BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

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

STAFF'S INITIAL BRIEF

Respectfully submitted,

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October 28, 2011

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I. Introduction

Staff's Initial Brief provides an overview of Staff's case in GR-2009-0417 in its Executive Summary.

The Brief explains the inter-relationship of the prior '07-'08 ACA addressed in Case No. GR-2008-0364 to the '08-'09 ACA case, GR-2009-0417 and how both cases are connected by a common affiliate supply agreement.

In GR-2008-0364, Staff proposed a $308,000 disallowance or alternatively, a Scenario 1 or 2 reliability disallowance. In support of Staff's proposed disallowances, Staff summarizes the relevant evidence of record admitted into evidence in GR-2008-0364 which was incorporated into the record of Case No. GR-2009-0417.[1] Then Staff applied the appropriate prudence standard, the Commission's affiliate rules and relevant case law to that evidence.[2] The Staff summarizes Case GR-2008-0364 as an aid to understanding that case and for the ease of understanding the evidence supporting Staff's proposed disallowance of $337,000 in GR-2009-0417.

The evidence in this case provides proof of the lack of reasonableness in Atmos Energy Corporation's (Atmos) Request For Proposal (RFP) bid award process. The evidence also provides support of Staff's belief that Atmos' bid award process was unable to establish a reasonable fair market price of its gas supplies. Additionally the evidence provides proof of Atmos' failure to specify contractual rights in its supply contracts with its affiliate Atmos Energy Marketing, LLC (AEM). Atmos has not met its burden in demonstrating the reasonableness of its gas costs paid to its affiliate AEM.

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[1] Tr Vol 2 p 237 ln 19 – p 238 ln 11.

[2] See Staff's Initial Brief in Case No. GR-2008-0364, p 11, **Legal Standards, Supporting Case Law and Affiliate Requirements**.

II. <u>Executive Summary of GR-2009-0417: 2009 – 2009 ACA</u>

As a result of Staff's prudence review of Atmos' gas purchasing practices and decisions, the Staff proposes the Commission disallow $337,226 of gas costs Atmos paid to its unregulated affiliate AEM for gas flowing to the Hannibal/Canton/Palmyra/Bowling Green and Butler service areas during the 2008-2009 ACA period.[3]

The $337,000 disallowance equalizes Atmos' fair market price of gas to AEM's weighted average cost of its gas supplies <u>plus</u> AEM's reported overhead expenses allocated by AEM to its affiliate transaction with Atmos, the Missouri regulated Local Distribution Company (LDC).[4]

The $337,000 disallowance would be applied as a credit to the gas costs of Atmos' Hannibal area and Butler ratepayers.[5]

Staff's proposed $337,000 disallowance is just and reasonable under RSMo Section 393.130.1, as earlier stated, because Atmos has failed to meet its burden of demonstrating the reasonableness of its gas costs paid to its affiliate AEM.

The Staff contends the record evidence shows Atmos' RFP, its bid award process and its contracts with AEM during this ACA period are unreasonable and flawed based on the results they produced. Because of these flaws and inconsistencies, discussed in detail later in the Brief, Atmos has not met its burden in demonstrating its affiliate gas costs are reasonable.

The record evidence shows a series of facts that when viewed *in their entirety* cast serious doubt over the reasonableness of Atmos' bidding process and the inability of that process to attract enough competitive bids to set a true fair market price for gas as set out below:

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[3] The "ACA" refers to the Actual Cost Adjustment for the period of *September 2008 through August 2009*. The Hannibal/Canton/Palmyra/Bowling Green service areas in northeast Missouri are collectively "Hannibal area." Butler service area is part of Atmos' western service territory. The $337,226 disallowance represents the difference between the amount Atmos paid AEM for gas and the total of AEM's cost of gas plus its reported overhead expenses (FN 2 below).

[4] Ex 17, Sommerer Rebuttal p 15 ln 19 – p 16 ln 9; Ex 18, Sommerer Surrebuttal p 10 ln 17 – p 11 ln 5.

[5] Tr Vol 2, p 202 lns 6-11.

- RFP 1 attracted only 3 conforming bids, only 2 were non-affiliates, out of a pool of 60 qualified suppliers[6]
- RFP 2 attracted only 1 conforming bid from an unaffiliated supplier out of a pool of 60 suppliers[7] - further showing serious problems of the RFP's inability to attract bidders.
- In RFP 1, $235,000 separated the low AEM bid from the next highest bidder– a large difference for a 13,000 customer service territory[8]
- <u>Only</u> AEM bid into a Secondary Receipt Point, the other two bidders bid into the Primary Receipt Point at Haven[9]
- Atmos testified that it is significantly cheaper for a supplier to use a Secondary Receipt Point than for a supplier to deliver into a Primary Receipt Point[10]
- Atmos did not rebid to explore the potential for attracting cheaper supplies at an optional Secondary Receipt Point[11] (but still required delivery at the primary when constrained)
- Atmos RFP sent a mixed message to bidders that service must be Firm. On one hand, the RFP letter states in no less than *six* different places that the requested service is to be Firm, Firm and Warranted, and the delivery obligation is Firm without Fail.[12] On the other, the RFP letter contains a statement that Atmos will consider a secondary receipt point[13] – a lesser priority.
- Panhandle's FERC tariff sets Firm service from Primary Point of Receipt as the highest priority for scheduling of receipts and deliveries – *higher* than Firm service from Secondary Point of Receipt bid by AEM[14].
- Atmos' communications with its bidders show the bidders concerns in making service Firm at Haven, the requested Primary Receipt Point, let alone trying to make service Firm at a lower priority Secondary Receipt Point.[15]

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[6] Tr Vol 2, p 59, lns 8-12
[7] Tr Vol 2, p 60 ln 2 – p 61 ln 23
[8] Tr Vol 2, p 59 lns 13-21; Ex 1, Buchanan Direct, p 4 lns 11-14.
[9] Tr Vol 2, p 105, lns 11-21.
[10] Tr Vol 2, p 107, lns 2-15, p 136 ln 23 – p 137 ln 1.
[11] Tr Vol 2, p 133 lns 11-21; p 221 ln 13 – p 222 ln2.
[12] Tr Vol 2, p 106 ln 2 – p 107 ln 1.
[13] Ex 4 "RFP dated 2/14/2008 for gas supplies for 4/1/08-3/31/09 for the Hannibal area, Attachment I". Also see hearing testimony of Ms. Buchanan in GR-2008-0364, Tr Vol 5, p 357 ln 9 – p358 ln 13. See Ex 17 Sommerer Rebuttal p 14 lns 2-9.
[14] Tr Vol 2, p 101 ln 6 – p 104 ln 20. Ex 13 "Panhandle Eastern Pipe Line Company, LP, FERC Gas Tariff Fourth Revised Volume No. 1, Part VI General Terms and Conditions, pp 5-8"; also included as Ex 17, Sommerer Rebuttal, Sched. 4.
[15] Ex 17 Sommerer Rebuttal, Sched 3 contains Atmos' communications with non-affiliated suppliers that demonstrate supplier concern in getting firm transportation to Haven.

Adding more to the unreasonableness of Atmos' bid award process is the record evidence that shows Atmos employed *two different contracting approaches*, lax for AEM and strict for nonaffiliated suppliers.

When Atmos dealt with its affiliate AEM, Atmos' supply agreements were lax and incomplete. Proof of the inconsistencies and the lax approach to dealings with its affiliate AEM is evidenced in the agreements because the agreements:

- failed to specify contractual rights[16] to Firm supply for baseload,
- failed to lock in rights to monthly baseload (April 2008 – March 2009 Agreement) and swing volumes (both the April 2007 – March 2008 and the April 2008 – March 2009 Agreements),
- failed to lock in rights to specific *daily baseload* volumes for both supply agreements with AEM, and
- failed to lock in rights to specific *daily swing* volumes for one of the supply agreements with AEM.[17]

Atmos did not fail to lock-in contractual rights to Firm supply in its agreements with its non-affiliate suppliers. Atmos' non-affiliate supplier contracts specified clear contractual rights to Firm supply with specific Firm baseload and swing daily quantities.[18] The swing quantities with the non-affiliates had higher commitments than those with the AEM.[19]

Staff contends that Atmos' failure to specify contractual rights to Firm gas in its AEM contracts is not incidental. Review of the previous 2007-2008 ACA case record shows that AEM

[16] Contractual rights are also known as the "performance obligation" or "service level".

[17] NOTE: the following hearing testimony and exhibits demonstrate Atmos' lack of contractual rights with its affiliate AEM during this ACA period: Tr Vol 2 p 72 ln 8 – p 76 ln 18; **Ex 7 HC** " Atmos – AEM Transaction Confirmation for April 2008-March 2009 for PEPL, Haven Pool"; and Tr Vol 2 p 77 ln 2 – p 79 ln 10; **Ex 8 HC** "Atmos-AEM Transaction Confirmation for April 2008 – October 2008 for PEPL, Field Zone Pool".

