

BEFORE THE PUBLIC SERVICE COMMISSION  
STATE OF MISSOURI

In the Matter of Laclede Gas Company's )  
Purchased Gas Adjustment (PGA) Factors ) **Case No. GR-2005-0203**  
to be Audited in Its 2004-2005 Actual Cost )  
Adjustment. )  
)  
In the Matter of the Laclede Gas Company's ) **Case No. GR-2006-0288**  
Purchased Gas Adjustment for 2005-2006. )

**Staff's Prehearing Brief**

**COMES NOW** the Staff of the Missouri Public Service Commission ("Staff"), by and through the Chief Staff Counsel, and for its Prehearing Brief states as follows:

**INTRODUCTION**

The purpose of this hearing is to determine whether or not Laclede Gas Company ("Laclede") has finally obeyed the repeated orders of this Commission and the writ of the Circuit Court of Cole County requiring Laclede to produce certain documents. It is Staff's position that Laclede has not and that the Commission should direct its General Counsel to file a motion for contempt against Laclede in the Circuit Court.

**ARGUMENT**

***The Writ of Mandamus:***

On June 25, 2010, Judge Wilson entered judgment for the Commission and directed a writ of mandamus to Laclede requiring it to comply with the Commission's ***Order Granting Staff's Motion to Compel*** of October 20, 2008, and its ***Order***

**Directing Laclede to Produce Information** of November 4, 2009.<sup>1</sup> These were discovery orders sought by Staff in these two PGA/ACA cases and they refer back to the **List of Documents Required by Staff to Analyze Laclede's ACA Filings and Motion for Order Directing Laclede to Produce** filed on July 25, 2008. Judge Wilson directed Laclede to file its return to the writ by July 30, 2010, and further held:

Once LGC files its Return as ordered above, the PSC may move for contempt if it believes that LGC has not complied with this Court's Writ and the PSC Discovery Order. In that event, the Court will take evidence concerning LGC's compliance (or lack thereof) and, if it finds LGC has not complied, will assess appropriate sanctions.

Laclede filed its return in the Circuit Court on July 30, 2010, and both Laclede's return and the Court's judgment were filed in this docket on August 31, 2010. Thereafter, the Commission ordered Staff to file a report of Laclede's compliance or lack of compliance with the writ and Staff filed its verified report on September 30, 2010. The Commission then set this hearing.

Judge Wilson's order sets out the roadmap. If the Commission agrees with Staff's position that Laclede has not complied, then it must direct its General Counsel to file a motion for contempt in the circuit court and further proceedings will occur there. Laclede will have a full and fair opportunity to present evidence and raise defenses on its behalf. This hearing is only about Laclede's compliance and that is a factual determination.<sup>2</sup> Either Laclede has complied or it has not. Any attempt by Laclede to

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<sup>1</sup> The Court referred to these orders collectively as the "PSC Discovery Order." The case is **State of Missouri ex rel. Missouri Public Service Commission v. Laclede Gas Company et al.**, 10AC-CC00170, Circuit Court of Cole County, Missouri.

<sup>2</sup> The Commission's notice setting the hearing provided only, "On September 30, 2010, the Staff of the Commission filed pleadings setting out what information Laclede Gas Company has and has not provided in response to Staff's discovery requests. Although the time for Laclede's response has not lapsed, the Commission will set this matter for a hearing to make determinations as to the veracity of Staff's assertions." Therefore, pursuant to Chapters 536 and 610, RSMo, and the Due Process Clause, that is the **only** issue that the Commission may take up. In particular, the so-called "Sunshine Law" at Chapter

challenge the orders already issued by this Commission and the Court, or to re-litigate issues necessarily encompassed by those orders, must be resisted.<sup>3</sup> Staff asserts that Laclede has not complied and that contempt therefore lies. Staff notes that in its return to the writ, Laclede affirms that it has produced only “all of the information sought that is within Laclede’s possession, custody or control.”<sup>4</sup> That is not the same as saying it has produced all of the information sought; in fact, it is an admission that it has not.

