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

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| In the Matter of PGA/ACA filing of Atmos Energy Corporation for the West Area (Old Butler), West Area (Old Greeley), Southeastern Area (Old SEMO), Southeastern Area (Old Neelyville), Kirksville Area, and in the Northeastern Area. | )<br>)<br>)<br>)<br>) | **Case No. GR-2008-0364** |

# STAFF'S INITIAL BRIEF

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**<u>Introduction to the Purchased Gas Adjustment (PGA)/Actual Cost Adjustment (ACA) Process</u>**

This case and its discovery disputes arise from the PGA/ACA process whereby Atmos Energy Corporation (Atmos or LDC) recovers from its customers the cost of the natural gas it distributes to them. The rates of natural gas distribution utilities are set in two separate proceedings. In a general rate case, the Commission sets rates for the utility's cost of service. Rates for natural gas and its transportation are set in the annual two-part PGA/ACA.

The first part of the PGA/ACA rate case is a year-long period in which rates for gas may be adjusted several times to reflect changing forecasts of the market price of gas. The second part, the ACA, includes a true-up audit and prudence review. Unlike most utility rates, the PGA rates are collected on an interim basis, subject to refund, and are supposed to be a pass-through of the actual cost of gas and its transportation.

The goal of ACA true-up is to determine whether the PGA rates collected enough money or too much money to cover the cost of the gas and its transportation. If too much money was collected, the ratepayers get a credit. If not enough money was collected, the utility gets the credit. The credit, in whoever's favor, is reflected in an adjustment made to the annual rolling balance.

The prudence review of Atmos' gas purchasing decisions is part of the ACA that is at issue in this case. Staff recommends a disallowance if the decisions made by the utility result in the utility paying too much to acquire or transport the gas. If the Commission upholds the disallowance, the ratepayers will cover only a portion of the gas purchase or transportation costs and the shareholders will absorb the rest.

In the present case, this straightforward analysis is complicated by the fact that Atmos, the regulated gas distribution utility, bought gas from Atmos Energy Marketing, LLC (AEM), its wholly-owned, unregulated gas marketing affiliate. During this ACA period, AEM's share of Missouri's gas supply was about 36% of the state's total Atmos requirements.[1]

Alert to the dangers inherent in affiliate transactions, the Commission promulgated rules requiring (1) the utility to keep records of costs associated with its transactions with its affiliate and (2) rules governing the prices that may be charged in such transactions. Affiliate Rules also require the utility to use a competitive Request For Proposal (RFP) bidding process or to defend reasons why it does not.

At the heart of this case, Atmos seeks acceptance of its boilerplate RFP process[2] to be sufficient to set the fair market price for gas supplies as long as both independent third party suppliers, dealing at arms-length, and its affiliate are included in the bid evaluation process.

While Staff considers the RFP / Bid Evaluation process to be a key part of its prudence review and audit, the Staff cannot solely rely on the "robustness" of the RFP / Bid Evaluation process when evaluating the transaction between the LDC and its affiliate. In Atmos affiliate transactions, one senior management – the LDC management - controls both sides of this transaction.[3] Both Atmos and AEM management interests are aligned in a common incentive compensation program where growth in both regulated and non-regulated operations drive the achievement of targeted Earnings Per Share growth of Atmos stock.[4]

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[1] Tr, Vol 5, p 465, lns 9-14.

[2] Ms. Buchanan testified the RFP used in Missouri is the same for Iowa, Kansas, Illinois, Kentucky, Tennessee, and Georgia, and that Atmos is standardizing RFP methodology throughout the company. Tr Vol 5, p 399 ln 11 to p 400 ln 21.

[3] Ex 26, Sommerer Dir p 5.

[4] Ex 26, Sommerer Dir p 12, lns 1-36, citing from Atmos Energy Corporation's 2009 Proxy Statement.

"…[T]he existence of a bidding process does not eliminate the rule's requirement that Atmos not provide a financial advantage to its affiliate, and the mere existence of that bidding process does not necessarily establish the fair market price of the goods and services Atmos obtained from its affiliate company."[5]

Therefore, Staff must scrutinize gas purchases in affiliate transactions by performing a thorough audit and evaluation of documents explaining the cost methodology and allocations of the deal that the utility and the affiliate are required to keep under the record-keeping requirements of the Commission's affiliate transaction rules.

**<u>Overview of Atmos' Affiliate Transactions, Discovery Failures, and Staff's Theory of the Case</u>**

This case comes to the Commission as a dispute over Staff's proposed disallowance of $308,733.39 (hereinafter "$308K") in the 2007-2008 ACA case regarding the gas supplies Atmos bought from its wholly-owned, unregulated marketing affiliate AEM.

This dispute centers on the prudence audit to determine the justness and reasonableness of the gas supplies Atmos purchased from AEM for its northeast service area of Hannibal, Canton, Palmyra, and Bowling Green (hereinafter the "Hannibal" area). The Hannibal system serves over 14,000 customers of which nearly 13,000 are residential customers.[6]

The ACA period runs twelve months from September 2007 to August 2008. For the Hannibal area, there are two RFP / Bid Evaluation periods that overlap this ACA period:

> The <u>first</u> RFP/Bid Evaluation period (RFP 1) covers seven (7) months of the 07-08 ACA period from September 2007 through March 2008, and

[5] *Order Granting Staff's Motion to Compel Atmos to Respond to Data Requests*, Case No. GR-2008-0364, July 15, 2010, p.4.
[6] Ex 1, Buchanan Dir p 4, lns 8-9.

> The second RFP/Bid Evaluation period (RFP 2) covers five (5) months from April 2008 through August 2008.[7]

Each RFP/Bid Evaluation period runs 12 months and straddles two different ACA periods. Staff's analysis considered only the appropriate RFP 1 & 2 time periods germane to the September 2007 to August 2008 ACA period.

