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), Southeastern Area (Old Neelyville), Kirksville Area and the Northeastern Area	)))))	**File No. GR-2008-0364**

REPORT AND ORDER

Issue Date: November 9, 2011

Effective Date: November 19, 2011

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OF THE STATE OF MISSOURI

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Appearances

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

REPORT AND ORDER

FINDINGS OF FACT

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

Procedural History

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

For purposes of this case, the Commission's Staff conducted a review of Atmos' billed revenues and its natural gas costs for the period of September 1, 2007, to August 31, 2008. On December 28, 2009, Staff filed its recommendation regarding the actual cost adjustment for Atmos for the specified time period.

Staff initially recommended the Commission disallow $349,015 in gas costs for Atmos' Hannibal service area and $13,964 in gas costs for the Butler service area. The proposed disallowances represent Staff's calculation of the amount of profit earned by Atmos' gas marketing affiliate – Atmos Energy Marketing (AEM) – on sales of gas to Atmos. Staff's underlying concern about AEM's sale of gas to Atmos was its inability to determine whether the gas packages bought by AEM to provide service to Atmos were firm or interruptible packages of gas. Because it could not make that determination from the information supplied by Atmos, Staff proposed to disallow from Atmos' costs all profits AEM earned on the transaction.[1]

Atmos responded to Staff's recommendation on January 28, 2010. Atmos objected to Staff's proposed disallowance of the profits AEM earned on its sales of gas to Atmos. Atmos explained that AEM submitted the lowest and best bids for those transactions in competition with other, unaffiliated gas marketing companies. On that basis, Atmos contends there is no reason for the Commission to disallow the profits AEM earned on the transactions.

[1] Staff Recommendation Regarding Atmos Energy Corporation's Actual Cost Adjustment, Memorandum, Pages 4 and 5.

Thereafter, the Commission established a procedural schedule whereby Atmos and Staff prefiled direct, rebuttal, and surrebuttal testimony. An evidentiary hearing was held on March 23 and 24, 2011. Atmos, Staff, and the Office of the Public Counsel filed post-hearing briefs on April 29, 2011, followed by reply briefs on May 20, 2011.

The Disallowances Proposed by Staff

1. Staff proposed two related but independent disallowances of a portion of Atmos' gas costs for the ACA period in question. Initially, in its December 29, 2009 recommendation, Staff asked the Commission to disallow $349,015 in Atmos' gas costs for the Hannibal service area and $13,964 in gas costs for the Butler service area.[2] For both these service areas, Atmos' affiliated gas marketing company, AEM had submitted the lowest and best bid in a competitive bidding process. Staff based its proposed disallowance on its contention that because these were not arms-length transactions, AEM should not be allowed to earn a profit on the transactions. Therefore, Staff proposed to disallow the portion of Atmos' gas costs that would equal its calculation of AEM's gross profits on those transactions.[3]

2. Subsequently, Staff reduced its proposed disallowance of Atmos' gas cost for the Hannibal service area to $308,733.[4] Staff eliminated the proposed adjustment for the Butler service area after it determined that AEM had no gross profits and actually lost money on that transaction.[5]

3. For the first time in its surrebuttal testimony, Staff proposed a new disallowance related to a force majeure event on the Panhandle Eastern Pipeline that

[2] Sommerer Direct, Ex. 26, Page 4, Lines 7-9.
[3] Sommerer Direct, Ex. 26, Page 6, Lines 14-17.
[4] Transcript, Page 640, Lines 4-6.

supplied gas to the Hannibal and Butler regions. Staff contends that Atmos failed to nominate sufficient gas supplies and failed to ensure that AEM delivered contracted for supplies of gas during that force majeure event. Staff proposed to disallow either $52,572 or $85,775 depending upon alternative scenarios for how much additional gas Atmos had to obtain at a higher cost later in the winter.[6]

Background Facts

4. Atmos Energy Corporation (referred to in this report and order simply as Atmos) operates in Missouri as a regulated natural gas local distribution company, sometime referred to as an LDC. Atmos operates in many states and its Missouri LDC operations are part of its Kentucky/Mid-States division.[7]

5. As an LDC, Atmos obtains supplies of natural gas from natural gas producers and distributes that natural gas to homes and businesses within its service territory. Within Missouri, Atmos provides natural gas service to customers in three geographic areas: Northeastern, Southeastern, and Western. Within each area, Atmos serves customers through one or more operating systems.[8] Staff has proposed disallowances relating to two of those operating systems during the course of this case.

