

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

In the Matter of Atmos Energy	)	
Corporation's 2008-2009 Purchased Gas	)	<b><u>File No. GR-2009-0417</u></b>
Adjustment and Actual Cost Adjustment	)	

**POST-HEARING BRIEF OF  
ATMOS ENERGY CORPORATION**

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**NON-PROPRIETARY VERSION**

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**I. INTRODUCTION**

**A. EXECUTIVE SUMMARY**

This case involves Atmos Energy Corporation's ("Atmos") 2008-2009 ACA audit. The Company filed this case in October 15, 2009. After a year-long audit involving substantial discovery, the Commission Staff ("Staff") filed its recommendation on December 30, 2010, wherein the Staff proposed two affiliated transaction disallowances related to Atmos' gas purchasing practices in Hannibal and Butler, Missouri. Atmos filed its response to Staff's recommendation on February 2, 2011, disagreeing with the Staff's affiliated transaction adjustments and requesting that the Commission schedule a hearing to address this matter.

This case raises issues that are similar to the issues raised in Atmos' last ACA case, Case No. GR-2008-0364.<sup>1</sup> In fact, two gas supply contracts for the Hannibal and Butler service areas that are the subject of this case are also the same contracts reviewed in Case No. GR-2008-0364. However, since some costs of the gas supply contracts were

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<sup>1</sup> Since this case and Case No. GR-2008-0364 are so closely intertwined, Staff proposed at the conclusion of the evidentiary hearings in Case No. GR-2009-0417 to incorporate the record from Case No. GR-2008-0364 into this case. This request was granted by Chief Regulatory Law Judge Morris Woodruff. (Tr. 237-38) In order to avoid confusion since there are duplicate transcript pages and exhibit numbers in both cases, this Brief will highlight Transcript references, and Exhibit references from Case No. GR-2009-0417 with yellow highlighting. (e.g. Tr. xx; Ex No. 1, pp. xx). The transcript pages and exhibit numbers from Case No. GR-2008-0364 will not be highlighted, but will be identified in black typeface. (e.g., Tr. xx; Ex No. 1, pp. xx)

paid in the 2008-2009 ACA period, Staff is proposing to disallow these costs in this case in addition to the costs proposed to be disallowed in Case No. GR-2008-0364. However, as will be discussed herein, Staff is now suggesting a different theory for the disallowances in this case than previously proposed in Case No. GR-2008-0364. In other words, the Staff's "theory of the case" has once again changed or morphed in this proceeding, continuing a trend that began in Case No. GR-2008-0364. (See Atmos Post-Hearing Brief at 10-13.)

**B. ISSUES RAISED BY STAFF AND PUBLIC COUNSEL IN CASE NO. GR-2008-0364**

In Atmos' last ACA case, the Staff and Public Counsel raised the following legal issues:

1. Were Atmos' purchasing practices prudent during this ACA period?
2. Whether the Affiliated Transaction Rule requires that a regulated LDC like Atmos lower its gas supply costs in the PGA/ACA process by the same amount as the gross profits of an affiliated gas marketer that provided gas supplies after a formal competitive bidding process?
3. Whether Atmos provided a "financial advantage" to its affiliate?
4. Whether the Commission should prohibit affiliated transactions between Atmos and Atmos Energy Marketing ("AEM"), its affiliated gas marketer?
5. Whether the Commission should make a \$308,000 disallowance of gas costs because Atmos asserted its right to object to discovery related to its unregulated affiliate?
6. Whether Atmos was imprudent by failing to nominate a larger amount of gas under its contract with AEM during a December 2007 Force Majeure

period during the rupture of the natural gas pipeline owned and operated by Panhandle Eastern Pipeline Company?

At the conclusion of the hearings in Case No. GR-2008-0364, Staff's rationale for its proposed disallowance had morphed into new allegations that were not presented previously in its Staff Recommendation, Staff's direct, rebuttal, surrebuttal testimony, List of Issues or Staff Position Statement. (Atmos Br. at 1-10) Staff had abandoned several of its original rationales. Staff changed its rationale for recommending the disallowance in the face of the evidence that: (1) Atmos followed the Commission's requirement to conduct a competitive bidding process for its gas supplies (Atmos Br. at 14-17); (2) Atmos paid its affiliate less than the fair market price for its gas supplies (Atmos Br. at 25-32); (3) Atmos did not provide any "financial advantage" or other preference to its affiliate (Id.); (4) Atmos was prudent and reasonable in its gas purchasing activities during this ACA period (Atmos Reply Br. at 13-14); and (5) Staff abandoned its recommendation that the Commission should prohibit Atmos from engaging in affiliated transactions with AEM (Atmos Reply Br. at 23-25).

Instead, Staff focused on a new issue—Staff's allegation that AEM had violated the Affiliated Transaction Rule by failing to keep appropriate records required under the Affiliated Transaction Rule. In its Initial Brief in Case No. GR-2008-0364, Staff concluded that "[t]he lack of AEM records was foundational to Staff's proposed \$308K disallowance." (Staff Brief, p. 19) The information alleged to be "missing" related to AEM's overheads and allocated costs. Without this information, Staff could not calculate the "net profits" made by AEM on these transactions. However, during the cross-examination in Case No. GR-2008-0364, Staff witness Sommerer candidly admitted that

there is no requirement of the Affiliated Transaction Rule that “net profits” be kept or accounted for on a transaction-by-transaction basis. (Tr. 634-35). He reaffirmed this fact in this case. (Tr. 188-89) In reality, Staff never requested the information from AEM related to its overheads in Case No. GR-2008-0364. Rather, Staff specifically requested from AEM its calculation of the “gross profits” related to the gas supply contracts. (Tr. 643)

In this case, Staff again initially requested information associated with AEM’s “gross profits” on the gas supply transactions in Hannibal and Butler. It was not until after rebuttal testimony was filed that Atmos received a request for information regarding AEM’s overheads, administrative and general costs. Not only did Staff request this information for the ACA period at issue in this case, but it also requested it for the last ACA period that was already fully litigated in Case No. GR-2008-0364. (Ex No. 3 NP, Buchanan Surrebuttal, p. 10)

As discussed below, in Case No. GR-2009-0417, AEM provided information regarding its overheads that allowed Staff to calculate AEM’s “net profits” on the Hannibal and Butler transactions, but Staff continued to assert in its pre-filed testimony and Position Statement in Case No. GR-2009-0417 that AEM had failed to comply with the recordkeeping requirements of the Affiliated Transaction rule. (Ex No. 16 NP, pp. 12-13; 22; Ex No. 18 NP, pp. 2; Staff Position Statement, p. 1; Tr. 179-80)

However, during questioning of Staff counsel by Commissioner Kenney, Mr. Berlin made it clear that Staff is not relying upon the “flawed recordkeeping” rationale for support for its adjustment, but instead is now relying upon a “flawed RFP process” as the basis for its disallowance:

[Commissioner Kenney]: So I just want to be clear – thanks, Mr. Berlin. It’s the – it’s not the absence of any particular records or a flaw in the record-keeping. It’s a flaw in the RFP and the bid process that leads to the Staff’s determination that the PGA rates are not just and reasonable? Is that restating Staff’s position correctly?

[Mr. Berlin]: That – that is –that is correct. . . (Tr. 50)

As explained below, this new rationale for the affiliated transaction disallowance was not identified as the basis for Staff’s affiliated transaction disallowance in the Staff Recommendation. It is yet another “theory of the case” that is again being thrown up by Staff after the other justifications for the proposed affiliated transaction adjustment have been fully addressed and refuted. For the reasons stated herein, Staff latest theory should also be rejected.

### **C. ISSUES RAISED BY STAFF IN CASE NO. GR-2009-0417**

Based upon Staff’s ever changing and evolving theories of the case, this case now presents the following issues for resolution by the Commission:

1. Is Atmos’ Request For Proposal (RFP) process a “flawed” process?
2. Were the gas costs in the Hannibal and Butler service areas “just and reasonable” during this ACA period?<sup>2</sup>

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<sup>2</sup> Based upon Staff counsel’s answer to Commissioner Kenney (Tr. 50), it appears that Staff has now abandoned its “flawed recordkeeping” theory. However, out of abundance of caution, Atmos will nevertheless address Staff’s original allegations related in AEM’s recordkeeping in this brief.