At first, Staff's December 29, 2009 Recommendation, based on information it had at the time, proposed a $349,015 disallowance for Hannibal and a $13, 964 disallowance for Butler (in Atmos' western service area).[8] As a result of additional information provided by Atmos to Staff through the discovery process, the Staff withdrew its Butler disallowance and adjusted the Hannibal disallowance downward to $308,733.[9]

The $308K adjustment, discussed below in detail, captures the difference between the fair market price of the gas supplies that AEM bought from its suppliers and the price paid by Atmos to AEM for those supplies during the ACA period.[10] The $308K adjustment makes AEM's fair market price of gas the same as Atmos' fair market price – as if the LDC, using its RFP process and gas buying expertise, had bought the gas supplies for itself, without AEM participation. Staff's analysis of limited available records and the evidence of record show that AEM brought no discernible value to Atmos' captive ratepayers.

After extensive and contentious discovery,[11] AEM was either unable or unwilling to provide supporting documentation required under the record-keeping requirements of the

[7] Ex 24HC, p 2 and App. A.
[8] Tr. Vol 7, p 625 ln 23 – p 626 ln 4.
[9] Tr. Vol 7, p 640, lns 8-17; Ex 28HC, p 18 lns17-20; and, Ex 33HC.
[10] Tr. Vol. 7, p 739, lns 1-5.
[11] On 6/11/10, Staff filed its *Motion to Suspend Proposed Procedural Schedule* because Atmos had not responded to Staff DRs. On 6/14/10, Staff filed its first motion to compel, *Motion and Waiver Request Concerning Discovery* re: DR 117 (J) and (K). On 7/2/10, the Commission suspended the procedural schedule. On 7/15/10, the Commission granted Staff's motion to compel. On 9/14/10, Staff filed its second *Motion to Compel Atmos' Response to Staff DRs*

Commission's Affiliate Transaction rules 4 CSR 240-015(5) and 016(6) ("Rules").[12] AEM's failure to keep records required by the Rules that allocate costs both to and away from the deal obscures transparency of the deal and limits Staff's ability to investigate. AEM's inability to provide records that explain cost methods and value of the deal not only violate the Rules but work in tandem to make AEM's fair market price of gas the same to Atmos had the LDC purchased the same supplies. Atmos the LDC did purchase gas supplies for Hannibal – by choosing to buy supplies through its affiliate AEM.

The legal burden is on Atmos to overcome and explain why AEM's fair market price should not be the same as the LDC's – especially when Atmos the regulated LDC claims a "robust" RFP / Bid Evaluation process for obtaining gas supplies.[13]

From evidence adduced from prefiled and live testimony of Atmos' witnesses, it became clear to Staff that Atmos' lax approach to AEM's failure to meet its contractual obligation to provide firm and warranted gas supplies during 25 days of December 2007[14] caused Hannibal customers to pay more for their gas supplies than they should have. The evidence shows AEM, using the excuse of the Panhandle Eastern Pipeline Haven 400 line rupture,[15] asked Atmos to make significant cuts to its swing gas nominations through the month of December 2007.[16] But

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*117.1 and 131.1*. On 10/20/10, the Commission held a hearing on Staff's second motion to compel. On 11/10/10, the Commission issued its *Order Granting Staff's Motion To Compel Atmos To Respond to Data Requests and Reestablishing Procedural Schedule*.

[12] Tr. Vol. 7, p 728, ln 25 – p 729 ln 21.

[13] Tr. Vol 5, p 249, lns 16-18.

[14] Ex 18 shows 25 days of cuts to Hannibal contract 11671 and 24 days of cuts to Bowling Green contract 11474; Tr Vol 7, p 498 lns 16-19

[15] Tr Vol 5, p 452, lns 17 – 21; p 453 ln 19 – p 454 ln 4.

[16] Tr Vol 7, p 523, lns 7- 15; p 573 lns 13-25; Ex 17 Atmos DR response "Dec 07 – 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."; Ex 18 "Atmos Response to Staff DR 132.2 parts A & C detailing cuts from Nov. 27, 07 and Dec. 4 through 31, 2007."

AEM's outage excuse fails because AEM did <u>not</u> use Haven to bring in Hannibal gas from the field zone.

When Atmos awarded AEM the supply contract, Atmos' granted AEM permission to use the Pony Express secondary receipt point – a gas receipt location on Panhandle well downstream and out of the way of the Haven outage.[17] Panhandle made only 4 days of small cuts to gas flowing through Haven.[18] Even though AEM bypassed Haven to supply Hannibal, AEM still requested Atmos to make large cuts to its Hannibal swing gas nominations.

Hannibal customers paid too much for gas as a direct result of Atmos' blind compliance to AEM's requested cuts to northeast Missouri. The evidence shows that gas failed to show up at the critical time in December 2007 going into the coldest months of the winter. Gas that did not show up had to be purchased later by Atmos at higher average prices in January, February, and March 2008.[19] Atmos passed those higher prices on to Hannibal customers through its PGA.

Atmos' use of the Haven outage to excuse AEM's non-performance is not credible nor logical in light of five compelling and uncontroverted facts:

> (1) The gas flowing to the Butler service area in western Missouri had to flow on Panhandle from the field zone *through* the Haven outage.[20] Panhandle made only 5 days of small cuts to Butler.[21] AEM did not ask Atmos to reduce Butler's swing gas nominations and Atmos did not reduce its swing gas nominations for Butler.[22]
>
> (2) Atmos had to draw down its storage gas to supply Hannibal because of Atmos' decision to cut its swing gas nominations throughout December at AEM's request.[23] Storage gas had to travel from the field zone *through* the Haven outage

[17] See Ex 31, Powerpoint Map of Panhandle Delivery Points, p 5. Tr Vol 5, p 452, lns 9-13.
[18] Tr Vol 7, p 573, lns 1-12 (Panhandle cuts were made Nov. 27, Dec. 8 – 10, 2007; 4 days total)
[19] Ex 28HC, Sommerer Surr p 19, lns 11-22.
[20] Tr Vol 5, p 376, lns 13-17.
[21] Tr Vol 5, p 376, lns 1-7.
[22] Tr Vol 7, p 517, lns 2-6.
[23] Tr Vol 5, p 464, lns 14-19.

to end up at Hannibal city gate.[24] Panhandle made 4 to 5 days of small cuts to storage gas flowing through Haven on two contracts.[25]

(3) During the ACA period, AEM supplied flowing gas to Hannibal by putting gas into Panhandle through Pony Express secondary receipt point, *downstream* from the Haven event, *bypassing* the Haven outage.[26]

(4) Discovery showed AEM had plenty of gas in its Panhandle portfolio of supplies to meet the firm swing gas needs of Atmos *without* having to ask Atmos to cut its swing gas nominations.[27]

(5) AEM did not give Atmos written notice of the force majeure event as it is contractually obligated to do under Section 11.5 of its NAESB base agreement: "…The party whose performance is prevented by force majeure must provide notice to the other party. Initial notice may be given orally; however, written notice with reasonably full particulars in the event or occurrence is required as soon as reasonably possible."[28] The logical conclusion is that AEM had plenty of gas in its portfolio to supply Atmos and did not need to invoke the force majeure provision of its contract with Atmos because of Panhandle's force majeure notice.