[18] NOTE: the following hearing testimony and exhibit demonstrates the specific contractual rights Atmos had contracted with its non-affiliate supplier in the 2nd supply agreement of the '08-09 ACA period: Tr Vol 2 p 79 ln 11 – p 87 ln 20; **Ex 9 HC** "Atmos-Nonaffiliated Supplier Transaction Confirmation for April 2009-March 2010 for Panhandle Eastern, Haven and Field Zone Pool".

NOTE: the following hearing testimony and exhibits demonstrate the specific contractual rights Atmos had contracted with its nonaffiliated supplier <u>before AEM</u> became the supplier to Hannibal area: Tr. Vol 2 p 87 ln 21 – p 92 ln 3; **Ex 10 HC** "Atmos – Nonaffiliated Supplier Transaction Confirmation for April 2006-March 2007 for Panhandle Eastern Haven Pool"; Tr Vol 2 p 92 ln 4 – p 94 ln 4; **Ex 11 HC** "Atmos – Nonaffiliated Supplier Transaction Confirmation for April 2006 – March 2007 for Panhandle Eastern, Field Zone Pool."

[19] Ex 18 HC, Sommerer Surr, Sched 3.

had supplied <u>*less*</u> than Firm gas service to Atmos in both its ’07-‘08 supply contracts. That second supply contract (in the ’07 – ’08 ACA) runs into the 2008-2009 ACA period and is the contract in dispute in this case.

Atmos’ RFP sent an inconsistent message to bidders. Atmos’ RFP indicated that it was requesting Firm service at the primary delivery point of Haven, but that it would allow the use of a secondary receipt point. By definition, the secondary receipt point is a lower priority of firm service. In the 2008 RFP, *only AEM bid the secondary receipt point.* That no other supplier bid a secondary receipt point demonstrates only AEM assumed the higher risk of assuring “firm” deliveries “without fail” from the secondary receipt point.[20]

Atmos witness Buchanan testified that service through a secondary receipt point is cheaper than service through the primary point.[21] Atmos’ RFP and resulting supply agreement with AEM allowed delivery to a secondary receipt point, but the actual supply agreements (the transaction confirmations) listed the primary delivery point of Haven or Field Zone Pool – creating an ambiguity between what actually took place and the written requirement of the supply contracts.[22] Atmos did not clarify its requirements and rebid, thus losing the opportunity to attract more bidders to the cheaper secondary receipt point.

Moreover, Atmos’ supply contracts with AEM failed to specify the level of service - thus AEM had <u>NO</u> contractual obligation to provide Firm service to Atmos.[23] As a result of Atmos’ failure to specify a level of service, AEM was able to patchwork its supply portfolio in a way that could, and did, allow AEM to provide *less* than firm supplies.

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[20] This is the same supply agreement for this ACA that allows the performance obligation or service level in the transaction confirmation (the supply contract) to be “blank”. This is also the same supply agreement for this ACA that specifies no baseload quantities.
[21] Tr Vol 2, p 107 lns 2-15.
[22] See “Del or Rec Point” columns in Ex 7 HC “AEM Transaction confirmation for Ap[ril 2008-2009 for PEPL, Haven Pool” and Ex 8 HC “AEM Transaction Confirmation for April 2008-October 2008 for PEPL, Field Zone Pool”
[23] Other than the April 2007 – March 2008 agreement discussed earlier for unspecified daily quantities of firm baseload.

The evidence in the last ACA case established that AEM provided less than firm gas service because AEM could not supply Atmos in December 2007 through its secondary receipt point – *a point that bypassed the force majeure event on Panhandle*. (Evidence on the force majeure and Staff's disallowance in GR-2008-0364 is summarized below).

The gas service "product" supplied by AEM to a secondary receipt point is not the same "product" bid by non-affiliates. AEM's lone bid does not constitue a fair market price because:

- gas delivered to the secondary point is cheaper than gas delivered to the primary point,
- the performance obligation / service level is not specified in AEM's supply agreement (it is specified in non-affiliate contracts),
- Atmos failed to lock-in rights to specific baseload volumes for both supply agreements with AEM, and
- failed to lock in rights to specific swing volumes for one of the supply agreements with AEM.

It is an unfair comparison to liken bids from a primary receipt point to bids from a secondary point. It would be like trying to price apples by comparing them to the price of watermelons. Receipt point pricing is different and Panhandle's FERC tariff puts shippers on notice that the primary point carries a higher priority over the secondary point in the scheduling of receipts and deliveries. These differences make bids from a primary point more valuable. Because of their differences they cannot set a fair market price. Thus primary receipt point bids cannot be used to set a fair market price for secondary receipt point delivery.

Furthermore, had Atmos used the same lax contracting with non-affiliates that it had used with its affiliate AEM, there is no telling how many competitive bids the RFP would have attracted and no telling how low prices would have been bid.

If Atmos had let its unaffiliated suppliers off the hook in its supply contracts by failing to specify Firm service like Atmos did with AEM - that omission in contracting would have freed non-affiliates to cobble together any manner of low cost spot supplies to fulfill the contract.

Atmos' contracting process also was not reasonable because Atmos held non-affiliates to a stricter standard of detail than its affiliate AEM. Contracted "Firm" service from non-affiliate suppliers through the primary receipt point is a different product because the evidence shows non-affiliates valued it differently than AEM valued its service through a secondary point with no performance obligation in its contracts with Atmos.

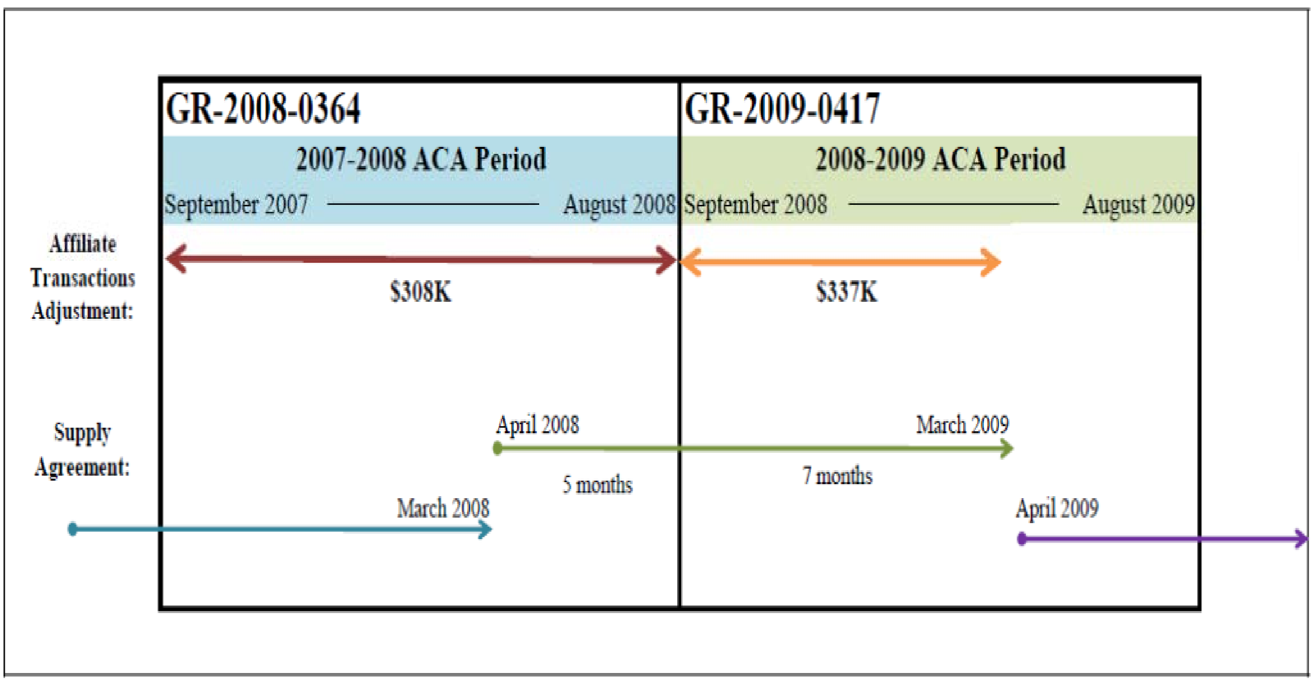
The record in this case, combined with the record evidence in the last ACA case, shows that Atmos has failed to demonstrate the reasonableness of its AEM gas costs and failed to establish a fair market price of its gas supplies in a competitive market – a market that is open to both Atmos and AEM.

Therefore, the Staff recommends the Commission adjust Atmos' gas costs by $337,226 to reflect AEM's actual cost of gas *plus* its reported overhead expenses. Thus, Atmos will recover only AEM's cost of gas and its reported overhead expenses. By approving Staff's adjustment, the Commission orders a just and reasonable result. Hannibal and Butler ratepayers will receive the benefit of the gas service level that they paid for – no less, no more.

