BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

The Staff of the Missouri Public Service Commission, Complainant, v. Missouri Pipeline Company, LLC; and Missouri Gas Company, LLC, Respondents.	)	**Case No. GC-2006-0491**

INITIAL POSTHEARING BRIEF

OF

THE MUNICIPAL GAS COMMISSION OF MISSOURI

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COMES NOW the Municipal Gas Commission of Missouri ("MGCM"), pursuant to the Commission's January 12, 2007 Order Establishing Briefing Schedule, and submits its Initial Posthearing Brief.

I. INTRODUCTION

On of about December 4, 2006, the parties filed their Statement of Position on various issues. At the time of the evidentiary hearing, Staff was presenting five issues for a Commission decision. As indicated in its Statement of Position, MGCM only takes an issue on Issue 3 and its various subparts. That is:

> 3. Did MPC and MGC provide transportation service to its affiliate, Omega, at a discounted rate and if so, should this rate become the maximum rate that MPC and MGC could charge for any of its non-affiliated customers for similar service?
>
> Subissue (a): If the above issue is answered in the affirmative, should MPC and MGC issue refunds for overcharges?
>
> Subissue (b): If the above issues are answered in the affirmative, should MPC / MGC's current charges be reduced so that the rates charged to non-affiliated shippers are equal to the lowest rates charged to Omega.

As will be proven in this Initial Brief, based upon the competent and substantial evidence accepted into the record, the answer to each of these questions is undoubtedly "yes". The evidence reveals that Missouri Pipeline Company ("MPC") and Missouri Gas Company ("MGC") (collectively referred to herein as the "pipelines") engaged in a practice of discriminatory pricing, contrary to the terms of its tariff, designed to provide its unregulated affiliate, Omega Pipeline Company, with a competitive advantage. Armed with the advantage of discounted shipping on the MPC / MGC system, Omega Pipeline Company was able to take customers away from other gas marketers.

Given the express provisions of MPC / MGC's tariffs, the pipelines should be required to issue refunds for that period of time in which the pipelines were charging unaffiliated shippers a higher rate than the rate being charged to the affiliate, Omega Pipeline Company. Furthermore, also consistent with the express provisions of their tariffs, MGC / MPC's current rates should be reduced to a level equal to the lowest rates charged to the pipelines' affiliate.

II. EVOLUTION OF NATURAL GAS INDUSTRY

Originally, natural gas was manufactured from coal and was generally distributed within the same municipality in which it was produced. As a result of the cost of constructing a distribution network, it was generally believed that a single distribution network could deliver natural gas cheaper than two companies with competing networks. Rather than face the possible abuses associated with a firm exercising monopoly power, local governments regulated than natural gas industry. Later, when the distribution of natural gas began to extend beyond the boundaries of municipalities, state governments began to create public utility commissions to regulate these "intrastate" natural gas industries.

As technology improved, natural gas pipelines were able to transport gas over ever increasing distances. The transportation of natural gas was no longer a municipal or intrastate affair, but began to be interstate in nature. Despite attempts by several states to regulate these interstate pipelines, the Supreme Court found that such state regulation violated the interstate commerce clause. As a result, the federal government stepped in to fill the growing regulatory gap. In 1938, the federal government passed the Natural Gas Act which placed regulation of the rates of natural gas pipelines under the authority of the Federal Power Commission.

Until the early 1980s, local gas distribution companies were forced to purchase a bundled product from its serving pipelines. This bundled product consisted of both: (1) the natural gas commodity and (2) transportation of the gas from the production field to the local distribution company. Local distribution companies were not permitted to purchase gas directly from the producers and then separately transport that gas over the pipeline.

In 1985, FERC issued Order 436. This order established a voluntary framework under which interstate pipelines could act solely as transporters of natural gas, rather than filling the role of a natural gas merchant. The interstate pipelines were barred from discriminating against transportation requests based on protecting their own merchant services. The long term effect of Order 436 was to make transportation the primary function of pipelines, as opposed to offering the bundled merchant service.

