REBUTTAL TESTIMONY

OF

CARL KLEIN

ON BEHALF OF

SOUTH CAROLINA ELECTRIC & GAS COMPANY

DOCKET NO. 2003-2-E

Q. Please state your name.

A. Carl Klein

Q. Have you previously filed direct testimony in this case?

A. Yes.

Q. What is the purpose of your rebuttal testimony?

A. My testimony is in rebuttal of two particular categories of adjustments made by the Staff to the Company's accounting of (over)under-recovered fuel costs. These adjustments are described in Section (4) (d) on pages 6 and 7 of the testimony of Staff Witness Jacqueline R. Cherry and in Footnote (4) (d) to Audit Exhibit G, on pages 4 and 5 of that exhibit.

Q. As a preface to your testimony, please explain the various types of power purchases that SCE&G makes.

A. SCE&G, like other vertically integrated electric utilities, may make purchases of electric capacity or electric energy. A capacity purchase entitles SCE&G to call upon the supplier for electrical energy, but it does not require SCE&G to purchase energy. Such a capacity purchase would be made as a reliability measure, to secure the necessary level of seasonal or daily reserves. SCE&G might buy a capacity reservation with firm transmission path reservations bundled with it, or SCE&G

might buy the capacity in one transaction and the firm transmission reservation in another, but in either arrangement, the capacity and wheeling expenses are part of SCE&G's fixed costs of doing business, similar to the cost of owning generating plants and our transmission system, and as such are recovered through the Company's base rates. These purchases do not flow through the fuel clause and are not an issue in this case.

We are concerned in this case only with economic purchases, purchases of electrical energy that are made because SCE&G can sometimes purchase energy and get it delivered to its transmission system for less than it can produce the energy with its own generation. Such purchases allow the Company to serve its customers with the mix of generated and purchased energy that is achieved at the least cost. Such economic purchases of energy and the transmission paths to deliver that energy are included for recovery through the fuel clause. I have attached as Exhibit No.___ (CK Rebuttal Ex.-1) my rebuttal testimony filed with this Commission in SCE&G's 2002 fuel clause hearing (Docket No. 2002-2-E). This testimony elaborates on economic purchases and the analysis we conduct to make economic purchases.

Q. What is the first category of the Audit Staff's adjustments that you oppose?

The Staff in its Audit Report and testimony suggested the reduction of the Company's accounting of underrecovery by $857,514.00 of delivery charges for purchased power called wheeling charges. The Company incurs wheeling charges whenever it reserves a transmission path either for a capacity purchase undertaken to provide required reserves or for a purchase of electrical energy made for economic reasons, to displace energy it might generate itself but only at a greater cost. As I mentioned above, the

1 Company does not include either capacity charges or wheeling charges for capacity
2 purchases in the fuel clause, but it does include wheeling charges to transport
3 economic energy purchases. These are necessary transportation expenses incurred by
4 some party whenever power is purchased and they are included for recovery through
5 the fuel clause.

6 **Q. How and why does the Company incur wheeling charges in the process of**
7 **purchasing economic power for delivery to its native customers?**

8 A. When our marketers purchase more economical power from some source
9 originating outside SCE&G's transmission system, arrangements must be made to
10 allow transportation of that power to us. When the marketers representing a seller
11 and a buyer strike a deal, they always settle several important points, such as price,
12 quantity, beginning and ending times, and the point of delivery (typically the interface
13 between two interconnected transmission systems) for the power. The seller has
14 responsibility for the cost and effort necessary to move the power to the point of
15 delivery and the buyer has responsibility for moving the power from the point of
16 delivery.

17 When the Federal Energy Regulatory Commission reformed the wholesale power
18 markets in 1996 it required electric transmission service to be offered by transmission
19 owners through a standard tariff called the Open Access Transmission Tariff (OATT),
20 and it required transmission customers to acquire transmission services at FERC-
21 approved rates under OATT terms and conditions. It became common practice for
22 SCE&G's marketers to buy purchased power delivered to its system so that the seller
23 had the responsibility to reserve and pay for transmission reservations on all