***The PGA/ACA Process:***

These cases, and the discovery dispute before the Commission today, arise from the PGA/ACA whereby Laclede recovers from its customers the cost of the natural gas it distributes to them. Unlike other utilities, in which the cost of service and the rates to be charged are set in a unified general rate case, the rates of natural gas distribution utilities are set in two separate proceedings. One of these is the traditional general rate case in which rates reflecting all of the cost of service except the natural gas commodity itself and its transportation are set. The other is the annual PGA/ACA<sup>5</sup> rate case in which the rates for the commodity and its transportation are set.<sup>6</sup>

The PGA/ACA rate case itself has two parts. The first part, the PGA, encompasses a year-long period in which rates for gas may be adjusted several times

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610, RSMo, requires at least 24-hours’ prior notice to the public of the matters that a public body will consider at a public meeting.

<sup>3</sup> Those issues include the relevance of the discovery sought by Staff, the scope of the Commission’s authority, and Laclede’s possession, custody and control of the information within the scope of the orders. The first two were considered and resolved in the Commission’s favor by Judge Wilson in the writ proceeding; the latter is a defense that Laclede may raise in a contempt proceeding.

<sup>4</sup> Laclede’s Return to the Writ of Mandamus, p. 3 (unnumbered).

<sup>5</sup> “PGA/ACA” stands for Purchased Gas Adjustment/Actual Cost Adjustment.

<sup>6</sup> Following deregulation of the natural gas industry at the federal level, purchases of natural gas generally separate the purchase of the gas itself from the purchase of the transportation of that gas. Thus, gas may be purchased from one provider and its transportation from another.

to reflect changing forecasts of the market price of gas. The second part, the ACA, includes a true-up audit and prudence review. Unlike most utility rates, the PGA rates are collected on an interim basis, subject to refund, and may not include any mark-up or profit on the commodity and its transportation. During the ACA true-up, it is determined whether the PGA rates collected enough money to cover the cost of the gas and its transportation or too much money. In the latter case, the ratepayers get a credit; in the former case, if enough money was not collected, the utility gets the credit. The credit, in whoever's favor, is reflected in an adjustment made to the annual rolling balance.

The prudence review part of the ACA is the issue in these cases. If the decisions made by the utility result in paying too much to acquire or transport the gas, then Staff recommends a corresponding disallowance and, if the Commission upholds the disallowance, the ratepayers will cover only a portion of the gas purchase or transportation costs and the shareholders will eat the rest. In the present cases, that fairly straightforward analysis is complicated by the fact that gas purchases and sales, and transportation capacity purchases and sales, were made between Laclede, the regulated gas distribution utility, and LER, its unregulated, gas-marketing affiliate.

***The Affiliate Transaction Rules:<sup>7</sup>***

Alert to the dangers inherent in affiliate transactions, the Commission has promulgated rules governing the prices that may be charged in such transactions. Where a gas distribution utility acquires goods or services from an affiliate, the price must be the *lesser* of the fair market price or the fully distributed cost; where a gas distribution utility sells goods or services to an affiliate, the price must be the *greater* of

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<sup>7</sup> This hearing is *not* about the Affiliate Transaction Rules or Laclede's compliance with them. It is about Laclede's compliance with the Commission's discovery orders and the Circuit Court's writ of mandamus.

the fair market price or the fully distributed cost.<sup>8</sup> These asymmetrical pricing standards are intended to prevent subsidization of unregulated affiliates by regulated utilities.

As is clear from the asymmetrical pricing standards, both the fair market price and the fully distributed cost must be determined for each affiliate transaction – how else, after all, can the Commission determine that the transaction was priced at the lesser or greater of the fair market price or the fully distributed price, as required by the rules? Central to these determinations is the gas utility’s cost allocation manual (“CAM”). The affiliate transaction rules require that “[t]he regulated gas corporation shall include in its **annual** Cost Allocation Manual (CAM), the criteria, guidelines and procedures it will follow to be in compliance with the rule.” 4 CSR 240-40.015(2)(E); 4 CSR 240-40.016(3)(E) (emphasis added). The rules further provide:

In transactions involving the purchase of goods or services by the regulated gas corporation from an affiliated entity, the regulated gas corporation will use a **commission-approved** CAM which sets forth cost allocation, market valuation and internal cost methods. This CAM can use benchmarking practices that can constitute compliance with the market value requirements of this section if approved by the commission.

