

Exhibit No.: _____

Issue(s):
Witness/Type of Exhibit:
Sponsoring Party:
Case No.:

Off-System Sales
Kind/Direct
Public Counsel
GR-96-181

DIRECT TESTIMONY

OF

RYAN KIND

FILED

JUN 24 1998

Missouri Public
Service Commission

Submitted on Behalf of the Office of the Public Counsel

LACLEDE GAS COMPANY

Case No.: GR-96-181

June 24, 1998

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

In the Matter of Laclede Gas Company's)
Tariff sheets to be Reviewed in its)
1995-1996 Actual Cost Adjustment.)

Case No. GR-96-181

AFFIDAVIT OF RYAN KIND

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

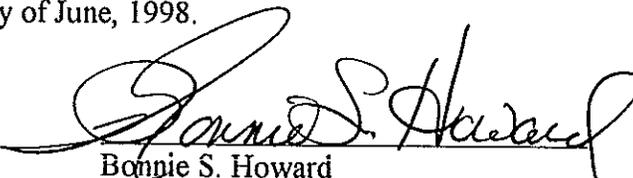
Ryan Kind, of lawful age and being first duly sworn, deposes and states:

1. My name is Ryan Kind. I am the Chief Public Utility Economist for the Office of the Public Counsel.
2. Attached hereto and made a part hereof for all purposes is my direct testimony consisting of pages 1 through 11.
3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.



Ryan Kind

Subscribed and sworn to me this 24th day of June, 1998.



Bonnie S. Howard
Notary Public

My commission expires May 3, 2001.

Direct Testimony of
Ryan Kind

1 **Q. HAVE YOU TESTIFIED PREVIOUSLY BEFORE THIS COMMISSION?**

2 A. Yes, prior to this case I submitted written testimony in: numerous gas rate cases, several
3 electric rate design cases and rate cases, as well as other miscellaneous gas, electric, and
4 telephone cases.

5 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

6 A. My testimony will present OPC's recommendation for the treatment of Laclede Gas
7 Company's (Laclede's or the Company's) off-system sales revenues in this case and also
8 provide the basis for this recommendation.

9 **Q PLEASE PROVIDE A BRIEF OVERVIEW OF THE EVENTS THAT LED TO THE DISPUTE**
10 **REGARDING THE MANNER IN WHICH \$3,569,843 IN NET REVENUES FROM OFF-SYSTEM**
11 **SALES THAT OCCURRED DURING THE 1995-1996 ACA PERIOD SHOULD BE**
12 **ACCOUNTED FOR IN THIS DOCKET.**

13 A. During the 1995-1996 ACA period, Laclede engaged in a series of off-system sales
14 transactions that yielded \$3,569,843 in net revenues. In the Company's 1995-1996 ACA
15 filing, the Company failed to reflect these net revenues as an offset to gas costs in
16 determining its over-recovery amount for this ACA period. At the time when Laclede
17 made the off-system sales, the Company was not subject to an incentive regulation plan
18 that would allow it to retain a share of the \$3,569,843 in net revenues.

19 On August 29, 1997, the Commission Staff (Staff) filed a recommendation in this docket
20 after conducting an audit of Laclede's ACA rates. In its recommendation, Staff proposed
21 to adjust the ACA balances of the Firm Sales and Interruptible Sales customers by a total
22 of \$3,569,843. This adjustment caused the Firm Sales ACA over-collection amount to

Direct Testimony of
Ryan Kind

1 increase from \$25,825,028 to \$29,379,755 and the Interruptible Sales ACA over-
2 collection amount to increase from \$47,324 to \$62,440.

3 **Q DOES PUBLIC COUNSEL SUPPORT THE \$3,569,843 ADJUSTMENT THAT WAS**
4 **PROPOSED BY STAFF IN ITS AUGUST 29, 1997 RECOMMENDATION?**

5 A. Yes.

6 **Q PLEASE EXPLAIN THE PURPOSE OF THE ACA RECONCILLATION PROCESS.**

7 A. The Commission established this process to review annually the gas procurement costs
8 that are actually incurred and set rates that account for any discrepancy between the
9 revenues that the utility collected for gas procurement costs through the PGA process and
10 the actual costs incurred to procure the gas. The Staff performs an audit of each
11 Company's gas procurement practices as part of the ACA review process and then
12 recommends that the utility be allowed to recover its prudently incurred gas procurement
13 costs. The Staff review is intended to assure that the PGA rates are set at a just and
14 reasonable level.