III. The 2007-2008 ACA Case GR-2008-0364 is directly related to the 2008-2009 ACA Case GR-2009-0417 because both ACA's involve the same RFP and same supply agreement with AEM

In the previous 2007-2008 ACA case, Atmos had two supply agreements with AEM. Atmos' second agreement with AEM started in the last five months of the '07-'08 ACA and ran through the first seven months of the 2008-2009 ACA case and is at the heart of Staff's proposed disallowance in this case.

At hearing, the Commission recognized the relationship of both cases and incorporated the evidentiary record of GR-2008-0364 into the record of GR-2009-0417. The chart below shows the relationship of the ACA cases and supply agreements:[24]



Atmos had two RFP supply agreements with AEM in the '07-'08 ACA case GR-2008-0364. Atmos' second supply agreement in the '07-'08 ACA case began in April 2008 and ran for the last 5 months of the '07-'08 ACA. It became the first supply agreement of the 2008-2009

[24] Staff Ex 19 shows the relationship of the 07-08 and 08-09 ACA cases and the timeline of Atmos' supply agreements.

ACA case (GR-2009-0417) and it ran a period of 7 months from September ’08 through March ’09.

Atmos’ second RFP supply agreement, which is not a part of Staff’s proposed disallowance in GR-2009-0417, was with a non-affiliate supplier that began in April ’09 and ran for the last 5 months of the ’08-’09 ACA.

IV. Summary of the Prior Case GR-2008-0364: Staff's Request for Relief and Supporting Evidence

An evidentiary hearing was held in GR-2008-0364 on March 23 and 24, 2011, regarding Staff's prudence review of Atmos' 2007-2008 ACA and its supply contracts with its affiliate AEM. Staff filed its Initial Brief on April 29, 2011 and its Reply Brief on May 20, 2011. That case is pending before the Commission.

The supporting evidence in the 07-08 ACA (GR-2008-0364) is also relevant in the 08-09 ACA case. Because the issues remain relevant, Staff offers a brief summary of Staff's case, its proposed disallowances, and supporting testimony.

GR-2008-0364: $308,000 Proposed Disallowance in 2007-2008 ACA Flows From Atmos' Failure to Keep Records Required by the Affiliate Rules

Staff's proposed $308K adjustment[25] equalizes the fair market price/value[26] of the gas supplies purchased by AEM to the fair market price/value of Atmos LDC.

The $308K adjustment is for the Hannibal area only. It is not proposed because AEM made a profit, it was proposed because the basis of the $308K adjustment was <u>not</u> <u>fully</u> <u>supported</u> by AEM.[27] The primary purpose of the adjustment was to bring to Atmos the fair market price of the gas AEM sold to Atmos – not to eliminate AEM's profit.[28]

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[25] Staff's Initial Brief in GR-2008-0364, p 17 citing to FN 46 "*AEM did not have a document that isolated the Hannibal transactions. AEM compiled the gas supplies on the Panhandle system and developed a weighted average cost of gas in a generic fashion and then compared the generic cost of supply to the revenues it earned from Atmos. Based on what AEM provided Staff, Staff determined the AEM-supplied document to be an inaccurate assessment of AEM's cost of gas supply. Staff used information provided by Atmos that AEM had more than sufficient baseload supply to meet the firm needs of its obligation with AEC. Staff readjusted the AEM cost of supply based on the typical practice of pricing baseload gas at first-of-month pricing to arrive at AEM's fair market value of gas supply of $308K. Ex 28HC, Sommerer Surr p 18, lns 1-20 and Ex 33HC*."

[26] Staff's Initial Brief in GR-2008-0364, p 17 citing to FN 47 "*Staff uses the terms "fair market price" and "fair market value" interchangeably. The term "value" brings with it the service level that is offered with the price of gas supplies, along with any other terms and conditions that may bear on "price" of supplies*."

[27] Staff's Initial Brief in GR-2008-0364, p 17 citing to FN 49 "*Tr Vol 7, p 612, lns 21-24*."

[28] Staff's Initial Brief in GR-2008-0364, p 17 citing to FN 50 "*Tr Vol 7, p 631, ln 8 to p 632 ln 5*."

When Staff tried to get detailed information from AEM about its gas supply, what that supply represented, what it was associated with, and what jurisdictions it may have applied to, AEM responded they had only one document in existence that addressed Staff's questions.[29]

That single AEM document did not answer Staff's questions because it did not include cost allocations. Thus, Staff could not have known AEM's costs associated with the affiliate transaction because AEM did not report them. AEM merely compared the generic Panhandle cost of supply to the revenues AEM earned from Atmos.[30] AEM listed gross profits. AEM did not report net profit.[31] If AEM had reported its overhead costs associated with the transaction, Staff may have reduced the profits by the amount of AEM's reasonable costs and considered it in its proposed adjustment. But AEM did not report costs of its transactions.[32]

> In addressing which records Staff was requesting, Staff witness Sommerer testified:
>
> "…those [AEM] records would include the costs that AEM believed relevant to the transaction, the costs that were related to the transactions that were allocated by AEM, the method that AEM allocated those costs to the transaction as well as the costs that may have been allocated to the transaction but AEM chose not to allocate to the transaction. I believe that's required by the rule."[33]

Mr. Sommerer is correct about the records AEM is required to keep. Affiliate Transaction Rule 4 CSR 240-40.015 section (5) requires records of affiliated entities, in pertinent part, as follows:

> (5) Records of Affiliated Entities.
> (A) Each regulated gas corporation shall ensure that its parent and any other affiliated entities ***<u>maintain books and records that include, at a minimum,</u>*** the following information regarding affiliate transactions:

[29] Staff's Initial Brief in GR-2008-0364, p 18 citing to FN 51 "*Tr Vol. 7, p 613, lns 2-9*."
[30] Staff's Initial Brief in GR-2008-0364, p 18 citing to FN 52 "*Tr Vol 7, p 634 lns 14-19*."
[31] Staff's Initial Brief in GR-2008-0364, p 18 citing to FN 53 "*Tr Vol 7, p 635, lns 6-9*."
[32] Staff's Initial Brief in GR-2008-0364, p 18 citing to FN 54 "*Tr Vol 7, p 638 ln 8 to p 639 ln 18*."
[33] Staff's Initial Brief in GR-2008-0364, p 18 citing to FN 55 "*Tr Vol 7, p 662, lns7-14. Staff witness Sommerer further testified on the companion rule's identical record keeping requirements in 4 CSR 240.016,Section 6, mirroring the same requirements on p 729, lns 6-21*."

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; [emphasis added]***

The lack of AEM records was foundational to Staff's proposed $308K disallowance.[34] AEM should have kept additional records to provide support for its fair market value of gas supplies charged to Atmos.[35]

Staff had asked for, and expected to receive, all information that AEM had associated with the deal in terms of the economics behind the deal, the information kept by the trading group related to the deal, the evaluation of the deal and the records associated with the deal. AEM did not provide Staff any of that information. AEM did not have trader evaluations of the deal, AEM evaluations of the deal, or economic analyses about the deal. AEM responded there were no documents in existence except for a trader validation report, which Staff received. It contained a limited amount of information on transaction confirmations[36] which was not responsive to the allocation of costs to and away from the transaction.

For Atmos to meet its legal burden to show the reasonableness of its transactions, Atmos and AEM must provide to Staff records required under the Affiliate Rules. Without records that explain and document the fair market price of the gas supplies Atmos chose to buy from AEM for captive Hannibal customers, the Staff is unable to scrutinize the transactions for

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[34] Staff's Initial Brief in GR-2008-0364, p 19 citing to FN 56 "*Tr Vol 7, p 674, lns7-8*."
[35] Staff's Initial Brief in GR-2008-0364, p 19 citing to FN 57 "*Tr Vol 7, p 731 lns 11-17*."
[36] Staff's Initial Brief in GR-2008-0364, p 19 citing to FN 58 "*Tr Vol 7, p 729 ln 25 to p 731 ln 17*."

reasonableness. Atmos and AEM have not met that burden and have not complied with the Affiliate Rules record keeping requirements.

By approving the $308K disallowance, the Commission is crediting back to Hannibal customers the gas costs that Atmos is unable to support as it is required to do under the Commission's Affiliate Rules.

GR-2008-0364: Proposed Scenario 1 and Scenario 2 Disallowances of $52,572 and $85,577 Capture the Low to High Range of Harm to Ratepayers From Imprudent Decisions of Atmos in its December 2007 Baseload and Swing Gas Nominations

Staff's Scenario 1 and Scenario 2 adjustments of $52,572 and $85,577 respectively capture the low to high range of unnecessary additional costs passed on to Hannibal customers because of imprudent decisions made by Atmos in making its unreasonably low December 2007 baseload nomination. Furthermore, Atmos' swing gas orders in December did not show up. Atmos did not press its affiliate AEM when AEM requested Atmos to make substantial cuts to its swing gas nominations throughout December, citing the deficient reason of the Haven line rupture – an event that happened far upstream from the receipt point. Atmos had to replace the gas supplies that did not show up in December with higher priced gas purchased in January, February, and March, 2008.[37]

Both Scenarios reflect Atmos' failure to meet the prudence standard because they are based on the lack of *reasonableness* of Atmos' purchasing decisions using information *known at the time* by Atmos when those decisions were made.

