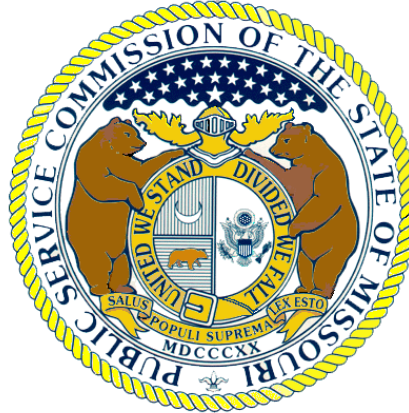


BEFORE THE PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI



In the Matter of Atmos Energy)
Corporation's 2008-2009 Purchased Gas)
Adjustment and Actual Cost Adjustment)

File No. GR-2009-0417

REPORT AND ORDER

Issue Date: December 21, 2011

Effective Date: January 20, 2012

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OF THE STATE OF MISSOURI**

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Appearances

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Robert S. Berlin, Senior Counsel, P.O. Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

Mark D. Poston, Deputy Public Counsel, P.O. Box 2230, Jefferson City, Missouri 65102, for The Office of the Public Counsel.

REGULATORY LAW JUDGE: **Morris L. Woodruff, Chief Regulatory Law Judge**

REPORT AND ORDER

FINDINGS OF FACT

The Missouri Public Service Commission, having considered all the competent and substantial evidence upon the whole record, makes the following findings of fact. The positions and arguments of all of the parties have been considered by the Commission in making this decision. Failure to specifically address a piece of evidence, position, or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision.

Procedural History

This Report and Order concerns the second phase of the two-phase PGA/ACA process. During the initial Purchased Gas Adjustment (PGA) phase, Atmos Energy Corporation (Atmos) adjusted the rates it charged its customers to allow it to recover its varying costs of acquiring a supply of natural gas to serve those customers. Now, in the Actual Cost Adjustment (ACA) phase of the process, the Commission is examining Atmos' natural gas purchases to determine whether the rate the company charged its customers was correct and whether the decisions the company made regarding its gas purchases were prudent.

For purposes of this case, the Commission's Staff conducted a review of Atmos' billed revenues and its natural gas costs for the period of September 1, 2008, to August 31, 2009. On December 30, 2010, Staff filed its recommendation regarding the actual cost adjustment for Atmos for the specified period.

Staff initially recommended the Commission disallow \$413,165 in gas costs for Atmos' Hannibal service area and \$81,852 in gas costs for the Butler service area. The proposed disallowances represent Staff's calculation of the amount of profit earned by Atmos' gas marketing affiliate – Atmos Energy Marketing (AEM) – on sales of gas to Atmos. Staff's underlying concern about AEM's sale of gas to Atmos was its inability to determine whether the gas packages bought by AEM to provide service to Atmos were firm or interruptible packages of gas. Because it could not make that determination from the information supplied by Atmos, Staff proposed to disallow from Atmos' costs all profits AEM earned on the transaction.¹

Atmos responded to Staff's recommendation on February 2, 2011. Atmos objected to Staff's proposed disallowance of the profits AEM earned on its sales of gas to Atmos. Atmos explained that AEM submitted the lowest and best bids for those transactions in competition with other, unaffiliated gas marketing companies. On that basis, Atmos contends there is no reason for the Commission to disallow the profits AEM earned on the transactions.

Thereafter, the Commission established a procedural schedule whereby Atmos and Staff prefiled direct, rebuttal, and surrebuttal testimony. An evidentiary hearing was held on

¹ Sommerer Direct, Ex. 16, Schedule 2.

September 14, 2011. Atmos, Staff, and the Office of the Public Counsel filed post-hearing briefs on October 28, 2011, followed by reply briefs on November 14, 2011.

The Disallowance Proposed by Staff

1. In its December 30, 2010 recommendation, Staff asked the Commission to disallow \$413,165 in Atmos' gas costs for the Hannibal service area and \$81,852 in gas costs for the Butler service area, for a total disallowance of \$495,017.² By the time Staff filed its direct testimony, it had recalculated its proposed disallowance to \$401,226.61.³ Staff further reduced its proposed disallowance in its surrebuttal testimony when it accepted AEM's representation that it had overhead expenses on the questioned transactions of approximately \$64,000, not including any profit. On that basis, Staff reduced its proposed disallowance to \$337,226.61.⁴

2. The disallowance Staff has proposed in this case is closely related to the disallowances it proposed in File No. GR-2008-0364, Atmos' ACA case for the previous year. By agreement of the parties, the evidentiary record from that earlier case was incorporated into the record for this case.⁵

3. On November 9, 2011, after the hearing of this case, the Commission issued a report and order in GR-2008-0364 that rejected the disallowances Staff proposed in that case. The Commission denied Public Counsel's Application for Rehearing regarding that report and order on November 30, 2011.

Background Facts

² Sommerer Direct, Ex. 16, Page 14, Lines 22-23.

³ Sommerer Direct, Ex. 16, Page 15, Lines 18-20.

⁴ Sommerer Surrebuttal, Ex. 18, Pages 10-11, Lines 19-23, 1-5.

⁵ Transcript, Pages 237-238, Lines 19-25, 1-11. All footnotes in this order refer to the record in GR-2009-0417 unless otherwise indicated.

