Schallenberg does not agree with the use of the Dstrigas approach ("Dstrigas") as a
15 general allocation method. Second, he states that SNGMO is not using a competitive bidding
16 process, pursuant to 4 CSR 240-40.015(3), to test the reasonableness of the charges for its
17 allocated goods and services from Summit Utilities, Inc. ("SUI"). Lastly, he states that
18 SNGMO is not testing its purchases from or sales to SUI for compliance with the financial
19 standards requirements of Affiliate Transactions Rule ("ATR") (4 CSR 240-40.015(3)).

20 **DISTRIGAS**

21 Q. As stated above, Mr. Schallenberg recommends that the Commission should
22 not approve SNGMO's proposed CAM partly on the basis that it uses the Dstrigas method to

1 generally allocate costs. Specifically, on page 11, lines 26 through 27 of his rebuttal testimony,
2 Mr. Schallenberg states, “SNGMO’s insistence on using the Distrigas methodology to allocate
3 costs to SNGMO is counter to the Rule’s compliance requirements.” Does Staff agree with
4 this statement?

5 A. No. In fact, other regulated utilities in Missouri use a general allocation method
6 similar to Distrigas. The affiliated entities Kansas City Power & Light Company (“KCP&L”)
7 and KCP&L Greater Missouri Operations Company (“GMO”) currently allocate common
8 costs between them using what is known as the Massachusetts Formula method.¹ The
9 Massachusetts Formula general allocation approach, which is a three factor formula, is very
10 similar to the Distrigas method except that it uses gross revenues (including purchased gas
11 costs) vs. net operating revenues (excluding purchased gas costs)² as one of the three factors
12 relied upon. Spire Missouri, Inc. also allocates common costs to its affiliates based on use of
13 the Massachusetts Formula method.³

14 Q. Please describe the overall cost assignment process outlined in
15 SNGMO’s CAM.

16 A. Under the ATRs (gas, electric, and steam heating), a cost assignment process is
17 necessary for all covered utilities in order to meet certain financial standards contained within
18 the ATRs, specifically calculation of fully distributed costs (“FDC”) values (discussed below).
19 The current proposed CAM for SNGMO includes three steps to assign costs, as follows in

¹ Order Approving Stipulation and Agreement Regarding Certain Issues, File No. ER-2016-0285, Item No. 457, approving the Non-Unanimous Partial Stipulation and Agreement, Attachment Exhibit B, pages 12-13.

² Direct testimony SNGMO witness Steven E. Birchfield, page 9, lines 13 through 20.

³ Order Approving Stipulation And Agreement, Granting Waiver, And Approving Cost Allocation Manual, File No. GC-2011-0098, Item No. 108, approving the Unanimous Stipulation And Agreement, Granting Waiver, And Approving Cost Allocation Manual, Appendix 1-CAM, page 15.

1 order of priority: (1) direct assignment; (2) indirect assignment (also known as indirect
2 allocation); and then (3) general allocation, which is explained in detail in my rebuttal
3 testimony on page 4, lines 3 through 11. It is Staffs' understanding that SNGMO intends to
4 use direct and indirect assignment as highest priority before using its general allocation method
5 to assign any remaining residual costs using the Distrigas method. I discussed the purpose and
6 use of general allocation methods in my rebuttal testimony at page 4, lines 13 through 21.

7 Q. What is the significance of FDC?

8 A. FDC is a costing method that examines all of the costs of a utility in relation to
9 all of the goods and services that are produced by the utility. Using an FDC approach, all
10 direct and indirect costs associated with a good or service are assigned to that good or service.
11 Common costs of the utility that cannot be specifically assigned to individual goods or services
12 are then proportionately assigned to each good or service through a "general allocation"
13 methodology. The FDC costing method attempts to ensure that all of the costs of a utility are
14 appropriately and proportionately accounted for in the assignment of costs to all of the utility's
15 goods and services.

16 Q. What role does FDC costing play within the ATRs?

17 A. FDC cost calculations are an important component of the "asymmetric pricing"
18 provisions of the ATRs, which are designed to prevent subsidization of a utility's
19 non-regulated operations by its regulated operations.

20 Q. Please describe the ATRs' asymmetric pricing provisions.

21 A. When a utility chooses to enter into an affiliated transaction, the ATRs require
22 the utility to calculate the FDC associated with each good or service it either purchases from
23 an affiliate or sells to an affiliate. Under the ATRs, the FDC value represents the "cost" of the

1 good or service in question, and is then compared to a fair market price ("FMP") for the good
2 or service to determine the appropriate price to pay for or to sell the product.

3 Under the ATRs, when a utility sells a good or service to an affiliate, the good or service
4 must be priced at the higher of the product's FDC or FMP. When a utility purchases a good
5 or service from an affiliate the good or service must be priced at the lower of the product's
6 FDC or FMP.