Starting as early as October 2008, the Staff had initiated data requests inquiring about service reliability and cuts to the company. Atmos' response by Ms. Buchanan, Atmos' witness in this case, failed to inform Staff of the Haven outage force majeure event.[29] On January 15, 2009, the Staff issued DR 100 inquiring:

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[24] Tr Vol 7, p 590, lns 21-24.

[25] Ex 18 shows 4 days of Panhandle cuts to Hannibal WS storage, Dec. 4-7, 2007, and 5 days of cuts to Hannibal FS storage, Nov.27 and Dec. 4-7.

[26] Tr Vol 5, p 452, lns 8-13.

[27] Ex 28HC, Sommerer Surr p 18 lns 14-16.

[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 27HC, Sommerer Reb, Sched p. 5-27HC.

[29] Ex 4, Staff sent DR 67 to Atmos on 10/9/2008 requesting "If there was any curtailment of gas supply and transportation to the Company and to the Company's customers during the ACA period in this case please provide: (a) The reasons for the curtailments. (b) The amount of penalty gas due to the curtailments. (c) Information on the timing of the curtailments. (d) Revenue impact." On 10/29/2008, the Staff received Atmos' response: "Refer to response to DR 63."; Ex 5 is DR 63, sent by Staff on 10/9/2008 and received 10/29/2008. In DR 63, Staff requested "If any interruptions to the Company's customers occurred in this ACA period, please list the following: date(s) and time of the interruption, names of customers interrupted, any unauthorized volumes taken, any penalties assessed against these customers, and the accounting treatment of any penalty." Atmos witness B. Buchanan responded to the DR and DID NOT address the Haven outage. At hearing, Ms. Buchanan testified that DR-63 does not answer the question in DR-67. See Tr Vol 5, p 347 lns 13-15.

> Regarding reliability for the ACA period, for the pipelines and suppliers that the LDC utilitzed for this ACA period, (a) were there any pipeline or supplier actions, including maintenance or pressure problems, during this ACA period that caused the LDC to question its reliance on the transport, storage, or supplies to be delivered to the LDC? (b) if yes, fully explain the actions that caused the concern and explain what actions the LDC has taken to alleviate those concerns for this ACA and subsequent ACA periods.

On February 4, 2009, Atmos gas buyer Mike Walker responded: "*<u>There were not any pipeline/supplier reliability issues during this ACA period</u>.*"[30] (*<u>emphasis added</u>*) At hearing, Mr. Walker testified that the Haven line rupture/outage was a "rare" event.[31] When asked:

> Q: Are the cuts that impacted 25 days for Hannibal and 24 days for Bowling Green a normal event for Atmos?
> Mr. Walker answered "*No.* "[32]

On January 15, 2009, Staff issued DR 7.1 requesting Atmos provide "The Company's analysis of line-segment constraints that would limit the capacity available to specific citygate points and whether this would permit the receipt of full peak day requirements at specific city-gate points." Atmos responded on February 4, 2009, *"…there were no line-segment constraints that limited the capacity available to the company's city gates and/or receipt of full peak day requirements."*[33]

Atmos responses, if accurate – as Staff believed them, tells the Staff there are no pipeline/supplier issues affecting reliability and there are <u>no</u> line-segment constraints limiting capacity available to the company – not at Panhandle and <u>not</u> at Pony Express downstream of Haven. The facts show otherwise. The record evidence shows that Atmos' early DR responses

[30] Ex. 7 is Staff DR 100 and Atmos' response by M. Walker.
[31] Tr Vol 7, p 498 lns 12-15.
[32] Tr. Vol 7, p 498 lns 20-23.
[33] Ex. 6 is Staff DR 7.1 and Atmos' response.

were incorrect and inaccurate, misleading Staff's evaluation of Atmos' gas purchasing practices and the supply reliability of AEM.

Despite Staff's efforts early on to obtain information on reliability, the company did not come forth with it. Atmos did <u>not</u> disclose to Staff Panhandle's line rupture at Haven and AEM's late November- December 2007 reliability issues and ensuing cuts until <u>after</u> rebuttal testimony was filed on June 14, 2010.

Staff witness Dave Sommerer testified on October 20, 2010, informing the Commission of his concern that Atmos did not receive significant quantities of gas supplies it had ordered from AEM starting in late November 2007, and that there appeared to be some sort of "value play" going on, driving up the total cost of the supply contract to ratepayers.[34]

Because Atmos had repeatedly asserted there were no reliability issues affecting the company, the Staff took Atmos at its word. Only <u>after</u> rebuttal testimony was filed did Staff receive Atmos responses to DRs 132.1 and 132.2 and learn that Atmos' earlier DR responses were not accurate and that Atmos had made significant cuts to its swing gas nominations throughout December 2007 based on Atmos' fresh claims of a line rupture causing an outage at Haven – later declared a force majeure event.[35] Staff DR 132.1 asked Atmos to explain, among other things, its nominations for December 2007. Atmos responded July 15, 2010, in part: "*Dec07 – Actual nominations were lower than planned nominations because a Haven 400 Line*

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[34] Tr Vol 3, p 128 ln 8 – p 129 ln 23; p 138 ln 11 – p 139 ln 1;and, Tr. Vol 4, p 181 ln 4 – p 182 ln 15.