While Order 436 created a voluntary framework for unbundling of gas transportation services, Order 636 (issued in 1992) made pipeline unbundling a requirement.

> Essentially, this Order meant that pipelines could no longer engage in merchant gas sales, or sell any product as a bundled service. This Order required the restructuring of the interstate pipeline industry; the production and marketing arms of interstate pipeline companies were required to be restructured as arms-length affiliates. ***<u>These affiliates, under Order 636, could in no way have an advantage (in terms of price, volume, or timing of gas transportation) over any other potential user of the pipeline.</u>***

The requirements of Orders 436 and 636 were made applicable to the Missouri intrastate pipelines through specific tariff provisions. For instance, Missouri Pipeline Company and Missouri Gas Company tariffs: (1) require the pipelines to provide transportation service to any shipper[1]; (2) preclude the pipeline from engaging in the sale of the natural gas commodity by requiring a separate marketing affiliate[2]; (3) establish

[1] Exhibit 70, Sheet No. 4, Paragraph 1; Exhibit 71, Sheet No. 4, Paragraph 1.
[2] Exhibit 70, Sheet No. 39, Paragraph 12; Exhibit 71, Sheet No. 39, Paragraph 12.

operational separation between the pipeline and its marketing affiliates[3]; and (4) prevent favorable treatment of a marketing affiliate.[4]

Out of these changes in the natural gas industry and the various provisions in the MPC / MGC tariffs come two undeniable conclusions:

1. The pipelines sole focus is the ***transportation*** of natural gas. Pipelines are no longer permitted to engage in the ***sale*** of natural gas or to offer bundled merchant service to its customers. Any efforts by the pipeline to engage in these activities must be done through a marketing affiliate.

2. The pipelines are precluded from engaging in preferential treatment of its marketing affiliate. The pipelines could not discriminate in favor of these affiliates in any way (price, volume or timing of transportation).

III. DISCOUNTED RATES PROVIDED TO PIPELINE'S MARKETING AFFILIATE

A. INTRODUCTION AND BACKGROUND

The Staff presents, in the expert testimony of Robert Schallenberg, irrefutable evidence that the pipelines provided preferential treatment to its marketing affiliate, Omega Pipeline Company. The evidence indicates that, shortly after the acquisition of the pipelines by Gateway in late 2001, the pipelines sought to offer a bundled service on its pipeline. In a response to an inquiry by the pipelines regarding this bundled service, Staff indicated "concern over the structure of these transactions and Staff's preference that an affiliate should make any "bundling" arrangements."[5] In fact, the evidence indicates that Staff conveyed its concern that this bundling proposal would "go against FERC policy of not allowing the monopoly pipeline [to engage in] a merchant service. This was done so that the pipeline could not use its monopoly power in one area to benefit another competitive area."[6]

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[3] Exhibit 70, Sheet No. 39, Paragraph 12(b); Exhibit 71, Sheet No. 39, Paragraph 12(b).
[4] Exhibit 70, Sheet No. 39, Paragraph 12(a); Exhibit 71, Sheet No. 39, Paragraph 12(a).
[5] Exhibit 308, page 2.
[6] Exhibit 310.

Ultimately, the pipelines gave up on its plans to offer a bundled merchant service in favor of utilizing a marketing affiliate. In order to provide the marketing affiliate a competitive advantage, however, the pipelines readily agreed to provide a transportation discount. The ability to extract such a discount from the pipelines was easily arranged since David Ries was the president of the pipelines and also the president of the marketing affiliate. Once armed with the competitive advantage of discounted transportation costs, the marketing affiliate was easily able to steal business from other energy marketers.