6. The first affected operating system is the Consolidated Hannibal/Canton/Palmyra/Bowling Green operating system within the Northeastern area. That system serves over 14,000 customers, of which approximately 13,000 are residential

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[5] Transcript, Page 641, Lines 16-19.
[6] Sommerer Surrebuttal, Ex. 28, Pages 19-20, Lines 13-22, 1-3.
[7] Buchanan Direct, Ex. 1, Page 2, Lines 7-13.
[8] Buchanan Direct, Ex. 1, Page 3, Lines 18-20.

customers. Natural gas is delivered to this operating system through the Panhandle Eastern Pipeline.[9]

7. The second operating system for which Staff initially proposed a disallowance was the Butler system, within the Western area. It serves approximately 3,700 customers, most of which are residential customers. It is also receives natural gas through the Panhandle Eastern Pipeline.[10]

8. In addition to its regulated operations as an LDC, Atmos also owns Atmos Energy Marketing, LLC. (AEM), a separate, unregulated gas marketing company.[11]

9. Atmos holds long-term contracts with various interstate pipelines for natural gas storage and transportation capacity to supply the firm natural gas requirements of its Missouri service areas.[12] Atmos does not produce its own natural gas and does not purchase that gas directly from producers. Instead, Atmos contracts with independent gas marketing companies to purchase the natural gas that is then flowed through the interstate pipeline using Atmos' pipeline capacity.[13]

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

10. Atmos uses the services of independent gas marketing companies to purchase its natural gas because it does not have the in-house expertise needed to perform the gas marketing services provided by those companies.[14]

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[9] Buchanan Direct, Ex. 1, Page 4, Lines 6-10.
[10] Buchanan Direct, Ex. 1, Page 6, Lines 8-11.
[11] Sommerer Direct, Ex. 26, Page 5, Line 4.
[12] Buchanan Direct, Ex. 1, Page 6, Lines 16-18.
[13] Buchanan Direct, Ex. 1, Page 6, Lines 18-20.
[14] Buchanan Direct, Ex. 1, Page 20, Lines 20-21.

11. If it were to undertake its own gas marketing services using its own, in-house employees, Atmos would need to hire or train additional personnel at a substantial cost and develop processes already used by independent gas marketers to secure gas supplies and transport gas through the interstate gas pipeline system.[15]

12. In-house gas marketing employees would still need to negotiate and contract for the purchase and transport of natural gas supplies. The price of gas and the cost to transport that gas would still be determined by market forces, just as those prices are determined by market forces when they are purchased by independent marketing companies.[16]

13. Most importantly, Atmos is a natural gas distribution company. Its core competency is in the distribution of natural gas to its customers. It is able to most efficiently provide service to its customers by focusing on that core competency while leaving gas marketing services to gas marketing companies that specialize in providing that service.[17]

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

15. Staff does not challenge the specifics of Atmos' decision to purchase its gas supplies through gas marketing companies rather than by using in-house gas marketing experts except to insinuate that it is "most remarkable that the 'largest natural-gas-only

[15] Buchanan Direct, Ex. 1, Page 21, Lines 5-8.
[16] Buchanan Direct, Ex. 1, Page 21, Lines 13-17.
[17] Buchanan Surrebuttal, Ex. 3, Page 4, Lines 1-15.
[18] Buchanan Direct, Ex. 1, Page 21, Lines 19-22.

distributor in the United States' (per the Company's website) asserts that it does not have the resources to optimize PGA assets."[19]

16. Furthermore, Staff does not seek to disallow Atmos' costs associated with acquiring its gas supply through the services of unaffiliated gas marketing companies. And Staff does not seek to disallow any of Atmos' gas costs based on a fully distributed costs argument.[20] Thus, it is apparent that Staff's concern is only with Atmos' affiliated transactions and not with Atmos' decision to obtain its gas supplies through gas marketing companies rather than by purchasing those supplies using in-house gas marketing personnel.

17. The Commission finds that Atmos' fully distributed cost of providing gas-marketing services through its own employees would exceed the market price for those gas-marketing services as established by a competitive bidding process among gas marketing companies.[21]

The Competitive Bidding Process

18. Atmos awards contracts to gas marketing companies using a competitive bid process. Under that process, Atmos issues a request for proposal - an RFP – and interested suppliers submit confidential bids with their proposed pricing for the gas supply services. Atmos evaluates the bids and awards the contract to the company that offers the best bid for reliable supply at the least cost.[22]

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[19] Sommerer Rebuttal, Ex. 27, Page 2, Lines 9-11.
[20] Transcript, Page 698, Lines 10-14, See also, Transcript, Pages 197-198, Lines 4-25, 1-8..
[21] Buchanan Direct, Ex. 1, Page 21, Lines 19-22.
[22] Buchanan Direct, Ex. 1, Page 6, Lines 20-23.

19. Atmos used the same RFP process to obtain competitive bids for gas supply service contracts to serve each of its eight operating systems in Missouri. During the 2007-2008 ACA period that is at issue in this case, Atmos awarded two contracts – for the Hannibal/Bowling Green and Butler operating systems – to AEM, its affiliated gas marketing company. The other contracts were awarded to five other, non-affiliated, gas-marketing companies.[23]

20. For the Hannibal/Bowling Green operating system, Atmos sent RFP letters to 56 entities on the bidder list maintained by the company. Atmos sent out 39 RFP letters for the Butler operating system. Several gas-marketing companies submitted conforming bids in response to that RFP. AEM submitted bids for both systems.[24]

21. AEM does not dominate Atmos' bidding process. For the period 2004-2009, Atmos issued 48 RFPs for Missouri gas supply. AEM submitted the successful bid six times. That is consistent with the number of successful bids submitted by other major gas marketers.[25]

