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Affiliate Transactions
Meisenheimer/Rebuttal
Public Counsel
GC-2011-0098

REBUTTAL TESTIMONY

OF

BARBARA A. MEISENHEIMER

Submitted on Behalf of
the Office of the Public Counsel

Laclede Gas Company

Case No. GC-2011-0098

April 19, 2011

**Rebuttal Testimony
of
Barbara Meisenheimer**

Laclede Gas Company

GC-2011-0098

1 **Q. PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.**

2 A. Barbara A. Meisenheimer, Chief Utility Economist, Office of the Public Counsel,
3 P. O. Box 2230, Jefferson City, Missouri 65102. I am also an adjunct instructor
4 with William Woods University.

5 **Q. PLEASE SUMMARIZE YOUR EDUCATIONAL AND EMPLOYMENT BACKGROUND.**

6 A. I hold a Bachelor of Science degree in Mathematics from the University of
7 Missouri-Columbia (UMC) and have completed the comprehensive exams for a
8 Ph.D. in Economics from the same institution. My two fields of study are
9 Quantitative Economics and Industrial Organization. My outside field of study is
10 Statistics.

11 I have been with the Office of the Public Counsel since January 1996. I have
12 testified before the Missouri Public Service Commission (Commission) on
13 economic issues and policy issues in the areas of telecommunications, gas, electric,
14 water and sewer. In rate cases my testimony has addressed class cost of service,
15 rate design, miscellaneous tariff issues, low-income and conservation programs and

1 revenue requirement issues related to the development of class revenues, billing
2 units, low-income program costs, incentive programs and fuel cost recovery.

3 Over the past 15 years I have also taught courses for the following
4 institutions: University of Missouri-Columbia, William Woods University, and
5 Lincoln University. I currently teach undergraduate and graduate level economics
6 courses and undergraduate statistics for William Woods University.

7 **Q. HAVE YOU TESTIFIED IN PAST LACLEDE GAS CASES?**

8 A. Yes. I have testified in a number of Laclede Gas Company cases. I have testified on
9 issues of class cost of service and rate design, gas supply, incentive plans, low-
10 income program design, tariff and billing issues.

11 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

12 A. The purpose of my rebuttal testimony is to present Public Counsel's response to
13 the direct testimony of Charles R. Hyneman filed on behalf of the Staff of the
14 Missouri Public Service Commission (Staff) and the direct testimony of Glen W.
15 Buck, Michael T. Cline and Patricia A. Krieger filed on behalf of Laclede Gas
16 Company (Laclede or the Company).

17 **Q. WHAT IS PUBLIC COUNSEL'S PRIMARY INTEREST IN THIS CASE?**

18 A. Public Counsel's primary interest in this case is to protect consumers by ensuring
19 that Laclede Gas Company's affiliate transactions adhere to the Commission's
20 rules regulating such transactions.

1 **Q. HAVE YOU PROVIDED A TIMELINE OF THE DEVELOPMENT OF THE COMMISSION'S**
2 **AFFILIATE TRANSACTION RULES RELATED TO GAS SERVICES AND LACLEDE'S**
3 **RESTRUCTURING?**

4 A. Yes. Schedule 1 provides a timeline of the development of the Commission's
5 rules related to gas affiliates (Case No. GX-99-444), and gas marketing affiliates
6 (GX-99-445). The timeline also tracks Laclede's restructuring activities in Case
7 No. GM-2001-342. As a result of Case No. GM-2001-342, Laclede's gas
8 purchasing activities transferred to an unregulated affiliate, Laclede Energy
9 Resources (LER).

10 **Q. WHAT IS THE ASYMMETRIC PRICING STANDARD CONTAINED IN THE**
11 **COMMISSION'S AFFILIATE TRANSACTIONS RULE?**

12 A. The asymmetric pricing standard that applies to affiliate transactions provides that
13 customers of the regulated service receive the higher of fair market price (FMP)
14 or fully distributed costs (FDC) when the regulated entity sells to an affiliate and
15 pays the lower of fair market price or fully distributed costs when the regulated
16 entity buys from an affiliate. The asymmetric pricing standard protects the
17 captive customers of the regulated utility from predatory pricing and subsidization
18 of competitive service that might otherwise occur as a result of affiliate
19 transactions.

1 **Q. ARE THE COMMISSION’S AFFILIATE TRANSACTION RULES AND SPECIFICALLY**
2 **THE ASYMMETRIC PRICING STANDARD CONTAINED IN THE RULES CONSISTENT**
3 **WITH GENERALLY ACCEPTED REGULATORY GUIDELINES FOR AFFILIATE**
4 **TRANSACTIONS?**

5 A. Yes. The Commission’s affiliate transaction rules and specifically the
6 asymmetric pricing standard contained in the rules are consistent with guidelines
7 developed by the NARUC Staff subcommittee on Accounts. The NARUC Staff
8 subcommittee guidelines for cost allocations and affiliate transactions are
9 included as Schedule 2 to this testimony.