7 Q. Please describe the use of the Distrigas method for allocating common costs to
8 multiple entities.

9 A. Cost allocation factors are derived under this method by taking the composite
10 percentage of each of the subsidiaries' direct labor, capital investments and net sales revenues
11 divided by the total company direct labor, capital investment and net revenues, respectively.
12 This factor is then applied to all corporate costs that are not directly assigned.

13 Q. Is there specific language in the Commission's ATR relating to gas utilities
14 requiring Missouri utilities to use a specific general allocation method?

15 A. No. While the ATR requires a general allocation process be used as part of
16 FDC costing, there is no specific method defined, Commission Rule 4 CSR 240-40.015(1)(F).
17 Therefore, there is no policy in place in Missouri as to a specific methodology to use for general
18 allocation of costs. While Mr. Schallenberg may assert that his proposed general allocation
19 approach contained within his rebuttal testimony is superior to the Distrigas method, adoption
20 of his preference is not dictated by the ATR. Staff continues to take the position that the
21 SNGMO's use of the Distrigas method is reasonable for the reasons discussed in my rebuttal
22 testimony, including the analysis which is attached to that testimony as Schedule ACM-r2.

1 Q. Does SUI, use the Distrigas general allocation method to allocate costs to
2 affiliated regulated utilities in its other jurisdictions?

3 A. Yes. The CAMs currently being used by SUI's other regulated affiliates are
4 very similar to the one being proposed by SNGMO in this case. Each SUI regulated affiliate
5 CAM relies upon the process of allocating costs based on (1) direct assignment, (2) indirect
6 assignment and (3) general allocation using the Distrigas method.

7 **COMPETITIVE BIDDING**

8 Q. Mr. Schallenberg's second stated reason for recommending the Commission
9 not approve SNGMO's proposed CAM is that SNGMO does not use a competitive bidding
10 process as part of the process for receipt of corporate support services from SUI. What is
11 Staff's response?

12 A. Mr. Schallenberg is correct that SNGMO does not currently use, or plan to use,
13 a competitive bidding process for corporate support services. However, SNGMO states in the
14 proposed CAM that it will use other alternative measures, such as "benchmarking," to
15 determine the FMP of goods and services. Under the ATR, use of benchmarking is allowed
16 as an alternative to competitive bidding when approved by the Commission. (4 CSR 240-
17 40.015(3)(D)). Additionally, the ATR provides that a utility may demonstrate why competitive
18 bids for an affiliate transaction are neither necessary nor appropriate. (4 CSR 240-
19 40.015(3)(A)(B)).

20 Q. What is benchmarking?

21 A. Benchmarking is an attempt to determine the market value of a given good or
22 service through research of the relevant competitive markets (for example, taking a survey of
23 the price of goods and services available from unaffiliated/independent third party vendors).

1 Q. Does Mr. Schallenberg acknowledge benchmarking in his rebuttal testimony?

2 A. Yes, briefly at page 6, lines 24-26 and page 11, lines 21-23.

3 Q. Does Staff support SNGMO's proposed use of benchmarking to determine the
4 market value of SUI services in lieu of competitive bidding?

5 A. Yes. SUI is the parent company and affiliate of SNGMO that provides
6 corporate support services to SNGMO and its affiliates on a centralized basis, an arrangement
7 common within utility structures containing multiple regulated entities. Due to the service
8 company structure of SUI, it can be reasonably assumed to be less costly in most situations
9 than arrangements in which the utility receives goods and services from unaffiliated entities at
10 market values. The expected lower costs associated with provision of service company goods
11 and services are due to the inherent economies of scale available in the offering of centralized
12 services to multiple entities, as well as the fact that SUI does not include a profit margin for
13 the charges associated with provision of its the goods and services, unlike the case with
14 unaffiliated/independent third party vendors.

15 For this reason, Staff takes the position that it is reasonable to primarily rely
16 on SNGMO's benchmarking activities for purposes of applying asymmetric pricing to
17 corporate support activities. Extensive competitive bidding by SNGMO for goods and services
18 obtained from SUI is unlikely to be either cost-effective or practical in most cases. In this
19 situation, Staff holds that benchmarking of a broad selection of goods and services obtained
20 by SNGMO from SUI is a reasonable substitute for obtaining the type of information
21 associated with competitive bids. Such benchmarking activities should include both labor
22 and non-labor cost components, as applicable, for the goods and services selected
23 for benchmarking.

1 However, competitive bidding activities on the part of SNGMO should still take place
2 where appropriate, as discussed in the CAM attached to Mr. Birchfield's testimony at Tab B,
3 pages 9 – 10.