4. Atmos Energy Corporation (referred to in this report and order simply as Atmos) operates in Missouri as a regulated natural gas local distribution company, sometime referred to as an LDC. Atmos operates in many states and its Missouri LDC operations are part of its Kentucky/Mid-States division.⁶

5. As an LDC, Atmos obtains supplies of natural gas from natural gas producers and distributes that natural gas to homes and businesses within its service territory. Within Missouri, Atmos provides natural gas service to customers in three geographic areas: Northeastern, Southeastern, and Western. Within each area, Atmos serves customers through one or more operating systems.⁷ Staff has proposed disallowances relating to two of those operating systems during the course of this case.

6. The first affected operating system is the Consolidated Hannibal-Canton-Palmyra-Bowling Green operating system within the Northeastern area. That system serves over 13,000 customers, of which approximately 11,500 are residential customers. Natural gas is delivered to this operating system through the Panhandle Eastern Pipeline.⁸

7. The second operating system for which Staff proposed a disallowance is the Butler system, within the Western area. It serves approximately 3,500 customers, most of which are residential customers. It is also receives natural gas through the Panhandle Eastern Pipeline.⁹

8. In addition to its regulated operations as an LDC, Atmos also owns Atmos Energy Marketing, LLC (AEM), a separate, unregulated gas-marketing company.¹⁰

⁶ Buchanan Direct, Ex. 1, Page 1, Lines 7-8.

⁷ Buchanan Direct, Ex. 1, Page 4, Lines 1-3.

⁸ Buchanan Direct, Ex. 1, Page 4, Lines 11-15.

⁹ Buchanan Direct, Ex. 1, Page 6, Lines 1-3.

¹⁰ Sommerer Direct, Ex. 16, Page 5, Lines 1-9.

9. Atmos holds long-term contracts with various interstate pipelines for natural gas storage and transportation capacity to supply the firm natural gas requirements of its Missouri service areas.¹¹ Atmos does not produce its own natural gas and does not purchase that gas directly from producers. Instead, Atmos contracts with independent gas-marketing companies to purchase the natural gas that is then flowed through the interstate pipeline using Atmos' pipeline capacity. Gas suppliers are selected through a competitive bidding process.¹²

Atmos' Use of Gas Marketing Companies to Procure its Gas Supply

10. Atmos uses the services of independent gas-marketing companies to purchase its natural gas because it does not have the in-house expertise needed to perform the gas marketing services provided by those companies.¹³

11. If it were to undertake its own gas-marketing services using its own, in-house employees, Atmos would need to hire or train additional personnel at a substantial cost and develop processes already used by independent gas marketers to secure gas supplies and transport gas through the interstate gas pipeline system.¹⁴

12. In-house gas-marketing employees would still need to negotiate and contract for the purchase and transport of natural gas supplies. Market forces would still determine the price of gas and the cost to transport that gas, just as market forces determine those prices when independent marketing companies purchase them. Gas-marketing companies can aggregate all of their customers' gas requirements and therefore purchase larger

¹¹ Buchanan Direct, Ex. 1, Page 6, Lines 9-11.

¹² Buchanan Direct, Ex. 1, Page 6, Lines 11-14.

¹³ Buchanan Direct, Ex. 1, Page 22, Lines 6-10.

¹⁴ Buchanan Direct, Ex. 1, Page 22, Lines 14-17.

amounts of gas from suppliers and obtain better gas prices than utilities.¹⁵ For that reason, it is unlikely that large natural gas producers would be willing to sell natural gas directly to Atmos in the small baseload quantities that the company would purchase for its relatively small service areas¹⁶ In fact, if an upstream supplier of natural gas wanted to sell gas directly to Atmos it could submit a bid to do so under Atmos' RFP process.¹⁷

13. On the basis of those facts, Atmos contends that its fully distributed cost of providing gas-marketing services through its own employees would exceed the market price for those gas-marketing services as established by a competitive bidding process among gas marketing companies.¹⁸

14. Staff does not challenge Atmos' decision to purchase its gas supplies through gas marketing companies rather than by using in-house gas marketing experts.¹⁹ Staff does not seek to disallow Atmos' costs associated with acquiring its gas supply through the services of unaffiliated gas marketing companies.²⁰ Thus, it is apparent that Staff's concern is only with Atmos' affiliated transactions and not with Atmos' decision to obtain its gas supplies through gas marketing companies rather than by purchasing those supplies using in-house gas marketing personnel.

15. Based on the foregoing facts, the Commission finds that Atmos' fully distributed cost of providing gas-marketing services through its own employees would exceed the market price for those gas-marketing services as established by a competitive bidding process among gas marketing companies.

¹⁵ Buchanan Surrebuttal, Ex. 3, Pages 4-5, Lines 20-23, 1.

¹⁶ Transcript, Page 118, Lines 8-16.

¹⁷ Buchanan Surrebuttal, Ex. 3, Page 7, Lines 13-17.

¹⁸ Buchanan Direct, Ex. 1, Page 22-23, Lines 22, 1-2.

¹⁹ Transcript, Page 195, Lines 8-17.