The Scenario 1 and Scenario 2 adjustments are not additive to the $308K proposed disallowance

The Scenario 1 adjustment of $52,572 has two components:

[37] Staff's Initial Brief in GR-2008-0364, p 21 citing to FN 59 "*Tr Vol 7, p 731 ln 18 to p 732 ln 18. Ex 28HC, Sommerer Surr p 18 ln 21 – p 20 ln 16*".

The first component of the adjustment comes from Atmos' unreasonable and unexplained deviation from its own Supply Plan that provides for a 20% adjustment to normal planned baseload first-of-the-month nomination for flexibility should warmer weather occur.[38]

<u>December 2007 Baseload Nomination (NOM) for Hannibal Area</u>

Total Planned Normal First of Month (FOM) Nomination	= 4,680 Mcf/day[39]
Total FOM Nomination adjusted 20% per Atmos MO Supply Plan	= 3,730 Mcf/day[40]
Atmos' <u>Actua</u>l FOM Nomination	= 2,800 Mcf/day[41]

The actual December FOM NOM is 75% of Atmos' MO Supply Plan, or 25% <u>below</u> the percentage adjustment specified in the Plan.[42]

The rationale for the second component of Staff's Scenario 1 disallowance is based on the fact that Atmos' storage level at the end of November was 5% below plan. Additionally, Atmos' December baseload FOM NOM did not take the end of month November storage deficiency into consideration, as required by the Atmos Gas Supply Plan.

When asked at hearing to explain what he knew of the weather for the month of December when he made his nomination for December, Mr. Walker said "*I can't forecast that much in advance to know what December's going to do.*"[43] If Mr. Walker is so unsure as to the weather going into December, then he should have followed the 20% adjustment called for in the

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[38] Staff's Initial Brief in GR-2008-0364, p 21 citing to FN 60 "*Ex 1, Buchanan Dir, Attach. 1, <u>Gas Supply And Services Manual</u>," Gas Supply Plan Procedure, Effective January 1, 2007," stating: " The supply plan is based on normal degree days, however, for operational and nomination purposes, the plan should also reflect requirements based on normal, a percent warmer and a percent colder than normal degree days. This percent will vary by state, for example it is 20% in Missouri." Tr. Vol 7, p 543 ln 25 to p 544 ln 12*".

[39] Staff's Initial Brief in GR-2008-0364, p 21 citing to FN 61 "*Ex 20, Atmos response to Staff DR 79 in GR-2007-0403 showing PEPL (Hannibal/Canton) and PEPL (Bowling Green) Gas Supply Plan for Missouri, Apr 2007-Mar 2008*".

[40] Staff's Initial Brief in GR-2008-0364, p 21 citing to FN 62 "*Ex 20; Tr Vol 7, p 544 ln 13 to p 547 ln 8*".

[41] Staff's Initial Brief in GR-2008-0364, p 21 citing to FN 63 "*Tr Vol 7, p 547, ln 9 to p 548 ln 25; Ex 21, Atmos response to Staff DR 33, Nominations and Revisions on PEPL for the Month of December 2007. Note: Dth (dekatherms) and Mcf (thousand cubic feet) are used interchangeably.*"

[42] Staff's Initial Brief in GR-2008-0364, p 21 citing to FN 64 "*Tr Vol 7, p 548 lns 19-25.*"

[43] Staff's Initial Brief in GR-2008-0364, p 22 citing to FN 65 "*Tr Vol 7, p 558 lns 7-11.*"

Atmos Supply Plan. He did not. Instead, he deviated from his Supply Plan and adjusted his December FOM NOM downward another 25%. Staff notes that in the preceding December, 2006, Mr. Walker increased the FOM nomination above the warm weather requirements.[44]

Furthermore, Mr. Walker deviated from another provision of the Atmos Supply Plan requiring "*…the plan should only be adjusted prospectively to adjust for planned storage level difference experienced in previous months.*"[45] Atmos' Plan requires the Company only <u>prospectively</u> adjust its plan to consider its end of month November storage balance when making its December baseload nomination. Atmos did not. Atmos' end of month November storage level was 5% below plan.[46]

At hearing, Atmos witness Ms. Buchanan downplayed the importance of adhering to the Gas Supply Plan's adjustments when she testified:

> *It's not an absolute. There's a lot of judgment on his part as far as what's happening during that – the month preceding the gas flow month he's ordering gas for. He would be looking at storage balances. He would be looking at weather condition.*
> *He would be looking at historic purchase – purchases in that same area for that same month, and – as well as the plan quantities that we were just discussing. And taking that all into consideration, he develops his first-of-month nomination.*
>
> *That is true for all of our suppliers, and all three of my supply reps do that same analysis to create a first of month plan.*[47]

Ms. Buchanan defended Atmos' failure to consider storage balances by explaining that Mr. Walker made his FOM December NOM on November 20th, before the Thanksgiving holiday, testifying "*Well you did not know what your storage for November was going to end up*

[44] Staff's Initial Brief in GR-2008-0364, p 22 citing to FN 66 "*Ex 28 HC, Sommerer Surr p 16, lns 10-12*."
[45] Staff's Initial Brief in GR-2008-0364, p 22 citing to FN 67 "*Ex 1, Buchanan Dir, Attach 1, <u>Atmos Gas Supply Plan</u>, "Gas Supply Plan Procedure, Effective January 1, 2007", para. 2*."
[46] Staff's Initial Brief in GR-2008-0364, p 22 citing to FN 68 "*Tr Vol 5, p 426*."
[47] Staff's Initial Brief in GR-2008-0364, p 23 citing to FN 69 "*Tr Vol 5, p 424 ln 23 to p 425 ln 10*."

with on November 20th, because the month has not finished yet. You don't know that until the pipeline measurement statements come out sometime after the first week in December."[48]

Ms. Buchanan's testimony conflicts with Atmos Gas Supply plan. Why would Atmos Gas Supply Plan require considering storage balances of the preceding month to make FOM NOMs for the flowing month if storage level information was not available to Atmos in some form? Not only does the Supply Plan contradict Ms. Buchanan, but Ms. Buchanan contradicted herself when she testified (above) "*There's a lot of judgment on his part as far as what's happening during that – the month preceding the gas flow month he's ordering gas for. He would be looking at storage balances.*"

In addition, Mr. Walker, who submitted his December FOM baseload NOM on November 20, 2007, was not in the office on November 21st, but returned to the office on Monday morning, November 26, 2007.[49] Late November 21st, Panhandle issued its first notice of the 400 line rupture at Haven and declared a force majeure event on November 26th, when Mr. Walker first learned of the rupture event.[50]

Atmos' RFP letter to its suppliers specifies Atmos will nominate first-of month gas supplies within five working days before the beginning of any month.[51] The last day to make baseload nomination was November 26, 2007, the day Mr. Walker returned to work.

Mr. Walker testified the latest he could make a change in his December baseload FOM NOM was at 9:00am, November 26th, because 9:00am began a new gas day. He also testified he checked his storage balance on November 26th and he deemed that his storage balance was where

[48] Staff's Initial Brief in GR-2008-0364, p 23 citing to FN 70 "*Tr Vol 5, p 426, lns 9-13*."
[49] Staff's Initial Brief in GR-2008-0364, p 23 citing to FN 71 "*Tr Vol 7, p 556 ln 3 to p 557 ln 25*."
[50] Staff's Initial Brief in GR-2008-0364, p 24 citing to FN 72 "*Tr Vol 7, p 558 ln 25 to p 560 ln 18*."
[51] Staff's Initial Brief in GR-2008-0364, p 24 citing to FN 73 "*Tr Vol 7, p 554 ln 8 to p 555 ln 10; and Ex 22, Atmos Energy Corporation Gas Supply Request for Proposal For Natural Gas Supply to Hannibal & Bowling Green, Missouri Service Area, February 19, 2007, Section 5.2 Description of Proposal, para..2*."

his plan needs to be. Mr. Walker was asked if he would consider calling his supplier on the 27th, one day outside the 5 working day period (in the RFP letter). Mr. Walker testified he would not do something like that because he did not believe his supplier would allow him to change his FOM NOM, further stating he has not tried to do that.[52]

Staff asserts the reasonable approach would have been for Mr. Walker to at least approach his supplier about upping his FOM NOM. He did not. The 5 working day requirement *is not a contractual obligation* between Atmos and AEM. It is not a binding obligation because it is not contained in the transaction confirmations and not contained in the underlying NAESB contract.[53]

Alarming to Staff is Atmos' loose interpretation of its RFP letter in its dealings with AEM. Both Mr. Walker and Ms. Buchanan testified that the requirement to make the FOM baseload NOM is "5 or 6 working days"[54] when the RFP letter says 5 working days. Atmos' loose interpretation seems to work only one way – in favor of the supplier. Mr. Walker should have called his supplier later in the day November 26th or early on November 27th, (working day number 4) to readjust his low December baseload FOM NOM.

