

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

In the Matter of Laclede Gas Company's) Purchased Gas Adjustment for 2004-2005)	Case No. GR-2005-0203
)	
In the Matter of Laclede Gas Company's) Purchased Gas Adjustment for 2005-2006)	Case No. GR-2006-0288

**PUBLIC COUNSEL'S MOTION FOR
RECONSIDERATION AND REQUEST FOR CLARIFICATION**

Public Counsel requests reconsideration of the Commission's April 22, 2009 *Order Denying Motion to Compel* ("Order") because it allows Laclede Gas Company (Laclede) to conceal information that would determine whether the natural gas prices Missouri consumers paid for Laclede's services during 2004-2005 and 2005-2006 were unlawfully or unreasonably higher than they should have been. The Staff believes that Laclede may have **

**¹ The information sought in the Staff's Motion to Compel would either prove or disprove whether Laclede's gas transactions with LER have harmed ratepayers. The information sought in this discovery dispute is required to be kept by Laclede, must be released when requested, and its production in this case

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¹ Public Counsel questions the need to label the information in this Motion as Highly Confidential (HC), however, Public Counsel has maintained the HC designation consistent with the Commission's treatment of this information.

is essential to determine whether the rates charged by Laclede are just and reasonable as required by §§ 393.130 and 393.140 RSMo.

Furthermore, the *Order* does not explain the Commission's about-face from the unanimous *Order Granting Motion to Compel* issued just six months prior wherein the Commission concluded that the information sought by Staff is relevant and that the Staff *must* have access to that information to conduct its review. The *Order* makes no mention of the prior orders and simply concludes without explanation that "the information Staff seeks is not reasonably calculated to lead to the discovery of admissible evidence." Public Counsel asks that the Commission clarify its *Order* to explain the basis for this conclusion and the reasons for the contradictory orders. Public Counsel asks that the Commission explain why the information requested, and any information that the requested information could lead to, would be inadmissible in an evidentiary hearing that serves the purpose of gathering evidence regarding Laclede's gas purchasing operations and decisions. Public Counsel asserts that this information would be admissible, relevant, and necessary if the Commission is to satisfy its statutory duty to establish gas rates at levels that are just and reasonable and no more than allowed by law. Without an explanation, the ratepayers cannot properly challenge the reasoning behind the Commission's decision.

The *Order* also does not explain how the Commission intends to address Laclede's multiple violations of Commission orders when Laclede refused to provide the information it was repeatedly ordered to provide. For six months Laclede violated Commission orders compelling it to produce the information. Public Counsel asks that the Commission clarify and explain why the Commission should or should not direct its

General Counsel to seek penalties in Circuit Court against Laclede for repeatedly violating Commission orders.

1. Procedural Background

Public Counsel first became aware of this discovery controversy in the Staff's 2006 Recommendation in the 2004-2005 prudency review (GR-2005-0203), wherein Staff stated that Laclede was not forthcoming with the information that Staff needed to conduct its prudency review of Laclede's gas purchasing decisions and operations. In Staff's 2007 Recommendation in the 2005-2006 prudency review (GR-2006-0208), Staff repeated that Laclede had not provided the necessary information.

Staff's discovery frustrations with Laclede continued, prompting Staff to file its July 25, 2008 List of Documents Required by Staff to Analyze Laclede's ACA Filings and Motion for Order Directing Laclede to Produce. Staff later withdrew its list and re-filed a much shorter list in the Staff's September 18, 2008 Motion to Compel. The Motion to Compel states that on August 28, 2008, Staff provided Laclede with a revised data request that reduced the request from 24 months of records to two months of records for each ACA period at issue.