The Competitive Bidding Process

16. Atmos awards contracts to gas marketing companies using a competitive bid process. Under that process, Atmos issues a request for proposal - an RFP – and interested suppliers submit confidential bids with their proposed pricing for the gas supply services. Atmos evaluates the bids and awards the contract to the company that offers the best bid for reliable supply at the least cost.²¹

17. Atmos used the same RFP process to obtain competitive bids for gas supply service contracts to serve each of its eight operating systems in Missouri. During the 2008-2009 ACA period (September 1, 2008 – August 31, 2009), Atmos awarded contracts for the Hannibal-Bowling Green and Butler operating systems – the two operating systems that are at issue in this case – to nonaffiliated, gas-marketing companies.²² However, during the previous ACA period (September 1, 2007 – August 31, 2008) Atmos awarded contracts for those two operating systems to its affiliate, AEM. A portion of those agreements entered into in the previous ACA period carried over into the ACA period at issue. Those portions of those agreements are at issue in this case.²³

18. For the Hannibal-Bowling Green operating system, the challenged supply-only agreement with AEM was in effect from April 1, 2008, to March 31, 2009. For the Butler operating system, the challenged supply-only agreement with AEM was in effect from November 1, 2007 to October 31, 2008.²⁴

19. For the Hannibal-Bowling Green April 2008 gas-supply agreement, Atmos sent an RFP letter to sixty companies. It received bids from four gas-marketing companies.

²⁰ Transcript, Page 222, Lines 20-25.

²¹ Buchanan Direct, Ex. 1, Page 6, Lines 14-17.

²² Buchanan Direct, Ex. 1, Page 12, Lines 1-12.

Three of those bids were considered to be conforming.²⁵ AEM submitted the lowest bid and was awarded the contract.

20. The amount bid by AEM for the Hannibal-Bowling Green gas-supply agreement was approximately \$235,000 lower than the bid submitted by the next lowest conforming bidder. That difference amounts to about two percent of the total gas cost under the contract.²⁶

21. For the Butler November 2007 gas-supply agreement, Atmos received bids from six gas-marketing companies. AEM submitted the lowest bid and was awarded the contract.²⁷

22. For the Hannibal-Bowling Green April 2009 gas supply agreement, Atmos again sent an RFP letter to approximately 60 gas-marketing companies. It received bids from only two companies and only one of those bids was conforming. AEM did not offer a bid on that agreement. Atmos awarded the contract to the unaffiliated company that submitted the low bid.²⁸

23. AEM does not dominate Atmos' bidding process. For the period 2004-2009, Atmos issued 48 RFPs for Missouri gas supply. AEM submitted the successful bid six times. That is consistent with the number of successful bids submitted by other major gas marketers.²⁹

Fair Market Value

²³ Sommerer Direct, Ex. 16, Page 13, Lines 13-22.

²⁴ Sommerer Direct, Ex. 16, Page 13, Lines 14-22.

²⁵ Transcript, Pages 58-59, Lines 22-25, 1-12. See also, Buchanan Direct, Ex. 1, Attachment 2.

²⁶ Transcript, Pages 59-60, Lines 13-25, 1.

²⁷ Buchanan Direct, Ex. 1, Attachment 2.

²⁸ Transcript, Page 60, Lines 2-16. See also, Buchanan Direct, Ex. 1, Attachment 2.

²⁹ From GR-2008-0364 - Buchanan Direct, Ex. 1, Page 12, Lines 15-20. The same chart is also found in GR-2009-0417 - Buchanan Direct, Ex. 1, Attachment 2.

24. Much of the testimony and effort put into this case by all parties concerns Staff's attempt to discern what it describes as a fair market value for Atmos' affiliate transactions with AEM. Staff's attempts to establish such a fair market value apart from the results of the bidding process are misguided.

25. All parties accept that fair market value of a good or service can be defined as the price that a seller is willing to accept and a buyer is willing to pay on the open market in an arms-length transaction.³⁰

26. Staff and Public Counsel contend that such a definition of fair market value does not apply to these transactions because, by definition, an affiliate transaction is not arms length. On that basis, Staff claims the need to audit the books and records of AEM to determine the fair market value of the transaction from AEM's perspective. Since AEM was unable to produce the documents Staff claims it needs to establish that fair market value, Staff asks the Commission to disallow all gross profits that AEM earned on the transaction.

27. Staff and Public Counsel's position ignores the existence of the bidding process in establishing the fair market value for the transaction. If AEM had not submitted a bid, or if it had not submitted the lowest bid, there would be no question that the bidding process established the fair market value of the transaction. Indeed, Staff did not propose any disallowance related to the contracts for Missouri gas supply in which an unaffiliated gas marketing company submitted the lowest and best bid³¹ and agreed that the bidding process would establish fair market value for those transactions.³²

³⁰ From GR-2008-0364 - Transcript, Page 627, Lines 21-25.

³¹ Transcript, Page 167, Lines 20-22.

³² For GR-2008-0364 - Transcript, Page 667, Lines 7-16.