1 transmission systems that the power had to leave or cross on its way to us. Sellers
2 would price power to us on a "delivered" basis—that is, they would quote a price that
3 presumably would cover all their costs, including costs for electric transmission. If
4 such an offer was accepted and the power delivered, then the seller would include on
5 his invoice the MWH delivered and the cost per MWH, and if our records agreed, we
6 paid the bill. Electric transmission charges were thus incurred, paid, and recovered
7 by the seller and ultimately but not explicitly paid by SCE&G, the buyer. They were
8 not explicitly paid by the buyer, because they were not explicitly identified in any bill
9 the buyer ever saw, but the transmission costs were nevertheless incurred by the
10 seller, included in SCE&G's payment, and recovered by SCE&G through inclusion of
11 purchased power through the fuel clause.
12 **Q. Has something happened to cause you to change your power purchasing**
13 **practices?**
14 A. Under some circumstances, yes. Since the summer of 2000 the southeast region
15 of the US has been experiencing an increasing number of TLR (Transmission
16 Loading Relief) conditions, wherein regional Security Coordinators would order
17 transactions to be "cut" (interrupted and cancelled) in order to reduce loading on
18 certain parts of the interconnected transmission system. Most of the problems
19 originated in systems to the west of us, but loop flows affected systems throughout
20 the region, and we found that our economic purchases began to be cut. According to
21 FERC rules, transactions are cut in order of the security of the transmission path
22 purchased, so all non-firm transmission paths were cut before firm paths, daily firm
23 paths were cut before weekly firm, weekly firm before monthly, and so forth. It

1 became important to predict when we were likely to be subject to TLRs and to have
2 firm paths for our purchases at those times. But we also noticed that when we asked
3 sellers to make firm path reservations (which are more costly) when they delivered,
4 they tended (correctly) to take it as a signal that our need was serious, and so they
5 demanded higher prices for the power. As a strategy to preserve our delivery paths
6 but avoid sending signals into the marketplace that would cause sellers to raise their
7 prices, SCE&G decided in some cases to make its own purchases of firm transmission
8 pathways separate from its power purchases. We would ask the seller to price power
9 delivered just to his border, not ours, and then we would use our own transmission
10 reservation, which we had previously arranged.
11 We believe that this has been a very effective strategy for keeping purchased power
12 costs down. By using firm paths we run less risk of having purchases cut. By
13 making our own transmission reservations we avoid signaling our situation to
14 potential sellers. And by occasionally buying longer-term transmission reservations
15 we actually get firm transmission service for less than would be the case if firm paths
16 were purchased (by us or by the seller) on a daily basis, concurrent with most of the
17 power purchases that we flow over these paths. To illustrate this last point, let me
18 point out that the average wheeling charge for the MWHs delivered for the $857,514
19 the Audit Staff seeks to exclude is about $2.37 per MWH. Compare that to the
20 effective per-MWH transmission charge for power delivered in a typical daily on-
21 peak (sixteen-hour) schedule using a daily firm reservation on the following systems:
22 CP&L--$2.99; Duke Power--$3.60; Southern Company--$5.61; SCPSA--$5.63. Our
23 wheeling purchasing practices have saved our customers transmission costs necessary

1 to deliver the power in addition to allowing us to purchase the power itself more
2 cheaply.
3 When we began purchasing transmission separately we made Ms. Cherry aware of
4 the issue, and she asked us to identify Wheeling Charges for Purchases in our
5 monthly reporting, and we have done so consistently. We have also made available
6 to her the accounting processes whereby we separate the uses of our transmission
7 purchases into transportation of power for use by native load customers and
8 transportation for resale, so that only that portion of our wheeling charges that
9 actually served native load customers are included for recovery.
10 **Q. Do you believe that these charges should be recovered through the fuel**
11 **clause?**
12 A. Yes, I do. Consider that our primary fuel, coal, is of no use to our customers until
13 it is on the pile at a plant. Coal has to be transported, and coal transportation costs are
14 included in the fuel clause whether we purchase the coal on an as-delivered basis or
15 we buy it at the mine mouth and make our own separate arrangements for
16 transportation. However the transportation is acquired, as long as it is properly
17 accounted and prudently accomplished, the expense is recovered through the fuel
18 clause. The wheeling charges we seek to include are exactly analogous to charges we
19 incur when we buy coal transportation as a separate transaction. Since our wheeling
20 purchases have been prudent, our accounting has been thorough and reported as Ms.
21 Cherry requested, and the objective of least cost power supply for our customers has
22 been achieved, those expenses should also be included in fuel clause accounts as one
23 of the fuel costs of purchased power.

1 **Q. Is the Audit Staff correct in observing that the Company books these**
2 **wheeling expenses in Account 565 (Transmission of Electricity by Others)**
3 **instead of in Account 555 (Purchased Power), in the FERC Uniform System of**
4 **Accounts?**
5 A. The observation about the location of our booking is accurate but it is not relevant
6 for deciding the question of recovery of these expenses through the Fuel clause. The
7 Uniform System was set up decades ago, long before FERC's recent overhaul of
8 electric transmission markets. And separate identification of data in the FERC
9 system does not necessarily imply separate or different treatment in regulatory
10 decisions. As a matter of fact, FERC itself allows the recovery of wheeling charges
11 in the fuel accounts subject to its jurisdiction.
12 Ms. Cherry noted that the Uniform System of Accounts was "adopted by this
13 Commission for Electric utilities." Most state commissions have adopted the
14 Uniform System as a convenient way of organizing accounting information, but that
15 does not imply that any commission has adopted the title attached to any particular
16 account number in the Uniform System as a rule for determining what use to make of
17 any part of that accounting data.
18 **Q. What is the other of the Audit Staff's adjustments that you wish to address?**
19 A. The Audit Staff made downward adjustments amounting to $5,012,249.00 to
20 purchased power costs from Duke Power Company and Carolina Power and Light
21 Company in a manner that is not consistent with past practice nor with the ruling of
22 this Commission in this same proceeding last year. To do so, Staff rejected the
23 avoided generation cost measure of the prudence of power purchases in the cases of