[35] Ex 19, Panhandle Eastern Pipe Line Company, LP, Critical Notice declaring 400 line rupture to be a force majeure event, effective Nov.26, 2007, pursuant to section 8.8(b) of Panhandle's FERC Gas Tariff; <u>beginning curtailments effective December 8, 2007</u>, in accordance with Section 9.2 of Panhandle's FERC Gas Tariff. Tr Vol 7, p 559 lns 2-3. NOTE: The 400 line rupture occurred on November 21, 2007. Panhandle sent out a critical notice informing shipper/suppliers of 400 line rupture. Tr Vol 7, p 559 lns 4-8.

*rupture occurred during late Nov07, resulting in the pipeline curtailing nominations during December, which reduced actual nominations.*"[36]

On August 27, 2010, the Staff issued DR 132.2 re: "follow up regarding Have[n] 400 line curtailment." Atmos responded to Staff in its "Response to Staff DR 132.2 parts A & C", a spreadsheet showing extensive cuts to Hannibal (25 days) / Bowling Green (24 days) throughout December 2007, including 5 days of smaller cuts to Butler.[37]

Because of Atmos' late about-face in its DR responses on supply reliability and the guidance Staff received from the Commission at its October hearing, the Staff closely scrutinized Atmos' nominations to AEM for December 2007.

As a result of Atmos' failure in earlier Staff DRs to disclose the Haven outage, its effect on reliability, and the cuts Atmos made to Hannibal, the Staff was forced to address the harm done to ratepayers in its surrebuttal testimony. In effect, Atmos had sandbagged Staff with incorrect information by neglecting to address the impact on Atmos of the Haven line rupture – an event that Atmos, much later in its responses to Staff DRs, now alleges to be the root cause of its cuts to its swing gas nominations in December 2007.

Despite a deposition, Staff learned from Atmos gas specialist Mike Walker's testimony at hearing that he had imposed cuts on his swing gas nominations to Hannibal because his supplier AEM asked him to make them.[38] In Staff's surrebuttal, Staff rebutted Atmos' hollow claims (made in its pre-filed direct and rebuttal testimony) of having reliable firm supply and claims that

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[36] Ex 17 is Staff DR 132.1 sent 6/25/10 re: "questions on individual nominations" and answered by Atmos on 7/15/10.

[37] Ex 18, also Ex 28HC Sommerer Surr Sched 3-1 HC.

[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 <u>no</u> pipeline cuts on days 9 through 31 [December 07]. Tr Vol 7, p 520 lns 1-8.

Hannibal got all of its gas – which hearing testimony and Atmos' DR responses clearly show Hannibal did not get all its gas.

Staff's Scenario 1 and 2 calculation of harm to ratepayers flows from the unreasonably low, unsupported and imprudent first-of-month baseload nomination Atmos made for December 2007. Staff's calculation recognizes that the Haven 400 line rupture caused no pipeline reductions to first-of-month baseload gas nominations for December 2007.[39]

Staff's Scenario 1 and Scenario 2 adjustments of $52,572 and $85,577 respectively capture the range of additional and unnecessary costs passed on to Hannibal customers. The adjustments measure harm to ratepayers from the higher cost of gas supplies that had to be purchased much later due to the low December 2007 baseload nomination. Both Scenarios are based on the *reasonableness* of purchasing decisions using information *known at the time* those decisions were made and are explained below in greater detail.

The Scenario 1 and Scenario 2 adjustments are not additive to the $308K proposed disallowance. The $308K adjustment equalizes the fair market price/value of the gas supplies between AEM and Atmos LDC based on the limited and incomplete records of the affiliate transaction provided to Staff by Atmos and AEM. If the Commission should approve the $308K disallowance, then the Scenario 1 and 2 adjustments fall out.

**Legal Standards, Supporting Case Law and Affiliate Requirements**

Prudence Standard

MO statute section 393.130.1 requires that "All charges for gas service must be just and reasonable."

[39] Ex 28HC, Sommerer Surr, p 12, lns 15-21.

To determine whether a utility's costs meet this statutory requirement, the Commission employs a "Prudence" standard. It is the governing legal standard in this case.

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)(hereinafter "ANG").

ANG <u>defines</u> the "Prudence Standard" as follows:

> "A utility's costs are presumed to be prudently incurred…. However the presumption does not survive a showing of inefficiency or improvidence.
>
> 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.
>
> 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."

Though the Commission follows a "prudence" standard, this case is further complicated by Atmos having chosen its unregulated affiliate AEM to buy gas supplies for Hannibal area.

Because this case involves an affiliate transaction, it calls into play the Commission's Affiliate Transaction rules and the case law supporting the affiliate rules. Case law is clear there is no presumption of reasonableness when a utility deals with its affiliate.

<u>In an Affiliate Transaction the Burden is on the Company to Show the Reasonableness of its Transactions with its Affiliate</u>

The presumption that is to be applied to companies that engage in affiliate transactions is aptly stated on p. 311 of The Process of Ratemaking, Vol. I[40]:

> *Services provided by the affiliate*.
> Unlike ordinary expenses of a regulated company, expenses paid to an affiliate do not carry a presumption of reasonableness. The burden is on the company to prove their reasonableness.
> [See U.S. West Communications, Inc. v. Utah PSC, 901 P.2d 270, 1995 Utah LEXIS 46 (Utah, 1995)]

A utility's costs are presumed prudent when parties deal in an arms-length transaction. But when the dealings are between affiliates, section 393.140(11) and 4 CSR 240-40.015 clearly remove any presumption of prudence and place the burden of record keeping and compliance with the law on Atmos. "It is generally held that …the utility bears the burden of proving that expenses incurred in transactions with affiliates are reasonable."[41]

"Throughout the United States it is recognized that a public utility's dealings with affiliates require thorough investigation and close scrutiny by a public utility commission."[42]

The Commission's Affiliate Transaction Rules 4 CSR 240-40.015(6)(C) and 40.016(7)(C) do "…not modify existing legal standards regarding which party has the burden of proof in commission proceedings." The case law discussed above puts the burden on Atmos.

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[40] The Proces of Ratemaking Volume I, Leonard Saul Goodman, Public Utilities Reports, Inc., Vienna, Virginia, 1998, p. 311.

[41] Boise Water Corp. v. Idaho Public Util. Commission [Boise Water I], 97 Idaho 832, 555 P.2d 163, 167-169 [1976]; Boise Water Corp. v Idaho Public Util. Com'n. [Boise Water II], 99 Idaho 158, 578 P.2d 1089, 1090, 1091 [1978]; Washington Water Power v. Idaho Public Util., supra note 26, 617 P.2d at 1251 and Southwestern Bell v. State Corp. Com'n of Kan., 4 Kan.App.2d 44, 602 P.2d 131, 133 [1979].