15 **Q HOW DO PGA RATES DIFFER FROM THE MARGIN RATES THAT ARE SET FOLLOWING A**
16 **GAS UTILITY'S GENERAL RATE CASE?**

17 A. Since gas procurement costs are collected from customers in the PGA rates that they pay,
18 the rates that are set in general rate cases are intended to allow gas companies a
19 reasonable opportunity to earn a fair rate of return on the non-gas procurement part of
20 their operations. This non-gas procurement part of their operations consists primarily of
21 costs associated with corporate overhead (e.g. general plant and administrative and

Direct Testimony of
Ryan Kind

1 general expenses), customer service, customer billing, and transporting and distributing
2 gas from the city gate to the customer's side of the meter.

3 **Q YOU STATED THAT "THE RATES THAT ARE SET IN GENERAL RATE CASES ARE**
4 **INTENDED TO ALLOW GAS COMPANIES A REASONABLE OPPORTUNITY TO EARN A FAIR**
5 **RATE OF RETURN ON THE NON-GAS PROCUREMENT PART OF THEIR OPERATIONS."**
6 **ARE THE RATES SET IN THE PGA/ACA PROCESS INTENDED TO ALLOW GAS**
7 **COMPANIES A REASONABLE OPPORTUNITY TO EARN A FAIR RATE OF RETURN ON THE**
8 **GAS PROCUREMENT PART OF THEIR OPERATIONS?**

9 A. No. These rates are solely intended to allow a gas local distribution company (LDC) to
10 recover from customers the expenses that are associated with prudently incurred gas
11 procurement costs.

12 **Q ARE LDCs FACED WITH SIMILAR RISKS IN RECOVERING BOTH THEIR GAS**
13 **PROCUREMENT COST AND THEIR NON-GAS PROCUREMENT COSTS?**

14 A. No. While there is some risk associated with the recovery of gas procurement costs,
15 there is a much greater risk associated with the recovery of non-gas procurement costs.

16 **Q PLEASE EXPLAIN.**

17 A. Both gas procurement costs and non-gas procurement costs can be subject to prudence
18 adjustments. These adjustments essentially impact the amount of revenue requirement
19 that the Commission decides is appropriate for recovery. However, the reviews for
20 prudence occur at different times in the rate setting process. In general rate cases, the
21 prudence of historical costs are examined when setting future rates. The future rates are
22 supposed to reflect prudently incurred historical test year costs plus "known and

Direct Testimony of
Ryan Kind

1 measurable” changes in the future level of costs. Since many of the future changes in
2 costs will not be known and measurable at the time when rates are set, the utility will be
3 at some risk for recovering these costs and that risk will be reflected in the rate of return
4 that is incorporated into the future rate level.

5 When rates are set through the PGA/ACA process, the initial PGA rates will be set based
6 on historical costs, but these rates are later true-up through the ACA process to reflect
7 the actual costs that were prudently incurred. Thus, the utility is not at risk in the
8 PGA/ACA process for those cost changes that were either not anticipated or not known
9 and measurable at the time initial rates were set. This risk reduction was, of course the
10 main rationale for creating the PGA. The PGA was initiated in a pre FERC 636
11 environment where it was argued that utilities had little, if any, control over gas
12 procurement costs and therefore needed a mechanism where they could transfer the risk
13 of gas price fluctuations from themselves to the customers they served.

14 **Q YOU HAVE DESCRIBED HOW THE TRUE-UP MECHANISM USED IN THE PGA/ACA**
15 **PROCESS LOWERS THE RECOVERY RISK THAT CAN ARISE FROM ACTUAL FUTURE**
16 **COSTS DIFFERING FROM THE HISTORICAL COSTS ON WHICH RATES ARE BASED (COST**
17 **RISK). IS THERE ANOTHER TYPE OF RECOVERY RISK THAT IS REDUCED OR**
18 **ELIMINATED BY THE PGA/ACA TRUE-UP MECHANISM?**

19 **A.** Yes. The PGA/ACA true-up mechanism greatly reduces the volumes risk faced by gas
20 utilities. When utilities use a PGA/ACA mechanism, they are only subject to volumes
21 for the non-gas procurement costs that are recovered through general rate cases.

22 **Q PLEASE EXPLAIN WHY UTILITIES ARE SUBJECT TO VOLUMES RISK FOR COSTS**
23 **RECOVERED THROUGH GENERAL RATE CASES.**

Direct Testimony of
Ryan Kind

1 A. In general rate cases, future rates are set based on the volumes of gas that are expected to
2 be consumed in a normal weather years with some possible exceptions for known and
3 measurable future changes in volumes. In their simplest form, rates are equal to the
4 revenue requirement divided by the expected level of future volumes. Actual volumes
5 vary from expected future volumes, due primarily to deviations of actual weather from
6 normal weather. Because of the deviation of actual volumes from expected volumes (and
7 other factors unrelated to volumes risk, such as increases or decreases in the overall
8 efficiency of utility operations), the utility never recovers its Commission determined
9 revenue requirement in the future, but instead receives some amount greater or less than
10 the Commission determined revenue requirement.