For the reasons stated herein, the Commission should find and conclude:

1. Atmos' RFP process is reasonable, consistent with the Commission's Affiliated Transaction Rule requirements, and results in the lowest cost gas supply available in Atmos' service areas.
2. Atmos' cost of gas in the Hannibal and Butler service areas is "just and reasonable" when compared to the gas costs in the other Atmos service areas in Missouri.
3. AEM did not violate the recordkeeping requirements of the Affiliated Transaction and Gas Marketing Transaction Rules.

## **II. THE FACTS OF THE CASE**

Atmos used a formal competitive bidding process to solicit bids from numerous unregulated gas marketers for the Company's gas supplies in all of its various service areas in Missouri. This formal, competitive bidding process is fully described in the Direct Testimony of Rebecca Buchanan in this proceeding. (Ex No. 1NP, Buchanan Direct, pp. 6-13; (Tr. 124-41)<sup>3</sup>; Ex No. 1NP, Buchanan Direct, pp. 6-14)(Tr. 444) As explained by Ms. Buchanan:

In total, nine RFPs were issued during the ACA period under review in this Case. For the Hannibal/Bowling Green system, Atmos sent out two RFP letters during this ACA review period. The first RFP went out in the October 2008 and was for a three month winter peaking service. The RFP letter was sent to fifty-nine (59) entities on the Bidder List maintained by the Company. Out of the 59 solicited bid requests, Atmos received \*\*\_\_\_\_\_\*\*. Subsequent to issuing the peaking RFP, the repairs on the Hannibal Propane Air Plant were completed. Since the Propane Air Plant was available for peaking, an RFP winter peaking service was not needed. The second RFP for Hannibal/Bowling Green system went out in February 2009 for a one year agreement for firm system supply. The RFP letter was

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<sup>3</sup> Ms. Buchanan explained the Atmos RFP process in detail in answer to Commissioner Jarrett's questions during the hearings in Case No. GR-2009-0417 (Tr. 124-41).

sent to sixty (60) suppliers. The Company received \*\* \_\_\_\_\_ \*\*, one of which was non-conforming. \*\* \_\_\_\_\_ \*\*

For the Butler system, Atmos sent RFP letters to sixty (60) entities on the Bidder List maintained by the Company. Out of the 60 solicited bid requests, Atmos received conforming bids from the following  
\*\* \_\_\_\_\_ \*\* gas marketers: \*\* \_\_\_\_\_ \*\*

\_\_\_\_\_ \*\*

For the Rich Hill/Hume system, gas supply is provided in conjunction with the Company's firm supply for its Kansas service area on SSCGP. In this regard, Atmos sent RFP letters in November 2008 to twenty-three (23) potential suppliers. Out of the 23 solicited bid requests, Atmos received conforming bids from the following \*\* \_\_\_\_\_ \*\*

\_\_\_\_\_ \*\*

For the Kirksville system, Atmos sent RFP letters to sixty (60) entities on the Bidder List maintained by the Company. Out of the 60 solicited bid requests, Atmos received conforming bids from the following \*\* \_\_\_\_\_ \*\*

\_\_\_\_\_ \*\*

For the MRT Piedmont/Arcadia system, Atmos sent RFP letters to sixty (60) entities on the Bidder List maintained by the Company. Out of the 60 solicited bid requests, Atmos received conforming bids from \*\* \_\_\_\_\_ \*\*

For the NGPL Jackson system, Atmos sent RFP letters to sixty (60) entities on the Bidder List maintained by the Company. Out of the 60 solicited bid requests, Atmos received conforming bids from the following  
\*\* \_\_\_\_\_ \*\*

\_\_\_\_\_ \*\*

For the TETCO SEMO system, Atmos sent RFP letters to sixty (60) entities on the Bidder List maintained by the Company. Out of the 60 solicited bid requests, Atmos received conforming bids from the following  
\*\* \_\_\_\_\_ \*\*

\_\_\_\_\_ \*\*

For the Ozark SEMO system, Atmos sent RFP letters to sixty (60) entities on the Bidder List maintained by the Company. Out of the 60 solicited bid requests, Atmos received \*\* \_\_\_\_\_ \*\* conforming bids from the

following gas marketers: \*\* \_\_\_\_\_  
\*\* (Ex No. 1HC, Buchanan Direct, pp. 9-11).

Two of its gas supply contracts were awarded to AEM which submitted the lowest and best bid for those gas supplies for the Hannibal and Butler areas of the Company during the 2007-2008 ACA period. (Ex No. 1NP, Buchanan Direct, pp. 12-13) These two gas supply contracts with AEM are the only contracts for which Staff is proposing disallowances in this proceeding. (Tr. 155, 167) AEM did not win the bid for the other areas of the state which make up about 66% percent of Atmos' load in Missouri. In these areas, the winning bids went to other unregulated gas marketers who submitted lower bids than AEM.

AEM has not been a dominant gas supplier for Atmos in Missouri. For the period April 2004 through November 2009, Atmos issued forty-eight (48) Missouri RFPs. Of these 48 RFPs, AEM participated in twenty-four (24) RFPs, and AEM was the winning bidder in only 6. Other suppliers who have won multiple times include: BP Energy Company —8 wins; Tenaska--7 wins; Anadarko—7 wins; Centerpoint--5 wins; Conoco Phillips—5 wins, Shell—2 wins, and OGE—2 wins. (Ex No. 1NP, Buchanan Direct, p. 12.) (Ex No. 1HC, Buchanan Direct, Schedule 2HC)

Staff is not proposing any disallowances related to the gas marketers that submitted the lowest and best bid in the Kirksville, Piedmont/Arcadia, Jackson and other Southeast service areas. In other words, Staff is not proposing to disallow any costs associated with AEM's competitors—Laclede Energy Resources, ConocoPhillips, Centerpoint, BP Energy Company, Anadarko, or Tenaska Marketing. This fact is true even though Atmos used the same RFP process to choose the unaffiliated gas marketers

as it did when it awarded the bid to AEM in the Hannibal and Butler areas. (Tr. 155, 167)

Staff apparently recognizes that Atmos' competitive bidding process produced contracts in these regions that are just and reasonable. In these areas, these contracts represent the lowest and best price that was available to Atmos and its customers.

Even though Atmos used the same competitive bidding process for the Hannibal and Butler areas, Staff proposed disallowances in the Staff Recommendation related to the gas supply contracts with AEM, Atmos' unregulated gas marketing affiliate. During the hearings in both cases, however, Staff confirmed that it is not asserting that Atmos was imprudent in accepting the lowest and best bid, even though it was from its affiliate. (Tr. 169-70, 197; Tr. 624)

There are several important areas of agreement between Atmos and Staff in this case. Staff agrees that Atmos is contractually obligated to pay the full amount included in the AEM contracts that were accepted after the formal, competitive bidding process. (Tr. 692) Staff also agrees with Atmos that the AEM bids were the lowest and best bids available to Atmos and its customers in these areas. (Tr. 169-70; Tr. 645) Staff also agrees with Atmos that Staff has not produced any evidence that Atmos intentionally attempted to increase shareholder profits by accepting the lowest bid from AEM. (Tr. 170) Finally, Staff agrees that there is no evidence in the record that Atmos treats affiliated and unaffiliated suppliers differently. (Tr. 171) Atmos witness Buchanan confirmed that Atmos treats AEM the same as any other unaffiliated gas marketer. (Tr. 123-34, 128-29; 139-40; Ex No. 1NP, Buchanan Direct, p. 17)

In this case, Staff has now modified its original position (Tr. 173-74), and reduced its proposed disallowance to \$337,226 related to Hannibal and Butler. (*Id.*) This reduction was intended to reflect the information provided related to AEM's overheads that AEM voluntarily provided to Staff when Staff finally requested it. (Tr. 174)