22. For this ACA period, there were two overlapping RFP processes.[26] AEM submitted the lowest bid both times. In the first RFP process for the period of April 1, 2007 to March 31, 2008, there were six unaffiliated bidders. AEM submitted the lowest bid at $14,723,472. The lowest bid from an unaffiliated marketer was $14,761,471, but that was a nonconforming bid.[27] The lowest conforming bid from a non-affiliated bidder was for

[23] Buchanan Direct, Ex. 1, Page 11, Lines 10-22.
[24] Buchanan Direct, Ex. 1, Page 10, Lines 3-6. The gas marketers that submitted conforming bids are identified in the testimony but those identities are considered highly confidential and so will not be revealed in this report and order.
[25] Buchanan Direct, Ex. 1, Page 12, Lines 15-20.
[26] Transcript, Page 646, Lines 9-15.
[27] Transcript, Page 647, Lines 2-8. *See also*, Ex. 24HC.

$15,069,726, which is approximately $346,000 higher than the bid submitted by AEM.[28] Staff's witness indicated he did not believe Atmos should have accepted the higher bid over the lower bid from AEM.[29]

23. Interestingly, Atmos paid AEM approximately $13.4 million during the contract period for the amount of gas it actually supplied to the Hannibal district under that contract.[30] Thus, based on actual costs and actual prices, Atmos paid AEM less than it would have paid under the bids submitted by the unaffiliated gas marketing companies.[31]

24. For the second RFP process, covering the period of April 1, 2008 to March 31, 2009, AEM also submitted the lowest bid at $13,947,511. The next lowest bid submitted by a non-affiliated gas marketer was for $14,049,424.[32]

Fair Market Value

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

26. All parties accept that fair market value of a good or service can be defined as the price that a seller is willing to accept and a buyer is willing to pay on the open market in an arms-length transaction.[33]

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[28] Transcript, Page 651, Lines 4-17.
[29] Transcript, Page 651, Lines 18-21.
[30] Transcript, Page 654, Lines 16-23.
[31] Transcript, Page 709, Lines 14-18.
[32] Transcript, Page 684, Lines 15-20.
[33] Transcript, Page 627, Lines 21-25.

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

28. Staff and Public Counsel's position ignores the existence of the bidding process in establishing the fair market value for the transaction. If AEM had not submitted a bid, or if it had not submitted the lowest bid, there would be no question that the bidding process established the fair market value of the transaction. Indeed, Staff did not propose any disallowance related to the contracts for Missouri gas supply in which an unaffiliated gas marketing company submitted the lowest and best bid and agreed that the bidding process would establish fair market value for those transactions.[34]

29. Assuming the bidding process was fair and open, and no party has presented evidence to establish a serious doubt about the fairness of the bidding process, that bidding process established the fair market value for the affiliate transactions, just as it did for the transactions with non-affiliated gas marketing companies. Because of the bidding process, Atmos, and ultimately its ratepayers, will pay no more for the services of the affiliated gas marketing company than they would have to obtain the same services from an unaffiliated gas marketing company. In effect, it is the non-affiliated gas marketing companies bidding in the open market that establish the fair market value for the bids won by AEM as much as they do for the bids won by non-affiliated bidders. Absent some showing of insider-dealing

[34] Transcript, Page 667, Lines 7-16.

to favor an affiliate in the bidding process or some showing of facts that cast doubt on the bidding process itself, there is no need for Staff to search behind the bidding process to try to establish an independent fair market value for the affiliate transactions, if any such determination were possible.

30. While it does not need to establish a fair market value for the affiliate transactions apart from the value established by the actual fair market, Staff certainly has an obligation to closely examine Atmos' transactions with its affiliate. Indeed, despite a lot of confusing and distracting testimony, it is apparent that Staff's real concern is not with fair market price, AEM's record keeping, or even with the bidding process, rather it is about the actual relationship between Atmos, AEM, and the gas supplied by AEM. In short, Staff is concerned that AEM may have met its obligation to supply gas under its winning bids by providing Atmos with something less than firm gas supplies.[35]

The Provision of Gas Supplies

31. A local distribution company such as Atmos must transport its natural gas supplies from the gas producing areas of the country to its service area through one of several interstate natural gas pipelines. For both the Hannibal/Bowling Green and Butler service areas, Atmos transported its gas through the Panhandle Eastern Pipeline under terms of a long-term firm contract.[36]

32. For the Panhandle Eastern Pipeline the demarcation between the field area, where gas is produced, and the market portion of the pipeline, where commercial deliveries are made, is found at Haven in Kansas.[37] Haven is not however the only receipt point on

[35] Staff's argument is rather confused, but is best set out in Sommerer Surrebuttal, Ex. 28, Page 3.
[36] Buchanan Direct, Ex. 1, Pages 4-6.
[37] Transcript, Page 446, Lines 13-20.

the Panhandle Eastern Pipeline. There are also secondary receipt points, including one at Louisburg, Kansas, where the Kinder Morgan Pony Express Pipeline connects to the Panhandle Eastern Pipeline.[38]