[42] Turpen v. Oklahoma Corp. Comm., 769 P.2d 1309, 1320 (OK. Sup.Ct. 1988) citing United States v. Western Elec. Co., Inc. 392 F.Supp.836,853 [D.D.C. 1984] See also Smith v. Illinois Bell Teleph. Co., 282 U.S. 133, 157, 51 S.Ct. 65, 72, 75 L.Ed. 255, 267 [1930]; General Tel. Co. of Upstate N.Y. v. Lundy, 17 N.Y.2d 373, 271 N.Y.S.2d 216, 222-23, 218 N.E.2d 274, 278-279 [1966]; New England T.&T. Company v. Dept. of Pub. Util., 371Mass. 67, 354 N.E.2d 860868-869 [1976]; Washington Water Power v. Idaho Public Util., 101 Idaho 567, 617 P.2d 1242, 1247-1248, 16 A.L.R.4th 435 [1980]; Pacific Telephone and Telegraph Co. v. Flagg, 189 Or. 370, 220 P.2d 522, 529-530 [1950] and Town of New Shoreham v R.I. Pub. Util. Com'n., 464 A.2d 730, 733 [R.I. 1983].

Missouri's Supreme Court Warned of Dangers of a Utility Dealing with its Affiliate When it Upheld the Commissions' Affiliate Transaction Rules

The Missouri Supreme Court articulated that when a traditional regulated monopoly expands into non-regulated areas, that "… expansion gives utilities the **opportunity and incentive** to shift their non-regulated costs to their regulated operations with the effect of unnecessarily increasing the rates charged to the utilities' customers…. As long as a [public utility] is engaged in both monopoly and competitive activities, it will have the **incentive as well as the ability** to 'milk' the rate-of- return regulated monopoly affiliate to subsidize its competitive ventures."[43] [**emphasis added**]

The Record-Keeping Requirements of the Affiliate Transaction Rule are Critical to Staff's Evaluation of Gas Purchasing Decisions for Prudence

The Procurement Analysis Department Staff relies heavily on information supplied by Atmos and its affiliate AEM to fully evaluate the gas purchasing decisions of the gas utility. Staff's scrutiny of affiliate records is essential to its prudence review. Staff may uncover preferences passed to the affiliate in any number of subtle ways. The Affiliate Transaction Rule 4 CSR 240-40.015 section (5) requires records of affiliated entities as follows:

> **(5) Records of Affiliated Entities.**
> **(A) 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**

[43] State ex rel. Atmos Energy Corporation v. Public Service Commission, 103 SW.3d 753, 764 (Mo. Sup. Ct. enbanc 2003).

> **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]**
> 4. Descriptions of the types of services that corporate divisions and/or other centralized functions provided to any affiliated entity or division accessing the regulated gas corporation's contracted services or facilities;
> 5. Names and job descriptions of the employees from the regulated gas corporation that transferred to a nonregulated affiliated entity;
> 6. Evaluations of the effect on the reliability of services provided by the regulated gas corporation resulting from the access to regulated contracts and/or facilities by affiliated entities;
> 7. Policies regarding the availability of customer information and the access to services available to nonregulated affiliated entities desiring use of the regulated gas corporation's contracts and facilities; and
> 8. Descriptions of, and supporting documentation related to, any use of derivatives that may be related to the regulated gas corporation's operation even though obtained by the parent or affiliated entity.

The companion Marketing Affiliate Transaction Rule 4 CSR 240-40.016 section (6) Records of Affiliated Entities is a mirror copy of the above record-keeping requirements 1. through 8.

<u>Atmos' Unsuccessful Missouri Supreme Court Challenge of Affiliate Transaction Rules Targeted the Rule's Record-Keeping Requirements</u>

Atmos' clearly understands the Rule's requirements for keeping affiliate transaction records. In 2003, Atmos contested its requirement to keep records when it unsuccessfully challenged the Commission's affiliate Rules at the Missouri Supreme Court. In excerpts from its brief to the Court, Atmos strenuously argued *against* the Rule's record-keeping requirements:

*The Rules violate that statute because they purport to bring the unregulated business under the jurisdiction of the Commission. For example, they require a utility to"ensure" that affiliates keep their records in a certain way and require the utility to "make available" the records of the unregulated affiliates.* ***See****, 4 CSR 240-40.015(5) and (6); 4CSR 240-80.015(5) and (6). Thus, the Commission is using its jurisdiction over the regulated utility to force the unregulated affiliate corporation to keep its separate books and records in a manner deemed suitable by the Commission. This clearly violates the statutory mandate that the* ***unregulated*** *business* ***shall not*** *be subject to any provisions of the Public Service Commission law. See, § 393.140.12 RSMo.* [44]

*Another example can be found in sections (5) and (6) of 4 CSR 240-40.015, sections (6) and (7) of 4 CSR 240-40.016, and sections (5) and (6) of 4 CSR 240-80.015. These are unreasonable and unlawful, an abuse of discretion and in excess of the jurisdiction of the Commission because they* ***require a gas corporation and a steam heating company to "ensure" that its affiliates keep their records in a certain way and require the gas corporation or steam heating company to "make available" the records of the affiliates****. These provisions thus purport to impose indirect controls and conditions on entities over which the Commission has no subject matter jurisdiction. Natural gas utilities in Missouri and elsewhere may release the interstate pipeline capacity they hold pursuant to rules established by the Federal Energy Regulatory Commission (FERC) and the tariff* ***(Emphasis added)***[45]

The Commission must enforce compliance. Atmos must be held accountable for its failure to keep records of its affiliate transaction. Atmos' brief to the Court finds the Rule's record-keeping requirements to be burdensome and a hindrance to doing business with its affiliate. Its unsuccessful Court challenge does not excuse Atmos' duty of compliance.

If Atmos does not wish to build into its business model the processes needed to keep proper records, then Atmos has two choices. It may either stop doing affiliate transactions in the state, or it may apply to the Commission for a waiver from the Rule.