Staff initially proposed to lower the gas costs that are passed through to consumers by the same amount as the gross profits of AEM on these contracts in Case No. GR-2008-0364 (Tr. 640-42), and by the "gross profits"<sup>4</sup> of AEM in Case No. GR-2009-0417 (Tr. 177, 188) Staff is now proposing to disallow from Atmos' gas costs an amount equal to the net profits earned by AEM on these contracts in this case. In Case No. GR-2008-0364, Staff ignored these overheads of AEM and did not request the information. (Atmos Initial Brief at 24; Tr. 636-43). However, in this case, the Staff belatedly requested the overhead information for both ACA periods and it was provided by AEM. (Tr. 175-76, 186)

In the Hannibal and Butler area, if the supply contract had not been awarded to the lowest cost bidder, which happened to be the affiliate, but instead had been awarded to the second place bidder, the annual costs for the Hannibal and Butler area customers would have increased by over \$526,000—looking at the two RFP processes used during this ACA period. (Staff Ex No. 17HC, Sommerer Rebuttal, Schedule 1HC)(Tr. 203) The record indicates that Staff would have had a "concern" if the Company had accepted a higher bid from an unaffiliated gas marketer and Staff would have wanted to look at that transaction "in great detail." (Tr. 200; 645)

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<sup>4</sup> Initially in this case, Staff proposed to disallow the gross profits of AEM. However, Staff later revised its proposed disallowance to remove AEM's overheads. (Ex No. 16 NP, Sommerer Direct, pp. 13-15; Ex No. 18 NP, Sommerer Surrebuttal, pp. 10-11)

Because Atmos tried to save its customers an additional \$526,000 by accepting the lowest and best bids, it is now facing a disallowance proposed by Staff of \$337,000 in this case, and \$308,000 in the last Atmos ACA case (i.e \$645,000 of disallowances). (Tr. 203-04) The Commission should ask itself the following questions: Is this the type of perverse incentive that the Commission wants to build into the PGA/ACA process? On its face, does this make good public policy sense?

The only difference between the circumstances in the Hannibal and Butler service areas and in the rest of the Company's service areas is that AEM happens to be an affiliate of Atmos, and AEM won the competitive bidding process in the Hannibal and Butler service areas.

It is important to emphasize that AEM is an unregulated gas supplier in competition with numerous other unregulated gas suppliers seeking to win the business of Atmos in Missouri. AEM is not a purchasing agent of Atmos seeking to obtain gas supplies for Atmos. (Ex No. 1NP, Buchanan Direct, pp. 23)

### **III. THE PRUDENCE STANDARD**

#### **A. MISSOURI CASE LAW**

The Commission recently reviewed and reaffirmed the prudence standard used in Missouri in its *Report & Order* in Re Kansas City Power & Light Company, Case No. ER-2010-0355 (April 12, 2011) at 74-77. As explained by the Commission in the *Kansas City Power & Light Company* decision, the prudence standard is articulated in the *Associated Natural Gas Case* (which was an PGA/ACA case) as follows:

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

...[W]here some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent. (Citations omitted).

In the [Union Electric] case, the PSC noted that this test of prudence should not be based upon hindsight, but upon a reasonableness standard:

[T]he company's conduct should be judged by asking whether the conduct was reasonable at the time, under all the circumstances, considering that the company had to solve its problem prospectively rather than in reliance on hindsight. In effect, our responsibility is to determine how reasonable people would have performed the tasks that confronted the company.

*See State ex rel. Associated Natural Gas v. Public Serv. Comm'n*, 954 S.W.2d 520, 528-529 (Mo. App. W.D. 1997).

Furthermore, in order for the Commission to disallow a utility's recovery of costs from its ratepayers, the Commission must apply the following two pronged test: (1) evaluate whether the utility acted imprudently (that is, did it act reasonably at the time under the applicable circumstances); and 2) evaluate whether such imprudence was the *cause* of the harm (increased costs) to the utility's ratepayers. *See Associated Natural Gas*, 945 S.W.2d at 529.

#### **B. BURDEN OF PROOF**

As stated above, under the prudence standard, the Commission presumes that the utility's costs were prudently incurred. *See State ex rel. Associated Natural Gas v. Public Serv. Comm'n*, 954 S.W.2d 520 (Mo. App. W.D. 1997); *State ex rel. GS Technologies Operating Co. Inc. v. Public Serv. Comm'n*, 116 S.W.3d 680 (Mo. App. W.D. 2003) (citations omitted).

Under Missouri law, the legal presumption of prudence also applies to affiliated transactions as well as other types of expenditures. In *State ex rel. Public Counsel v.*

Public Service Commission, 274 S.W.3d 569, 577 (Mo.App. 2009), the State of Missouri and Public Counsel argued that there was no legal presumption of prudence for affiliated transactions. However, the Court clearly and unequivocally held that the Commission properly presumed that the utility was prudent in its purchases even though it purchased from an affiliated company:

Their [State of Missouri and Public Counsel] assertion is incorrect. Regulation 240–20.015(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. State ex rel. Associated Natural Gas Company v. Public Service Commission of the State of Missouri, 954 S.W.2d 520, 528 (Mo.App.1997).

This holding means that utilities seeking a rate increase or change in their PGA rates are not required to demonstrate in their cases-in-chief that all expenditures were prudent. See *Union Electric*, 66 P.U.R.4th at 212. Such expenditures are presumed to be prudent as a matter of law.

Staff or any other party may challenge the prudence of an expenditure by presenting competent and substantial evidence that creates “a serious doubt” as to the prudence of an expenditure. Once a serious doubt has been raised, then the burden shifts to the public utility to “dispel those doubts” and prove that the questioned expenditure was prudent.

Missouri case law has described the showing necessary to create a serious doubt sufficient to shift the burden back to the utility. In the *Associated Natural Gas* case, the Missouri Court of Appeals held that the Staff must provide evidence that the utility’s

actions caused higher costs than if prudent decisions had been made. *See Associated Natural Gas*, 945 S.W.2d at 529. Substantive and competent evidence regarding higher costs includes evidence about the particular controversial expenditures and evidence as to the “amount that the expenditures would have been if the [utility] had acted in a prudent manner.” *See id.* In other words, Staff or the other parties must satisfy the following two-pronged evidentiary test to support a disallowance: 1) identify the imprudent action based upon industry standards and the circumstances at the time the decision or action was made; and 2) provide proof of the increased costs caused by Atmos’ imprudent decisions. To meet this standard, a party must provide substantive, competent evidence establishing a causal connection or “nexus” between the alleged imprudent action and the costs incurred. In this case, Staff and Public Counsel have failed to meet their burden.

#### **IV. STAFF’S CHANGING AND EVOLVING POSITIONS**

On December 30, 2010, the Staff filed its recommendation following completion of the audit of the 2008-2009 Actual Cost Adjustment (“ACA”) filing. The Staff’s audit consisted of a review and analysis of the billed revenues and actual gas costs for the period of September 1, 2008 to August 31, 2009 for all areas served by the Company in Missouri. As a part of the Staff Recommendation, the Staff proposed an affiliated transaction adjustment of \$413,165 for the Hannibal area and an adjustment of \$81,852 for the Butler area related to Atmos’ acceptance of the low bids of its affiliate AEM for the Hannibal and Butler service areas. (Staff Recommendation, Appendix A-1, page 6 of 11).

Atmos filed its response to Staff's recommendation on February 2, 2011. In its Response, the Company disagreed with Staff's affiliated transaction adjustments and requested that the Commission schedule a hearing.