The reasonable, prudent thing for Atmos to have done, knowing what it knew at the time – or should have known by checking - about its 1) unreasonably low baseload FOM NOM, 2) its low storage level, 3) the cold snap in late November,[55] and 4) the Panhandle notice, would have been for Atmos to increase its December baseload FOM NOM to make up for it being 25%

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[52] Staff's Initial Brief in GR-2008-0364, p 24 citing to FN 74 "*Tr Vol 7 p 580 ln 22 to p 583 ln 1*."
[53] Staff's Initial Brief in GR-2008-0364, p 24 citing to FN 75 "*The NAESB base agreement, any addendums to the base agreement and the transaction confirmations between Atmos and AEM form the contractual agreement and obligations of the parties. Tr Vol 5, p 361 ln 7 to p 362 ln 10. The base NAESB contract and the transaction confirmations between Atmos and AEM are contained in Ex 27HC, Sommerer Reb, Sched 5-1 to 5-57, noting there is no Addendum B between Atmos and AEM.*"
[54] Staff's Initial Brief in GR-2008-0364, p 25 citing to FN 76 "*Tr. Vol 7, p 582, lns 12-13; Tr Vol 5, p 436 lns 13-15*."
[55] Staff's Initial Brief in GR-2008-0364, p 25 citing to FN 77 "*Ms. Buchanan testified there was a cold snap later in the month of November 2007. Tr Vol 5, p 426 lns 18-21.*"

lower than its warm-weather adjusted plan and to make up its storage deficiency especially when going into the coldest months of the winter. Atmos' own Gas Supply Plan requires Atmos to do this. Atmos did not even try.

Staff's Scenario 1 disallowance of $52,572 is the low end measure of the harm, in higher gas costs paid by Hannibal customers, for making up the gas Atmos should have bought, but did not, because of Atmos' unreasonably low December baseload FOM NOM and because Atmos had to make up its 5% storage deficiency that it had ignored.

Staff's Scenario 2 disallowance of $85,577 is the high end measure of the harm using the same rationale as Scenario 1, with one difference. Scenario 2 presumes the reasonable course of action for Mr. Walker, when going into the coldest part of the winter with the knowledge of trouble on the pipeline, would be to adjust Atmos' December baseload FOM NOM to eliminate the 5% storage deficiency and <u>to include additional gas to raise the Company's storage level to 5% above its plan</u>.[56] (Scenario 1 brings storage to the planned level).

Atmos' low December FOM baseload NOM is not reasonable, does not follow Atmos' own Gas Supply Plan, and its actions deviating from its stated procedure lack any credible explanation given the information Atmos knew at the time or should have known from checking.

The "Prudence Standard" is articulated in the <u>Associated Natural Gas Company v. Public Service Commission of Missouri,</u> a Western District Court of Appeals case from 1997 (cite 954 SW2d 520, 528-529) (hereafter "ANG"):

> "A utility's costs are presumed to be prudently incurred…. However **<u>the presumption does not survive a showing of inefficiency or improvidence</u>**.
>
> Where some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent.

[56] Staff's Initial Brief in GR-2008-0364, p 26 citing to FN 78 "*Ex 28HC, Sommerer Surr p 20 lns 1-16*."

> The **test of prudence should not be based upon hindsight, but upon a reasonableness standard**: The company's conduct should be judged by asking **whether the conduct was reasonable at the time, under all the circumstances, considering that the company had to solve its problem prospectively** rather than in reliance on hindsight. In effect, our responsibility is to determine how reasonable people would have performed the task that confronted the company." (**emphasis added**)

Atmos' actions in setting its December 2007 FOM NOM were not reasonable or prudent and do not survive a showing of improvidence. Webster's II New College Dictionary defines "improvident" as "Not providing for the future."[57] The record evidence shows that Atmos did not take reasonable prospective actions at the end of November 2007, actions that are called for in Atmos' Missouri Gas Supply Plan, to provide for Hannibal's December 2007 gas supplies.

[57] Staff's Initial Brief in GR-2008-0364, p 26 citing to FN 79 "*Webster's II New College Dictionary, Houghton Mifflin Company, 1999, p. 557*."

V. <u>AEM's Failure to Supply Firm Gas in December 2007 and the Record Evidence Show Atmos received Less than Firm Service From AEM in GR-2008-0364 and GR-2009-0417</u>

Atmos' first supply agreement in GR-2008-0364 (RFP 1) had seven (7) bid responses of which <u>five (5) were conforming</u>.[58] In RFP 1, AEM had won the low bid for "firm" gas service by nearly $297,000 from the next closest bidder.[59]

Similarly, the second supply agreement in GR-2008-0364 (RFP 2) had four (4) bid responses of which <u>three (3) were conforming</u>.[60] In RFP 2, AEM had low bid firm gas service by nearly $235,000 from the next closest *conforming* number 3 bidder.[61] (*This AEM supply agreement runs into the 2008-2009 ACA case GR-2009-0417 and is the same supply agreement in dispute in that case*).

Because AEM bids were so low compared to the non-affiliates, it raised a red flag with Staff after Staff confirmed at deposition that Atmos had included *nonconforming* bid responses in its bid evaluation report. The RFP process lacked robustness.

Looking at the total of the differences of both '07-'08 supply agreements, AEM had underbid firm service by nearly $532,000, or $38.00 per Hannibal customer.[62] Atmos testified that it had 14,000 customers in the Hannibal area.[63] So by adding the difference of both period bid amounts (RFP 1 and RFP 2), this results in a total difference of $532,000 for purportedly "firm" gas service over the two year period.

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[58] Staff's Reply Brief in GR-2008-0364, p 4 citing to FN 6 "*Tr Vol 5, p 360; Ex 1, Buchanan Dir, Attach 2, p 2*."
[59] Staff's Reply Brief in GR-2008-0364, p 4 citing to FN 7 "*Tr Vol 7, p 724. Ex 24HC*"
[60] Staff's Reply Brief in GR-2008-0364, p 4 citing to FN 8 "*Tr Vol 7, pp 726-727; Ex 1, Buchanan Dir, Attach 2, p 2*."
[61] Staff's Reply Brief in GR-2008-0364, p 4 citing to FN 9 "Tr Vol 7, pp 726-727."
[62] Staff's Reply Brief in GR-2008-0364, p 4 citing to FN 12 "*Divide total $532,000 bid difference for both RFP periods by 14,000, the total number of Hannibal area customer. This equals a bid difference of AEM and the next conforming bidder of $38.00 per customer for the highest level of firm gas service*."
[63] Staff's Reply Brief in GR-2008-0364, p 4 citing to FN 11 "*Ex 1, Buchanan Dir p 4*." Buchanan testimony in GR-2008-0364 is that Hannibal area had 14,000 customers. Buchanan testimony in GR-2009-0417 is that Hannibal area had 13,000 customers. (See above FN 8). Staff does not view this difference to be material and may be a result of timing and rounding.

Staff applied the following facts that, *when considered in their entirety*, show the lack of "firmness" of the gas supplies AEM sold to Atmos:

1) AEM is the only bidder using a secondary receipt point onto Panhandle downstream from Haven. All other suppliers bid firm service delivery at Haven as their primary or main bid alternative[64] - evidence other suppliers saw higher risk in bidding firm service through a secondary point.

2) Atmos has characterized it gas supply contracts with AEM as requiring gas supplies that are "firm and warranted" and "firm without fail".[65]

3) The NAESB base agreement between Atmos and its affiliate AEM permits AEM to provide firm *or* interruptible gas supplies.[66]

4) The "Service Level" term – the contracted performance obligation - listed on many transaction confirmations between AEM and Atmos for the RFP 2 period was left blank and does not specify any service level.[67] (*This is the same RFP supply agreement at issue in GR-2009-0417. Atmos' failure to specify its contractual right to "Firm" gas in its contracts with AEM is discussed in detail below in the '08-'09 ACA*).