4 **TRANSACTIONS WITH REGULATED NATURAL GAS AFFILIATES**

5 Q. Please restate Mr. Schallenberg's third primary concern with SNGMO's
6 proposed CAM.

7 A. His concern is that the current SNGMO proposed CAM does not require
8 SNGMO to comply with the financial standards within the ATR for purchases from and sales
9 to the holding company.

10 Q. What is Mr. Schallenberg referring to here?

11 A. Staff interprets this section of Mr. Schallenberg's rebuttal testimony as
12 advocating that the "asymmetric pricing" standards in the ATR be applied to transactions for
13 support services between SNGMO and its regulated natural gas affiliates operating in other
14 jurisdictions. These transactions were generally discussed in the proposed CAM attached to
15 SNGMO witness Birchfield at Schedule SEB-1, Tab F. These exchanges of goods and services
16 between affiliated SUI utility companies are currently being made at "cost," FDC, but no
17 comparison to FMP is performed.

18 Q. Is it appropriate for SNGMO to use "asymmetric pricing" for this type
19 of transaction?

20 A. Staff does not believe it is generally either appropriate or necessary for SNGMO
21 to use "asymmetric pricing" for transfers of goods and services between affiliated regulated
22 natural gas companies. As explained above, "asymmetric pricing" requires costing at the
23 higher of FDC or FMP of the good or service for the selling affiliate and costing at the lower

1 of FDC or FMP of the good or service for the purchasing affiliate. It seems clear to Staff that
2 there cannot be a difference between the price charged by a seller and the price paid by the
3 buyer for a good or service in this situation, yet application of the “asymmetric pricing”
4 standard to utility transfers of goods and services would potentially lead to that result.
5 The Commission has noted in the past that affiliated transactions between regulated affiliates
6 was not intended to be covered by the rule.⁴ For this reason, Staff believes that is not
7 appropriate to require SNGMO to strictly adhere to the “asymmetric pricing” portion of the
8 ATR for these particular transactions. If the Commission believes it is necessary for SNGMO
9 to request a variance, Staff would recommend approval of a variance for the “asymmetric
10 pricing” requirement of the ATR for transactions between regulated affiliates.

11 **OTHER ISSUES**

12 Q. Does Staff agree with Mr. Schallenberg’s rebuttal testimony at page 8,
13 lines 10 through 11, that the four activities identified in response to Staff Data Request
14 No. 0024 require variances?

15 A. No. SNGMO’s response to Staff Data Request No. 0024 was submitted
16 by SNGMO prior to several discussions between SNGMO and Staff took place. As a result
17 of these discussions, several CAM revisions were agreed to. Staff believes that the current
18 proposed CAM, as discussed in detail in the surrebuttal testimony above, follows all
19 procedures necessary to be consistent with the ATR without the need for variances for
20 the listed items (concerning the Distrigas methodology, competitive bid process and
21 “asymmetric pricing”).

⁴ Report and Order, File No. EM-2007-0374, EFIS Item No. 486, pages 263-264.

1 **CONCLUSION**

2 Q. Please summarize why Staff is recommending that the Commission approve the
3 CAM, with the language suggestions included in Staff witness Myers rebuttal testimony that
4 SNGMO has agreed to, submitted in this docket and attached to the direct testimony of
5 SNGMO's witness Mr. Birchfield filed on June 28, 2019, with the Commission.

6 A. Staff finds that the current CAM proposed by SNGMO, adequately supports the
7 intended purpose of the ATR, 4 CSR 240-40.015, for the specific circumstances under which
8 SNGMO operates.

9 Q. Does this conclude your surrebuttal testimony?

10 A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

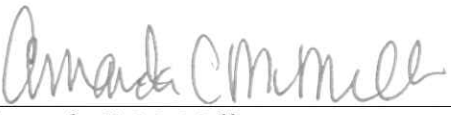
In the Matter of the Application of Summit)
Natural Gas of Missouri, Inc. for Approval of)
its Cost Allocation Manual) Case No. GO-2012-0322

AFFIDAVIT OF AMANDA C. MCMELLEN

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

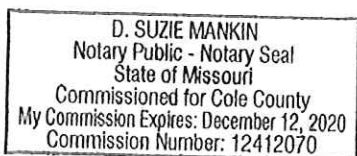
COMES NOW Amanda C. McMellen and on her oath declares that she is of sound mind and lawful age; that she contributed to the foregoing Surrebuttal Testimony and that the same is true and correct according to her best knowledge and belief.

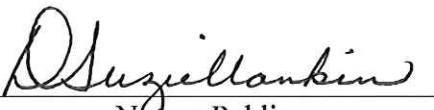
Further the Affiant sayeth not.


Amanda C. McMellen

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 22nd day of August, 2019.




Notary Public