10 **Q. DO YOU AGREE WITH LACLEDE’S DEFINITIONS OF FAIR MARKET PRICE?**

11 A. I do not. When the regulated utility buys from an affiliate, the definition that
12 appears on Page 8, of Laclede’s 2004 Cost Allocation Manual (CAM) defines fair
13 market price as the affiliates price in transactions regardless of whether the
14 affiliate’s competitors offer substantially the same service at a lower price. This
15 definition could result in customers of the regulated utility paying more for a
16 service provided by an affiliate than the prevailing market price charged by
17 competitive firms.

18 **Q. WOULD THE UTILITY BUYING FROM AN AFFILIATE AT THE PREVAILING MARKET**
19 **PRICE CHARGED BY THE AFFILIATES COMPETITORS OR SELLING TO AN**
20 **AFFILIATE AT THE PREVAILING MARKET PRICE CHARGED BY THE UTILITY’S**
21 **COMPETITORS BE SUFFICIENT TO DEMONSTRATE COMPLIANCE WITH THE**
22 **COMMISSION’S AFFILIATE TRANSACTION RULES?**

1 A. No. In addition to consideration of the prices charged by competitors, the rule
2 requires an additional comparison to fully distributed costs. The cost comparison
3 required by the asymmetric pricing requirement ensures that the regulated utility's
4 customers are protected from utility purchases above costs or utility sales below
5 costs.

6 **Q. HAS THE COMMISSION EXPLAINED THE PURPOSE OF THE FDC PRICING STANDARD**
7 **IN RESPONSE TO OBJECTIONS TO ITS USE?**

8 A. Yes. The Commission's Order of Rulemaking (see Schedule 4) explained that
9 considering the FMP in conjunction with the FDC "assures that the regulated
10 utilities obtain the best prices or lowest costs possible whether buying or selling
11 or producing goods or services." The Commission further explained:

12 The commenters that objected to FDC and asymmetrical pricing
13 proposed costing methodologies that would not fully account for direct
14 costs, indirect costs and opportunity costs or that would permit
15 transactions to occur at a pricing standard that was not optimized to
16 ratepayers. The alternative proposals would allow cost shifting to occur
17 so long as a direct cost increase did not result for ratepayers. Prices for
18 regulated goods and services would be higher over time than if the
19 affiliate transactions occurred using FMP, FDC and asymmetrical
20 pricing. (Missouri Register, Vol. 25, No. 1, p. 60, January 3, 2000).

21 The Commission already determined that the pricing method endorsed by Laclede
22 "would allow cost shifting to occur" and would lead to higher prices over time.
23 This is why it is important to adhere to the rule requirement that consumers pay
24 no more than the lesser of the FMP or the FDC instead of the different standard
25 being pushed by Laclede.

1 **Q. HAS LACLEDE GAS COMPANY EVER CLAIMED THAT THE COMMISSION'S**
2 **AFFILIATE TRANSACTION RULES IMPOSE OBLIGATIONS THAT PREVENT LACLEDE**
3 **FROM "EFFECTIVELY" ENGAGING IN AFFILIATE TRANSACTIONS?**

4 A. Yes. In Laclede's July 1, 1999 Comments to the Commission in Case Numbers
5 GX-99-444 and GX-99-445 regarding the proposed affiliate transaction rules,
6 Laclede stated:

7 As issued, the Proposed Rules would ensure that Missouri utilities could
8 not effectively engage in non-regulated efforts to enhance their financial
9 status or, at best, be "last among competitors." Moreover, because of the
10 asymmetrical pricing provisions in the Proposed Rules, and the broad
11 definition of "affiliate transaction," it is likely that utilities would not
12 even be able to conduct routine utility transactions and other efficient
13 practices...

14 **Q. ONCE THE AFFILIATE TRANSACTIONS RULES APPLIED TO LACLEDE IN 2003, DID**
15 **LACLEDE STOP ENGAGING IN THE AFFILIATE TRANSACTIONS THAT IT CLAIMED**
16 **COULD NOT BE EFFECTIVE?**

17 A. No. Laclede continues to engage in transactions with its affiliates, as shown in
18 Laclede's 2004-2005 and 2005-2006 Actual Cost Adjustment (ACA) cases, Case
19 Numbers GR-2005-0203 and GR-2006-0288. In these cases the Commission's
20 Staff is proposing disallowances of transactions between Laclede and its affiliated
21 gas marketing company, Laclede Energy Resources.