33. Atmos' request for proposal for natural gas supply, the letter that was sent to all prospective bidders to supply natural gas to meet Atmos' needs, specified that the bidder was to "provide firm and warranted natural gas commodity only requirements for its Missouri service areas." That request for proposal letter further specified, "[a]ll gas supply is to be **firm and warranted** assuring that natural gas supply services will meet all contractual obligations without fail." (emphasis in original)[39]

34. Atmos' request for proposal for natural gas supply allowed all potential bidders to use either the Haven receipt point or a secondary in-path receipt point between Haven and Atmos' service area.[40] As it was allowed to do under the request for proposal, AEM chose to use a secondary in-path receipt point at Louisburg to take gas supplies off the Kinder Morgan Pony Express Pipeline and then transport them along the Panhandle Eastern Pipeline for delivery to Atmos.[41]

35. In the hierarchy established by the Pipeline's tariff, primary firm delivery is the highest priority gas supply. The priority of secondary in-path firm delivery is a notch below primary firm delivery.[42]

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[38] A map showing the primary and secondary delivery points on the Panhandle Eastern Pipeline was included in a PowerPoint presentation made as part of Staff's opening statement. That PowerPoint presentation, including the map, was marked for identification as Ex. 31, but was not admitted into evidence.
[39] Exhibit 8. *See also*, Transcript, Page 355, Lines 9-25.
[40] Transcript, Page 357, Lines 16-23.
[41] Transcript, Page 452, Lines 8-12.
[42] Transcript, Page 383, Lines 1-8.

36. Although Atmos' request for proposal specifies that the gas supply it seeks to purchase is to be firm, Staff and Public Counsel are concerned that perhaps AEM actually supplied something less than firm gas. As one basis for that concern, Staff points to several transaction confirmation documents for the period in which the statement of service level under the contract was left blank as an implication that AEM was allowed to deliver less than firm gas;[43] an implication that Atmos' witness denied.[44] The priority and firmness of gas supplies becomes important because of events in December 2007.

The Events of December 2007

37. At the end of each month, Atmos nominates the volume of gas that it intends to purchase from its gas marketer in the subsequent month. That volume of gas is known as the company's First of Month (FOM) nomination. The FOM nomination represents a baseload amount of gas that Atmos is committing to buy for each day of the month. If Atmos needs more than the baseload amount of gas for a particular day during the month, it can nominate additional daily gas supplies, or draw more gas from storage. Daily supplies are also known as swing gas or spot gas.[45]

38. When Atmos signs a contract with a gas marketer, a separate index price is set for FOM gas and for daily gas supplies. The price for daily gas supplies may be higher or lower than the FOM prices depending upon the behavior of the gas market.[46]

39. Correctly setting the baseload gas through the FOM nomination is important because nominating too little baseload supply may require the utility to purchase more expensive daily gas supplies. Nominating too much baseload gas may also create

[43] Transcript, Pages 390-392.
[44] Transcript, Page 392, Lines 18-22.
[45] Transcript, Pages 435-436.
[46] Transcript, Page 437, Lines 5-14.

problems because the company must take all the baseload gas it has nominated. So, for example, if Atmos were to experience a string of 70 degree days in December it could wind up with gas that it could not use. It might then need to sell that gas back to the supplier at a cost to the company.[47]

40. The usage of natural gas is dependent upon the weather. More gas is used on cold days when customers must use gas to heat their homes and businesses. Thus, gas utilities must consider the weather when deciding how much gas to nominate. Atmos' Gas Supply Plan, which is used for the guidance of the company's gas supply specialists, indicates the company's gas supply plan is based on normal degree-days, a measure of temperature within the company's service area. According to that plan, FOM nominations are typically made to cover gas requirements assuming that monthly heating degree-days will be twenty percent warmer than normal. In that way, the company will have flexibility if warmer weather occurs, or if daily gas prices drop after the FOM nominations are made.[48]

41. For December 2007, the average daily requirement was 3,900 units of gas for the Hannibal/Canton area. Twenty percent warmer than average weather would require 3,100 units for that area.[49] In addition, twenty percent warmer than average weather would require 630 units of gas for the Bowling Green area. The total for the twenty percent warmer than average weather for the two areas is 3,730 units of gas. However, Atmos' actual FOM nomination for Hannibal/Canton/Bowling Green for December 2007 was only

[47] Transcript, Pages 437-438, Lines 15-25, 1-9.
[48] Buchanan Direct, Ex. 1, Attachment 1. *See also*, Transcript, Pages 543-544, Lines 13-25, 1-12.
[49] Ex. 20. *See also*, Transcript, Page 546, Lines 8-14.