B. PIPELINE TARIFFS

MPC and MGC tariffs certainly contemplate a situation in which the pipeline might seek to provide a customer a transportation discount. In order to avoid any affiliate abuse, however, the tariffs mandate that any discount provided to a marketing affiliate must also be offered to all non-affiliate shippers. Section 3.2(b) of the pipeline tariffs provide:

> For all Transportation Agreements entered into by Transporter with any affiliate of Transporter after the effective date of tariff sheets having a Date of Issue of January 18, 1995, in those instances in which the term of the Agreement is greater than three (3) months:
>
> (1) The lowest transportation rate charged to an affiliate shall be the maximum rate that can be charged to non-affiliates.[7]

As Mr. Schallenberg indicates:

> This tariff language provides non-affiliate shippers protection from special pricing arrangements provided to MPC and MGC affiliates. This provision would provide to MPC and MGC non-affiliated shippers the same pricing terms offered to Omega. Therefore, MPC and MGC would be in violation of their tariffs to charge a non-affiliated shipper more for transportation service than MPC and MGC charged to Omega.[8]

[7] Exhibit 70, Sheet No. 6, Section 3.2(b); Exhibit 71, Sheet No. 6, Section 3.2(b).
[8] Exhibit 19, page 21.

The remainder of this brief will detail three specific transactions in which the pipelines provided affiliate discounts for firm transportation service. Given the application of Section 3.2(b) of its tariffs, the pipelines should be required to issue significant refunds to non-affiliate shippers to account for these affiliate discounts.

C. MISSOURI GAS COMPANY DISCOUNT PROVIDED TO OMEGA PIPELINE ASSOCIATED WITH SERVICE TO CITY OF CUBA (JULY 1, 2003)

Despite the clear direction from Staff, and despite the prohibition against pipelines engaging in the sale of natural gas, it is apparent that the pipelines moved forward with its bundling proposal. In mid-2003, the pipelines approached the City of Cuba with a bundled service proposal. An article from the Cuba Free Press, dated June 25, 2003, describes the rationale underlying Cuba's decision to move its bundled service offering from Ameren to Missouri Gas Company.

> The recommendation was approved to move forward with Ries [owner of Missouri Gas Company], waiting for the best prices before locking in. Ries was approved because of his low transportation costs. ***He will be going through the New York Maximum Exchange (NYMX) to determine gas prices. Last year, prices were locked in in September, but it will depend on the market when prices will be locked in this year.***[9]

Additional evidence indicates that the pipelines also attempted to entice other municipalities, including St. James, by offering its bundled service.[10] Clearly, the pipelines intended to utilize "low transportation costs" bundled with the sale of natural gas to provide it a competitive advantage over other gas marketers including Ameren.

Ultimately the evidence indicates that Mr. Ries, president of the pipelines, followed through on his bundled offering. In order to avoid criticism of the pipelines being involved in the sale of natural gas, Ries, substituted a marketing affiliate (Omega Pipeline Company) on the contract. However, in order to maintain the economics of the

[9] Exhibit 304, Appendix EE (emphasis added).
[10] *Id.*

proposed bundled offering, Missouri Gas Company was required to provide Omega Pipeline a transportation discount.

Exhibit 22 is an executed contract between Omega Pipeline Company and the city of Cuba. The contract reflects a bundled service in that it provides for both the sale of natural gas as well as the transportation of that gas to the Cuba city gate meter station. Normally, Omega would have been charged the tariffed rates for transportation service on the MGC pipeline consisting of a $13.1766 / Dth reservation charge and a $0.9433 / Dth commodity charge.[11] Pipeline invoices indicate that, while the affiliate was charged a full reservation rate, Omega was only charged **___________** commodity rate.[12] Therefore, in order to give its marketing affiliate a competitive advantage in securing the business of the City of Cuba, Missouri Gas Company provided its marketing affiliate a **_____________** commodity discount.[13] The affiliate discount rate provided by Missouri Gas Company associated with Omega's service to the City of Cuba compares to the tariffed rate as follows:

	Reservation Charge	Commodity Charge
Tariffed Rate	$13.1766 / Dth	$0.9433 / Dth
Discount Rate	$13.1766 / Dth	**__________**