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[44] Excerpt from *Substitute Initial Brief Of Appellants Atmos Energy Corp., Missouri Gas Energy, Laclede Gas Co., and Trigen-Kansas City Energy Corp.*, p. 41, in State of Missouri ex rel. Atmos Energy Corporation, et al., Appellants, vs. Public Service Commission of the State of Missouri, et al., Respondents and Ameren Corporation and Union Electric Company, d/b/a AmerenUE, Appellants, vs. Public Service Commission of the State of Missouri, et al., Respondents, In the Supreme Court of Missouri, SC84344.

[45] *Id* at pp. 45-46.

**$308,000 Proposed Disallowance Flows From Atmos' Failure to Keep Adequate Records Required by the Affiliate Rules**

As discussed above, the $308K adjustment[46] equalizes the fair market price/value[47] of the gas supplies purchased by AEM to the fair market price/value of Atmos LDC. Staff witness Sommerer testified:

> The Staff's focus in this case has been about fair market value, what is the utility's fair market value for the goods and services that were purchased from the affiliate. We believed it relevant to look at AEM's fair market value as perhaps impacting the ultimate fair market value decision.
>
> If you take a look at the entire gross revenues of AEM and you make a mathematical calculation removing the gross margin, you will arrive at an estimate of the fair market value of AEM's supplies. So although we've discussed profit, that was not the -- primary goal. It was an indirect result of trying to measure AEM's fair market value.[48]

The $308K adjustment is not proposed because AEM made a profit, it was proposed because the basis of the $308K adjustment was not fully supported by AEM.[49] 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.[50]

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[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.
[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.
[48] Tr Vol 7, p 612 lns 1-13.
[49] Tr. Vol 7, p 612, lns lns 21-24.
[50] Tr Vol 7, p 631, ln 8 to p 632 ln 5.

When Staff attempted 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.[51]

Staff could not have known AEM's costs associated with the affiliate transaction because the single AEM document did not answer Staff's questions. AEM had compared the generic Panhandle cost of supply to the revenues AEM earned from Atmos.[52] AEM listed gross profits. AEM did not report net profit.[53] 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.[54]

> What records was Staff looking for from AEM? 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."[55]

Mr. Sommerer is spot on correct about the records AEM is required to keep. The 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 ***maintain books and records that include, at a minimum,*** the following information regarding affiliate transactions:

[51] Tr Vol. 7, p 613, lns 2-9.
[52] Tr Voll 7, p 634 lns 14-19.
[53] Tr Vol 7, p 635, lns 6-9.
[54] Tr Vol 7, p 638 ln 8 to p 639 ln 18.
[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.[56] AEM should have kept additional records to provide support for its fair market value of gas supplies charged to Atmos.[57]

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[58] which was not responsive to the allocation of costs to and away from the transaction.

For the Company 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

[56] Tr Vol 7, p 674, lns7-8.
[57] Tr Vol 7, p 731 lns 11-17.
[58] Tr Vol. 7, p 729 ln 25 to p 731 ln 17.

from AEM for captive Hannibal customers, the Staff is unable to scrutinize the transactions for reasonableness. Atmos and AEM have not met that burden and have not complied with the Affiliate Rules record keeping requirements.

Staff had to bring this matter to Commission attention and propose that it order the $308K disallowance to bring to Atmos' Hannibal customers the fair market price of AEM's cost of supplies that are tied to AEM's actual sale of gas to the LDC.

Further aggravating Atmos' non-compliance with the Affiliate Rules' record-keeping requirements is that the Company *knows* its requirement to keep affiliate transaction records, as demonstrated by Atmos' unsuccessful challenge in the Missouri Supreme Court.

The Commission must hold harmless Hannibal customers from the failure of Atmos and AEM to keep the records required by the Affiliate Rules. If the Commission does not enforce its Affiliate Rules, then the Commission will be powerless to scrutinize and to police affiliate transactions in the state. The public interest demands transparency in affiliate transactons and the Affiliate Rules provide for it.

**Scenario 1 and 2: Measures of Harm to Ratepayers From Imprudent Decisions in Making December 2007 Baseload and Swing Gas Nominations**

As discussed above, Staff's Scenario 1 and Scenario 2 adjustments of $52,572 and $85,577 respectively capture the low to high range of additional and unnecessary 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 empty reasons of the Haven line rupture. 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.[59]

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:

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.[60]

| December 2007 Baseload Nomination (NOM) for Hannibal Area | |
|---|---|
| Total Planned Normal First of Month (FOM) Nomination | = 4,680 Mcf[61] |
| Total FOM Nomination adjusted 20% per Atmos MO Supply Plan | = 3,730 Mcf[62] |
| Atmos' Actual FOM Nomination | = 2,800 Mcf[63] |

The actual December FOM NOM is 75% of Atmos' MO Supply Plan, or 25% below the percentage adjustment specified in the Plan.[64]

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 and Atmos' December

[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.
[60] Ex 1, Buchanan Dir, Attach. 1, Gas Supply And Services Manual," 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 op 544 ln 12.
[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.
[62] Ex 20; Tr Vol 7, p 544 ln 13 to p 547 ln 8.
[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.
[64] Tr Vol 7, p 548 lns 19-25.

baseload FOM NOM did not take the end of month November storage deficiency into consideration, as Atmos Gas Supply Plan requires.

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.*"[65] 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 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.[66]

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.*"[67] 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.[68]

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.*

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[65] Tr Vol 7, p 558 lns 7-11.
[66] Ex 28 HC, Sommerer Surr p 16, lns 10-12.
[67] Ex 1, Buchanan Dir, Attach 1, <u>Atmos Gas Supply Plan</u>, "Gas Supply Plan Procedure, Effective January 1, 2007", para. 2.
[68] Tr Vol 5, p 426, lns p 426 ns

> *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.*[69]

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, saying "*Well you did not know what your storage for November was going to end up 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.*"[70]

This raises the question. Even with the early baseload NOM, 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.[71] Late November 21st, Panhandle issued its first notice

[69] Tr Vol 5, p 424 ln 23 to p 425 ln 10.
[70] Tr vol 5, p 426, lns 9-13.
[71] Tr Vol 7, p 556 ln 3 to p 557 ln 25.