11 **Q PLEASE EXPLAIN HOW VOLUMES RISK IS LARGELY ELIMINATED BY THE PGA/ACA**
12 **PROCESS.**

13 A. PGA rates are set based on the expected level of future volumes in a normal weather
14 year. However, during the ACA process, the utility is made whole for any under or over-
15 recovery of prudently incurred costs by determining an adjustment that needs to be made
16 to future rates to make up for any past over or under-recovery amounts. This over or
17 under-recovery is usually due to both the divergence of actual costs from expected costs
18 and the divergence of actual volumes from expected volumes. The ACA process of
19 compensating the utility for under-recoveries and compensating the ratepayers for over-
20 recoveries eliminates both the volumes and cost risk that the utility would otherwise face.

21 **Q ARE GAS UTILITIES ALLOWED TO EARN PROFITS ON THEIR GAS PROCUREMENT**
22 **ACTIVITIES?**

23 A. Some gas utilities are currently allowed to retain a portion of the profits that they earn as
24 part of the gas procurement process in accordance with Commission approved incentive

Direct Testimony of
Ryan Kind

1 plans. Laclede did not, however, have an incentive plan in place for the time period that
2 is covered by this ACA docket.

3 **Q DOES PUBLIC COUNSEL BELIEVE THAT IT WAS IMPROPER FOR LACLEDE TO MAKE**
4 **OFF-SYSTEM SALES THAT UTILIZED GAS CONTRACTS THAT HAD BEEN ENTERED INTO**
5 **FOR THE PURPOSE OF PROVIDING SERVICE TO ITS NATIVE LOAD CUSTOMERS?**

6 A. No. To the contrary, Public Counsel believes that it would have been imprudent for
7 Laclede not to have made off-system sales where it could offset the costs of providing
8 service to native load customers without adversely impacting the reliability of late winter
9 gas supplies. OPC's difference with Laclede is not about whether or not it should have
10 made off-system sales that had \$3,569,843 in net revenues associated with them. Public
11 Counsel's difference with Laclede concerns whether the Company or the ratepayers
12 should benefit from these net revenues. This difference stems from OPC's beliefs that:
13 (1) it was totally inappropriate for Laclede to attempt to retain profits from an area of
14 their operations where most of the risk is borne by ratepayers due to the PGA/ACA
15 mechanism and (2) it would have been imprudent for Laclede not to have pursued
16 reasonable opportunities to offset some of its gas procurement costs with off-system
17 sales.

18 **Q PLEASE EXPLAIN IN GREATER DETAIL OPC'S BELIEF THAT UTILITIES HAVE AN**
19 **OBLIGATION TO TAKE ADVANTAGE OF OFF-SYSTEM SALES OPPORTUNITIES WHERE**
20 **THESE SALES CAN OFFSET THE COSTS OF PROVIDING SERVICE TO NATIVE LOAD**
21 **CUSTOMERS WITHOUT ADVERSELY IMPACTING THE RELIABILITY OF LATE WINTER GAS**
22 **SUPPLIES.**

23 A. Off-system sales opportunities are the result of a utility having excess gas supplies. This
24 excess can occur in at least two ways. First, a utility may have contracted for more gas

Direct Testimony of
Ryan Kind

1 than it should have (even accounting for weather extremes). Second, a utility may have
2 contracted for a quantity of gas that was appropriate at a certain point in time (e.g. prior
3 to the peak usage season) but which is no longer appropriate at a later point in time (e.g.
4 later in the peak usage season when actual volumes are significantly below anticipated
5 volumes or when a portion of reserves are no longer needed to ensure adequate supplies
6 in the event of weather extremes).

7 When a utility has excess supplies for either of the reasons cited above, customers will
8 not be paying just and reasonable rates unless the utility undertakes all prudent actions to
9 market some of the extra capacity in order to offset some of its gas procurement costs. In
10 the first situation described above, the utility may still be subject to prudence
11 disallowances because it purchased too much capacity to start with, but the magnitude of
12 the disallowance would be tempered by the steps that it took to offset the costs associated
13 with its mistake. The second situation described above appears to be the source of the
14 \$3,569,843 adjustment that Public Counsel is recommending in this case.

15 **Q ARE YOU AWARE OF ANY PROVISIONS IN THE LACLEDE ACA TARIFFS THAT WERE IN**
16 **EFFECT DURING THE 1995/1996 ACA PERIOD THAT WOULD ALLOW LACLEDE TO**
17 **KEEP 100% OF THE PROCEEDS FROM OFF-SYSTEM SALES?**

18 A. No. In Public Counsel's view, such a provision would be inconsistent with the
19 responsibility of a public utility to provide safe and adequate service at just and
20 reasonable rates.