5) AEM had sufficient gas in its Panhandle portfolio of supplies to meet the firm swing gas needs of Atmos *without* having to ask Atmos to make huge cuts to its swing gas nominations in December 2007.[68]

6) Atmos witness Buchanan testified that other shippers moved downstream to the Pony Express line (secondary receipt point) to avoid the Haven rupture, jamming up the Pony Express receipt point.[69] This means AEM's gas supplies were not firm supplies because AEM's gas got crowded out in favor of the new suppliers relocating to Pony Express. It also means that AEM's

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64 Staff's Reply Brief in GR-2008-0364, p 5 citing to FN 13 "*Tr Vol 5, p 358. Though some bidders quoted a secondary pont as an alternative, the primary point of Haven was the main bid quote*."
65 Staff's Reply Brief in GR-2008-0364, p 5 citing to FN 14 "*Tr Vol 5, p 355-356*."
66 Staff's Reply Brief in GR-2008-0364, p 5 citing to FN 15 "*Tr Vol 7, pp 404-407; See Ex 27HC, Sommerer Reb, Sect. 1.1 of NAESB, Sched 5-47 and Sect 3.1 of NAESB, Sched 5-49*."
67 Staff's Reply Brief in GR-2008-0364, p 5 citing to FN 16 "*See Ex 12HC, "AEM Transaction Confirmations for the period 4/1/07 to 4/1/08". On 5-10, the first transaction confirmation in the exhibit (for RFP 1), specifies "Firm/Baseload" for Service Level. In RFP 2, Transaction confirmations 5-15, 5-16, 5-17, 5-18, and 5-19 list no Service Level*."
68 Staff's Reply Brief in GR-2008-0364, p 5, citing to FN 17 citing Staff's Initial Brief p 7, FN 27 "*Ex 28HC, Sommerer Surr p 18 lns 14-16*."
69 Staff's Reply Brief in GR-2008-0364, p 5, citing to FN 18 "*Tr Vol 5 p 452*."

gas got crowded out *after* AEM had committed delivery to Atmos through the secondary point.

7) Ms Buchanan testified that AEM's supply coming through Pony Express secondary receipt point was limited and that AEM could only get a certain amount of gas to serve Atmos' contracts.[70]

8) Ms. Buchanan testified that Butler nominations were cut approximately: 7% on 12/8/07; 7% on 12/9; 13% on 12/10; 13% on 12/11; and, 1% on 12/12, further noting no cuts from 12/13/07 to 12/31/07.[71] Butler gas flowed from the field zone *through* the Haven rupture[72] with minimal disruption. This means the force majeure event was not a significant disruption.

9) Contrast Ms. Buchanan's testimony on the force majeure impact on Butler with her testimony on Atmos' cuts to Hannibal: Ms. Buchanan acknowledged the Hannibal cuts on 12/8, 12/9, and 12/10/07 were approximately 48%, ranging from 48% to 28% through the end of month 12/31/07, with a slight letup on 12/23, 12/24, and 12/25.[73] Atmos cannot explain how gas that *did not flow through Haven* was so widely disrupted by AEM's requested cuts and the gas that did flow through Haven had near minimal disruptions.

10) Mr. Walker testified the pipeline did not make cuts from 12/9/07 to 12/26/07 and 12/28 to 12/31/07 and that those were cuts made by him to help out his supplier: "…Those [22 days of cuts] are the dates we nomed lower to help out the supplier and the pipeline during this Haven outage.[74]" Gas flowing to Hannibal area was brought into Panhandle downstream of Haven, *bypassing* the Haven rupture.[75] Again, based on record evidence, the Haven rupture had minimal, if any effect at all on the ability of the Pony Express line to bring gas

[70] Staff's Reply Brief in GR-2008-0364, p 6, citing to FN 19 "*Tr Vol 5, p 454*."

[71] Staff's Reply Brief in GR-2008-0364, p 6, citing to FN 20 "*Tr Vol 5, pp 374-376. See Ex 10, Atmos Energy Corporation GR-2008-0364 Response to Staff DR 132.2 parts A & C for list of actual cuts. This is also Ex 18. On Tr Vol 5 p 376, Ms Buchanan testified* "Well, I still think 13 percent is a pretty good-sized cut…""

[72] Staff's Reply Brief in GR-2008-0364, p 6, citing to FN 21 "*Tr Vol 5 p 376*."

[73] Staff's Reply Brief in GR-2008-0364, p 6, citing to FN 22 "*Tr Vol 5, pp 377-378. See Ex 10 (also Ex 18) for detailed list and comparison of cuts for December 2007*."

[74] Staff's Reply Brief in GR-2008-0364, p 6, *citing to* FN 23 "*See Staff's Initial Brief p 10 and FN 38 [Under Staff's direct examination regarding cuts (Atmos' response to Staff DR 132.2 Parts A & C is the spreadsheet showing cuts to Hannibal, Bowling Green, and Butler for Nov. 27 and Dec 4 – 31, 2007), Mr. Walker stated the pipeline did not make cuts from 12/9/07 to 12/26/07 and 12/28-31/07 and that those were cuts made by him to help out his supplier: "…Those [22 days of cuts] are the dates we nomed lower to help out the supplier and the pipeline during this Haven outage." Tr Vol 7, p 516 lns 2-9. For Bowling Green, Mr. Walker stated there were no pipeline cuts on days 9 through 31 [December 07]. Tr Vol 7, p 520 lns 1-8.]*

[75] Staff's Reply Brief in GR-2008-0364, p 6, citing to FN 24 "*Staff's Initial Brief p 7, FN 26* [*Tr Vol 5 p 452, lns 8-13*].

into Panhandle downstream from the 400 line rupture. Atmos' self-imposed Hannibal cuts (from reducing its AEM nominations at AEM's request) were far greater and of much longer duration than Panhandle's small cuts over 5 days at Butler.

11) AEM and Atmos are contractually bound by the base NAESB provisions regarding Force Majeure. If AEM had a problem in supplying its affiliate LDC related to force majeure, then it is *bound by its NAESB agreement* with the LDC to invoke the force majeure provision and to provide the particulars of its supply incapability in writing. AEM did not invoke a force majeure event and did not put the particulars of its alleged supply constraints in writing to Atmos. *By not invoking its force majeure provision, AEM has represented that it had no supply disruption that would impact its ability to supply its affiliate LDC as a result of the Haven rupture.*[76] This fact is consistent with the fact that AEM had plenty of flowing supplies to service its LDC contracts.

12) Ms. Buchanan testified its "… supplier [AEM] has the obligation to deliver firm supply into our contract. And then we transport it on a firm transportation contract to our citygate." If AEM cannot get its gas to Panhandle through its chosen Pony Express (secondary) receipt point, then Atmos has no gas to transport.[77] Despite Ms. Buchanan's testimony, Atmos' supply contracts had "blank" service levels and failed to specify a Firm performance obligation.

Firm gas has higher priority than non-firm or interruptible gas. Firm gas costs more than non-firm gas. Unless the pipeline is making cuts that impact firm gas, firm gas shows up. Butler gas had to flow through the Haven 400 line rupture and Butler had minimal cuts over a few days.

AEM failed to meet its contractual obligation to provide firm gas to Hannibal – the highest level of service quality – and provided something less than firm service. AEM used the excuse of a Panhandle force majeure event *upstream* from the Pony Express line, a receipt point that *bypasses* the Haven rupture, as cover to ask its willing affiliate Atmos to make huge cuts to

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[76] Staff's Reply Brief in GR-2008-0364, p 7, citing to FN 25 "*Staff's Initial Brief p 7, FN 28* [*Tr Vol 5, p 361 ln 16 to p 362 ln 10; p 363 ln 1 to p 364 ln 2. See NAESB contract, Section 11.5 on Force Majeure, between Atmos and AEM in Ex 27 HC, Sommer Reb, Sched p. 5-27HC*].

[77] Staff's Reply Brief in GR-2008-0364, p 7, *citing to* FN 26 "*Tr Vol 5, p 384*."

its swing gas nominations. Atmos did as AEM asked and cut its swing gas nominations throughout the month of December 2007.

AEM's use of the Haven 400 line rupture to excuse its performance is not reasonable. As discussed above, it is troubling that AEM had plenty of flowing supplies in its portfolio to supply Atmos <u>without</u> having to ask its affiliate LDC to make any cuts at all.

In point of fact, Atmos' response to DR132.1 wrongly claimed Atmos had cut its nominations solely because of a request from the pipeline.[78] At hearing, Atmos employee Walker reversed his response to DR 132.1 and testified he cut his nominations for 22 days in December 2007 because of AEM – <u>not</u> because of a request from Panhandle.[79]

The fact that Atmos agreed to cut its swing gas nominations to "help out" AEM required Atmos to draw down storage in December 2007 below planned levels. Atmos had to make up its end-of-December 2007 storage deficiency by purchasing additional gas supplies at higher cost to ratepayers during the cold months of January, February, and March 2008.

By using its storage gas Atmos gave AEM a free pass to serve its other customers. Atmos passed on to Hannibal ratepayers the higher cost of make-up gas supplies through its PGA clause. The amount of harm to ratepayers from these higher costs ranged from $52,572 to $85,577.