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.[72]

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.[73] This means 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 deemed that his storage balance was where 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.[74]

Staff contends it would have been reasonable 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.[75]

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[72] Tr Vol 7, p 558 ln 25 to p 560 ln 18.

[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.

[74] Tr Vol 7 p 580 ln 22 to p 583 ln 1.

[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.

Alarming to Staff is the loose interpretation of the RFP letter taken by Mr. Walker and Ms. Buchanan. They both testified that the requirement to make the FOM baseload NOM is "5 or 6 working days"[76] 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 unreasonably low baseload FOM NOM, its low storage level, the cold snap in late November,[77] and the Panhandle notice, would have been for Atmos to increase its December baseload FOM NOM to make up for it being 25% 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 calls for 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

[76] Tr. Vol 7, p 582, lns 12-13; Tr Vol 5, p 436 lns 13-15.
[77] Ms. Buchanan testified there was a cold snap later in the month of November 2007. Tr Vol 5, p 426 lns 18-21.

the 5% storage deficiency and to include additional gas to raise the Company's storage level to 5% above its plan.[78] (Scenario 1 brings storage up to 100% of plan).

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.

As discussed above, the ANG case defines the "Prudence Standard" as follows:

> "A utility's costs are presumed to be prudently incurred…. However **the presumption does not survive a showing of inefficiency or improvidence**.
>
> 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.
>
> 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.[79]" 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.

**Policy Implications of Atmos' ACA Review, Discovery Lapses, and Affiliate Transactions**

During the discovery phase of this case, Atmos thwarted Staff's efforts seeking records of the supply deals made by AEM to supply its captive LDC. To perform a careful and thorough

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[78] Ex 28HC, Sommerer Surr p 20 lns 1-16.
[79] Webster's II New College Dictionary, Houghton Mifflin Company, 1999, p. 557.

prudence review, the Staff must examine records documenting the economics and rationale of the supply deals patched together by the affiliate.

Audit of the affiliate tends to be detailed and forensic in nature. The audit seeks to "peel layers off the onion" to get to the fair market price of the supplies bought by AEM – gas supplies that could otherwise have been bought by the LDC without AEM's involvement. Unless Atmos can show documented evidence of any special value AEM brought to the "deal", without sacrificing supply reliability, Staff auditors have no documented costs to justify why the LDC's fair market price of gas supplies should not be the same as AEM's.

Staff's prudence review of the LDC's gas purchasing decisions is an effort to establish whether the fair market price of the gas bought by the affiliate AEM is the same, or close to, the fair market price of gas if that gas had been purchased by the LDC from gas suppliers. Staff's Atmos audit looks at, among other things, pricing, receipt and delivery points, gas volumes, transportation contracts and capacity constraints, contracted service levels, and risk exposure. All these things, and more, make up the fair market price of gas supplies.[80]

When records either do not exist or are incomplete or inaccurate, the Staff completes its prudence review with the information available to make a reasonable determination of fair market price. Add in time and resource draining discovery disputes, and the process grinds slowly, if at all.

This situation is not uncommon. In Illinois, Atmos also bought gas from its affiliate AEM. The Illlinois Commerce Commission had a similar contentious docket with an affiliate

[80] Ex 27HC, Sommerer Reb p 4, lns p 4 lns 1-16; Ex 28HC, Sommerer Surr p 8, lns 1-8; p 9 ln11 to p 10 ln 5; Tr Vol 4, p 142 ln 17 to 143 ln 3; Tr Vol 7, p 740 ln 21 to p 741 ln 20.

disallowance that has gone on over a number of years. Illinois has a number of controversial and difficult ACA cases with Atmos that are still pending.[81]

The Railroad Commission of Texas (RCT) has addressed the matter of Atmos' gas dealings with its affiliate marketer. In the RCT's Final Order in an Atmos Energy Corp., Mid-Tex Division Gas Utility Docket, the RCT, in its Findings of Fact, reported the Commission established a triennial review procedure and imposed seven standards on the gas purchases of the utility. Though the RCT did not prohibit Atmos' affiliate transactions, two conditions are quite striking:

> a. Affiliate purchases may be included at the lowest price charged by the affiliated supplier to other divisions, affiliates, or third parties for the same class of purchased gas. [and]
>
> f. Charges by affiliates of any margin above the affiliate's cost of gas may not be included.[82]

Standard 12 a. provides ratepayers with the lowest cost of gas supplies in the affiliate's portfolio and 12.f. prevents any margin above the affiliate's cost of gas from being included in the PGA.

It is logical to conclude from 12 a. and f. that the RCT's "standards" did have a chilling effect on Atmos' affiliate transactions in Texas. Atmos witness Buchanan testified "*The Company's Texas jurisdiction alone comprises more than half of all Atmos' utility business throughout its system, yet it does no business with AEM in Texas.*"[83]

At hearing, Atmos made much of Staff's Position Statement filed June 30, 2010, when Staff was caught in the heat of a discovery dispute that had caused Staff to file incomplete rebuttal testimony:

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[81] Tr. Vol 7, p 739 ln 15 – p 740 ln 3.

[82] Ex. 13, Final Order, Railroad Commission of Texas, Gas Utility Docket 9696, p.3, para. 12 a. and f., August 18, 2009.

[83] Ex 3, Buchanan Surr, p 5 lns 22-23.

> Staff further states that Atmos has waged an unrelenting campaign of discovery obstruction during the course of this case in order to prevent Staff from determining whether Atmos unlawfully provided financial and other advantages to AEM, wholly-own, captive, unregulated-gas-marketing subsidiary, in any number of subtle ways. Further, Staff points out that Atmos' behavior in this regard is common among Missouri LDCs, with the result that Staff now urges the Commission to prohibit LDCs from engaging in gas supply transactions with unregulated affiliates and subsidiaries.[84]

This problem is of Atmos' own making. Atmos has all the information. Atmos' failure to provide complete DR responses and its failure to keep adequate records that explain and document its supply transactions as required by the Affiliate Rules falls squarely back on Atmos.

The burden stays on Atmos to show the reasonableness of its transactions with its affiliate AEM. Atmos is required by the Affiliate Rules to keep records that permit Staff auditors to scrutinize the transactions as required by law. Atmos has a duty to be accurate and complete in its DR responses to Staff, and to update its responses as necessary.