The Commission appeared to have resolved the discovery dispute in its October 20, 2008 *Order Granting Motion to Compel*, which ordered: "Laclede Gas Company shall produce the information set out in the Staff of the Commission's motion." The Commission specifically concluded in the *Order Granting Motion to Compel* that the records appear reasonably calculated to lead to the discovery of admissible evidence and that Staff must have the information it seeks:

Staff seeks information concerning LER, Laclede's affiliate. Many of the concerns set out in Staff's memorandum have to do with LER and how

LER acquires natural gas. In its memorandum in Case No. GR-2005-0203, after discussing discretion in sourcing supply, Staff specifically states: “This discretion in sourcing supply could result in gains for LER that should be allocated to Laclede’s ACA.” Additionally, in Case No. GR-2006-0288, Staff describes in its memorandum a transaction wherein Laclede may have shared the benefit of a sale with LER, thus receiving less than fair market value. Staff has demonstrated that in order to answer these questions, it must have access to the information it seeks. The Commission therefore concludes that the information Staff seeks appears reasonably calculated to lead to the discovery of admissible evidence. The Commission will therefore grant Staff’s motion.

Any question as to the whether the data requests are reasonably calculated to lead to the discovery of admissible evidence was resolved. The Commission concluded that under Missouri Rule of Civil Procedure 56.1 “it is not grounds for objection that the information sought will be inadmissible at the trial if the information sought appears reasonably calculated to lead to the discovery of admissible evidence.”

The *Order Granting Motion to Compel* was the first of *three* Commission orders ordering Laclede to produce the records sought by Staff. Laclede requested reconsideration of the *Order Granting Motion to Compel*, and on December 17, 2008 the Commission was unanimous in its *Order Denying Motion for Reconsideration*.

Laclede filed a Request for Clarification on December 29, 2008. The Commission’s unanimous January 21, 2009 *Order Regarding Request for Clarification* made it clear that if Laclede possessed the information, Laclede was required to produce it:

The Commission has ordered Laclede to produce information about its affiliate according to the rules of discovery not under the Commission’s Affiliate Transaction Rule. Although it is true that by granting Staff’s motion, Staff is permitted to investigate Laclede’s affiliate transactions, such investigation is limited to information that may lead to evidence that is relevant to these ACA cases. To the extent that Laclede is in possession of the information, the Commission clarifies its order compelling Laclede to produce the information requested by Staff.

Laclede has also requested that the Commission hold a hearing on the above-captioned matters prior to producing the information requested by Staff. The purpose of discovery, which is to facilitate preparation for hearing, would be thwarted if the Commission granted this relief to Laclede. Laclede's request, in this regard, shall therefore be denied.

The Commission has directed Laclede to produce the information requested by Staff. Laclede is reminded that under Section 386.570, RSMo 2000, the Commission is allowed to seek penalties against Laclede for failure to comply with a Commission order. To this end, the Commission will again direct Laclede to produce information set out in the Order Granting Motion to Compel issued on October 20, 2008.

The Commission recognized that any information Laclede is ordered to provide would still need to be determined to be relevant if and when an attempt was made to enter that information into evidence. The Commission also recognized that Staff's discovery efforts would be thwarted if Staff were forced into a hearing before given an opportunity to review the requested information.

In an unusual turn of events, the Commission subsequently allowed Laclede to continue violating the three Commission orders directing Laclede to provide the information. Instead of enforcing its prior orders, the Commission held an oral argument regarding the same discovery dispute the Commission had considered and resolved. Following the oral argument, the Commission issued the abbreviated *Order Denying Motion to Compel* that simply concludes:

Upon hearing the arguments of Staff and Laclede the Commission is convinced that the information Staff seeks is not reasonably calculated to lead to the discovery of admissible evidence.

Despite the fact that this discovery issue has been ongoing for several years, and despite the fact that it has involved many pleadings, heated discovery disagreements, and an on-

the record oral argument, the Commission's *Order* does not explain the basis for denying the Motion to Compel.

The Commission's expert Staff of auditors is simply seeking the information that is necessary to properly perform an audit under the circumstances of these prudency reviews. The *Order* essentially limits the scope of the Staff's audit before Staff is given an opportunity for full discovery. Commission limitations on the scope of Staff's audit should be clearly explained to the ratepayers that are the most likely to be harmed if the Staff's concerns are proven to be true.