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[78] Staff's Reply Brief in GR-2008-0364, p 7, *citing to* FN 27 "Ex 28 HC, Sommerer Surr, Sched 4-3. Atmos' response to Staff's DR 132.1 states: *Dec07- Actual nominations were lower than planned nominations because a Haven 400 Line rupture occurred during late Nov07, resulting in the pipeline curtailing nominations during December, which reduced actual nominations.* "

[79] Staff's Reply Brief in GR-2008-0364, p 7, *citing to* FN 28 *Tr Vol 7, p. 518-519*:
Mr. Walker testified:
<u>Q</u>. *Now, why didn't you get verification from Panhandle for the reason for the cuts to Hannibal contract 11671 on the other 22 days?*
<u>A.</u> *Because the nomination was not cut. We nominated what we could get during this Haven outage and the pipeline did not cut that volume.*
<u>Q.</u> *Did you know what volume you could get?* <u>A.</u> *That -- what we nominated is what we could get from our supplier.*

Ultimately, Atmos shareholders benefited from AEM having Atmos' LDC cut its "firm" swing gas nominations. Atmos accepted AEM's flawed excuse of the Haven 400 line rupture and did not question AEM or hold AEM to its firm supply obligation, causing increased costs for Hannibal customers.

VI. Atmos' RFP has failed to establish a Fair Market Price for the Hannibal area and Butler Gas Supplies Purchased from AEM as required under the Commission's Affiliate Rules

Atmos failed to establish a fair market price because it is unreasonable to think that one bid sets the market price. One lone bidder (AEM) using a secondary receipt point does not establish fair market price[80] for gas through cheaper secondary points. Atmos' RFP for the Hannibal area was sent to a pool of 60 qualified suppliers and only 3 returned conforming bid responses.[81] Of the 3 bids, only AEM bid into a secondary receipt point. Two non-affiliate bidders bid the primary receipt point of Haven.[82]

The evidence shows that nonaffiliated suppliers questioned Atmos' RFP requirement to bring gas into the primary receipt point to meet the "firm and warranted" demands stated in the RFP.[83]

Atmos' RFP states in no less than six places that service is to be "firm," "firm and warranted," and deliveries are to be "firm without fail."[84]

The fact that AEM won the bid by a significant margin should come as no surprise given the circumstances of the bidding process. For the entire year of the supply agreement, AEM

[80] The asymmetrical pricing provision of the Marketing Affiliate Rule 4 CSR 240.016(3)(A) requires the LDC to compensate its affiliate at the lower of the fair market price or the fully distributed cost to the LDC for the provision of gas supplies. Atmos witness Buchanan testified the company had not calculated its fully distributed costs at the time it had made its agreements with AEM. (Tr Vol 2, p 99 ln 12 – p 100 ln 22). Therefore Staff's prudence review must necessarily focus on determining the reasonableness of the fair market price of supplies obtained from the bid award process.

[81] Tr Vol 2, p 59, lns 8-12.

[82] Tr vol 2, p 105, lns 11-21.

[83] Ex 17 Sommerer Reb, p 6 lns 16-17 "As a result, some potential bidders inquire whether deliveries truly need to be delivered firm to HAVEN in the market zone, as noted in the attached Schedule 3". See nonaffiliated company communications to Atmos in Sched 3. Note in Sched 3-2 the nonaffiliated supplier considered using the named [secondary] receipt point but stated it had "no way to backstop" the secondary point at Haven. This means the nonaffiliate could not reroute its supplies to Haven if there was a problem on the [secondary] receipt point. [Staff treats the name of the secondary point as HC].

[84] Tr Vol 2, p 106 ln 2 – p 107 ln1.

underbid the closer of the two nonaffiliated bids by $18/customer.[85] How could AEM be so far apart? Atmos witness Becky Buchanan testified it is cheaper for a supplier to bring gas into a secondary receipt point than into a primary point.[86] Ms. Buchanan also testified that Atmos, satisfied with only AEM's bid response through the secondary receipt point, did not rebid the RFP to explore lower market prices.[87] Atmos' bidding process was not reasonable. It effectively ignores the fact that the bids were not comparable. The bids were for different products (i.e. cheaper supplies through a lower priority secondary receipt point).

Secondary receipt points, while not only cheaper than primary points, are also second in priority of scheduling receipts and deliveries under Panhandle's FERC tariff.[88] Secondary in path firm service is not the same as primary in path firm service. They are different products that carry different pricing and different tariff scheduling priorities. Therefore, as previously stated, it is unreasonable for Atmos to rely on one (AEM) bid through a secondary receipt point to establish a fair market price for gas as the result of comparing it to two bids through the requested primary point of Haven. They are apples and oranges.

By the RFP allowing an option of using secondary receipt points, Atmos has, with its insistence on "Firm" supplies, created a Hobson's choice for prospective bidders – which is no choice at all.[89] Only AEM chose to make a value play by welcoming the higher risk and lower cost associated with bringing gas into the secondary receipt point. One supplier told Atmos it

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[85] Tr Vol 2, p 59, lns 13-21; Ex 1 Buchanan Direct, p 4 lns 11-14. NOTE: $18/customer is derived by dividing the $235,000 difference between AEM's bid and the next closest nonaffiliated bid by 13,000, the total number of customers in Hannibal area.

[86] Tr Vol 2, p 107, lns 2-15; p 136, ln 23 – p 137 ln1.

[87] Tr Vol 2, p 133, lns 11-21; p 221 ln 13- p 222 ln2.

[88] Tr vol 2, p 101 ln 6 – p 104 ln 20. Ex 13 "Panhandle Eastern Pipe Line Company, LP, FERC Gas Tariff Fourth Revised Volume No. 1, Part VI General Terms and Conditions, pp 5-8"; also included as Ex 17, Sommerer Rebuttal, Sched. 4.

[89] A Dictionary of Modern Legal Usage, Bryan Garner (2nd edition, 1995), p 404, defines *Hobson's choice*: "…Tradition has it that Thomas Hobson (1549-1631), a hostler in Cambridge, England, always gave his customers only one choice among his horses: whichever one was closest to the door. Hence….a *Hobson's choice* came to denote no choice at all – either taking what is offered or taking nothing at all." [further explanation] "…..that they had no real option…."

could “not backstop” the secondary receipt point at Haven[90] – meaning it could not ensure firm service at Haven if a problem developed at the secondary receipt point.

Atmos’ RFP process in the’08-‘09 ACA period for the Hannibal area is seriously flawed and incapable of producing a fair market price for gas. In the second RFP supply agreement, Atmos attracted only 1 conforming bidder – a single non-affiliate supplier- out of a pool of 60 qualified suppliers.[91] With only 1 bid response, there can be no comparison of prices and no determination of fair market price. Based on the information provided, Staff is unable to determine if the lone bidder returned the lowest and best bid or the highest and worst bid. The RFP as it was written failed to attract bidders and failed to set a fair market price.

[90] Ex 17 Sommerer Reb. See Sched 3 nonaffiliated company communications to Atmos. Note in Sched 3-2 the nonaffiliated supplier considered using the named [secondary] receipt point but stated it had “no way to backstop” the secondary point at Haven. This means the nonaffiliate could not reroute its supplies to Haven if there was a problem on the named [secondary] receipt point. [Staff treats the name of the secondary point as HC].

[91] Tr Vol 2, p 60 lns 2-16; p 61 lns 18-23; p 62 lns 6-9.

VII. <u>Atmos failed to lock-in contractual rights to Firm Baseload and Swing gas in its supply contracts with AEM, passing an opportunity to AEM to bid cheaper less-than- firm gas supplies</u>

Atmos applied two vastly different contracting approaches that treated the affiliate differently than non-affiliates – passing an opportunity to AEM to provide cheaper, less reliable "less than firm" gas supplies. [92]

Atmos' lax approach with AEM failed to lock-in rights to Firm baseload and swing supplies. Using a strict approach with non-affiliates Atmos did lock-in enforceable rights to Firm baseload and swing supplies, as explained below.

It is an essential business practice for the LDC to lock in enforceable rights to firm gas supply with its suppliers because captive ratepayers depend on reliable gas supply. Atmos failed to specify contractual rights to Firm supply with AEM. As a result of this failure, Atmos' contracts violate sound business practice and put supply reliability at risk.

Atmos' transaction confirmation (the "supply contract") with AEM for April 2008 – March 2009 for PEPL, Haven Pool does not list any performance obligation under the "Service Level" part of the contract. "Service Level" is blank. Because Atmos has failed to specify a contractual right to a "Firm" gas service level, AEM is free to supply less-than firm or even interruptible gas supplies. The contract does not list any firm fixed daily quantity (baseload) for April '08 – March '09. Atmos does list a firm variable quantity per day (swing) that varies for each winter month – but at a markedly lower per day amount than that of the non-affiliates.[93] The contract has no specified minimum or maximum <u>daily</u> requirements for the fixed quantity

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[92] The Commission's Marketing Affiliate Rules 4 CSR 240-40.016(3)(B) provides that "*…the regulated gas corporation shall conduct its business in such a way as not to provide any preferential service, information or treatment to an affiliated entity over another party at any time*." Staff contends the evidence shows Atmos took a lax approach in contracting with its affiliate AEM because Atmos failed to lock-in enforceable contractual rights to firm gas supply. Atmos' failure to secure enforceable rights from AEM is not reasonable and not prudent. A comparison of Atmos' supply contracts with its non-affiliates, both before and after AEM, shows no such omissions.