When confronted with conclusive documentation, the pipelines suddenly claimed that the discounted pricing was not really provided to its affiliate, but instead was provided directly to the City of Cuba. In support of this claim, the pipelines produced an

[11] Exhibit 70, Sheet No. 5, Section 3.1(a) & (b).
[12] Exhibit 67, Appendix E-1.
[13] Exhibit 67, Appendix E reflects all transportation invoices to Omega Pipeline associated with its provision of bundled service to the City of Cuba. The first invoice, reflected on Appendix E-1, is for transportation in January, 2004. To date, the pipelines have refused to provide any invoices for 2003. This failure has been documented in numerous pleadings before the Commission. Nevertheless, it is apparent that the referenced commodity discount predates the January 2004 invoice and was applicable upon commencement of service to the City of Cuba.

alleged letter which it believes memorializes the discount between the pipelines and the City of Cuba.[14] Comparison with other properly executed contracts (i.e., Exhibit 25 – previous pipeline contract with Cuba; Exhibit 27 – pipeline contract with Waynesville; and Exhibit 28 – previous pipeline contract with Waynesville) reveal several inconsistencies which mandate a conclusion that this agreement was never executed and was created after the fact. First, unlike ***all*** the other properly executed agreements, the claimed contract with Cuba was never signed by the Mayor. Second, unlike ***all*** the other properly executed agreements, the claimed contract with Cuba was never even formatted for signature by the Mayor. Third, as of the date of the claimed contract, Missouri Pipeline Company no longer operated as a corporation. On December 3, 2002, the Commission approved the reorganization of Missouri Pipeline Company from a corporation to a limited liability company. This approval was effective on December 12, 2002. As reflected on the letterhead on Exhibit 28, Missouri Pipeline Company was already holding itself out as a LLC a mere 6 days after the reorganization approval. Nevertheless, letters allegedly created eight months later were inexplicably on letterhead reflecting a change back to a corporation. Given the explicit bar in Section 347.020(2) against a limited liability company using any name which contains the word or abbreviation for corporation or incorporated, it is unlikely that Mr. Ries suddenly used the wrong letterhead. Rather, it is apparent that this document was a hastily prepared attempt, created after the fact and modeled after Exhibit 25, to make the Commission believe that no affiliate discount actually existed.

The documentary evidence provided by Mr. Schallenberg leads to one irrefutable conclusion - that Missouri Gas Company provided an affiliate discount to allow Omega Pipeline to better compete against other gas marketers and secure the natural gas business

[14] Exhibit 26.

of the City of Cuba. Given the explicit provisions of Section 3.2(b) of its tariff, Missouri Gas Company was explicitly prohibited from charging non-affiliates a transportation rate higher than that charged to Omega. As such, Missouri Gas Company should be required to provide refunds to non-affiliate shippers.

D. MISSOURI GAS COMPANY AND MISSOURI PIPELINE COMPANY DISCOUNTS PROVIDED TO OMEGA PIPELINE ASSOCIATED WITH SERVICE TO **____________** (MAY 1, 2005)

The affiliate discount provided to Omega Pipeline to serve the City of Cuba was not the last discount provided by the pipelines. On May 1, 2005, Missouri Gas Company and Missouri Pipeline Company commenced another affiliate discount to allow Omega to better compete for the natural gas business of **____________**. As Mr. Schallenberg indicates:

> **____
> ____
> ____
> ____________________________**[15]

As mentioned previously the tariffed rates for firm transportation service on the MGC pipeline consist of a $13.1766 / Dth reservation charge.[16] In addition, a shipper was charged a $4.1381 / Dth reservation charge on the MPC pipeline.[17] Pipeline invoices indicate that, prior to May 1, 2005, Omega was actually charged the full firm transportation rates by MPC and MGC to serve **____________**.[18] Commencing on May 1, 2005, however, both Missouri Gas Company and Missouri Pipeline Company began **____________________________** associated with Omega's firm service to **____________**.[19] These represented significant affiliate discounts which were not