28. Assuming the bidding process was fair and open, that bidding process established the fair market value for the affiliate transactions, just as it did for the transactions with non-affiliated gas marketing companies. Because of the bidding process, Atmos, and ultimately its ratepayers, will pay no more for the services of the affiliated gas marketing company than they would have paid to obtain the same services from an unaffiliated gas marketing company. In effect, it is the non-affiliated gas marketing companies bidding in the open market that establish the fair market value for the bids won by AEM as much as they do for the bids won by non-affiliated bidders. Absent some showing of insider-dealing to favor an affiliate in the bidding process or some showing of facts that cast doubt on the bidding process itself, there is no need for Staff to search behind the bidding process to try to establish an independent fair market value for the affiliate transactions, if any such determination were possible.

29. In Atmos' previous ACA case, GR-2008-0364, the Commission found that no party "presented evidence to establish a serious doubt about the fairness of the bidding process"³³ In this case, Staff attempts to cast doubt on that bidding process.

30. Staff asserts that the bidding process used by Atmos to award contracts for the Hannibal-Bowling Green and Butler systems was not "robust" because it attracted few bidders.³⁴ Atmos received three conforming bids for the April 2008 gas-supply contract for the Hannibal-Bowling Green system.³⁵ For the November 2007 gas-supply contract for the Butler system, Atmos received six bids.³⁶ Attachment 2 to Rebecca Buchanan's direct testimony is a chart summarizing the bids Atmos received in response to its RFP's for all of

³³ *In the Matter of the PGA/ACA Filing of Atmos Energy Corporation*, File No. GR-2008-0364, Report and Order, Page 11 (November 9, 2011).

³⁴ Sommerer Direct, Ex. 16, Page 19, Lines 4-5.

its operating systems between April 2004 and November 2009. An examination of that chart reveals that the submission of bids by three or six interested gas-marketing companies is well within an average range for that period.³⁷ Yet, Staff did not propose a disallowance relating to any of the gas-supply contracts awarded under the same RFP process, except for the contracts for which AEM submitted the winning bid.³⁸

31. Furthermore, for the April 2009 gas-supply contract for the Hannibal-Bowling Green system, Atmos' RFP process attracted only two bidders, only one of which was found to be a conforming bid.³⁹ AEM did not submit a bid for that contract and Staff did not propose a disallowance based on that RFP.⁴⁰ Clearly, Staff's concern is with the fact that the contract was awarded to an affiliated gas-marketing company rather than with the number of bidders attracted by the RFP process.

32. It is apparent that Staff's real concern is not with fair market price, AEM's record keeping, or even with the bidding process, rather it is about the actual relationship between Atmos, AEM, and the gas supplied by AEM. In short, Staff is concerned that AEM may have met its obligation to supply gas under its winning bids by providing Atmos with something less than firm gas supplies.

The Provision of Gas Supplies

33. A local distribution company such as Atmos must transport its natural gas supplies from the gas producing areas of the country to its service area through one of several interstate natural gas pipelines. For both the Hannibal-Bowling Green and Butler

³⁵ Transcript, Pages 58-59, Lines 22-25, 1-12. See also, Buchanan Direct, Ex. 1, Attachment 2.

³⁶ Buchanan Direct, Ex. 1, Attachment 2.

³⁷ Transcript, Page 129, Lines 3-20.

³⁸ Transcript, Page 167, Lines 10-22.

³⁹ Transcript, Page 60, Lines 2-16. See also Buchanan Direct, Ex. 1, Attachment 2.

⁴⁰ Transcript, Page 167, Lines 10-22.

service areas, Atmos transported its gas through the Panhandle Eastern Pipeline under terms of a long-term firm contract.⁴¹

34. For the Panhandle Eastern Pipeline the demarcation between the field area, where gas is produced, and the market portion of the pipeline, where commercial deliveries are made, is found at Haven in Kansas. Haven is the primary receipt point, but it is not the only receipt point on the Panhandle Eastern Pipeline. There are also secondary receipt points, including one at Louisburg, Kansas, where the Kinder Morgan Pony Express Pipeline connects to the Panhandle Eastern Pipeline.⁴²

35. Atmos' request for proposal for natural gas supply, the letter that was sent to all prospective bidders to supply natural gas to meet Atmos' needs, specified that the bidder was to "provide firm and warranted natural gas commodity only requirements for its Missouri service areas." That request for proposal letter further specified, "[a]ll gas supply is to be **firm and warranted** assuring that natural gas supply services will meet all contractual obligations without fail." (Emphasis in original)⁴³

36. Atmos' request for proposal for natural gas supply allowed all potential bidders to use either the Haven receipt point or a secondary in-path receipt point between Haven and Atmos' service area.⁴⁴ As it was allowed to do under the request for proposal, AEM chose to use a secondary in-path receipt point at Louisburg, Kansas, to take gas supplies off the Kinder Morgan Pony Express Pipeline and then transport them along the Panhandle Eastern Pipeline for delivery to Atmos.⁴⁵

⁴¹ Buchanan Direct, Ex. 1, Pages 4-6.

⁴² Transcript, Page 104, Lines 13-25.

⁴³ Exhibit 4. See also, Transcript, Page 106, Lines 2-24.

⁴⁴ Transcript, Page 133, Lines 1-10. See also, Ex. 4.

⁴⁵ Transcript, Page 105, Lines 1-13.