In the present case, the Staff apparently is not: (1) challenging the prudence of Atmos' acceptance of the lowest and best bid from an affiliate, AEM, for the Hannibal and Butler services areas (Tr. 169-70); (2) asserting that the Affiliated Transaction Rule itself requires that Atmos lower its gas supply costs in the PGA/ACA process by the same amount as the profits of an affiliated gas marketer that provided gas supplies after a formal competitive bidding process; (Tr. 181) (3) asserting that Atmos provided a "financial advantage" to its affiliate; (4) arguing the Commission should prohibit Atmos from engaging in affiliated transactions with AEM (Tr. 197); or (5) arguing that the Commission should order Atmos to go back to a pre-Order 636 market structure where LDCs would buy gas themselves rather than dealing with gas marketers. (Tr. 196-97)

Instead, the Staff focused its rationale for the proposed affiliated transaction disallowance on Staff's allegations that: (1) Atmos' RFP process itself is "flawed"; and (2) The gas costs paid by Atmos are not "just and reasonable." (See Staff Position Statement, pp. 1-2) Atmos will address each of these rationales for the proposed disallowance below.

## **V. AFFILIATED TRANSACTION RULES**

### **A. ATMOS USED A COMPETITIVE BIDDING PROCESS AS REQUIRED BY THE AFFILIATED TRANSACTION RULE.**

Atmos has been successful in obtaining gas supplies during this ACA period that were reasonable and prudent. In every instance, the Company used a fair and arms-

length competitive bid process to solicit, evaluate, and award the contract to the qualified bidder who offered the least cost supply. Both the Affiliated Transactions Rule and the Marketing Affiliate Transaction Rule have the following provision that mandates competitive bidding unless good cause is shown why competitive bidding is not necessary or appropriate:

4 CSR 240-40-40.15(3)(A) states in part:

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. (emphasis added)

Atmos followed the preferred competitive bidding process. (Ex No. 1 NP, pp. 6-12; Tr. 124-26; Tr. 444-45) **In Case No. GR-2008-0364, Staff and Public Counsel did not challenge the reasonableness or legitimacy of the Atmos RFP process.** (Tr. 147).

But in this case, Staff is now focusing upon the RFP process itself as its primary basis for its \$337,000 disallowance.

The record reflects that Atmos has carefully considered Staff's comments regarding its RFP process in past cases and has incorporated those suggestions into its RFP process:

**Q. HAS STAFF BEEN PROVIDED AN OPPORTUNITY TO REVIEW OR PROVIDE INPUT REGARDING ATMOS' RFP PROCESS?**

**A.** Yes. In this case, as well as in Case Nos. GR-2008-0364 and GR-2007-0403, Staff has had forty-one (41) months of discovery (issuing 117 Data Requests commencing on October 3, 2007 in the -0403 case, 134 Data Requests commencing on October 27, 2008 in the -0364 case, and 122 Data Requests commencing on September 21, 2009 in this matter). Staff and the Company held several conference calls discussing, among other things, the RFP

process. These meetings resulted in improvements to the RFP documentation. For example, Staff asked the Company to keep better documentation for the reason why some RFP bids are considered non-conforming. The Company agreed with Staff's suggestion.

(Ex No. 1 NP, Buchanan Direct, p. 7)

In the Staff Recommendation in this case, there is a separate section devoted to the "Request For Proposal (RFP)" process in which the Staff made specific recommendations. **However the RFP process is never identified in the Staff Recommendation as the basis for its affiliated transaction adjustment in this case.**

Instead, Staff merely made recommendations related to the RFP process itself:

Accordingly, Staff recommends that the supply bid process and the resulting supply contracts must contain sufficient terms and conditions to assure firm supply, except in specific situations where the LDC may not require firm supplies, and must provide detailed explanation of penalties and consequences of failure to perform. . . . Staff recommends the RFPs be re-evaluated by the Company to ensure that potential supplies are put on notice of the requirement to provide firm gas supplies and that any disruption of firm supplies may be subject to penalties. Staff also requests the Company provide the current status of all Company actions regarding Staff's past RFP recommendations for the 2006-2007 and 2007-2008 ACA cases. (Staff Recommendation, Memorandum, p. 5 of 11)

In the Atmos Response To Staff Recommendation in this case, Atmos specifically accepted Staff's recommendations, with the exception of the affiliated transaction adjustments. (Atmos Response To Staff Recommendation, p. 17.) In addition, Atmos made the following response to the Staff's recommendations about the RFP process:

**Request for Proposals (RFPs)**

Staff recommends that "the supply bid process and the resulting supply contracts must contain sufficient terms and conditions to assure firm supply." (Staff Memorandum, page 5 of 11.) The Company's RFPs and gas supply contracts clearly require firm supply. Beginning with the 2011-2012 RFPs, Atmos has also included language in its RFPs specifying that the "asset manager's rights to storage and associated transportation

are secondary to Atmos's rights" and "the asset manager selected is responsible for any penalties or incremental costs associated with non-compliance with any rule, regulation tariff provision of any Federal, State, or local governing entities including asset manager's election to deviate from the company provided planned flowing and storage gas injections and/or withdrawal requirements."

Staff further recommends that RFPs should provide a "detailed explanation of penalties and consequences of failure to perform." (Staff Memorandum, page 5 of 11.) Atmos disagrees. Penalties and consequences are a matter of contract and cannot properly be addressed in the RFP, which is a document describing the supply requirements of the LDC. If penalties were separately listed in the RFP which were inconsistent with the industry standard base NAESB provisions, Atmos could further limit the pool of interested bidders.

Staff states that "when an LDC deals with its affiliate, the LDC must have clear assurances that its affiliate provides the same high level of service as is expected from non-affiliates. (Staff Memorandum, page 5 of 11.) The Company's affiliate is and always has been held to the same standards as non-affiliate suppliers. Further, there is no evidence that the affiliate's service has been anything less than reliable. Atmos's affiliate has consistently provided reliable service over the many years supplying Atmos.

Staff goes on to opine that the "LDC must take appropriate action in the event of an affiliate's non-performance, including seeking of penalties that would hold captive ratepayers harmless." Affiliate non-performance has never been an issue for Atmos. It is the Company's position, however, that any penalties for non-performance are more properly placed in the contract rather than the RFP. This is true for any supplier. It should be noted that there is nothing in the RFP that limits the ability of the LDC to seek contract damages against any breaching supplier, affiliated or non-affiliated.

Staff states that this is of heightened concern because of the "potential for supply cuts to firm service" such as those experienced during the 2007-2008 ACA period. (Staff Memorandum, page 5 of 11.) The referenced supply cuts were made as the result of a force majeure pipeline event and had nothing to do with supplier reliability. The Company's supply plan worked as intended, gas was withdrawn from storage, and no customers were impacted. Atmos has explained this situation to Staff on more than one occasion, during the Meeting and in a Data Request.<sup>2</sup> To mention this as a reason for concern about the RFP process is not only inaccurate and misleading, but also demonstrates a lack of fundamental understanding of gas supply.

Finally, Staff requests that Company provide the current status of all Company actions regarding Staff's past RFP recommendations for the 2006-2007 and 2007-2008 ACA cases. Atmos found no recommendations regarding the RFP process in Staff's memorandum in the

2007-2008 case. The status of the recommendations made pursuant to the 2006-2007 case are as follows:

- Starting with the 2009-2010 Hannibal RFP, Atmos added the statement “Field Zone bids in lieu of Haven bids will not be accepted and considered nonconforming” in response to Staff’s recommendation that the Company clarify language regarding the Market receipt point and the treatment of Field transport charges to the receipt point.
- In response to Staff’s recommendation to clarify all future gas supply RFP language to indicate whether Atmos is using a flat charge for fuel and L&U or whether the bidder is to include the cost of fuel and L&U in its bid. As part of our RFP bid analysis, if there is any uncertainty over fuel or other variable prices, Atmos clarifies with the bidders and the appropriate pricing is included in the RFP analysis. Atmos will add language to the RFPs asking bidders to specify whether fuel is to be added or is included in their bid price.
- Starting with the 2008-2009 RFPs, language was included under the Asset Management section to clarify language regarding the gains from capacity releases and storage arbitrage, reliability standards, and real and virtual storage.