4 CSR 240-40.015(3)(D); 4 CSR 240-40.016(4)(D) (emphasis added). In the present cases, it is critically important that the Commission is mindful that (1) Laclede has never submitted a CAM annually as the Affiliate Transaction Rules require and (2) Laclede has never sought nor obtained Commission approval of its CAM as the rules require.<sup>9</sup>

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<sup>8</sup> 4 CSR 240-40.015(2)(A); 4 CSR 240-40.016(3)(A). “Fully distributed cost” means a costing methodology that recognizes all direct and indirect costs of producing a good or service, considering all costs of the enterprise. 4 CSR 240-40.015(1)(F); 4 CSR 240-40.016(1)(F). “Fair market price” is 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[.]” *Black’s Law Dictionary* 1549 (7<sup>th</sup> ed., 1999).

<sup>9</sup> This is, necessarily, Laclede’s responsibility. Submission of the CAM to Staff on an irregular and occasional basis does not meet the express requirement of Commission approval stated in the Affiliate Transaction Rules.

***Policing Affiliate Transactions:***

Because Laclede's CAM has never been approved by the Commission, it does not establish the methodology to be used to determine either the fair market price or the fully-distributed cost of any affiliate transaction. That is the specific and unmistakable import of the plain language of the rules. Consequently, Staff can only do so by a thorough audit and review of LER's activities, particularly to determine the prices at which LER bought and sold gas and capacity in true arm's-length transactions. It is for this reason that Staff seeks the discovery that is the subject of this hearing.

Additionally, the conduct of Laclede and LER during these two ACA periods betray unmistakable symptoms of unlawful cross-subsidization. Unlawful cross-subsidization is the very evil that the Commission seeks to prevent by its Affiliate Transaction Rules. But those rules are ineffective unless they are enforced. That is the other reason that Staff seeks the discovery that is the subject of this hearing.

***Laclede's Vilification of the Staff:***

In its continuing efforts to evade, obstruct and prevent the discovery sought herein by Staff and twice ordered by this Commission and affirmed by the Circuit Court in a peremptory writ, Laclede has pursued a strategy of attacking the Staff. Normally, this commonly-encountered tactic would not merit comment, but the degree of vilification and animosity directed at Staff in this case is unparalleled. Staff therefore respectfully reminds the Commission that it is not on trial here. It is Laclede's conduct that is the subject of scrutiny today. The Staff is merely the Commission's servant and its activities in this case have all been directed to enforcing the rules that the

Commission itself has imposed on Laclede and making an informed and accurate recommendation to the Commission concerning the just and reasonable rates.

### **CONCLUSION**

The single issue that the Commission has noticed up for this hearing is Laclede's compliance with the Commission's orders of October 20, 2008, and November 4, 2009, and the circuit court's writ of mandamus. Staff has filed its review of the material produced by Laclede and its conclusion that Laclede has still not complied. Laclede has responded in opposition to Staff's position. That is the single issue that is joined here. Staff is confident that a fair and neutral consideration of the evidence can only result in a determination that Laclede has, again, failed and refused to obey the lawful orders of this Commission and of the Circuit Court.

**WHEREFORE**, on account of all the foregoing, Staff prays that the Commission will, after due hearing, issue its order finding that Laclede Gas Company has failed and refused to obey the Commission's order and directing its General Counsel to seek contempt against Laclede in the Circuit Court of Cole County, Missouri.

Respectfully submitted,

s/ Kevin A. Thompson  
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**Certificate of Service**

I hereby certify that a true and correct copy of the foregoing was served, either electronically or by hand delivery or by First Class United States Mail, postage prepaid, on this **3<sup>rd</sup> day of November, 2010**, on the parties of record as set out on the official Service List maintained by the Data Center of the Missouri Public Service Commission for this case.

s/ Kevin A. Thompson