37. In the hierarchy established by the Pipeline's tariff, primary firm delivery is the highest priority gas supply. The priority of secondary in-path firm delivery is a notch below primary firm delivery.⁴⁶ However, both primary and secondary firm delivery require the supplier to deliver firm as opposed to interruptible supplies of natural gas.⁴⁷

38. Bids to supply gas at a secondary receipt point frequently have a cost advantage over bids to supply gas at a primary receipt point.⁴⁸ However, for the conforming bids submitted under the RFP in question, only AEM's bid was based on receipt at a secondary receipt point.⁴⁹

39. Although Atmos' request for proposal specifies that the gas supply it seeks to purchase is to be firm, Staff and Public Counsel are concerned that perhaps AEM actually supplied something less than firm gas. As one basis for that concern, Staff points to several transaction confirmation documents for the period in which the statement of service level under the contract was left blank as an indication that AEM was allowed to deliver less-than-firm gas.⁵⁰

40. Atmos' witness, Rebecca Buchanan, explained that the service level designations in the transaction confirmation documents were likely left blank through an oversight. However, she was adamant that Atmos fully expected to receive firm gas service under the contract.⁵¹

41. Staff also suspects that AEM was supplying less-than-firm gas under its contract because its successful April 2008 bid to supply gas to the Hannibal-Bowling Green

⁴⁶ Transcript, Page 104, Lines 17-20.

⁴⁷ Transcript, Pages 119-120, Lines 21-25, 1-4.

⁴⁸ Transcript, Page 107, Lines 2-15.

⁴⁹ Transcript, Page 105, Lines 5-21.

⁵⁰ Ex. 7 and Ex. 8.

system was too low in relation to the bids submitted by non-affiliated gas-marketing companies.⁵² AEM's successful bid was \$235,000 lower than the lowest bid from a non-affiliated gas-marketing company, a difference of about two percent of the roughly \$14,000,000 total gas cost under the contract.⁵³ That modest difference is not enough to raise any red flags about the fairness of the bid.

42. Aside from its concerns about Atmos' failure to fill-in a blank in the contract and the amount of AEM's bid, Staff points to the events of December 2007 as a basis for its contention that AEM may have supplied less than firm gas to Atmos under the contracts.

43. In the afternoon of November 26, 2007, Panhandle Eastern Pipeline sent out a notice declaring a *force majeure* event due to a partial rupture on the pipeline at Haven.⁵⁴ The *force majeure* event meant that the pipeline would likely be cutting gas nominations on the pipeline because of the reduced capacity for transporting gas past the pipeline rupture.

44. Staff and Public Counsel criticize Atmos' behavior during the course of the *force majeure* event, implying that Atmos sacrificed its own position for the benefit of its affiliated gas marketer, AEM. During the course of the *force majeure* event of December 2007, the pipeline cut Atmos' gas nominations by 31 percent.⁵⁵ Furthermore, Atmos' witness agreed that he cooperated with the pipeline and his supplier by not nominating as much daily flowing gas through the pipeline as he could have during the *force majeure*

⁵¹ Transcript, Page 138, Lines 2-24.

⁵² Sommerer Rebuttal, Ex. 17, Page 8, Lines 9-11.

⁵³ Transcript, Pages 59-60, Lines 13-25,1.

⁵⁴ From GR-2008-0364 - Transcript, Pages 450-451, Lines 25, 1-2.

⁵⁵ From GR-2008-0364 - Transcript, Page 373, Lines 2-9.

event to avoid additional cuts from the pipeline.⁵⁶ Instead, Atmos pulled additional gas out of storage to meet the needs of its customers.⁵⁷

45. Despite the *force majeure* event, Atmos was able to meet the gas needs of all its customers. No customer suffered a curtailment during that event.⁵⁸

46. Staff proposed a disallowance relating to the *force majeure* event in GR-2008-0364 but did not do so in this case as the event occurred in the prior ACA period. However, Staff believes that the cuts to Atmos' flowing gas supplies during the *force majeure* event raise a suspicion that AEM was actually supplying less-than-firm gas under its contract.

47. Although Staff frequently stated throughout the case that there was a risk that AEM was meeting its obligations under the contract with something less-than-firm gas, implying that AEM was using cheaper interruptible supplies that could result in disruptions to customer gas supplies, Dave Sommerer, Staff's witness, actually testified that AEM was meeting its supply obligations with secondary firm delivery taken off the secondary delivery point on the pipeline.⁵⁹ The use of secondary firm supply may have resulted in lower priority during the *force majeure* event, but the option to use secondary firm supply through a secondary delivery point was available to all bidders, not just to AEM. Therefore, Atmos and its customers received the service they paid for through the bidding process. There is no credible evidence to show that AEM was using interruptible gas supplies to meet its obligation under the contract.

⁵⁶ From GR-2008-0364 - Transcript, Page 506, Lines 6-17.

⁵⁷ From GR-2008-0364 - Transcript, Page 521, Lines 4-7.

⁵⁸ From GR-2008-0364 - Transcript, Page 450, Lines 2-12.

⁵⁹ Transcript, Page 217, Lines 15-23. See also, Page 223, Lines 14-24.