2,800 units of gas,[50] which is a volume roughly 25 percent lower than the average volume for the 20 percent warmer than average weather scenario.[51]

42. While Atmos' Gas Supply Plan indicates Atmos will typically nominate FOM gas sufficient to meet gas requirements for 20 percent warmer than normal weather, that is just a guideline for the company's gas buyers.[52] Atmos' gas buyer is expected to exercise a great deal of independent judgment in determining how much FOM gas to nominate in a particular month.[53]

43. The person at Atmos responsible for the decision to nominate less FOM gas volumes for December 2007 was Mike Walker. Walker testified that in formulating his FOM nomination plan he took into account the amount of gas actually billed during that month in previous years, anticipated weather patterns, and the amount of gas available in storage.[54] Walker explained that he reduced the December 2007 FOM nomination below the 20 percent warmer than average weather scenario because the previous December had been substantially warmer than average and because he believed his November storage gas levels were where they were supposed to be.[55]

44. In fact, November storage levels were five percent lower than Atmos had planned, likely because of a cold snap in late November. But Walker would not have known about his final November storage figures until he received a report from the pipeline in the first week of December.[56]

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[50] Ex. 21, *See also*, Transcript, Page 548, Lines 3-9.
[51] Transcript, Page 548, Lines 22-25.
[52] Transcript, Page 577, Lines 9-25.
[53] Transcript, Pages 424-425, Lines 20-25, 1-10.
[54] Transcript, Page 550, Lines 1-4.
[55] Transcript, Page 558, Lines 12-24.
[56] Transcript, Page 426, Lines 3-21.

45. While Staff and Public Counsel criticized Atmos' decision to nominate FOM gas at volumes below the 20 percent warmer than average scenario, the basis for their proposed disallowance is more closely tied to events that occurred after Atmos made its FOM nominations. Normally Walker sent his FOM gas nominations to the various gas marketers that supplied gas to Atmos six business days before the end of the month, which because of the Thanksgiving Holiday, would have fallen on Wednesday, November 21.[57] However, Walker took a vacation day before the holiday, so he made his FOM gas nominations for December 2007 on Tuesday, November 20.[58]

46. On Wednesday, November 21, at about 10:00 p.m., after the close of business, Panhandle Eastern Pipeline sent out a notice to Atmos and other shippers stating that the pipeline would be reducing its mainline capacity because of problems at Haven but that there was no anticipated impact on shippers.[59]

47. By the terms of Atmos' request for proposal letter that formed the basis for its agreement with its gas supplier, it would make its FOM gas nominations within five working days before the beginning of any month.[60] That means its final December FOM nominations were to be sent to the gas supplier no later than 9:00 a.m. on Monday, November 26.[61]

48. In the afternoon of November 26, Panhandle Eastern Pipeline sent out a notice declaring a *force majeure* event due to a partial rupture on the pipeline at Haven.[62]

[57] Transcript, Page 448, Lines 18-20.
[58] Transcript, Page 569, Lines 5-6.
[59] Transcript, Pages 569-570, Lines 16-25, 1-11.
[60] Ex. 22, Section 5.2, *See also*, Transcript, Page 555, Lines 6-14.
[61] Transcript, Pages 556-557, Lines 23-25, 1.
[62] Transcript, Pages 450-451, Lines 25, 1-2.

The *force majeure* event meant that the pipeline would likely be cutting gas nominations on the pipeline because of the reduced capacity for transporting gas past the pipeline rupture.

49. Walker agreed that had he known of the *force majeure* event before he made his December FOM nominations, he would have increased his FOM nominations.[63] However, he did not attempt to change his FOM nomination after receiving notice of the *force majeure* declaration because he did not believe the gas suppliers would allow him to change his nomination after it was submitted.[64]

50. Staff and Public Counsel also criticize Atmos' behavior during the course of the *force majeure* event, implying that Atmos sacrificed its own position for the benefit of its affiliated gas marketer, AEM. During the course of the *force majeure* event of December 2007, the pipeline cut Atmos' gas nominations by 31 percent.[65] Furthermore, Atmos' witness agreed that he cooperated with the pipeline and his supplier by not nominating as much daily flowing gas through the pipeline as he could have during the *force majeure* event to avoid additional cuts from the pipeline.[66] Instead, Atmos pulled additional gas out of storage to meet the needs of its customers.[67]

51. Despite the force majeure event, Atmos was able to meet the gas needs of all its customers. No customer suffered a curtailment during that event.[68]

52. Staff agreed that it was reasonable for Atmos to work with the pipeline and its gas supplier during the *force majeure* event to mitigate adverse consequences to the entire

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[63] Transcript, Page 592, Lines 4-6.
[64] Transcript, Pages 582-583, Lines 8-25, 1.
[65] Transcript, Page 373, Lines 2-9.
[66] Transcript, Page 506, Lines 6-17.
[67] Transcript, Page 521, Lines 4-7.
[68] Transcript, Page 450, Lines 2-12.

pipeline system, to the extent that doing so did not have a negative impact on Atmos.[69] The question is whether Atmos' cooperation had a negative impact on Atmos and its customers.

53. Staff asserts that Atmos' decision to use more storage gas while failing to push its affiliated gas supplier harder for flowing gas supplies during the December *force majeure* event harmed its customers when Atmos had to spend more later in the winter to obtain flowing gas supplies that could have been drawn from storage at a lower cost if storage supplies had not been depleted in December. To compensate Atmos' customers, Staff proposed two alternative disallowances.