1 these two sellers, who submitted a total of 24 invoices over the year, but Staff
2 retained and applied a refined version of that avoided generation cost standard in all
3 173 of the other invoices the Company received and paid during the year.
4 In its ruling in last year's proceeding, the Commission recognized the fact that most
5 bulk power sellers either cannot or will not identify their fuel costs to their customers.
6 Since fuel portions of purchased power costs cannot or will not be provided by most
7 sellers of bulk power, and since such fuel costs as are reported by the minority of
8 sellers are not subject to test and verification, Staff and the Company both defended
9 the existing practice of testing the prudence of power purchases by comparing their
10 cost to the recorded avoided generation cost that would have been incurred by the
11 purchasing utility if it had not made the purchase. Avoided generation cost records
12 are subject to audit and test. They are certainly relevant to the issue of fuel (since fuel
13 consumption is the largest part of the generation cost that is avoidable). And they
14 relate directly to the underlying objective of the basic idea behind regulating fuel
15 costs separately from other utility costs: motivating utilities every day to provide
16 power to their customers at the least cost without either interfering with the interests
17 of their shareholders or inviting interference from their shareholders. If costs are
18 passed through, then shareholders have nothing to gain or lose. If the costs that are
19 passed through can be determined to be the lowest that could be achieved, then the
20 interests of the customers are assured. If the interests of the customers and the
21 shareholders are not at odds with each other, then the motivations of utility personnel
22 are clear and unambiguous. The Commission ruled that the avoided generation cost

1 was the appropriate proxy to test purchased power expenses for recovery through the
2 fuel clause.
3 **Q. What alternative procedure did the Audit Staff apply to the 24 invoices that**
4 **concern you in this case?**
5 A. Duke Power and Carolina Power and Light included with their monthly bills to
6 SCE&G statements of fuel components of their sales to us. For those invoices, and
7 those only, the Staff identified the proportion of total energy billed that was
8 ultimately delivered to native load customers (some is usually sold away in further
9 wholesale transactions), and applied that proportion to the fuel charges stated on the
10 bill, allowing recovery of that product and in effect disallowing the recovery of the
11 difference between that amount and the total bill for the power that went to native
12 customers. That disallowance, as I pointed out earlier, amounted to over five million
13 dollars.
14 **Q. Does SCE&G know how Duke Power and Carolina Power and Light**
15 **calculate the fuel component shown on their invoices?**
16 A. No.
17 **Q. Did your Company provide fuel cost data to Duke Power and Carolina**
18 **Power and Light in your invoices to them?**
19 A. We provided a dollar amount called "Fuel" on each invoice. It is important to
20 understand how we arrive at those figures.
21 SCE&G does a thorough sources-and-uses analysis each day that identifies each
22 MWH as to its source and assigns each MWH to a particular use. Each MWH that is
23 assigned to serve a sale to either Duke Power or Carolina Power and Light is either

1 generated out of some plant on our system or else it has been purchased from some
2 other supplier. We can identify the cost of the fuel burned to generate each MWH
3 that comes from our system. However, for every MWH that comes from some other
4 supplier and is resold by SCE&G to Duke Power or Carolina Power and Light, we
5 know only a purchase cost. At the end of the month we add up all the fuel costs for
6 the energy we generated and all the purchase costs for the energy we bought and
7 resold, and the total is reported as "Fuel." Our reported fuel numbers are thus usually
8 a blend of our fuel and our purchased power costs, the actual fuel components of
9 which are unknowable. We report a simple total.
10 Sometimes the proportion of our generated energy is very small. For instance, in
11 May of 2002 only seven of the 648 MWH we sold to Carolina Power and Light were
12 generated in our plants. We reported $25,063.78 as the fuel cost for that month, but
13 only $309.68 of that was the cost of fuel burned in our plants. All the rest of the
14 supply was purchased power reported at our cost to acquire. The Audit Staff would
15 not have been able to break our fuel report into components on the basis of the
16 invoice Carolina Power and Light received.
17 Our invoice to Duke Power for August of 2002 presents a different sort of dilemma
18 for the Audit Staff's method: we reported a fuel cost that was actually $5,389.28
19 higher than the total invoice amount. We generated only 617 of 1,512 MWH on the
20 invoice and purchased the rest. In the case of one transaction for 800 MWH we
21 agreed to sell for a particular price, expecting to purchase energy at a lower cost. But
22 the market developed otherwise and so SCE&G shareholders had to take a loss on the