48. Staff also expresses concern that if Atmos had done a better job of notifying potential bidders of their ability to satisfy the requirements of the contract by using secondary firm supply through a secondary delivery point the resulting bids might have been even lower than the bid submitted by AEM.⁶⁰ Thus, Staff criticizes AEM's bid at different times as both too high and too low. However, Atmos' RFP was quite straightforward in informing the potential bidders of the acceptability of a secondary delivery point and there was no credible evidence to establish that any such bidders were confused or misled by the RFP.

49. Staff concedes that it has no evidence of any intentional attempts by Atmos gas supply personnel to increase the profits of AEM and no evidence that Atmos intentionally attempted to increase shareholder profits by accepting the lowest bid from AEM.⁶¹ Furthermore, Staff concedes that the RFP was the same for all bidders and that Atmos evaluated the RFP the same way for all bidders.⁶²

50. While most of Staff's case concerns the contracts to supply gas to the Hannibal/Bowling Green district, it also proposes a disallowance for the Butler district. About the disallowance related to the Butler district, Staff's witness said:

In the Butler area, the RFP provides a better indication of fair market value. However, the Staff still proposes an adjustment to AEM's fair market value because AEM did not provide the cost methodology and allocation records required by the Affiliate Rules.⁶³

⁶⁰ Transcript, Page 232, Lines 14-24.

⁶¹ Transcript, Page 170, Lines 5-13.

⁶² Transcript, Page 170, Lines 19-20.

⁶³ Sommerer Rebuttal, Ex. 17, Page 16, Lines 13-16.

Thus, at least for the Butler district, Staff's proposed disallowance is based primarily on its interpretation of the affiliate transaction rules. The Commission will address the requirements of the affiliate transaction rules in its conclusions of law.

CONCLUSIONS OF LAW

The Missouri Public Service Commission has reached the following conclusions of law:

A. Atmos is a Gas Corporation⁶⁴ and a Public Utility⁶⁵ as defined by Missouri statute and is therefore subject to the jurisdiction of the Missouri Public Service Commission.⁶⁶

B. In order to disallow a utility's recovery of costs from its ratepayers, a regulatory agency must find both that the utility acted imprudently and that such imprudence resulted in harm to the utility's ratepayers.⁶⁷

C. The Commission established its standard for determining the prudence of a utility's expenditures in a 1985 decision. In that decision, the Commission held that a utility's expenditures are presumed to be prudently incurred, but, if some other participant in the proceeding creates a serious doubt as to the prudence of the expenditure, then the utility has the burden of dispelling those doubts and proving the questioned expenditure to have been prudent.⁶⁸

⁶⁴ Section 386.020(18), RSMo (Supp. 2010).

⁶⁵ Section 386.020(43), RSMo (Supp. 2010).

⁶⁶ Section 386.250, RSMo 2000.

⁶⁷ *State ex rel. Assoc. Natural Gas Co. v. Public Serv. Comm'n*, 954 S.W.2d 520 (Mo. App. W.D. 1997).

⁶⁸ *In the matter of the determination of in-service criteria for the Union Electric Company's Callaway Nuclear Plant and Callaway rate base and related issues. And In the matter of Union Electric Company of St. Louis, Missouri, for authority to file tariffs increasing rates for electric service*

D. Contrary to the assertions of Staff and Public Counsel, the Commission's prudence standard applies even when the Commission is evaluating the prudence of an affiliated transaction. In fact, the appellate court decision that explicitly upheld the appropriateness of the Commission's prudence standard concerns the prudence of an affiliate transaction that the Commission was reviewing in an ACA case; exactly the question before the Commission in this case.⁶⁹

E. The Missouri Court of Appeals again explicitly held that the prudence standard applies when the Commission is considering the prudence of an affiliate transaction in its review of the Commission's decision in a Union Electric rate case. In that case, the court rejected an assertion that the Commission's affiliate transaction rule had shifted the burden of proof to the utility to demonstrate the prudence of an affiliate transaction. In the words of the court:

Their assertion is incorrect. Regulation 240-20.105(6)(c) says, 'this rule does not modify existing legal standards regarding which party has the burden of proof in the commission proceeding.' This means that the regulation does not modify the existing burden of proof. Although UE purchased the CTGs from its affiliates, the commission properly presumed that UE was prudent in its purchase of the CTGs, until the State or Public Counsel presented evidence that raised a 'serious doubt' concerning the prudence of its expenditure. (Citation to *Associated Natural Gas* omitted).⁷⁰

F. The Commission has a general affiliate transactions rule – 4 CSR 240-40.015 – that establishes regulatory standards surrounding a regulated gas utility's dealings with

provided to customers in the Missouri service area of the company. 27 Mo. P.S.C. (N.S.) 183 (1985).

⁶⁹ *State ex rel. Assoc. Natural Gas Co. v. Public Serv. Comm'n*, 954 S.W.2d 520 (Mo. App. W.D. 1997).

⁷⁰ *State ex rel. Public Counsel v. Pub. Serv. Com'n*, 274 S.W.3d 569, 578 (Mo. App. W.D. 2009). In that case, the court was interpreting the Commission regulation applicable to electric utilities. However, the affiliate transaction regulations applicable to gas utilities - 4 CSR 240-40.015(6)(C) and 4 CSR 240-40.016(7)(C) - contain the same language indicating that the rules do not modify the legal standards regarding which party has the burden of proof in commission proceedings.

its affiliated companies. The Commission also has a marketing affiliate transactions rule - 4 CSR 240-40.016 - that specifically regulates transactions between regulated gas corporations and affiliated gas marketing companies. Both rules apply to the transactions between Atmos and its marketing affiliate, AEM.