54. In its first scenario, Staff proposed to disallow $52,572 in Atmos' gas costs based on Staff's contention that Atmos should have nominated enough FOM gas for December to meet its gas volume requirements for average December weather.[70] Staff also proposed a larger disallowance of $85,775 based on an assumption that Atmos should have increased its December FOM nominations by enough to meet gas volume requirements for average December weather and increase its gas storage volumes by five percent.[71]

55. A third scenario was calculated at the hearing that would result in a disallowance of $24,900 if Atmos had increased its December FOM nominations enough to meet the 20 percent warmer than normal December weather volumes assumption.[72]

[69] Transcript, Page 700, Lines 5-19.
[70] Sommerer Surrebuttal, Ex. 28, Page 19, Lines 11-22.
[71] Sommerer Surrebuttal, Ex. 28, Page 20, Lines 1-10.
[72] Transcript, Page 572, Lines 8-18

56. The record does not include a detailed explanation by Staff of how it calculated any of the three disallowance scenarios.

CONCLUSIONS OF LAW

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

A. Atmos is a Gas Corporation[73] and a Public Utility[74] as defined by Missouri statute and is therefore subject to the jurisdiction of the Missouri Public Service Commission.[75]

B. In order to disallow a utility's recovery of costs from its ratepayers, a regulatory agency must find both that the utility acted imprudently and that such imprudence resulted in harm to the utility's ratepayers.[76]

C. The Commission established its standard for determining the prudence of a utility's expenditures in a 1985 decision. In that decision, the Commission held that a utility's expenditures are presumed to be prudently incurred, but, if some other participant in the proceeding creates a serious doubt as to the prudence of the expenditure, then the utility has the burden of dispelling those doubts and proving the questioned expenditure to have been prudent.[77]

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[73] Section 386.020(18), RSMo (Supp. 2010).
[74] Section 386.020(43), RSMo (Supp. 2010).
[75] Section 386.250, RSMo 2000.
[76] *State ex rel. Assoc. Natural Gas Co. v. Public Serv. Comm'n*, 954 S.W.2d 520 (Mo. App. W.D. 1997).
[77] *In the matter of the determination of in-service criteria for the Union Electric Company's Callaway Nuclear Plant and Callaway rate base and related issues. And In the matter of Union Electric Company of St. Louis, Missouri, for authority to file tariffs increasing rates for electric service provided to customers in the Missouri service area of the company.* 27 Mo. P.S.C. (N.S.) 183 (1985).

D. Contrary to the assertions of Staff and Public Counsel, the Commission's prudence standard applies even when the Commission is evaluating the prudence of an affiliated transaction. In fact, the appellate court decision that explicitly upheld the appropriateness of the Commission's prudence standard concerns the prudence of an affiliate transaction that the Commission was reviewing in an ACA case; exactly the question before the Commission in this case.[78]

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

> Their assertion is incorrect. Regulation 240-20.105(6)(c) says, 'this rule does not modify existing legal standards regarding which party has the burden of proof in the commission proceeding.' This means that the regulation does not modify the existing burden of proof. Although UE purchased the CTGs from its affiliates, the commission properly presumed that UE was prudent in its purchase of the CTGs, until the State or Public Counsel presented evidence that raised a 'serious doubt' concerning the prudence of its expenditure. (citation to *Associated Natural Gas* omitted).[79]

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

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

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

CSR 140-40.016 - that specifically regulates transactions between regulated gas corporations and affiliated gas marketing companies. Both rules apply to the transactions between Atmos and its marketing affiliate, AEM.

G. The general affiliate transactions rule provides:

> When a regulated gas corporation purchases information, assets, goods or services from an affiliated entity, the regulated gas corporation shall either obtain competitive bids for such information, assets, goods or services or demonstrate why competitive bids were neither necessary nor appropriate.[80]
>
> The marketing affiliate transaction rule includes the same language.[81] Atmos complied with these rule requirements when it obtained competitive bids before awarding gas-marketing contracts to AEM.

H. The general affiliate transactions rule further provides:

> A regulated gas corporation shall not provide a financial advantage to an affiliated entity. For the purposes of this rule, a regulated gas corporation shall be deemed to provide a financial advantage to an affiliated entity if –
> 1. It compensates an affiliated entity for goods or services above the lesser of –
>   A. the fair market price; or
>   B. the fully distributed cost to the regulated gas corporation to provide the goods or series for itself … .[82]

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

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

J. Neither the general nor the specific affiliate transaction regulation includes any language that would preclude an affiliate gas marketing company from earning a profit

[80] 4 CSR 240-40.015(3)(A).
[81] 4 CSR 240-40.016(4)(A).
[82] 4 CSR 240-40.015(2)(A).

on its transaction with the regulated gas corporation. Indeed, such a provision would have the practical effect of banning the transactions that are clearly allowed under the rule, as no affiliated company will enter into a transaction in which it is not allowed to earn a profit.