Notwithstanding Staff’s new assertions during the evidentiary hearings regarding the RFP process, the Company’s competitive bidding process allows the opportunity for the Company to obtain numerous proposals from a variety of gas marketers who are in the very competitive market of providing gas supplies to local distribution companies throughout the country. Atmos has been successful in obtaining sufficient gas supplies at market prices by using this competitive bid process that allows the Company to provide its customers with reliable natural gas at just and reasonable rates.

The competitive bidding process is well developed and described within the Manual attached to the Direct Testimony of Rebecca M. Buchanan. (Ex No. 1, Buchanan Direct, Attachment No. 1)(Tr. 124-41).; Ex No. 1, Buchanan Direct, Attachment No. 1; Tr. 445) The processes for maintaining a Supplier List and Qualification Procedure are described on pages 5-7 of the Manual. A “Sample RFP Letter” is contained on pages 8-10 of the Manual. In the case of the Hannibal area, the Company sent out RFP Letters to

sixty (60) different gas marketers during the February 2009 bid process. (Ex No. 1, Buchanan Direct, pp. 10); See also Ex No. 14NP, Buchanan Direct, RFP Evaluation, Appendix A)

The Bid Evaluation and Documentation Procedure is discussed on pages 11-12 of the Manual.

The **Affiliated Procedures Section** of the Manual states as follows:

**“Purpose:**

The purpose of this policy is to detail the requirements for dealing with affiliate operations.

**RFP Process:**

The Company’s RFP process ensures that no preferential treatment is given to an affiliated company.

**General:**

The goal is to prevent preferential treatment being given to any marketer, especially an affiliate. It will be each employee’s responsibility to treat all marketers the same. A particular marketer may have more experience on a particular pipeline and may be better equipped to ask certain questions. A rule of thumb should be that an employee should feel comfortable giving several marketers the same information. If an employee has concerns over providing certain data to a marketer or to a group of marketers, the employee should go to their Manager. If concern still exists, the employee and the Manager will consult with the Director, Gas Supply and Services.

**Affiliate Guidelines:**

In the event a state has specific guidelines for affiliated transactions, it is the Gas Supply Specialist’s responsibility to know and follow those guidelines.” (Affiliated Procedures Section of Manual)

It is undisputed in this case that Atmos followed the Commission’s requirement to use competitive bidding when it obtained its gas supplies during this ACA period, and treated its affiliate AEM like any other unaffiliated gas marketer (Tr. 170). By accepting the lowest and best bids, whether from an affiliate or an unaffiliated gas marketer, Atmos conducted itself in a prudent and reasonable manner. Staff and Public Counsel have not

challenged the prudence of accepting the lowest and best bid, even if it was offered by an affiliate. (Tr. 169; Tr. 624)

In this case, Staff has challenged for the first time the Company's RFP process itself. (Tr. 43-44) In Case No. GR-2008-0364, however, the Staff did not challenge in any way the Company's RFP process, even though it is the same RFP process that was used in this case. (Tr. 147) While Staff never clearly explained in its pre-filed testimony exactly what Staff is concerned about regarding the RFP process, the Company will address the concerns that came up during the evidentiary hearings.

In Staff's opening statement, Staff counsel suggested that Staff was concerned that there were areas in which there were only three (3) bidders out of sixty (60) solicitations. (Tr. 42-43) In addition, Staff was concerned that AEM's bid was \$235,000 less than the next conforming bid. (Tr. 43)

As noted by Commissioner Jarrett, what is truly curious about the Staff's position is that the Staff has only challenged the Atmos RFP process in instances when AEM happened to win the bid. Staff has not challenged the Atmos RFP process or made any disallowances when unaffiliated gas marketers have won the bid. This is true even in instances when there was only one unaffiliated bidder. (Tr. 46-48) When asked why Staff did not allege that the RFP process that produced one bidder was imprudent, Staff counsel replied: "We have nothing to base it on, other than the fact that we have a problem with the process as it relates to the way in which they selected their own affiliate. . . ." (Tr. 47) According to Staff's curious logic, the RFP process is only flawed if Atmos' affiliated gas marketer happens to win the bid.

Staff also made an issue of the fact that AEM's bid was \$235,000 less than the next conforming bid. (Tr. 43) Apparently, Staff believes that a \$235,000 difference "raise Staff's concerns about the RFP." (Id.) However, as Ms. Buchanan pointed out, a \$235,000 difference is a small difference (approximately 2%) between the AEM bid and the next conforming bid when the total amount of gas used in Hannibal/Butler area is considered. (Tr. 148-50)(See Ex No. 15, p. 3 [ $\$235,000/\$9,683,738 = 2\%$ ])

Would Staff prefer to have consumers pay two percent (2%) more in Hannibal and Butler? Alternatively, would Staff prefer that AEM just not bid at all? If Staff would answer these questions, it might shed some light on the reason that Staff is proposing its affiliated transaction disallowance in this case. Based upon the competent and substantial evidence in the record in this proceeding, the Commission should find that Atmos' RFP process is prudent and consistent with the requirements of the Affiliated Transactions Rule.

**B. ATMOS' RFP PROCESS IS NOT FLAWED AND RESULTED IN THE LOWEST COST GAS SUPPLY AVAILABLE IN ITS HANNIBAL AND BUTLER SERVICE AREAS.**

In this case, Staff has apparently abandoned its theory that Atmos provided a "financial advantage" and is now attempting to lower the cost of gas by the same amount as the "net profits" of AEM as a penalty for Atmos' "flawed RFP process." As explained herein, Staff has again changed its theory to justify the disallowance. Apparently, Staff is now concerned that a number of unregulated gas marketers chose not to bid on the Atmos business. Atmos witness Buchanan also testified that Atmos would prefer "to have as many [bidders] as we can get." (Tr. 129) However, Atmos can not determine the number of bidders that choose to submit bids for Atmos' business. Atmos certainly can not be

held responsible for the lack of interest by unregulated gas marketers in a specific RFP. If Staff believes that more bidders are preferable, as Atmos does, then Staff certainly should not be advocating regulatory policies that are likely to reduce the number of bids by discouraging AEM from bidding on Atmos' business in Missouri.

In the first RFP Process, there were six unaffiliated bidders that offered to provide gas to Atmos, and second RFP Process, there were there three unaffiliated bidders that offered gas to Atmos—in addition to AEM. (See Ex No. 17 HC, Schedule 1; Tr. 201-04); Ex No. 24HC, Appendix A, p. 7)

During the hearings in this case, the three unaffiliated bids in the second RFP Process were discussed without identifying the names of the specific bidders to avoid public disclosure of the highly confidential information. The following were the bid amounts received during the second RFP process covering the April 2008 to March 2009 period:

AEM Low Bid—\$14,723,472

Unaffiliated Bidders:

Bidder 2—\$14,761,471 (non-conforming)

Bidder 3—\$14,958,757 Mean of conforming unaffiliated bids--\$15,014,241

Bidder 4—\$15,069,726

The bid prices among unaffiliated bidders ranged from \$14.959 Million to \$15.070 Million. These bids established the fair market price for the gas supplies, or the “price that a seller is willing to accept and a buyer is willing to pay on the open market and in an arm’s length transaction.” Based upon the bidding process among these unaffiliated companies, it is clear that the fair market price for the gas supplies was in the

\$14.959 to \$15.070 Million range at the time of the bidding process. However, AEM's bid was less than the fair market price established by these unaffiliated bids. In fact, the AEM bid was at least \$235,286 less than the fair market price for the gas established by next lowest of the unaffiliated bidders. Staff witness Sommerer recognized this fact "mathematically speaking", assuming the volumes, nominations, and prices were as assumed in the RFP itself. (Tr. 201-02)

During the evidentiary hearings in Case No. GR-2008-0364, the six unaffiliated bids were also discussed without identifying the names of the specific bidders. The following were the bid amounts received during the first RFP process covering the April 2007 to March 2008 period (Staff Ex No. 24 HC)(Tr. 683-86):

AEM Low Bid—\$13,947,511

Unaffiliated Bidders:

