

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

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

**REPLY BRIEF OF THE
OFFICE OF THE PUBLIC COUNSEL**

The Office of the Public Counsel (OPC) offers this Reply Brief to respond to the Post-Hearing Brief of Atmos Energy Corporation (Atmos). Throughout this case, and throughout Atmos' brief, Atmos has attempted to turn the focus away from its practices, and to make this a case about the Commission's Staff. To that end, Atmos has alleged inconsistencies in the Staff's position and has even gone so far as to make the absurd accusation that the Staff's disallowance recommendation is nothing but retaliation against Atmos for Atmos' refusal to provide requested records.¹ Atmos offers no evidence that remotely supports this claim – instead Atmos offers nothing more than unsupported accusations. The evidence of the case shows a Staff motivated by ensuring that ratepayers pay no more than just and reasonable rates. The Commission's Staff has been diligent in investigating Atmos' gas costs and in following up as additional data was reluctantly released by Atmos.

This is a case about Atmos, a regulated monopoly provider of an essential service that charged customer for natural gas before the rates charged have been determined to be

¹ Post-Hearing Brief of Atmos Energy Corporation, p. 35.

just and reasonable. Now is the time to determine whether the prices paid by Atmos for natural gas were lawful, and whether Atmos gas purchasing decisions were prudent.

Atmos Misstates the Prudency Standard

In its Post-Hearing Brief, Atmos tries to modify the Commission's prudency standard by claiming that the Commission is to consider "industry standards" along with the circumstances at the time of the gas purchasing decisions.² Atmos conveniently replaced the Commission's "reasonable person" standard with its own "industry standard" without any support whatsoever, and makes no mention of the reasonableness standard. Atmos cites to *State ex rel. Associated Natural Gas Company v. P.S.C.*, 954 S.W.2d 520 (Mo. App. W.D. 1997)("ANG") to support its legal analysis, however, the Court of Appeals in ANG explained the standard adopted by the Commission in ACA cases is one of reasonableness:

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 tasks confronting the company.³

Atmos' purported prudency standard should be rejected and the true reasonableness prudency standard should be followed in this case. The question to ask is whether a reasonable person responsible for ensuring just and reasonable gas costs would have made the decisions that Atmos made in acquiring gas supply for this ACA period.

Atmos Misstates Staff's Position

Atmos misstates the Staff's position in claiming that it is the Staff's position that "Atmos did not act prudently when it failed to nominate the maximum level of

² Post-Hearing Brief of Atmos Energy Corporation, April 29, 2011, p. 9.

nominations possible under its contract with its affiliate, AEM, during December 2007 when a Force Majeure event had been declared”.⁴ OPC is aware of no instance where the Staff argued that Atmos should have nominated the *maximum* amount possible. The citation provided by Atmos (Sommerer Surrebuttal Testimony pp. 19-20) does not support Atmos’ mischaracterization of the Staff’s argument – nowhere on the cited pages does the Staff make this argument. Instead, the Staff is critical of Atmos’ unexplained decision to nominate far below the average baseload amount of December gas, even when adjusted for warmer weather. Atmos’ attempts to distort the Staff’s position are an attempt to twist the issue, and are indicative of Atmos’ weak explanations as to why its low nominations occurred, which resulted in harmful rates for consumers.

Atmos Erroneously Concludes that OPC Has “Not Challenged the Prudence of Accepting the Lowest Bid from an Affiliate”

Atmos argues that “Staff and Public Counsel have not challenged the prudence of accepting the lowest and best bid, even if it comes from an affiliate.”⁵ Atmos may be correct when it states that Staff and OPC have not challenged the prudence of accepting low bids, however, Atmos is incorrect in concluding that OPC is not challenging the prudence of purchasing natural gas through AEM. OPC specifically challenges the prudence of purchasing gas at a marked up price from an affiliate gas marketer rather than by acquiring the gas resources for itself without such a mark-up, something Atmos is fully capable of doing. Atmos’ weak argument that it lacks the expertise necessary does not overcome the Staff’s evidence showing that nothing prevented Atmos, the largest

³ *State ex rel. Associated Natural Gas Company v. P.S.C.*, 954 S.W.2d 520 (Mo. App. W.D. 1997).

⁴ Post-Hearing Brief of Atmos Energy Corporation, p. 12.

⁵ Post-Hearing Brief of Atmos Energy Corporation, p. 17.

LDC in the nation,⁶ from acquiring the gas supply itself rather than through a middle-man created for the sole purpose of flowing profits back to Atmos' shareholders.

Atmos' Continues to Protect the Records of its Affiliate

Atmos' decision not to be forthcoming with evidence from its affiliate should be an important factor as the Commission determines whether Atmos has met its burden of overcoming the Staff's testimony and evidence.⁷ The evidence shows that Atmos had no reasonable basis for acquiring gas that has been marked up for AEM profit, rather than through a direct gas purchase by Atmos. Atmos makes little if any attempt to provide evidence showing that it was necessary to acquire gas through AEM. Instead, Atmos continues to argue against the relevance of the very records that Atmos would need to overcome the Staff's evidence showing that the cost of gas to AEM is the fair market price of the natural gas. Atmos has not met its burden of proving that AEM's gas costs do not establish the fair market price of the gas.

