

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

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| In the Matter of Atmos Energy |) | |
| Corporation's 2008-2009 Purchased Gas |) | Case No. GR-2009-0417 |
| Adjustment and Actual Cost Adjustment |) | |

**INITIAL BRIEF OF THE
OFFICE OF THE PUBLIC COUNSEL**

This prudence review is to determine whether the natural gas commodity rates charged by Atmos Energy Corporation (Atmos) to its Missouri customers for the 2008-2009 Actual Cost Adjustment (ACA) were just and reasonable. Atmos' gas rates were authorized by the Commission "on an interim basis, subject to refund, pending final Commission approval" and the Commission must now determine whether to approve the rates as charged, or refund \$337,226 back to ratepayers. OPC urges the Commission to approve the Staff's recommended disallowance and bring "the costs passed through the ACA to a level that reflects the reasonable fair market value."¹

1. Atmos Has Not Met Its Burden of Proof

Any presumption that the rates Atmos charged were prudent disappeared once the Staff raised serious doubts by claiming ratepayers in Hannibal and Butler overpaid for gas Atmos purchased from itself through an affiliate, Atmos Energy Marketing (AEM).² Among the serious doubts raised by the Staff was the following:

Atmos has provided no compelling reason why AEM is able to buy cheaper supplies than its LDC gas purchasing function. The main reason Atmos claims that its affiliate AEM can buy cheaper supplies is because of its marketer expertise. The Company's argument seems to be that the

¹ Ex. 16 Sommerer Direct, p. 14; 4 CSR 240-40.015 and 40.016.

² State of Missouri ex rel. Associated Natural Gas Company v. P.S.C., 954 S.W.2d 520 (Mo. App. W.D. 1997)(ANG).

LDC does not have the expertise to buy gas directly from suppliers – a business model chosen and implemented by Atmos. This is inconsistent with Atmos’ declaration that it is the largest natural-gas-only distributor in the United States. It is inconsistent with the fact that in evaluating the design and operation of its boilerplate RFP, Atmos must have expertise to evaluate and deal directly with the same suppliers that are serving its affiliate AEM.³

This testimony moves the burden to Atmos to prove it was prudent for Atmos to purchase gas from AEM at a marked up price, and it moves the burden to Atmos to prove that Atmos could not have performed the same function as AEM.⁴

As predicted, Atmos claimed in the direct testimony of Atmos witness Ms. Buchanan that Atmos lacks “specialized inventory management skills” and that it does not possess “access to wholesale markets and trading activities.”⁵ Ms. Buchanan did not explain why Atmos does not or could not obtain the same inventory management skills as a marketer, nor does she explain why Atmos would not have the same access to wholesale markets or trading activities as its affiliate. Ms. Buchanan concludes that the cost “of providing these gas services in-house would exceed the market price of these gas supplies,” but she fails to provide any cost calculations to support her conclusion.⁶

In rebuttal testimony, Ms. Buchanan claims that Atmos “would need to incur substantial cost and develop many processes” to make the same gas acquisitions as AEM.⁷ Once again, Atmos provides no analysis that attempts to quantify those costs, nor does Atmos provide any analysis to quantify the savings such processes could bring to Atmos ratepayers. Moreover, Atmos does not dispute Staff’s assertion that Atmos’ gas supply department already performs “several key gas procurement functions” that

³ Ex. 16, pp. 21-22.

⁴ *ANG supra*, 954 S.W.2d 520.

⁵ Ex. 1, Buchanan Direct, pp. 6-7.

⁶ Ex. 1, p. 23.

⁷ Ex. 2, Buchanan Rebuttal, p. 4.

“include but are not limited to financial hedging, peak day planning, acquisition of capacity agreements, nomination of supplies, storage monitoring, weather monitoring, end-use transport monitoring, imbalance tracking, and gas accounting functions.”⁸ This suggests a high level of gas procurement expertise.

Ms. Buchanan also states that “Atmos would be entitled to include these additional expenses in its cost of service upon which its rates are based and earn a reasonable return on any capital investment related to these services”.⁹ Recovery of the costs incurred by Atmos’ gas supply department is not an issue in this case. The issue is whether the evidence provided by Atmos is sufficient to overcome the logical conclusion that Atmos, the largest natural gas distributor in the nation, could provide the same services in-house. Atmos’ direct and rebuttal testimonies fall short of providing a supportable explanation.