Bidder 2—\$14,049,424 (non-conforming)

Bidder 3—\$14,064,796 (non-conforming)

Bidder 4—\$14,244,297      Mean of conforming unaffiliated bids--\$14,421,092

Bidder 5—\$14,425,783

Bidder 6—\$14,472,350

Bidder 7—\$14,541,937

The bid prices among unaffiliated bidders ranged from \$14.2 Million to \$14.5 Million. These bids established the fair market price for the gas supplies, or the "price that a seller is willing to accept and a buyer is willing to pay on the open market and in an arm's length transaction." Based upon the bidding process among these unaffiliated companies with conforming bids, it is clear that the fair market price for the gas supplies

was in the \$14.244 to \$14.541 Million range at the time of the bidding process. However, AEM's bid was less than the fair market price established by these unaffiliated bids. In fact, the AEM bid was at least \$296,786 less than the fair market price for the gas established by next lowest unaffiliated bidders. (Ex No. 17 HC, Schedule 1)

During cross-examination in Case No. GR-2008-0364, Staff witness Sommerer candidly admitted that the fair market price for this period would be in the range of \$14.0 million to \$14.5 million (Tr. 685), and that the AEM bid of \$13,947,297 was less than the fair market value. (Tr. 686):

Q. Now just looking at the bids for the unaffiliated marketers, the second through the seventh, the range is about \$500,000 for those unaffiliated – or the spread, I guess is a better word, would be about \$500,000 among the unaffiliated gas marketers?

A. That's correct.

Q. And based upon these unaffiliated gas marketer bids, would you agree that the fair market price for the gas during this period to Hannibal would be somewhere between 14 million and 14 and a half million dollars, that's the range?

A. Well, again, assuming what we've already discussed about volumes and estimated prices and then the prudence would still be applicable, that's—that's the fair market value.

Q. And I believe you agree that the AEM bid was for \$13,947,297, which was less than the fair market price established by these unaffiliated gas marketer bids. Right?

A. That's correct. (*emphasis added*)(Tr. 685-86)

Staff never produced any evidence that showed that Atmos could have obtained a lower cost of gas if it had rejected the AEM bid. (Tr. 198)

Based upon the competent and substantial evidence in the record, the Commission should find that the Atmos RFP Process resulted in the lowest cost gas supply available to Atmos in the Hannibal and Butler service areas. In addition, the Commission should find that Staff's criticisms of Atmos' RFP process itself are unfounded. As a result, the Commission should reject Staff's proposed affiliated transactions adjustments in both ACA cases that are pending before the Commission.

**VI. THE GAS COSTS PAID BY ATMOS IN THE HANNIBAL AND BUTLER AREAS WERE REASONABLE WHEN COMPARED TO THE GAS COSTS IN OTHER AREAS OF THE STATE.**

Throughout this case, and Case No. GR-2008-0364, Atmos has endeavored to demonstrate that the price it paid AEM for its gas was less than the fair market price as determined by the competitive bidding process. However, if the Commission desires to analyze the reasonableness of the cost of gas in the Hannibal and Butler areas using an alternative "benchmarking approach," then the following information would clearly suggest that the cost of gas in the Hannibal and Butler service areas was reasonable when compared to the other areas of the state served by Atmos.

In this case, Atmos witness Rebecca Buchanan compared the gas costs of in the Hannibal and Butler areas with the gas costs paid in the other Atmos service areas. The survey demonstrated that the Hannibal and Butler gas costs (i.e. \$3.6273/Dth) were approximately 13.6% less than the state-wide average gas costs for Atmos service areas (i.e. \$4.1983/Dth) during the September 2008 to August 2009 ACA period. (Tr. 151-

53)(Ex. No. 15, pp. 2-3) In fact, only one service area—Greeley—had a lower total delivered cost of gas on a per Dekatherm basis:

<u>Interstate Pipeline Purchases</u>	<u>Supply Avg. Price /Dth</u>
ANR Pipeline Company—Kirksville	\$ 3.6343
Mississippi River Transmission—SEMO	\$ 5.0132
Natural Gas Pipeline Company—Neely/SEMO	\$ 3.9503
<b>Panhandle Eastern Pipeline—Hannibal/Butler</b>	<b>\$ 3.6273</b>
Texas Eastern Transmission—Neely/SEMO	\$ 4.8995
Ozark Gas Transmission—SEMO	\$ 4.9714
<u>Southern Star Central Gas Pipeline-Greeley-Div71</u>	<u>\$ 3.2188</u>
<b>Total Delivered—Statewide Average</b>	<b>\$ 4.1983</b>

Based upon this information, it is difficult to understand how Staff can suggest that the price of gas in Hannibal and Butler is not “just and reasonable” when the cost of gas in these service areas is less than the state-wide average, and almost the lowest cost per Dekatherm for any service area served by Atmos in Missouri. The Commission should therefore find that the cost of gas paid by Atmos in the Hannibal and Butler services areas using a benchmarking analysis is “just and reasonable” when compared to the gas costs that it paid in other areas of the state.

## **VII. AEM HAS NOT VIOLATED THE RECORDKEEPING REQUIREMENTS OF THE AFFILIATED TRANSACTION OR GAS MARKETING AFFILIATED TRANSACTION RULES**

Atmos initially believed that Staff’s theory in this case was that AEM was not keeping appropriate records under the Affiliated Transactions Rules. As explained above, it appears that Staff has now abandoned the “flawed recordkeeping” allegation in favor of the “flawed RFP Process” allegation. However, Atmos will nevertheless address in this section Staff’s allegation related to AEM’s “flawed recordkeeping.” As explained herein, Staff’s allegation is erroneous and should be rejected.

Section 4 CSR 240-040.015 (5)(A)(Affiliated Transaction Rule) and 4 CSR 240-040.016(6)(A) (Marketing Affiliate Transactions Rule) provide in part:

(A) Each regulated gas corporation shall ensure that its parent and any other affiliated entities maintain books and records that include, at a minimum, the following information regarding affiliate transactions:

1. Documentation of the costs associated with affiliate transactions that are incurred by the parent or affiliate 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.

\* \* \*

AEM has maintained the appropriate records as required by the Affiliate Transaction Rule, and AEM has provided those records to Staff in this proceeding. In fact, there have been absolutely no discovery disputes in this case (Tr. 208-10), and Staff and Public Counsel have not filed any motions to compel or otherwise complained about Atmos and AEM refusing to answer their questions. (Id.) The bottom line: Atmos and AEM have fully cooperated with Staff's and Public Counsel's audit.

Apparently, Staff wishes that AEM had kept the information in a different format, or kept its net profits on a transaction by transaction basis. However, even Staff admits that there is nothing in the Affiliated Transaction Rules that mandates that any

information be kept in a specified format, or that the net profits be determined on a transaction by transaction basis. (Tr. 210)

Nevertheless, Staff is arguing that AEM is not keeping track of the costs that it allocates to Atmos, as required by the Affiliated Transaction Rule. (Ex. No. 16NP, Sommerer Direct, pp. 12-13.) As Mr. Sommerer testifies on page 10 of his Direct Testimony, the Affiliated Transaction Rules provide that regulated gas corporations and their affiliates need to maintain books and records that include “documentation of the methods used to allocate/or share costs between affiliated entities.” (Ex No. 16 NP, Sommerer Direct, p. 10)

This regulation assumes that allocation or cost sharing is taking place with respect to the affiliate transaction. In this case, this assumption is not correct. (Tr. 157) Atmos utilizes an RFP process that results in a contract. AEM does not allocate costs to Atmos. (Tr. 156-57)

In other words, cost allocation is not required in a competitive bidding situation because there are no costs “allocated” to the LDC. (Tr. 156) The LDC merely accepts the lowest bid of the gas marketer, and pays for the gas supply. It does not have any costs “allocated” or “assigned” from its affiliate. (Tr. 156) In this regard, AEM is just like any other unaffiliated gas marketer. (Tr. 157)

If AEM was performing services for the public utility as a service company or a purchasing agent, then it is conceivable that it would “allocate” its cost of the services to the public utility. The Atmos Cost Allocation Manual which is filed annually with the Commission, Staff, and Public Counsel addresses how such costs are allocated in that

situation. In Case No. GR-2008-0364, Staff witness Sommerer testified that the Atmos Cost Allocation Manual was not a concern to Staff. (Tr. 155-56; 183)

The Commission should also note that Staff has not filed a Complaint against Atmos or AEM under the Affiliated Transaction Rule. (Tr. 210-213) Instead Staff initially sought to reduce Atmos' gas costs by the same amount as the profits of AEM because of AEM's alleged failure to keep its records in the format desired by Staff. (Staff Position Statement, p. 1-2) Staff has apparently recognized the legal problems with its "flawed recordkeeping" argument in this case, and has now abandoned this position.