Laclede has identified no harm that would come from releasing the information. Any information that could cause harm to Laclede or any other party if released to the public can remain confidential. The Commission's *Order* has essentially allowed Laclede to remove the most significant issue in these cases before any party is given an opportunity for the discovery of relevant information. Any information provided to Staff would still need to be offered into the record, and the relevance of that information could be fully considered and ruled upon by the Commission at that time, which is the appropriate time for addressing these relevancy claims.

2. Laclede's Authority to Use a Purchased Gas Adjustment

The purpose of the Purchased Gas Adjustment (PGA) prudency review is to determine whether the gas rates charged by Laclede were just and reasonable under the Commission's statutory ratemaking authority. If Laclede imprudently entered into a particular contract or gas purchase that resulted in higher gas costs for ratepayers, the Commission may disallow those excessive costs. *State ex rel. Midwest Gas Users*

Association v. P.S.C., 976 S.W.2d 470 (Mo.App. 1998) (*MGUA*). In *MGUA*, the Court explained:

If the PSC finds the fuel costs are unreasonable or the result of imprudent purchases, it can disallow some or all of the adjustment sought. Moreover, when an ACA is filed the following year, the PSC can and has disapproved some of the actual cost adjustment sought on the basis that the costs were imprudent.

These consolidated cases serve the required and essential purpose of reviewing rates to ensure they are just and reasonable. § 393.130. In Laclede's last ACA case, Mr. David Sommerer, Manager of the Commission's Procurement Analysis Department, explained the three primary purposes of the Staff's ACA review:

The Procurement Analysis Department conducts an Actual Cost Adjustment (ACA) Review annually at the end of each ACA period. The ACA process has a number of purposes. A primary purpose of the ACA process is to reconcile the company's actual gas costs with what it charged customers (its billed revenues). In its purchased gas adjustment (PGA) filings the Company estimates its gas costs for the upcoming year. In the ACA, the estimate is reconciled with the actual cost of gas. In this function the Procurement Analysis Department Staff reviews the gas purchases of the LDC to ensure that the claimed costs are properly attributed to the period under review and that the pipelines and natural gas suppliers have charged or invoiced the LDC for the volumes nominated and received at the proper contract rates. A comparison of billed revenue recovery with actual gas costs will normally yield either an over-recovery or under-recovery of the ACA balances.

Another purpose of the ACA process is to examine the reliability of the LDC's gas supply, transportation, and storage capabilities. For this analysis, Staff reviews the estimated peak day requirements and the capacity levels to meet those requirements, peak day reserve margin and the rationale for this reserve margin, and natural gas supply plans for various weather conditions.

A third purpose of the ACA process is to review the LDC's gas purchasing practices to determine the prudence of the Company's natural gas purchasing and operating decisions. Staff will consider the financial impact on customers of the LDC's use of its gas supply, transportation and

storage contracts in light of the conditions and information available when the operational decisions were made.²

To protect Missouri consumers from paying rates that are unjust and unreasonable, the Commission must have an open understanding of the transactions of Laclede and its affiliate. Moreover, Laclede's ACA cases deserve increased scrutiny because they involve affiliate transaction questions that have not been raised in other ACA cases.

Since PGA cases are a function of the Commission's ratemaking authority, the Commission must adhere to the ratemaking requirement that all rates charged by a utility be just and reasonable. §§ 393.140 and 393.150 RSMo 2000; *Associated Natural Gas Company v. P.S.C.*, 954 S.W.2d 520 (Mo.App. 1997). Missouri courts have held that § 393.270.4 RSMo requires that the Commission's determination of the proper rate for gas is to be based on all relevant factors. *State ex rel. Midwest Gas Users Association v. P.S.C.*, 976 S.W.2d 470 (Mo.App. 1998). The relevant factors related to these prudence reviews include the prudence of the transactions between Laclede and its affiliate. The Commission cannot properly perform its ratemaking function without considering the information that will determine whether Laclede's transactions with LER caused ratepayers to overpay for gas.