G. The general affiliate transactions rule provides:

When a regulated gas corporation purchases information, assets, goods or services from an affiliated entity, the regulated gas corporation shall either obtain competitive bids for such information, assets, goods or services or demonstrate why competitive bids were neither necessary nor appropriate.⁷¹

The marketing affiliate transaction rule includes the same language.⁷² Atmos complied with these rule requirements when it obtained competitive bids before awarding gas-marketing contracts to AEM.

H. The general affiliate transactions rule further provides:

A regulated gas corporation shall not provide a financial advantage to an affiliated entity. For the purposes of this rule, a regulated gas corporation shall be deemed to provide a financial advantage to an affiliated entity if –

1. It compensates an affiliated entity for goods or services above the lesser of –

A. the fair market price; or

B. the fully distributed cost to the regulated gas corporation to provide the goods or series for itself ...⁷³

The same language is found in the marketing affiliate transaction rule at 4 CSR 240-40.016(3)(A).

I. Both the general and the specific affiliate transaction rules clearly contemplate that a regulated gas corporation may engage in dealings with an affiliated gas-marketing company so long as it complies with the requirements of the regulation.

⁷¹ 4 CSR 240-40.015(3)(A).

⁷² 4 CSR 240-40.016(4)(A).

⁷³ 4 CSR 240-40.015(2)(A).

J. Neither the general nor the specific affiliate transaction regulation includes any language that would preclude an affiliated gas-marketing company from earning a profit on its transaction with the regulated gas corporation. Indeed, such a provision would have the practical effect of banning the transactions that are clearly allowed under the rule, as no affiliated company will enter into a transaction in which it is not allowed to earn a profit.

K. The general and specific affiliate transaction regulations impose record-keeping requirements on both the regulated gas company and its affiliates. The relevant portion of the regulations states:

Each regulated gas corporation shall ensure that its parent and any other affiliated entities maintain books and records that include, at a minimum, the following information regarding affiliate transactions:

1. Documentation of the costs associated with affiliate transactions that are incurred by the parent or affiliated entity and charged to the regulated gas corporation;
2. Documentation of the methods used to allocate and/or share costs between affiliated entities, including other jurisdictions and/or corporate divisions;
3. Description of costs that are not subject to allocation to affiliate transactions and documentation supporting the nonassignment of these costs to affiliate transactions; ...⁷⁴

L. Staff and Public Counsel complain that Atmos and its affiliate, AEM, have failed to comply with the record-keeping requirements of the regulations in that AEM failed to provide Staff with records sufficient to allow Staff to determine the fair market value of gas-supply costs charged to Atmos.⁷⁵

M. However, the record-keeping requirements cited by Staff and Public Counsel do not require AEM to keep records sufficient to allow Staff to determine the fair market

⁷⁴ 4 CSR 240-40(5)(A). The rule goes on to list further record keeping requirements that are not related to the issues in this case. The same language is found in the Marketing Affiliate Transaction rule at 4 CSR 240-40.016(6)(A).

value of gas supplies charged to Atmos, because no such gas-supply costs have been charged to Atmos within the meaning of the regulation.

N. The record-keeping requirements cited by Staff and Public Counsel apply to records of affiliated entities concerning the allocation of common costs among the affiliated companies. For example, an affiliate may share an accountant with the regulated utility and some portion of the cost of employing that accountant may be charged to the regulated utility. Those record-keeping requirements do not contemplate a situation where an affiliated company has simply sold a product to the regulated entity at a fair market price determined through an above-board, competitive bidding process.

O. In fact, Staff's witness indicated he was unaware of any provision in the Commission's rules that would require AEM, or any other affiliate, to maintain records sufficient to allow Staff to determine the affiliate's net profits on a transaction-by-transaction basis.⁷⁶

P. The Commission is required to follow its own rules, because "[r]ules of a state administrative agency duly promulgated pursuant to properly delegated authority have the force and effect of law and are binding upon the agency adopting them."⁷⁷ Furthermore, as an administrative agency, the Commission cannot repeal its rules through an adjudicated order. "To repeal a rule, an agency must comply with the notice, publication, and public comment method prescribed in Section 536.021 of Missouri's Administrative Procedures Act."⁷⁸

⁷⁵ Transcript, Page 731, Lines 7-17. See also, Staff's Initial Brief, at Page 19.

⁷⁶ From GR-2008-0364 - Transcript, Page 635, Lines 17-21.

⁷⁷ *Missouri Nat. Educ. Ass'n v. Missouri State Bd. of Mediation*, 695 S.W.2d 894, 897 (Mo. banc 1985).

⁷⁸ *Greenbriar Hills Country Club v. Director of Revenue*, 47 S.W.3d 346, 357 (Mo. banc 2001).

DECISION

Staff and Public Counsel are appropriately concerned that the Commission closely examine transactions between regulated utilities and their affiliated companies. Certainly, such transactions can be used by a utility to improperly pass profits to an unregulated affiliate or transfer costs from an unregulated affiliate to be recovered in rates from captive utility customers. Because of its concerns about such practices, the Commission promulgated rules to govern affiliate transactions in general, and marketing affiliates in particular.