Even if there was a problem in AEM's recordkeeping (which there is not), the penalty being proposed by Staff for Atmos is not reasonable or authorized by law. Under Staff's approach, the penalty proposed by Staff is tied directly to the level of profits made by AEM on the transactions. If AEM had made a profit that was 10 times larger—e.g., \$3.4 Million rather than \$340,000, then Staff's approach would produce a proposed penalty for the failure to keep the same records would be 10 times greater (Tr. 213). This approach is unreasonable and is contrary to the statutes related to penalty actions. See Sections 386.460, 386.570, 386.580, 386.600 RSMo.

#### **VIII. STAFF HAS FAILED TO RAISE A SERIOUS DOUBT REGARDING THE PRUDENCE OF ATMOS' GAS PURCHASING PRACTICES.**

In Case No. GR-2008-0364, and in this case, the Staff has searched for some rationale to meet its burden to raise a "serious doubt" about Atmos' gas purchasing practices in the Hannibal and Butler service areas to justify its proposed disallowance or penalty. Having raised (and now abandoned) many different rationales for the proposed

disallowances, Staff witness Sommerer finally summarized for Commissioner Jarrett at the very end of the hearing what Staff now believes to be the imprudence of Atmos that justifies a \$337,000 disallowance in this case (Tr. 214):

Q. Could you give me, I guess, just a simple laymen's terms as possible what exactly Staff believes Atmos, the regulated company, did that was imprudent in this case?

A. In this case, we believe that during the bid evaluation process and the transaction confirmation process, AEC, the LDC, should have spent more time trying to figure out what the service level was. And it should have been apparent to them that the service level that they were requesting in the RFP really wasn't the same thing that was coming back in the transaction confirmation. And so that's really Staff's primary concern about the RFP process. It's not the letter that goes out. Because the letter was the same. The evaluation was a mathematical evaluation and the low bid was chosen. So it's not really a problem with choosing mathematically the low bid. But it's an expectation that they go a step farther than that and they ask themselves, do we have apples to apples here, or is it apples to oranges. And that's really where we're concentrating. (emphasis added)

Based upon Mr. Sommerer's testimony to Commissioner Jarrett, it now appears that Staff's last theory of the case is that the service that Atmos received from AEM "may well have been less than" firm service. (Tr. 214). However, the competent and substantial evidence in the record simply does not support his position. Staff's only

evidence that Atmos “may well have been less than” firm service was: (1) the Force Majeure Event that occurred in December 2007 when a pipeline rupture occurred<sup>5</sup> (Tr. 215)(See Atmos Initial Br. at 43-53; Atmos Reply Br. at 14-17); and (2) certain missing checkmarks or other information on two transaction confirmation forms of AEM where the level of service was to be marked. (Tr. 226-27).

In her Direct Testimony, Ms. Buchanan explained that “All of the gas supply contracts require firm supply.” (Ex No. 1, Buchanan Direct, p. 13) She further explained why Staff’s reliance on the Force Majeure Event to suggest that AEM’s gas supply was not firm was simply inappropriate:

The Company requires firm service from all its suppliers, regardless of affiliation. In the previous Case No GR-2008-0364, Staff pointed to a Force Majeure Event in which the affiliate was unable to obtain a portion of its upstream supply. Staff used this event as evidence that the affiliate was providing less than firm service. The Force Majeure event was an unusual circumstance and many suppliers were impacted. This does not reflect on the reliability of the supplier or firm nature of the supply provided.

\* \* \*

Staff’s accusation that the Company has allowed AEM or any other supplier to use “less than primary firm supplies” is a word play intended to mislead or confuse the issue. In its \*\* \_\_\_\_\_ \*\*, the Company clearly gives the option to all bidders to bring supply in to our firm contract at \*\* \_\_\_\_\_ \*\*. The primary receipt point on our \*\* \_\_\_\_\_ \*\*, but any of the “secondary in-path” receipt points are Firm as well. They are not interruptible points on our contract, they are Firm. Using a Firm secondary in-path receipt point provides firm supply at a lower cost to customers because the receipt point is closer to the \*\* \_\_\_\_\_ \*\* and thus incurs less pipeline mileage charges. Therefore, it is clear the intention of the Company to offer this Firm secondary in path point to suppliers is to provide lower cost gas and additional savings to the Missouri customers. The purpose is not to somehow benefit the suppliers or the affiliate as Staff has implied. Again, all suppliers bidding on the \*\* \_\_\_\_\_ \*\* were given the option to

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<sup>5</sup> Mr. Sommerer testified in this case that “Staff has not proposed any prudence adjustments related to that pipeline interruption or anything similar to that.” (Tr. 171)

utilize this receipt point and to purchase upstream supplies using the daily priced gas if they so choose (which we believe most suppliers do).

(Ex No. 1, Buchanan Direct, p. 14)

The record also demonstrates that Atmos' RFP "clearly indicates multiple times that we require Firm supply." (Ex No. 1, Buchanan Direct, p. 16) As Ms. Buchanan explained: "Furthermore, the Company has actually received firm supply from all of its supplies including AEM. No suppliers have expressed confusion that the obligation is anything but Firm; there have been no disputes between Atmos and any supplier regarding the firm nature of the supply." (Ex No. 1, Buchanan Direct, p. 16)

During the hearings, Commissioner Jarrett asked Ms. Buchanan how she knows that Atmos receives firm gas supplies, and she replied:

We put a nomination in for the first-of-the-month gas or incremental daily gas. If you receive that gas, you've gotten your firm supply. So for this ACA period under review, we received our gas every day we asked for it. Outside of a few clerical errors with some of our supplies, including AEM had a few, I believe. (Tr. 141-42)

Staff and Public Counsel have not produced any evidence to rebut the competent and substantial evidence that Atmos received its firm gas supply throughout the ACA period, with the exception of the clerical errors referenced above. In fact, Mr. Sommerer testified that "there weren't any interruptions that I saw beyond those [clerical errors] that were discussed for this ACA period. (Tr. 216)

With regard to the transaction confirmation documentation, Staff seems to be suggesting that because two the AEM's trade confirmations did not have checkmarks or other information in a table defining the quality of firm service that it is appropriate to conclude that AEM did not provide the "firm and warranted" service required by the RFP itself. This leap of logic by Staff is unwarranted.

In fact, in both the spring 2008 RFP and the spring 2009 RFP it is very clear that Atmos seeks Firm supply. The cover letters to both RFPs have the following subject line in **BOLD CAPITAL** letters: “**RE: Request for Proposal for Firm Gas Supply (Hannibal and Bowling Green, Missouri) on Panhandle Eastern Pipeline for April 20XX – March 20XX.**” The first sentence in the body of each cover letters reads “*Atmos Energy Corporation is requesting proposals for firm gas supply requirements on Panhandle Eastern Pipeline for a one year term effective April 1, 200X through March 31, 20XX.*”

Within the RFP documents for both years, there are no less than six occurrences where Atmos states the Company is seeking Firm Supply.