3. Laclede's Authority to Purchase Gas from an Unregulated Affiliate

In 2001 the Commission granted Laclede the authority to restructure into a holding company (The Laclede Group, Inc.), regulated company (Laclede Gas Company), and unregulated affiliate (LER) according to the terms of a Unanimous Stipulation and Agreement. This restructuring moved Laclede's gas marketing group LER from Laclede to an unregulated affiliate. To protect ratepayers from the potential

² Direct Testimony of David Sommerer, September 8, 2006, Case No. GR-2004-0273.

abuse created by this restructuring, the Commission approved the Unanimous Stipulation and Agreement, wherein the Laclede companies agreed to make available to Staff and Public Counsel “all books, records and employees of The Laclede Group, Inc., Laclede Gas Company and its affiliates.”³ Laclede now wishes to conceal “all” books and records of the Laclede and LER relationship, in violation of the agreement.

The Laclede Group, Inc. and Laclede also represented and agreed in the Unanimous Stipulation and Agreement as follows:

The Laclede Group, Inc., represents that it does not intend to take any action that has a material possibility of having a detrimental effect on Laclede Gas Company’s utility customers, but agrees that, should such detrimental effects nevertheless occur, nothing in the approval or implementation of the Proposed Restructuring shall impair the Commission’s ability to protect such customers from such detrimental effects.⁴

The Laclede Group, Inc. and Laclede Gas Company agree that the Commission has, and will continue to have, the authority after the Proposed Restructuring to regulate, through the lawful exercise of its current statutory powers, any direct or indirect transfer or disbursement of earnings from Laclede Gas Company to an affiliate that would jeopardize the Company’s ability to meet its utility obligations. The Laclede Group, Inc., and Laclede Gas Company also agree that the Commission has the authority, through the lawful exercise of its ratemaking powers, to ensure that the rates charged by Laclede Gas Company for regulated utility service are not increased as a result of the unregulated activities of Laclede’s affiliates and Laclede agrees, consistent with such standard, that rates should not be increased due to such activities.⁵

Laclede also agreed that its right to object to the production of records specifically excludes “any objection that such records and personnel of affiliates or subsidiaries...are either not relevant or are not subject to the Commission’s jurisdiction and statutory authority by virtue of or as a result of the implementation of the Proposed

³ Unanimous Stipulation and Agreement, p. 8, Case No. GM-2001-342, July 9, 2001.

⁴ *Id.* at p. 5.

⁵ *Id.* at p. 7.

⁶ *Id.* at p. 9.

Restructuring.”⁶ The Commission must enforce the agreement it approved and not allow Laclede to conceal records that it agreed to provide for the very purpose of ensuring that the relationship between Laclede and LER is not harmful to ratepayers.

4. The Information Sought by the Motion to Compel

The data requests ask Laclede to provide the following information:

a. **

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b. **

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c. **

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d. **

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This information is relevant to Laclede's gas purchases, as explained by the Staff during the March 26, 2009 oral argument before the Commission, because **_____

_____.⁷ This is

relevant because determining **_____** will determine Laclede's prudence in its gas purchasing operations and decisions. The Staff argued during oral argument that ***"_____

_____.⁸

_____.⁹ These

relevant facts may only be discovered if the Commission reconsiders its *Order* and compels Laclede to produce the information.

The information sought is also relevant to Laclede's off-system sales to LER because Laclede could have resold its capacity in the same manner that LER resold Laclede's excess capacity for a profit. LER resold Laclede's gas and profited while providing no benefits to Laclede's customers. Had Laclede resold the gas, it was subject to a sharing mechanism whereby Laclede's customers receive up to fifty percent of the off-system sales revenues. The information sought is relevant because it will determine

⁷ Transcript of In-Camera Proceedings, Volume 3, page 35.

⁸ *Id.* at page 37.

⁹ *Id.*

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whether Laclede's gas purchasing transactions with LER unlawfully circumvented the sharing mechanism set forth in Laclede's tariff. These issues are very relevant to the prudency reviews. Public Counsel asks that the Commission reconsider its *Order* and avoid thwarting the Staff's attempts to properly and thoroughly investigate and audit these transactions.