[15] Exhibit 19, page 26.
[16] Exhibit 70, Sheet No. 5, Section 3.1(a) & (b).
[17] Exhibit 71, Sheet No. 5, Section 3.1(a) & (b).
[18] Exhibit 67, Appendix D-7.
[19] Exhibit 67, Appendix D-12.

provided to other non-affiliates that were attempting to compete against Omega Pipeline. Again, as compared to the tariffed rates, the pipelines affiliate rates associated with service to **____________** for service in May, 2005 was as follows:

	Missouri Pipeline Company		Missouri Gas Company	
	Reservation Charge	Commodity Charge	Reservation Charge	Commodity Charge
Tariff	$4.1381 / Dth	$0.1699 / Dth	$13.1766 / Dth	$0.9433 / Dth
Discount	**_________**	$0.1699 / Dth	**__________**	$0.9433 / Dth

E. MISSOURI GAS COMPANY AND MISSOURI PIPELINE COMPANY DISCOUNTS PROVIDED TO OMEGA PIPELINE ASSOCIATED WITH SERVICE TO **____________** (JUNE 1, 2005)

One month after implementing the discount described in the immediately previous section, Missouri Gas Company implemented an additional discount for Omega Pipeline to serve **____________**. As Mr. Schallenberg describes:

> In June 2005, MPC and MGC began transporting Omega gas to Emhart under rate terms further reduced from the previous month. Omega payments to MPC and MGC for this transportation service were based on rates less than the maximum tariff rate.[20]

As indicated previously, both Missouri Pipeline Company and Missouri Gas Company had **______________________________** associated with Omega's service to **____________**. Commencing on June 1, 2005, however, Missouri Gas Company provided an additional discount by reducing the commodity rate from the $0.9433 / Dth tariffed rate to a discounted rate of **__________**.[21] Compared to the tariffed rate, the discount applicable to Omega commencing June 1, 2005 looked as follows:

[20] Exhibit 19, page 26.
[21] Exhibit 67, Appendix D-17.

	Missouri Pipeline Company		Missouri Gas Company	
	Reservation Charge	Commodity Charge	Reservation Charge	Commodity Charge
Tariff	$4.1381 / Dth	$0.1699 / Dth	$13.1766 / Dth	$0.9433 / Dth
Discount	**________**	$0.1699 / Dth	**________**	**________**

The need to provide an additional affiliate discount a mere month after providing the initial discount is made apparent by a review of the invoices issued by Omega Pipeline Company to **____________**. As indicated, those invoices directed the customer to send payment to **________________________**. While these revenues were being sent to **________________________**, **________________________** was still being billed, albeit at a significantly reduced rate, by the pipelines for transportation service. **____**

IV. CONCLUSION

The record evidence, in the form of expert testimony of Robert Schallenberg and significant documentary evidence, readily reveals an ongoing pipeline policy of providing transportation discounts in order to better enable its marketing affiliate, Omega

Pipeline Company, to compete in the unregulated gas marketing business. Until the filing of this complaint and despite the strict requirements of its tariffs, this policy of affiliate discounts went undiscovered. In the meantime, Omega Pipeline Company, armed with the advantages of these transportation discounts, was able to steal gas marketing business from numerous other gas marketers. Pipeline tariffs provide a clear remedy for these transgressions – refunds to all non-affiliate transporters. While case law suggests that the Commission can not order refunds, a Commission finding regarding the appropriate rates that were applicable for certain time periods will allow these non-affiliate shippers to seek refunds in Circuit Court.

The documentation is overwhelming. The Commission should not allow itself to be diverted by pipeline discussion of agency agreements and load factors. The money trail created by the pipeline invoices is abundantly clear and provides all the evidentiary necessary for the Commission's findings. For all the reasons set forth in this brief, MGCM respectfully requests that the Commission issue its Order consistent with its position.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing pleading by email, facsimile or First Class United States Mail to all parties by their attorneys of record as provided by the Secretary of the Commission.

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David L. Woodsmall

Dated: February 9, 2007