Atmos’ surrebuttal testimony also falls short. In surrebuttal testimony, Ms. Buchanan states that Atmos “cannot purchase gas at the same price as a third party gas marketer, unless that price has been submitted by a willing supplier in the RFP process.”¹⁰ Once again Ms. Buchanan does not sufficiently explain why Atmos could not obtain gas in the same manner that AEM acquired the gas, using the same processes AEM uses, and using the same suppliers that are available to AEM. The explanation provided by Ms. Buchanan is that “third party gas marketers can aggregate all of their customers’ requirements and purchase more gas upstream”.¹¹ Ms. Buchanan raised this same argument in an answer to an OPC data request when she claimed that “it is unlikely

⁸ Ex. 16, p. 11.

⁹ Ex. 2, pp. 4-5.

¹⁰ Ex. 3, p. 7.

¹¹ Ex. 3, pp. 4-5.

that large producers would be willing to sell their gas directly to the utility in the small base load quantities that the company purchases.”¹² When asked how many large producers she contacted to determine their willingness to contract with Atmos, Ms. Buchanan admitted, “I didn’t contact any large producers.”¹³ Ms. Buchanan’s answer epitomizes the unsupported nature of Atmos’ assertion that Atmos is incapable of providing the same services in-house. Atmos has not provided any analysis or cost comparisons to substantiate its claims, and has not met its burden of disproving that a more prudent decision would have been for Atmos to cut out the AEM middle-man and protect ratepayers from paying additional profits on the sale of gas. These profits directly benefited Atmos’ own shareholders.

Ms. Buchanan’s assertion that Atmos “cannot purchase gas at the same price as a third party gas marketer, unless that price has been submitted by a willing supplier in the RFP process”¹⁴ also suggests that the RFP process chosen by Atmos is the reason why Atmos is limited in its ability to make the same gas purchases as AEM. Self-imposed limitations are no excuse for not acting in the best interests of ratepayers when making gas purchasing decisions.

Atmos has not met its burden of proving that it could not procure the same gas for its customers directly from the same suppliers used by AEM. Had Atmos’ own gas supply department utilized the same processes and same suppliers as AEM, Atmos’ customers would not have paid the profits charged by AEM to Atmos. The Staff calculated the profits earned by AEM to be \$337,226, offset for overhead. As result of Atmos’ imprudent decisions that caused it to acquire marked up gas from its own

¹² Tr. 118.

¹³ Tr. 118.

¹⁴ Ex. 3, p. 7.

affiliate, ratepayers in the Hannibal and Butler service areas were harmed in that they paid \$337,226 more than they would have paid had Atmos made more prudent decisions. Accordingly, the Commission should disallow \$337,226 in this ACA.

2. Affiliate Transaction Rule Violations

The Commission's Affiliate Transaction Rules (Rules), 4 CSR 240-40.015 and 4 CSR 240-40.016, provide the standards that natural gas companies must follow when conducting business with an affiliated entity. The Rules specifically prohibit a regulated gas corporation from providing a financial advantage to a marketing affiliate. 4 CSR 240-40.016(3)(A). A utility will be deemed to have provided a financial advantage in violation of this requirement if it compensates an affiliated entity for natural gas purchases above the *lesser* of: 1) the fair market price (FMP); or 2) the fully distributed cost (FDC) to the regulated utility to provide the good for itself. 4 CSR 240-40.016(3)(A). This has been called the Commission's "asymmetrical pricing" standard because it also requires gas sold to the affiliate to be sold at a price that is above the *greater* of FMP or FDC. 4 CSR 240-40.016(3)(A). Following the asymmetrical pricing standard obligates the utility to determine both the FMP and the FDC when purchasing gas from its affiliate. The lesser of the two becomes the maximum price that the utility is lawfully able to pay its affiliate for that gas.

Atmos attempts to satisfy the asymmetrical pricing standard by claiming that the fair market value was determined by Atmos' RFP bidding process.¹⁵ Here Ms. Buchanan is referring to Subsection (4) of the Commission's Affiliate Transactions Rules regarding "Evidentiary Standards for Affiliate Transactions," which establishes the evidence that Atmos must maintain when buying gas from an affiliate. 4 CSR 240-40.016(4). The

¹⁵ Ex. 1, p. 21.

Evidentiary Standards subsection of the Rules requires Atmos to “obtain competitive bids” when dealing with an affiliate “or demonstrate why competitive bids were neither necessary nor appropriate.” 4 CSR 240-40.016(4). Using the Evidentiary Standards for Affiliate Transactions to establish the pricing standards for affiliate transactions misinterprets the Commission’s rules. The Affiliate Rules do not state or imply that the bids received can be used establish a fair market price.