- 1) Section **1.0 RFP Overview**: “Atmos Energy Corporation (“Atmos”) is seeking proposals from qualified suppliers to provide firm and warranted natural gas commodity only requirements for its Missouri service areas.”
- 2) Section **1.0 RFP Overview**: “Essentially, Atmos is seeking firm, natural gas supply for daily flows up to its maximum firm capacity rights on Panhandle Eastern Pipeline split into first of month and swing components.”
- 3) Section **5.2 Description of Proposal**: “*The response should present firm and warranted commodity sales based upon the pricing methodology described in section “5.3 Pricing”.*”
- 4) Section **5.4 Reliability**: “*All gas supply is to be firm and warranted assuring that natural gas supply services will meet all contractual obligations without fail.*”
- 5) Attachment I: “*Atmos is seeking proposals from qualified suppliers to provide firm gas supply on Panhandle Eastern Pipeline, Field Zone and Market Zone as shown in the table below. All of this gas will flow on Atmos’s firm transportation agreements to our Hannibal, MO and Bowling Green, MO service areas.*”
- 6) Attachment I: “*We are seeking Firm supplies, including fuel, as follows: ...*”

It is apparent in reading these RFP references, in fact crystal clear, that the Company’s RFP specifies the need for Firm supply. In not one instance does the Company infer that it will accept Interruptible supply. (Ex No. 3, Buchanan Surrebuttal, pp. 18-19; See also Staff Ex Nos. 4 and 5)--Just because AEM failed to fill in blanks on the transaction

confirmation form does not transform the service into “less than firm” service as alleged by Mr. Sommerer.

Finally, Mr. Sommerer raised the specter that the use of a secondary receipt point by AEM might be evidence of either preference to the affiliate, or alternatively, evidence that AEM’s service was less than firm. (Ex No. 17 NP, Sommerer Rebuttal, p. 3) The record does not support this theory either.

As explained by Ms. Buchanan, the distinction of primary versus secondary has to do with the ranking of receipt and delivery points on the pipeline contracts. Whether a delivery point is considered “primary” or “secondary” does not have any impact on the “firmness” of the services. (Tr. 119-20) In a supply-only service, such as what Atmos used in the Hannibal/Bowling Green area during this ACA period, the Company utilizes its own firm transportation contracts. The suppliers/marketers are not providing a transportation service to Atmos. Thus, the use of the phrase “primary” or “secondary” is not applicable to a supply-only RFP. The distinction the Company makes in its RFP is for Firm supply as opposed to Interruptible supply. When Atmos and the marketer contract for Firm supply, that means that the marketer cannot interrupt. (Ex No. 3 NP, Buchanan Surrebuttal, pp. 12-16)

The use of secondary firm “in path” receipt points is a safe and economical way to provide customers savings on gas costs while still maintaining firm, reliable supply. The supply from a secondary “in path” point is firm, not subject to interruption. In fact, during the ACA period, there were no interruptions or cuts to Atmos’ supply because it utilized a firm secondary in path receipt point rather than a firm primary receipt point. (Id.)

Finally, Ms. Buchanan testified that the Atmos RFP permitted any supplier, whether affiliated or unaffiliated to Atmos, to utilize a secondary receipt point in the delivery of its gas supplies to Atmos. (Tr. 133) There is no support for Staff's suggestion that Atmos has provided preferential treatment to AEM since AEM used a secondary receipt point. In fact, Staff counsel conceded under questioning by Commissioner Jarrett, that other marketers could have used a secondary receipt point under the Atmos RFP. (Tr. 44)

Staff witness Sommerer also confirmed that Staff has no evidence regarding whether or not unaffiliated gas marketers use spot or interruptible supplies to fulfill firm obligations. (Tr. 171) Atmos personnel would also have no information regarding how affiliated or unaffiliated gas marketers are arranging their upstream gas supplies. (Tr. 387, 442-43) It is therefore disingenuous at best for Staff to be raising the specter that the gas supplies provided by AEM "may well have been less than" firm service as the basis for disallowances in excess of \$600,000 in both cases. There is simply no competent and substantial evidence in the record to support this proposition. Staff does not know how any gas marketer arranges its upstream gas supplies, and neither does Atmos. What is clearly demonstrated by the record, and conceded by Staff, is that all of AEM's gas supplies were delivered to Atmos during the ACA period, and there were no interruptions to any customers. (Tr. 216, 141-42) AEM's gas supplies were firm!

**IX. STAFF HAS FAILED TO SUPPLY THE REQUIRED "NEXUS" BETWEEN THE ALLEGED IMPRUDENCE AND ANY HARM TO CONSUMERS.**

Even if the Commission found that Staff witness Sommerer was correct (which he is not) that "during the bid evaluation process and the transaction confirmation process,

AEC, the LDC, should have spent more time trying to figure out what the service level was,” as alleged by Mr. Sommerer, there would not be a legal basis for an imprudence disallowance in this case. Contrary to the requirements of the *Associated Natural Gas* case, the Staff has failed to show the “nexus” between this alleged failure and any harm to consumers. *See Associated Natural Gas*, 945 S.W.2d at 529.

As both Mr. Sommerer and Ms. Buchanan testified, there were no interruptions of service to consumers during this ACA period (Tr. 216, 141-42), and the consumers received their gas at the lowest cost available to Atmos. (*Supra* at 15-27) As a result, Staff has not demonstrated that any failure to “figure out what the service level was” caused any harm to consumers. As previously noted, no consumers were adversely affected by this alleged “failure” by Atmos, and Staff has not proved any harm to consumers. Therefore, under the *Associated Natural Gas* decision, there is no nexus between the alleged imprudence and harm to consumers, and it would be unlawful to accept an imprudence disallowance in this case.

## **X. CONCLUSION**

In conclusion, the Commission should reject the Staff’s proposed \$337,000 Affiliated Transaction Adjustment in this case, and the \$308,000 disallowance in Case No. GR-2008-0364. Staff simply failed to raise a serious doubt regarding the prudence of Atmos’ gas purchasing practices during these ACA periods. Even if a “serious doubt” had been raised (which it has not), Atmos has dispelled those doubts. The evidence demonstrates that Atmos was prudent in its gas purchasing activities during the 2007-2008 and 2008-2009 ACA periods, and the overall gas costs for Hannibal and Butler were just and reasonable.

For the reasons stated herein, the Commission should find and conclude:

1. Atmos Energy Corporation's purchasing practices were prudent during these ACA periods.
2. The Affiliated Transaction Rule does not require that a regulated LDC like Atmos lower its gas supply costs in the PGA/ACA process by the same amount as the gross profits or the net profits of an affiliated gas marketer that provided gas supplies after a formal competitive bidding process.
3. Atmos did not provide a "financial advantage" to its affiliate since it paid AEM less than the fair market price, as established by a competitive bidding process, for its gas supplies.
4. The Commission should not prohibit affiliated transactions between Atmos and AEM, its affiliated gas marketer.
5. The Commission should not adopt the Staff's proposed \$308,000 imprudence disallowance in Case No. GR-2008-0364, since Atmos asserted its legal right to object to discovery related to its unregulated affiliate.
6. Atmos was not imprudent by failing to nominate a larger amount under its contract with AEM during a December 2007 Force Majeure period during the rupture of the natural gas pipeline owned and operated by Panhandle Eastern Pipeline Company.
7. AEM did not violate the Commission's recordkeeping rules.
8. Atmos' Request For Proposal process is not "flawed" or otherwise unreasonable or imprudent.

9. Atmos was not imprudent by failing to investigate in some manner the upstream arrangements of any gas marketer, including AEM.
10. Even if the Commission finds something that was imprudent, the Commission should conclude that there has been no competent and substantial evidence of any harm to consumers. Therefore the Commission should reject the proposed disallowances in these cases.

Respectfully submitted,

*/s/ James M. Fischer*

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### **CERTIFICATE OF SERVICE**

I do hereby certify that a true and correct copy of the foregoing document has been hand-delivered, emailed or mailed, First Class mail, postage prepaid, this 28th day of October, 2011, to all counsel of record in this matter.

*/s/ James M. Fischer*

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James M. Fischer