Atmos argues that it is unnecessary for the Staff to have access to the books and records of AEM to determine the fair market price of Atmos' gas supplies. Atmos argues there is no "need to look at all of the details and communications related to upstream transportation contracts and upstream gas supply arrangements".⁸ Atmos makes this argument despite the Commission's clear determination to the contrary. In the Commission's *Order Granting Staff's Motion to Compel Atmos to Respond to Data Requests* issued in this case, the Commission concluded that "if Staff is to satisfy its obligation to evaluate Atmos' compliance with the affiliate transaction rules...it must be

⁶ Ex. 27HC, Sommerer Rebuttal, p. 2.

⁷ Ex. 26HC, Sommerer Direct, p. 11.

⁸ Post-Hearing Brief of Atmos Energy Corporation, p. 23.

able to review the supply contracts entered into by Atmos' affiliate."⁹ The Commission went on to say that the "only" way Staff can evaluate whether Atmos complied with the affiliate transaction rule is through "full access to the relevant records of the affiliate."¹⁰ The Commission recognizes that reviewing the gas costs available to AEM is a necessary component in determining the fair market price of Atmos' gas.

Atmos' arguments not only ignore the Commission's *Order Granting Staff's Motion to Compel Atmos to Respond to Data Requests*, but they also ignore the Commission's rules requiring Atmos to keep and provide the very records it continues to argue are unnecessary. 4 CSR 240-40.016(6). Apparently Atmos has never stopped fighting the promulgation of the Commission's affiliate transaction rules. However, the Supreme Court of Missouri already rejected Atmos' arguments in its opinion affirming the affiliate transaction rules, and the record keeping requirements for affiliates, where the Supreme Court found authority in § 393.140(12). *State ex rel. Atmos Energy Corporation v. P.S.C.*, 103 S.W.3d 753 (Mo. 2003).

AEM-Atmos Transactions Will Never Be Arms-Length

Atmos would like the Commission to overlook the definitional requirement that a "fair market price" under the affiliate transaction rules can only be established in an arms-length transaction.¹¹ Atmos argues that Atmos' gas purchases from AEM were arms-length because Atmos was "under no compulsion" to purchase gas from AEM.¹² The "no compulsion" standard cited by Atmos implies that if Atmos is compelled in *any* way to acquire gas from AEM, that transaction is not arms-length. OPC asserts that

⁹ *Order Granting Staff's Motion to Compel Atmos to Respond to Data Requests*, Case Number GR-2008-0364, July 15, 2010, p. 4.

¹⁰ *Id.*

¹¹ Tr. 112.

Atmos *was* compelled to purchase gas from AEM in that AEM's profits flow right back to Atmos. Atmos receives direct monetary benefit when it purchases gas from its affiliate because it pockets AEM's profits – the higher the mark-up by AEM, the higher the benefit to Atmos. For an entity whose primary purpose is to increase the wealth of its shareholders,¹³ few things would be *more* compelling for Atmos than to acquire natural gas from its affiliate and pocket the affiliate's profit margin.¹⁴ Atmos is also compelled to purchase gas from AEM over other gas marketers because Atmos does not pocket the profits of the unaffiliated gas marketers. For these reasons, and due to the common control and ownership of both Atmos and AEM, gas purchased by Atmos from AEM is not an arms-length transaction and cannot be used to establish the fair market price under the Commission's affiliate transaction rules.¹⁵

Conclusion

The Missouri Court of Appeals has determined that the use of a PGA clause does not constitute single-issue ratemaking because, in part, gas costs are not subject to control of the utilities. *State ex rel. Midwest Gas Users' Association v. P.S.C.*, 976 S.W.2d 470 (Mo. App. W.D. 1998). The evidence of this case demonstrates that Atmos is capable of asserting substantial control over the gas costs charged to its customers due to its relationship with its gas marketer, AEM. The integrity of the ACA/PGA process can still be maintained, but only by aggressively prohibiting gas utilities like Atmos from

¹² Post-Hearing Brief of Atmos Energy Corporation, p. 27.

¹³ In *Peterson v. Continental Boiler Works, Inc.*, 783 S.W.2d 896 (Mo. 1990) the Supreme Court stated: "The development of fiduciary principles in the corporate field has historically been based upon the proposition that corporate managers owe their primary responsibilities to the owners of the corporation -- the shareholders." Ruder, *Duty of Loyalty -- A Law Professor's Status Report*", 40 Bus. Law. 1383, 1384 (1985).

¹⁴ Ex. 26HC, Sommerer Direct, p. 13.

¹⁵ Ex. 26HC, Sommerer Direct, pp. 4-6.

engaging in transactions that allow the gas utilities to profit from the sale of natural gas to its customers through the use of a middle-man affiliate.

Atmos has the burden of demonstrating that its gas costs were just and reasonable, and that they were prudently incurred. Atmos has not provided sufficient evidence to overcome the Staff's evidence demonstrating Atmos' imprudence. Accordingly, a disallowance is necessary to protect ratepayers from the harm suffered when they were forced to pay increased gas rates due to Atmos' imprudent decisions.

Respectfully submitted,

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record this 20th day of May 2011.

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