Mr. Sommerer testified, “The request-for-proposal (RFP) process that is used to select the lowest bid among a pool of qualified bidders does not set the true fair market price/value of gas supplies that are provided *after* the bid has been let.”¹⁶ Mr. Sommerer further testified:

The Staff’s position is that Atmos may only recover the fair market value of the gas supply services rendered by its affiliate AEM. The primary indicator of fair market value is AEM’s cost of gas supply. Because AEM provided only limited information regarding those gas supplies, the Staff used the available information to estimate the fair market value of the service. ... The limited information that AEM did provide shows that the fair market value of the gas supply delivered to Atmos is substantially less than what it charged its regulated LDC.¹⁷

The Staff has raised a serious doubt about the prudence of the gas cost incurred. Furthermore the Company has failed to dispel those doubts. The burden is on the Company to demonstrate the reasonableness of its affiliate transactions. The Company has generally not kept contemporaneous detailed records regarding the affiliated supplies allocated to and away from the transaction. This information is needed to determine the fair market price of the gas supplies provided. ... Simply put, the RFP is unable to yield a complete and accurate assessment of fair market value (fair market price) in this situation.¹⁸

Atmos attempts to satisfy the second part of the pricing standard, determining the FDC for Atmos to provide the same services in-house, by stating that it “is unlikely that

¹⁶ Ex. 16, p. 9.

¹⁷ Ex. 17, pp. 15-16.

¹⁸ Ex. 18, pp. 1-2.

Atmos could provide such specialized services for the sole benefit of the Missouri jurisdiction at a cost less than the supplier/marketer”.¹⁹ This unsupported assertion does not comply with requirements of the Rules. Atmos produced no cost evidence showing the FDC to Atmos to provide the gas supply for itself, and therefore, failed to follow the requirements of 4 CSR 240-40.016.²⁰ Mr. Sommerer testified that “Atmos has not calculated its FDC because Atmos did not provide the cost information that shows the cost that the LDC’s gas buyers could have acquired the gas for had the LDC’s buyers procured the same gas supplies as AEM’s buyers had done in a competitive market.”²¹

Atmos’ lack of recordkeeping violates 4 CSR 240-40.016(5) and (6), which impacted the Staff’s ability to calculate the FMP pursuant to the asymmetrical pricing standard. Mr. Sommerer explained:

[T]he limited information provided by Atmos was not adequate for Staff to perform its prudence audit of the reasonableness of the fair market value/price of gas supplies Atmos purchased from its affiliate Atmos Energy Marketing (AEM). The Company was only able to provide a limited amount of information regarding the costs incurred and allocated by its affiliate, AEM. The spreadsheet provided by AEM was compiled after-the-fact, in some instances did not include all supply applicable to the business in question, and did not adequately perform a thorough review of the transaction. Therefore, Staff cannot endorse the proposition that Atmos paid a fair market price to AEM for gas supplies that Atmos could have purchased for itself from the same third party suppliers in a competitive market that is available to both the LDC and its affiliate.²²

The only fair market price supported by the record evidence before the Commission is the price paid by AEM, offset for overhead, which results in a disallowance of \$337,226.

¹⁹ Ex. 1, p. 22.

²⁰ Ex. 17, p. 2.

²¹ Ex. 18, p. 5.

²² Ex. 17, p. 2.

3. Conclusion

The evidence before the Commission demonstrates that a disallowance is warranted to credit back to ratepayers increased gas prices resulting from the imprudent decision to acquire gas that was marked up for AEM. The evidence demonstrates that the markup Atmos passed on to captive Missouri ratepayers, to the benefit of Atmos' own shareholders, was avoidable because Atmos could have acquired the same gas using its own gas purchasing department and avoided the AEM markup. The evidence also demonstrates that Atmos violated the asymmetrical pricing and recordkeeping provisions of the Affiliate Transaction Rules. 4 CSR 240-40.016.

The Commission should dismiss Atmos' arguments that this case raises a question of the Commission dictating business decisions for Atmos. When Atmos' business decisions cause Missouri ratepayers to pay inflated rates that are not just and reasonable as required by Section 393.130.1, RSMo, the Commission owes no deference to Atmos' self-serving business decisions.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, emailed or hand-delivered to all counsel of record this 28th day of October 2011.

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