1 transaction, as happens from time to time. But we included the full cost of our
2 purchases in our reported fuel cost, according to our standard method.
3 Our reports of fuel expense on our invoices to Duke Power and Carolina Power and
4 Light reflect the underlying cost recovery problem in this issue: most power suppliers
5 either cannot or will not identify their fuel costs, and so when we resell purchased
6 power the only information we have available to report is the purchase price. Neither
7 Duke Power nor Carolina Power and Light nor the Audit Staff is able to tell from our
8 invoices what the true underlying fuel cost is for the power we sell them because we
9 do not know it ourselves. The only issue on which the purchase decision rides is
10 whether the cost to acquire the purchased energy is less than it would cost either to
11 generate it or to purchase it from someone else.
12 **Q. Does SCE&G know whether Duke Power or Carolina Power and Light sell**
13 **to SCE&G out of their own generation and also out of purchased power which is**
14 **resold to SCE&G?**
15 A. I presume that they do, but I cannot determine that from their invoices. We only
16 see that Duke Power and Carolina Power and Light each identify a single dollar
17 amount each month that they label "Fuel." SCE&G, Duke, and Carolina Power and
18 Light all face the same information predicament. For that reason, SCE&G regards
19 these reported numbers as untested and unverifiable, at least from the data available
20 to us. In contrast, the avoided generation cost data SCE&G keeps for each purchase
21 each hour have been made available for examination and testing in detail.
22 **Q. Did the Audit Staff apply the avoided generation cost standard to the other**
23 **173 invoices you received during the year?**

1 A. I am certain that the Audit Staff did. During Ms. Cherry's audit review Staff
2 requested that an adjustment be made to our recorded avoided generation costs. Our
3 avoided generation costs include fuel (the largest part), SO2 allowance costs (for
4 coal-fired generation), and other variable operating costs. Because S. C. Code 58-27-
5 865 includes SO2 allowance costs as recoverable but does not mention other variable
6 operating costs, Staff believed that avoided generation costs would be a more precise
7 proxy for fuel costs associated with purchased power if we could remove the other
8 variable operating cost component. That is the calculation would further refine the
9 avoided cost proxy approved by the Commission in Docket 2002-2-E. Staff Witness
10 A. R. Watts discussed this issue in his testimony.
11 Because the Company could not do this in the time available for each of the
12 thousands of avoided cost records it accumulated over the year individually, a method
13 was utilized for estimating the average per-MWH other variable operating cost
14 component for each month, so that Staff could apply month-specific adjustments to
15 the avoided generation costs associated with each monthly invoice to us. We
16 prepared the monthly analyses, Ms. Cherry reviewed the results, and she also
17 reviewed with us in detail the preparation of the data for each of the three months she
18 had previously selected for detailed review in regard to other accounts.
19 Subsequent to our provision of that data, the Audit Staff reduced our reported avoided
20 generation costs by the other variable operating costs for each invoice in each month
21 and then tested the outlays we proposed to collect against the lower adjusted avoided
22 generation costs. Mr. Watts in his testimony confirms that these adjusted numbers
23 were "used by the Audit Staff in determining the proper fuel expense for the period"

1 (p. 4, ll. 5-6). In some cases our outlays exceeded the adjusted avoided generation
2 cost, and Staff marked the differences for disallowance.
3 The Commission may agree with Mr. Watts and approve this refinement to the
4 avoided generation cost proxy approved in Commission Order No. 2002-347 (Docket
5 No. 2002-2-E), and the Company is not contesting those disallowances, but the
6 Company does object to all the disallowances proposed for the Duke Power and
7 Carolina Power and Light purchases. The Company has carefully observed the
8 Commission ruling and has carefully and faithfully maintained and presented
9 thorough avoided generation cost records. It has cooperated in the adjustment of
10 those records at Staff request. And it is not contesting any disallowances based on its
11 avoided cost records, even after the late adjustment.
12 However, the Company does not support an unprecedented departure from the
13 approved, appropriate and designated standard. Such a departure results in
14 adjustments based on untested data, relied upon in a selective manner. SCE&G's
15 purchases from Duke Power and Carolina Power and Light were appropriately
16 contracted for, justified, accounted, and paid for, and SCE&G should not be subjected
17 to large disallowances because of a departure from Commission approved practices.
18 **Q. What is your recommendation for the Commission?**
19 A. The Commission should reject the Audit Staff's proposed disallowance for
20 wheeling expenses in the amount of $857,514 and its proposed disallowances for
21 power purchased from Duke Power and Carolina Power and Light amounting to
22 $5,012,249.
23 **Q. Does this conclude your testimony?**

1 A. Yes.