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

> Each regulated gas corporation shall ensure that its parent and any other affiliated entities maintain books and records that include, at a minimum, the following information regarding affiliate transactions:
>
> 1. Documentation of the costs associated with affiliate transactions that are incurred by the parent or affiliated entity and charged to the regulated gas corporation;
> 2. Documentation of the methods used to allocate and/or share costs between affiliated entities, including other jurisdictions and/or corporate divisions;
> 3. Description of costs that are not subject to allocation to affiliate transactions and documentation supporting the nonassignment of these costs to affiliate transactions; …[83]

L. Staff and Public Counsel complain that Atmos and its affiliate, AEM, have failed to comply with the record-keeping requirements of the regulations in that AEM failed to provide Staff with records sufficient to allow Staff to determine the fair market value of gas supply costs charged to Atmos.[84]

M. However, the record-keeping requirements cited by Staff and Public Counsel do not require AEM to keep records sufficient to allow Staff to determine the fair market value of gas supplies charged to Atmos, because no such gas supply costs have been charged to Atmos within the meaning of the regulation.

[83] 4 CSR 240-40(5)(A). The rule goes on to list further record keeping requirements that are not related to the issues in this case. The same language is found in the Marketing Affiliate Transaction rule at 4 CSR 240-40.016(6)(A).

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

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

O. In fact, Staff's witness indicated he was unaware of any provision in the Commission's rules that would require AEM, or any other affiliate, to maintain records sufficient to allow Staff to determine the affiliate's net profits on a transaction by transaction basis.[85]

P. The Commission is required to follow its own rules, because "[r]ules of a state administrative agency duly promulgated pursuant to properly delegated authority have the force and effect of law and are binding upon the agency adopting them."[86] Furthermore, as an administrative agency, the Commission cannot repeal its rules through an adjudicated order. "To repeal a rule, an agency must comply with the notice, publication, and public comment method prescribed in Section 536.021 of Missouri's Administrative Procedures Act."[87]

[85] Transcript, Page 635, Lines 17-21.
[86] *Missouri Nat. Educ. Ass'n v. Missouri State Bd. of Mediation*, 695 S.W.2d 894, 897 (Mo. banc 1985).
[87] *Greenbriar Hills Country Club v. Director of Revenue*, 47 S.W.3d 346, 357 (Mo. banc 2001).

DECISION

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

The Commission's rules specifically allow such transactions to occur, but only if the regulated gas corporation does not provide a financial advantage to its affiliate. The rule establishes that a regulated gas corporation provides a financial advantage to its affiliate if it purchases goods or services from its affiliate above the lesser of the fair market price for those goods or services, or the cost the regulated gas corporation would incur to provide the goods or services for itself.[88]

Staff does not present any serious argument to suggest that Atmos could provide gas-marketing services for itself cheaper if it did not use the services of gas marketing companies. Staff's witness threw out some statements suggesting that a big company like Atmos should have the resources to purchase gas for itself, but when pressed, he conceded that Staff was not proposing any adjustment based on the company's fully distributed cost.[89]

[88] Commission Rule 4 CSR 240-40.015(2)(A).
[89] Transcript, Page 698, Lines 10-14.

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

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

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

Fair market price is set by the market, not by Staff's review of documents. Even if Atmos and AEM gave Staff every document they could ever hope to examine they could still never determine a "real fair market price" unless they were able to undertake a full rate case to establish among other things an allowed rate of return for the unregulated gas marketing company; because, as Staff's witness conceded, AEM should be allowed to earn a profit under the proper circumstances.[90]

Public Counsel goes one step beyond Staff and argues that AEM, and indirectly Atmos as its corporate parent, should not be allowed to earn a profit on gas transactions because such profits would be contrary to the regulatory principles surrounding Atmos' use of a PGA/ACA mechanism to recover its gas costs. Public Counsel contends that Atmos is capable of controlling its gas costs through its relationship with its affiliate gas marketing company and therefore its use of the PGA/ACA mechanism would constitute single-issue ratemaking under the test established by the Missouri Court of Appeals in *State ex rel. Midwest Gas Users' Assoc. v. Pub. Serv. Com'n*.[91]

Public Counsel's argument is incorrect because the cost of gas to Atmos is still controlled by the fair market. Atmos can award a gas supply contract to its affiliate only if that affiliate submits the low bid for those services. In fact, since the affiliate, AEM, submitted the low bid on these transactions, ratepayers benefit from the affiliate transaction. If Atmos refused to accept the low bid from its affiliate, its ratepayers would have to pay more for gas to their detriment.

[90] Sommerer Surrebuttal, Ex. 28, Page 3 Liens 7-9. *See also*, Transcript, Page 704, Lines 3-15.
[91] 976 S.W.2d 470 (Mo. App. W.D. 1998). Public Counsel makes this argument in its reply brief.

For the foregoing reasons, the Commission will reject Staff's proposed $308,733 disallowance to eliminate AEM's gross profits on its transactions with Atmos.

Staff offered a different basis for its secondary disallowance related to events in December 2007. Staff claims that Atmos acted imprudently when in late November 2007, it failed to nominate enough first of month (FOM) gas supplies for the month of December. On that basis, Staff proposed alternative disallowances that it calculated based on Atmos' deviation from the gas volumes it could be expected to nominate based on normal weather patterns.

Staff also presented a good deal of testimony regarding Atmos' behavior during a *force majeure* event declared by the interstate pipeline that delivered natural gas to the Hannibal/Bowling Green area. That event resulted in decreased flowing gas deliveries and required Atmos to draw more gas from storage than it might have absent the *force majeure* event. It is apparent that Staff was trying to prove that Atmos accepted less than firm gas from AEM and as a result suffered a greater decrease in flowing gas deliveries during the *force majeure* event than it should have if AEM had not attempted to "game" the system.