The Commission's rules specifically allow such transactions to occur, but only if the regulated gas corporation does not provide a financial advantage to its affiliate. The rule establishes that a regulated gas corporation provides a financial advantage to its affiliate if it purchases goods or services from its affiliate above the lesser of the fair market price for those goods or services, or the cost the regulated gas corporation would incur to provide the goods or services for itself.⁷⁹

Staff does not present any serious argument to suggest that Atmos could provide gas-marketing services for itself cheaper if it did not use the services of gas-marketing companies. Staff's witness threw out some statements suggesting that a big company like Atmos should have the resources to purchase gas for itself,⁸⁰ but when pressed, he conceded that Staff was not suggesting that Atmos should purchase gas supplies without using the services of a gas-marketing company.⁸¹

⁷⁹ Commission Rule 4 CSR 240-40.015(2)(A).

⁸⁰ Sommerer Surrebuttal, Ex. 18, Page 3, Lines 19-21.

⁸¹ Transcript, Page 195, Lines 8-17.

Furthermore, Staff did not propose any disallowance relating to the gas supply contracts that Atmos awarded to non-affiliated gas marketing companies after following the same request for proposal process. If it is less expensive for Atmos to purchase gas supplies through non-affiliated gas-marketing companies than to maintain its own staff of gas buyers, then there is no basis to believe that it should maintain such a staff of buyers only to avoid awarding a contract to its affiliated marketing company when that company happens to submit a bid lower than the bids submitted by the unaffiliated companies. That leaves the other side of the regulation's limitation that allows Atmos to purchase gas supplies from an affiliated gas marketer only if it does so at or below fair market price.

As simple as it sounds, fair market price is established by the fair market composed of willing buyers and sellers. In this case, that fair market resulted from the request for bids process undertaken by Atmos to determine the least-cost bid for gas-marketing services in its various service territories. For some of those service territories, but by no means for all, AEM, a gas marketer affiliated with Atmos, submitted the low bid.

For the service territories in which AEM did not submit the low bid, Staff is willing to accept the fair market price as established by the market. However, for those service territories for which AEM did submit the low bid, Staff claims that it must carefully examine AEM's contracts with its suppliers to determine the real fair market price. It argues that if only it had the full cooperation of Atmos and complete access to the records of the unregulated affiliate, including specific transaction records that the unregulated affiliate does not maintain, it could make such a determination. However, Staff's efforts to determine a "real fair market price" are misguided and doomed to failure.

Fair market price is set by the market, not by Staff's review of documents. Even if Atmos and AEM gave Staff every document they could ever hope to examine they could still never determine a "real fair market price" unless they were able to undertake a full rate case to establish among other things an allowed rate of return for the unregulated gas marketing company; because, as Staff's witness conceded in Atmos' last ACA case, AEM should be allowed to earn a profit under the proper circumstances.⁸²

For the foregoing reasons, the Commission will reject Staff's proposed \$337,226.61 disallowance to eliminate AEM's net profits on its transactions with Atmos.

On December 30, 2010, Staff recommended various adjustments to Atmos' ACA filing in addition to the affiliate transaction disallowances that the Commission is rejecting in this report and order. Atmos accepted most of those other adjustments in its response to Staff's recommendation, which it filed on February 2, 2011. However, Staff's recommended adjustments were filed before the Commission issued its decision in Atmos' prior ACA case, GR-2008-0364. It is not clear to the Commission how the adjustments ordered in GR-2008-0364 are reflected in the adjustments Staff proposed in this case. Therefore, rather than establish Atmos' ending balances for 2008-2009 in this order, the Commission will direct Staff to file a revised recommendation regarding those balances based on the Commission's decision in this report and order and in GR-2008-0364.

The Commission will make this order effective on January 20, 2012, which is at least fifteen days after Staff will file its adjusted ending balances recommendation pursuant to this order. The Commission will then issue a separate order, effective on the same date as this report and order, to establish those ending balances. That way no one considering a

⁸² From GR-2008-0364 - Sommerer Surrebuttal, Ex. 28, Page 3 Liens 7-9. See *a/so*, Transcript, Page 704, Lines 3-15.

request for rehearing of this report and order will have to request rehearing of an order that does not finally resolve this entire case.

THE COMMISSION ORDERS THAT:

1. The disallowances proposed by Staff regarding Atmos' transactions with its affiliate are rejected.
2. No later than January 5, 2012, Staff shall file a revised recommendation regarding Atmos' ending balances for the 2008-2009 ACA period incorporating the adjustments ordered in this Report and Order and in the Report and Order issued in GR-2008-0364. This ordered paragraph shall take effect immediately upon issuance.
3. This Report and Order shall become effective on January 20, 2012.

BY THE COMMISSION

(S E A L)



Steven C. Reed
Secretary

Gunn, Chm., Davis, and Jarrett, CC., concur;
Kenney, C., concurs, with separate concurring opinion to follow;
Stoll, C., not participating.
and certify compliance with the provisions
of Section 536.080, RSMo.

Dated at Jefferson City, Missouri,
on this 21st day of December, 2011.