[93] Ex 7 HC; See Staff's cross-examination of Atmos witness Becky Buchanan at Tr Vol 2, p 72 ln 6 to p 76 ln 18.

(baseload) gas supplies.[94] The contract with Atmos has monthly requirements that do not obligate AEM to daily commitments. However, there are daily commitment requirements in the non-affiliate supplier contracts. The monthly volumes are not specified as either a minimum or a maximum, nor is it explained whether the volumes must be delivered evenly over the month or only a few days.[95]

Atmos' transaction confirmation with AEM for April 2008 – October 2008 for PEPL, Field Zone Pool also contains a "blank" "Service Level" – meaning AEM again was not contractually bound to any performance obligation and was free to supply less-than firm or interruptible supplies. The AEM contract fails to specify a daily fixed quantity for baseload gas. The contract with Atmos has monthly requirements but it does not obligate AEM to daily commitments. However there are daily commitment requirements in the contract for the non-affiliate. The monthly volumes are not specified as either a minimum or a maximum, nor is it explained whether the volumes must be delivered evenly over the month or only a few days.[96]

Staff's concern is that Atmos' contracting process with AEM is unreasonable on its face because we will never know what prices non-affiliates would have bid to set a fair market price had Atmos applied the same apathy to non-affiliate supply contracts as they applied to AEM.

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94 Ex 7 HC; Tr Vol 2, p 76 lns 15-18.
95 Ex 7 HC.
96 Ex 8 HC; See Staff's cross-examination of Ms. Buchanan at Tr Vol 2, p 76 ln 18 – p 79 ln 10.

VIII. Atmos' contracts with its Non-affiliate Suppliers, both Before and After AEM, locked in specific Firm Baseload and Swing Gas amounts providing Atmos with enforceable rights to Firm supply

Atmos' second RFP supply agreement during the '08-'09 ACA period (after AEM) was with a non-affiliate supplier, *discussed in VI above*. (This non-affiliate was the only conforming bid response out of a pool of 60 qualified suppliers).

The non-affiliate transaction confirmation (contract) for April 2009 – March 2010 for PEPL, field zone pool and PEPL-Haven, covers the last 5 months of the '08-'09 ACA. This non-affiliate contract specifies both firm fixed (baseload) and firm variable (swing) quantities. The performance obligation is not left blank. The contract provides Atmos with enforceable rights to specific quantities of firm daily baseload and firm daily swing gas supplies.[97]

Another non-affiliate supplied Hannibal area before AEM began supplying Hannibal in cases GR-2008-0364 and GR-2009-0417. This non-affiliate had two supply contracts, one for April 2006-March 2007 Panhandle Eastern, Haven Pool ("Haven") and one for April 2006 – March 2007 Panhandle Eastern, Field Zone Pool ("Field Zone").[98]

The "Haven" contract specified both firm fixed and firm variable quantities. The performance obligation was not left "blank",[99] giving Atmos enforceable rights to specific firm gas supplies for both baseload and swing supplies.

[97] Ex 9 HC, p 1 shows firm fixed baseload at field zone and p2 shows firm fixed baseload for Haven and p 3 shows firm variable (swing) quantity for Haven. Also, note: The base NAESB agreement with the non-affiliate supplier is similar to the base NAESB with AEM. The NAESB agreement permits either Firm or Interruptible Service [Tr Vol 2, p 71]. See Staff's cross-examination of Ms. Buchanan at Tr Vol 2, p 80 ln 9 – p 87 ln 20.
[98] Ex's 10 HC and 11 HC respectively
[99] Ex 10 HC; See Staff's cross-examination of Ms. Buchanan at Tr Vol 2, p 88 ln 21 – p 92 ln 3.

As in the "Haven" contract, the "Field Zone" contract specified both firm fixed and firm variable quantities. There is no "blank" service level as in the AEM contracts, again, giving Atmos enforceable contract rights to specific quantities of firm gas supplies.[100]

If non-affiliate suppliers had an equal opportunity to contract with Atmos like AEM did with the expectation of no enforceable rights to Firm supplies, then non-affiliates would have been free to cobble together any manner of cheaper less-than-firm, or even interruptible and spot gas, to supply Atmos' LDC. Because non-affiliates were not afforded the same opportunity to bid with no expectation of binding terms requiring specific quantities of Firm baseload and swing gas, the bids may have been very different.

Atmos' lax contracting with its affiliate AEM casts serious doubt on the reasonableness of the prices Atmos paid AEM for its gas supplies since AEM was not legally bound to provide firm gas. Because the record evidence in GR-2008-0364 *discussed above* shows that AEM did not provide firm gas to Atmos and because the non-affiliate suppliers were contractually obligated to provide firm gas – the products are not the same. Because the products are not the same, the prices cannot be compared. It is unreasonable for Atmos to claim it set a fair market price for gas. The gas service it received from AEM was less reliable and less than firm than the gas service it received from its non-affiliates.

[100] Ex 11 HC; See Staff' cross-examination of Ms. Buchanan at Tr Vol 2, p 92 ln 4 – p 94 ln 4.

IX. Conclusion

GR-2009-0417: 2008-2009 ACA

The Commission should approve Staff's proposed $337,000 disallowance. The record evidence proves that Atmos has failed to demonstrate the reasonableness of the gas prices it paid its affiliate AEM. Abundant evidence proves the inability of the Atmos RFP process to establish a reasonable fair market price of gas. Staff believes serious doubt is raised by Atmos' failure to specify enforceable contractual rights in its supply contracts with AEM. The evidence proves the gas service "product" ratepayers received from AEM was not the same level of service or "product" they received from non-affiliate suppliers.

Atmos relied on one AEM bid at the cheaper secondary point and improperly compared it to bids at the more reliable, higher cost primary point. AEM was the only bid that incorporated the higher risk secondary receipt point and its cheaper supply cost in its bid to Atmos. The evidence proves the non-affiliate suppliers avoided bidding the cheaper secondary point because they could not bridge the higher risk of the secondary point with the RFP's insistence on "firm," "firm and warranted" gas supplies delivered "without fail."

If Atmos had rebid the Hannibal RFP to explore pricing through the cheaper secondary point and requiring delivery at the primary point if constrained, rather than relying solely on AEM's bid, Atmos would have been able to establish price levels that considered both primary and secondary points, allowing an "apples to apples" comparison. Atmos did not. Atmos took no other actions in its bidding to attract more bidders.

The bid award process used by Atmos was unreasonable because of the glaring inconsistencies in the process as set out and discussed above.

The $337,000 adjustment is just and reasonable because it is a fair market price for the gas supplies that AEM provided to Atmos. The adjustment brings gas costs down to AEM's actual cost of gas supplies plus its reported overhead expenses. Said another way, customers get what they paid for. The adjustment is not punitive to Atmos because the company will have recovered its gas costs and its reported expenses for the gas "product" it provided to ratepayers.

GR-2008-0364: 2007-2008 ACA

Based on the record evidence in GR-2008-0364, the Staff prays the Commission issue an order approving its proposed $308,733 disallowance. Approving this disallowance will hold Hannibal customers harmless from Atmos' failure to demonstrate the reasonableness of having its unregulated affiliate buy the gas supplies that Atmos the LDC could have acquired on its own without using AEM as an intermediary buyer.

As discussed at length above, the Staff proposed a $308K disallowance based on the failure of Atmos and AEM to document its costs and to provide the cost methodology and the cost allocations to and away from the deal as required by the Affiliate Rules. The $308K disallowance adjusts Atmos LDC's fair market price of gas to AEM's fair market price of gas supplies. Had AEM and Atmos provided the required cost allocation and cost methodology documentation in this case, the Staff would have considered that information in mitigating the adjustment downward. (In the '08-'09 ACA, GR-2009-0417, AEM did provide Staff a report of its overhead expenses. Staff evaluated the report and applied the expenses as an offset, mitigating Staff's adjustment).

Accordingly, the Commission should issue an order approving Staff's proposed $308K disallowance because the Company failed to meet its legal burden to show the reasonableness of the gas prices Atmos paid its affiliate AEM.

In the alternative, if the Commission should not approve the $308,733 disallowance, the Staff prays the Commission issue an order approving its Scenario 1 adjustment of $52,572 or Scenario 2 disallowance of $85,577 because the record evidence shows that Atmos' gas purchasing decisions in December 2007 were not reasonable and not prudent based on Atmos' decisions in conflict with its own Gas Supply Plan procedure and the information Atmos knew or should have known at the time those decisions were made. Moreover, the Scenario 1 disallowance makes Hannibal customers whole from having to pay the higher costs of make-up gas as a result of Atmos' having drawn down its storage to the benefit of its affiliate AEM.

Respectfully submitted,

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Certificate of Service

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

/s/ Robert S. Berlin______________________