5. **Supreme Court Recognized the Incentive for Cross-Subsidization**

The Commission would be in good company in recognizing that Laclede has a strong incentive to subsidize its non-regulated affiliate on the back of ratepayers. The Missouri Supreme Court recognized the potential for abuse between a regulated utility and its unregulated affiliate when it upheld the Commission's affiliate transaction rules:

Respondents concede that the rules regulate certain aspects of the relationship between utilities and their affiliates. In its brief, the PSC explained that the rules are a reaction to the emergence of a profit-producing scheme among public utilities termed "cross-subsidization," in which utilities abandon their traditional monopoly structure and expand into non-regulated areas. This 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.** See *United States v. Western Elec. Co.*, 593 F. Supp. 846, 853 (D.D.C. 1984) ("**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 the competitive ventures...**") To counter this trend, the new rules – and in particular, the asymmetrical pricing standards – prohibit utilities from providing an advantage to their affiliates to the detriment of rate-paying customers. In addition, to police compliance, the rules require the utilities to ensure that they and their affiliates maintain records of certain transactions. [emphasis added].¹⁰

Laclede has the "opportunity and incentive" to shift costs from LER to Laclede, and for this reason, the Commission must strongly reject Laclede's delay tactics and

¹⁰ *State ex rel. Atmos Energy Corp. et al. v. P.S.C.*, 103 S.W.3d 753 (Mo. 2003).

order Laclede to produce the records immediately and allow the Commission to conduct its prudency review.

6. The Commission's Authority to Compel Compliance

The Commission's authority to compel Laclede to produce records is found in § 393.140(8), which gives the Commission the authority to "examine the accounts, books, contracts, records, documents and papers of any" gas corporation. *See also* § 386.450. This authority is furthered by the Commission's § 393.140(5) power to "examine all persons and corporations under its supervision and keep informed as to the methods, practices, regulations and property employed by them in the transaction of their business."

The Commission's authority is also found, as discussed above, in Laclede's agreement to provide its affiliate transaction records, a concession Laclede made to garner Commission's approval of the restructuring that moved Laclede's gas purchasing out from under Laclede and into an unregulated affiliate. Laclede and LER shared the same office space at 720 Olive Street in St. Louis, and LER's executive officers, including LER's president, two vice presidents and secretary, all held similar positions for Laclede during the ACA periods.¹¹ These close ties and the need to fully understand the Laclede/LER transactions underscore the importance of the Commission's § 393.140(8) and § 386.450 authority to review records.

In *Midwest Gas Users' Association v. Office of Public Counsel*, 976 S.W.2d 470, 483 (Mo. App. 1998), the Missouri Court of Appeals for the Western District explained that the Commission has the authority to review the prudence of a company's "decision

¹¹ The Laclede Group and Laclede Gas Company Form 10-K Annual Report, filed with the Securities and Exchange Commission, for the fiscal year ended September 30, 2006.

to enter into a particular contract when a less costly alternative is available.” *Id.* The Commission does not conduct a prudence review of the purchased gas adjustment (PGA) before it becomes effective, and may disallow some or all of the adjustment sought when fuel costs are “unreasonable or the result of imprudent purchases.” *Id.*

Laclede is required under the rules to keep and make affiliate transaction records available for a period of six (6) years. 4 CSR 240-40.016(8). Without the requested documents, the Commission will be unable to fulfill its obligation to “keep informed as to the methods, practices, regulations and property employed by [Laclede] in the transaction of their business” and to fulfill the Commission’s obligation to prevent Laclede from engaging in transactions that are “unjust, unreasonable, unjustly discriminatory or unduly preferential or in any wise in violation of any provision of the law.” § 393.140(5). In addition, the requested documents are necessary to ensure that Laclede has not directly or indirectly by any special rate or other device or method, collected or received from its affiliate greater or lesser compensation for its service than it charges a non-affiliate. § 393.130(2) (2006 Supp); § 393.140(11); *State ex rel. Atmos Energy Corp. et al. v. P.S.C.*, 103 S.W.3d 753 (Mo. 2003).