If Atmos finds its duties too burdensome to its regulated or unregulated businesses, then Atmos should consider other options: Either not do affiliate transactions, or apply for a waiver from the Rule, or comply with the Rule and keep transaction records.

Because of the enormous amount of time and resources consumed by affiliate cases under their current posture, the Commission may also consider other options. For example, the Commission may initiate a rulemaking prohibiting affiliate transactions or a rulemaking imposing the protective standards adopted by the Railroad Commission of Texas in its Atmos Mid-Tex Division docket, discussed *above*.

[84] Ex 29, Staff Position Statement, June 30, 2010, p.2.

Greenbrier Hills Country Club v. Director of Revenue

At hearing, Commissioner Davis directed Staff counsel to address Greenbrier Hills Country Club v. Director of Revenue in its brief.[85]

The Greenbrier case held that agencies cannot promulgate, or repeal, a rule by an adjudicated order. The Court was careful to distinguish Greenbrier and cases where agency adjudication may serve as vehicles for the formulation of agency policies that generally provide a guide to action that the agency may be expected to take in future cases.[86]

Accordingly, Staff does not suggest, nor does Staff recommend, that the Commission promulgate any change or repeal of any section of the Affiliate Rules by adjudication. On the contrary, Staff urges the Commission to enforce compliance with the Affiliate Rules.

From abundant evidence of record, it is clear that Atmos did not follow the Rules' record-keeping requirements when Atmos failed to assure its affiliate identify, track, and allocate costs both to and from its gas purchases and then further failed to require records of its gas transactions. By not keeping records, Atmos created a situation where Staff could not determine the fair market price of the gas supplies sold by AEM to the LDC. The consequences of Atmos' failure to keep timely and accurate records or to request a variance from the Rules should fall on Atmos – not on Missouri ratepayers.

Furthermore, the Greenbrier Court also held "…that '[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."[87]

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[85] Tr Vol 5, p 307, lns 17-21. Greenbrier Hills Country Club v. Director of Revenue, 47 S.W.3d 346 (Mo. Banc 2001)
[86] *Id.* at 357.
[87] *Id* at 356, citing to *Missouri Nat. Educ. V. Missouri State Bd.* 695 S.W.2d 894, 897 (Mo. Banc 1985), citing *to Page Western, Inc. v. Community Fire Protection District of Saint Louis,* 636 S.w.2d 65, 68 (Mo. Banc 1982).

Clearly, the law requires the Commission to enforce its own regulations. Public interest requires the Commission to hold captive Hannibal area customers harmless from Atmos' failure to provide Staff auditors the documentation necessary to explain and evaluate the costs and cost methodology of Atmos' affiliate transactions required under the Affiliate Rules.

**Conclusion and Relief Requested**

AEM had plenty of flowing gas supplies in its Panhandle portfolio to meet Atmos' December 2007 *firm and warranted* swing gas needs for the entire month. AEM took advantage of Atmos, and Atmos' consent for AEM to use the Pony Express line to bring in its gas to Panhandle – especially in light of the fact the transaction confirmations and the RFP letter called for delivery into Haven. AEM's gas never flowed through Haven. The gas supplied by AEM to Butler and the storage gas that Atmos had to draw down to serve Hannibal flowed through Haven and through the Panhandle 400 line rupture, with minimal cuts.

Atmos, at AEM's request, made significant cuts to its swing gas orders throughout December 2007. Atmos cites the Panhandle Haven 400 line rupture as its reason for "helping out" AEM. But that reason fails because AEM supplied Hannibal by delivering gas into Panhandle well downstream of the Haven rupture through the Pony Express line, bypassing Haven. This raises the question: why did AEM, with plenty of "firm" flowing gas supplies, ask Atmos to reduce its swing gas NOMS throughout December 2007?

The record evidence suggests that AEM secured a preference from its overly-compliant and unquestioning affiliate when the LDC made swing gas NOM cuts at AEM's request.

Atmos had to make up those "cut" swing gas supplies at higher cost to Hannibal ratepayers by buying gas in the cold months of the winter, January, February, and March 2008.

Those costs were passed to ratepayers through the PGA. AEM continued to deliver gas to its other customers served on Panhandle, to the benefit of Atmos shareholders.

The record of this case, from the beginning, shows Atmos' long history of inaccurate and incomplete DR responses to Staff – effectively misleading Staff on the issue of supplier and pipeline reliability and calling into question Atmos' good faith and fair dealing in its responses to Staff's DRs.

This case cries out the need for transparency in affiliate transactions in Missouri. Without the records required under Missouri's Rules, the Staff and the Commission are not able to closely scrutinize and police affiliate transactions – a duty required of the Commission under its own Rules, existing case law, and Missouri statute.

Staff's reaction was to address reliability and the harm to Hannibal customers in its surrebuttal testimony, directly rebutting Atmos' rebuttal testimony that there were no problems. And when reliability problems of December 2007 nominations came under the light of day after rebuttal testimony had been filed, the Staff calculated the harm to customers in its Scenario 1 and 2 adjustments, ranging from $52,572 to $85,577, respectively, and included it in its surrebuttal testimony.

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 required by the Affiliate Rules. The $308K disallowance makes AEM's fair market value/price of gas supplies the fair market value/price to Atmos the LDC. Had AEM and Atmos provided the required cost allocation and cost methodology documentation, the Staff would have considered that information in mitigating the adjustment downward.

Accordingly, the Commission should issue an order approving Staff's proposed $308K disallowance and hold Hannibal customers harmless from Atmos and AEM's failure to document costs and to keep records required by the Rules, and the Company's failure to meet its legal burden to show that AEM's fair market price of the gas supplies should not be the same for Atmos the regulated LDC.

In the alternative, if the Commission should not approve the $308K disallowance, then the Commission should issue an order approving the Scenario 1 adjustment of $52,572 or Scenario 2 adjustment of $85,577 because the record evidence shows that Atmos' gas purchasing decisions in December 2007 were not reasonable and not prudent based on its own Gas Supply Plan procedure and the information known at the time those decisions were made, pursuant to the prudence standard in the ANG case discussed above.

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 29th day of April, 2011.

**/s/ Robert S. Berlin**