However, Staff does not attempt to quantify a disallowance based on harm to Atmos' customers resulting from its actions during the *force majeure* event. Instead, Staff attempts to punish Atmos for its questionable decisions in December, but does so by relying on its proposed disallowance based on Atmos' alleged failure to nominate enough FOM gas in November.

The problem with Staffs proposed disallowance is that Atmos' actions during the December *force majeure* event are not related to the prudence of Atmos' decision to nominate less FOM gas in November. Simply put, Staff did not establish that Atmos'

November decision to nominate less FOM gas for December was imprudent based on what Atmos knew at the time it made the nomination. While Atmos conceded that it would have increased its FOM gas nominations if it had known of the *force majeure* declaration at the time it made its nomination, the pipeline did not declare the *force majeure* event until after Atmos had finalized its nomination. Staff speculated that perhaps Atmos could have changed its FOM nominations after the force majeure was declared, but such speculation is not sufficient to overcome the presumption of prudence afforded to Atmos' decision about how much FOM gas to nominate for December.

Instead of proving that Atmos was imprudent because it nominated too little FOM gas in November, Staff sought to prove that Atmos was imprudent because it did not take a tougher position against AEM in December. But Staff did not quantify a disallowance based on those allegations. In other words, the evidence presented by Staff does not prove whether Atmos nominated less than the proper amount of FOM gas in November. All Staff showed was that Atmos might have suffered a bad result because it did not nominate more FOM gas in November. That 20/20 hindsight is not sufficient to justify a disallowance for imprudence.

In order to justify a disallowance of Atmos' gas costs, the party advocating such a disallowance must show both that the company acted imprudently and that harm resulted to ratepayers. Staff and Public Counsel have not done so and the Commission will reject Staff's secondary proposed disallowances.

On December 28, 2009, Staff recommended various adjustments to Atmos' ACA filing in addition to the affiliate transaction disallowances that the Commission is rejecting in this report and order. Atmos accepted those other adjustments in its response to Staff's recommendation, which it filed on January 28, 2010. The Commission will therefore establish Atmos' ending balances for 2007-2008 in this order based on those agreed upon adjustments.

THE COMMISSION ORDERS THAT:

1. The disallowances proposed by Staff regarding Atmos' transactions with its affiliate are rejected.

2. The ending (over)/under recovery balances for Atmos' 2007-2008 Actual Cost Adjustment are established as provided in the following tables:

Table 1.

Description	Company's ACA Balance	Staff Adjustments	Staff Recommended ACA Balance
Areas B, K, and S			
SEMO District (Area S): Demand ACA	($416,575)	$331 (C)	($416,244)
Commodity ACA	($2,643,834)	($69,893) (A) ($3,580) (B) $2,078 (C) ($16,459) (D)	($2,731,688)
Kirksville District (Area K): Demand ACA	($63,384)	$0	($63,384)
Commodity ACA	($594,196)	($40,657) (A) ($797) (B) ($1,119) (D)	($636,769)
Butler District (Area B): Demand ACA	($38,190)	$0	($38,190)
Commodity ACA	($214,329)	$54,184 (A)	($160.145)

Notes to Staff Adjustments:

(A) ACA beginning balances August 31, 2007, adjusted to prior year ending balances.
(B) Missouri school revenue recovery.
(C) Revenue recovery.
(D) Cash-out.

Table 2.

Description	Company's ACA Balance	Staff Adjustments	Staff Recommended ACA Balance
Consolidated Areas P and U			
Consolidated District: Demand ACA	($413,769)	($163) (D)	($413,932)
Commodity ACA	($744,056)	($102,617) (A) ($2,270) (B) ($26,188 (C) ($3,543) (D)	($908,674)
Neelyville District: Demand ACA	($17,000)	($10) (A)	($17,010)
Commodity ACA	($29,017)	($2,189) (A)	($31,206)

Notes to Staff Adjustments:
(A) ACA beginning balances August 31, 2007, adjusted to prior year ending balances.
(B) Missouri school revenue recovery.
(C) Cash-out.
(D) Revenue recovery.

Table 3.

Description	Company's ACA Balance	Staff Adjustments	Staff Recommended ACA Balance
(Greeley) Area G			
Total ACA Balance	($64,445) (C)	($90,893) (A) $2,734 (B)	($152,604)

Notes to Staff Adjustments:
(A) ACA beginning balances August 31, 2007, adjusted to prior year ending balances.
(B) Revenue adjustment.
(C) Combined demand and commodity ACA balance.

3. This Report and Order shall become effective on November 19, 2011.

BY THE COMMISSION

Steven C. Reed
Secretary

(S E A L)

Gunn, Chm., Davis, and Jarrett, CC., concur;
Kenney, C., concurs with separate concurring opinion to follow;
and certify compliance with the provisions
of Section 536.080, RSMo.

Dated at Jefferson City, Missouri,
on this 9th day of November, 2011.