7. Response to Agenda Discussion Basis for the Commission’s Order

Questions and answers during an exchange between Mr. Steve Reed of Staff and Commissioner Murray were mentioned during Agenda discussion as a possible rationale for rejecting the Staff’s Motion to Compel. A portion of the exchange reads:

COMMISSIONER MURRAY: And for an ACA case, the Staff is going to be looking at whether Laclede complied with its tariff, including the Cost Allocation Manual that is included in its tariff; is that correct?

MR. REED: As part of the ACA Case, we’ll review that information as well, but the primary purpose for this information is to determine whether

Laclede paid too much to LER for gas and determine what LER did with Laclede's capacity that was released to LER.

COMMISSIONER MURRAY: And too much would be defined by the rule, would it not?

MR. REED: Not necessarily. Because if entering into the contract and taking action under the contract was not prudent in that it led to higher gas costs for the ratepayers, then that impacts the ACA.

COMMISSIONER MURRAY: So they could fully comply with their Cost Allocation Manual and still be imprudent, is that what you're saying?

MR. REED: Yes.

This exchange appears to have swayed the Commission's decision in approving the *Order* because of a suggestion that Laclede could comply with the law but still face a finding of imprudence. If this was a basis for the *Order*, it should be reconsidered because it does not recognize the statutory requirement that rates charged by Laclede be just *and reasonable*. § 393.130.1 RSMo. Review does not end if the rates are considered to be lawful because they must also be reasonable. Rates that are established during a rate case are found to be just and reasonable after an audit and *before* they become effective. PGA rates, however, are not fully audited before the rates are charged customers, and therefore, must undergo a "just and reasonable" analysis *after* they are charged to ratepayers. The Commission should reconsider the *Order Rejecting Motion to Compel* and reconsider any rationale for the *Order* that is based upon the idea that the information sought is not likely to lead to admissible evidence simply because Laclede may have followed the law. Such a conclusion suggests a misunderstanding of the purpose of the PGA/ACA process and the Commission's ratemaking duties.

Furthermore, there appears to be a misunderstanding regarding Laclede's Cost Allocation Manual (CAM). To Public Counsel's knowledge, Laclede has never

submitted its CAM to the Commission for approval, and therefore cannot use the CAM to establish compliance with Commission rules.¹² In fact, Laclede's CAM has been the subject of an ongoing disagreement between Laclede, the Staff and Public Counsel as to whether the CAM complies with the Commission's rules. Laclede's compliance with the terms of the CAM only proves that Laclede may have complied with Laclede's own interpretation of the Commission's rules.

8. Conclusion

The importance of allowing the Commission's Staff to review the requested information goes beyond the ACA periods on review in these cases. Since Laclede continues transacting business with LER, the potential for abuse by Laclede continues today. Insight into the transactions between Laclede and LER from 2004 to 2006 will assist the Commission in reviewing subsequent ACA periods, and in possibly making immediate changes to Laclede's practices if necessary to protect future ratepayers from continued abuse. Public Counsel asks that the Commission avoid binding the hands of its Staff in performing its investigation, which the Commission would be doing were it to let the *Order* stand and permit Laclede to continue concealing its affiliate transaction records.

Public Counsel asks that the Commission fulfill its obligation to serve the public and provide Missourians with the assurance that their rates are not subsidizing the excessive profits of non-regulated enterprises. Ignoring this issue now could allow

¹² Commission rule 4 CSR 240-40.015(3)(D) states: "(D) In transactions involving the purchase of goods or services by the regulated gas corporation from an affiliated entity, the regulated gas corporation will use a commission approved CAM which sets forth cost allocation, market valuation and internal cost methods. This CAM can use benchmarking practices that can constitute compliance with the market value requirements of this section if approved by the commission." [emphasis added].

Laclede to continue with gas purchasing transactions that may be forcing Laclede's customers to subsidize the operations of Laclede's affiliate.

Public Counsel respectfully requests that the Commission reconsider its *Order Denying Motion to Compel* and issue a new order directing Laclede to provide the requested information. Public Counsel also asks that the Commission explain the basis for its *Order Denying Motion to Compel* and the reasons for the change in decisions from the earlier *Order Granting Motion to Compel*.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, emailed or hand-delivered to the following this 4th day of May 2009:

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