21 **Q ARE YOU AWARE OF ANY TARIFF PROVISIONS OR COMMISSION RULES THAT WERE IN**
22 **EFFECT DURING THE 1995/1996 ACA PERIOD THAT WOULD ALLOW LACLEDE EARN**
23 **UNREGULATED PROFITS FROM ASSETS THAT WERE PROCURED TO PROVIDE**
24 **REGULATED UTILITY SERVICE?**

Direct Testimony of
Ryan Kind

1 A. No.

2 **Q DO THE ELECTRIC UTILITIES REGULATED BY THIS COMMISSION GENERATE OFF-**
3 **SYSTEM SALES REVENUES AS PART OF THEIR NORMAL OPERATIONS?**

4 A. Yes, all of the electric utilities regulated by this Commission generate off-system sales
5 revenues. If they did not, it would be obvious that they were neglecting opportunities to
6 earn net revenues that could offset the cost of procuring electricity supplies for their
7 customers.

8 **Q YOUR PREVIOUS RESPONSE SEEMED TO IMPLY THAT THE COMMISSION CONSIDERS**
9 **THE PROCEEDS FROM ELECTRIC UTILITY OFF-SYSTEM SALES WHEN SETTING RATES**
10 **FOR ELECTRIC UTILITIES. IS THAT CORRECT?**

11 A. Yes, the Commission's policy in this area was questioned by Missouri Public Service
12 (MPS) in its last rate case, Case No. ER-97-394. In that case, MPS proposed that its
13 future rates reflect only 50% of the off-system sales that had occurred in the historical
14 test year. The Commission's order in Case No. ER-97-394 rejected MPS's proposal and
15 ordered that the full amount of test year off-system sales be used as an offset to test year
16 electric supply costs.

17 **Q PLEASE SUMMARIZE PUBLIC COUNSEL'S RECOMMENDATION FOR THE TREATMENT OF**
18 **THE OFF-SYSTEM SALES MADE BY LACLEDE DURING THE 1995/1996 ACA PERIOD.**

19 A. Public Counsel recommends that the \$3,569,843 in net off-system sales revenues that
20 were generated by Laclede during the 1995/1996 ACA period be used to offset the gas
21 procurement costs that were incurred by Laclede during the same period. The inclusion

Direct Testimony of
Ryan Kind

1 of \$3,569,843 in net off-system sales revenues as an offset to gas procurement costs will
2 cause Laclede's over-recovery amount for this period to be increased by \$3,569,843.

3 **Q PLEASE SUMMARIZE THE REASONS WHY OPC BELIEVES THAT ITS RECOMMENDATION**
4 **TO INCREASE LACLEDE'S OVER-RECOVERY AMOUNT IN THE 1995/1996 ACA PERIOD**
5 **BY \$3,569,843 IS APPROPRIATE.**

6 A. Public Counsel believes that Laclede's over-recovery amount for the 1995/1996 ACA
7 period should be increased by \$3,569,843 for the following reasons:

- 8 • The Company made \$3,569,843 in off-system sales during the 1995/1996 ACA
9 period.
- 10 • Laclede, like all other utilities faces an ongoing obligation to provide service to
11 the public at just and reasonable rates. Laclede would not have fulfilled its
12 public service obligations if it had not taken advantage of the considerable
13 opportunities that it had to offset gas procurement costs during the 1995/1996
14 ACA period by engaging in off-system sales.
- 15 • Commission regulated electric utilities have an ongoing responsibility to engage
16 in off system sales and pass 100% of the benefits from these sales on to
17 ratepayers (subject to the constraints of regulatory lag and retroactive
18 ratemaking).
- 19 • The PGA/ACA mechanism was created to transfer cost and volumes risk from
20 gas utilities to gas ratepayers. As a result of this risk transfer, the gas
21 procurement activities of well managed utilities are not subject to significant
22 downside risks so ratepayers, not shareholders, should receive the benefits from
23 opportunities to make off-system sales which offset gas procurement costs.

Direct Testimony of
Ryan Kind

1
2
3
4
5
6
7
8
9
10
11
12

- Laclede was not operating under a Commission approved gas procurement incentive plan during the 1995/1996 ACA period. If Laclede had been operating under such a plan, it presumably would have accepted some additional risk associated with its gas procurement operations that would have justified the Company's receipt of a share of the dollars associated with any increased gas procurement efficiencies that it was able to create.
- At the time when Laclede made \$3,569,843 in off-system sales during the 1995/1996 ACA period, there were no provisions in Laclede's tariffs or any generally applicable Commission rules or policies that would allow the Company's shareholders to retain the proceeds from these sales.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.