22 **Q. DO YOU AGREE WITH STAFF WITNESS HYNEMAN'S OBSERVATION THAT THE**
23 **PRICING DEFINITIONS RELATED TO GAS SUPPLY ARE NOT CONSISTENT WITH THE**
24 **COMMISSION'S AFFILIATE TRANSACTIONS RULES BECAUSE THEY DO NOT**
25 **COMPLY WITH THE ASYMMETRIC PRICING STANDARD REQUIRED BY THE RULES?**

1 A. Yes, I do.

2 **Q. WOULD A VARIANCE BE REQUIRED TO DEVIATE FROM THE ASYMMETRIC**
3 **PRICING STANDARD REQUIRED BY THE RULE?**

4 A. Yes. However, Laclede has not been granted such a variance.

5 **Q. MR. BUCK APPEARS TO SUGGEST THAT HISTORICALLY LACLEDE HAS NOT BEEN**
6 **MADE AWARE OF PARTIES CONCERNS WITH LACLEDE'S CAM OR AFFILIATE**
7 **PRACTICES. WAS PUBLIC COUNSEL ACTIVE IN BOTH THE DEVELOPMENT OF THE**
8 **AFFILIATE TRANSACTION RULES AND LACLEDE'S RESTRUCTURING CASE?**

9 A. Yes. In the rulemaking proceedings Public Counsel supported stringent tracking,
10 reporting and pricing requirements as well as limitations on shifting resources
11 such as skilled personnel from the regulated affiliate to unregulated affiliates.
12 Public Counsel's recommendations were intended to ensure that affiliate
13 transactions would not be detrimental to Laclede's captive ratepayers. In Case
14 No. GM-2001-342, Public Counsel presented three witnesses opposing Laclede's
15 restructuring proposal based on concerns similar to those raised in the rulemaking.
16 Case No. GM-2001-342 was resolved through a stipulation and agreement that
17 included provisions that Public Counsel hoped would improve the transparency of
18 Laclede's affiliate transactions. Requiring Laclede to develop a CAM, to submit
19 annual reports that provided information on affiliate transactions, and to describe
20 the methods and procedures Laclede intended to use to allocate costs between
21 affiliates were some of the provisions intended to improve transparency and to
22 protect the customers of regulated services.

1 **Q. HAS PUBLIC COUNSEL EXPRESSED ONGOING CONCERNS REGARDING LACLEDE’S**
2 **CAM AND THE AVAILABILITY OF DOCUMENTATION TO EVALUATE COMPLIANCE**
3 **WITH THE AFFILIATE TRANSACTION RULES.**

4 A. Yes. In November 2007, Ryan Kind acting on behalf of Public Counsel provided
5 Laclede a detailed list of concerns with Laclede’s CAM. Schedule 3 includes the
6 list of concerns. In June 2008, I met with Staff and Laclede regarding
7 documentation of Laclede’s compliance the affiliate pricing standards. Most
8 recently, in addressing Laclede’s proposal for liability tariff changes, I
9 recommended that Laclede’s cost allocations be reviewed to ensure a proper
10 allocation of common costs between Laclede’s regulated service and its
11 unregulated services and affiliates.

12 **Q. AT THE TIME OF RESTRUCTURING DID LACLEDE COMMIT TO IMPOSE NO**
13 **DETRIMENT ON ITS REGULATED SERVICE CUSTOMERS AS A RESULT OF**
14 **RESTRUCTURING.**

15 Yes. At Page 7, of its Application in GM-2001-342 Laclede argued that no detriment
16 would result from the restructuring for the following reasons:

- 17 • First, very little, if any, aspect of the way that customers receive
18 natural gas service from Laclede will change. After the Proposed
19 Restructuring, Laclede Gas Company will remain intact as a regulated
20 public utility subject to oversight by the Commission, just as it is
21 today. Accordingly, the Commission will continue to exercise its
22 broad powers to review and approve charges paid by customers of
23 Laclede.
- 24 • Second, the Proposed Restructuring does not involve any transfer of
25 utility-owned assets or any significant transfer of utility employees to
26 the new holding company or to any subsidiary or affiliate. The
27 fulfillment of the principal reason for the Proposed Restructuring, to
28 provide a structure for separation of non-utility operations from utility

1 operations going forward, will in no way diminish the jurisdiction of
2 the Commission. Current law recognizes that a regulated company is
3 authorized to engage in non-utility operations so long as these are
4 "substantially kept separate" from utility operations. (Section 393
5 .140(12) RSMo. 1994). The Proposed Restructuring will create an
6 additional organizational separation between non-utility and utility
7 operations and thus provide more assurance that the "substantially
8 kept separate" requirements of Section 393.140 continue to be
9 satisfied.

- 10 • Third, ratepayers will be protected from any harm associated with
11 affiliate transactions between Laclede Gas Company and the holding
12 company or other non-utility subsidiaries. Laclede has developed and
13 will continue to use accounting procedures in connection with the
14 Proposed Restructuring that will ensure a proper allocation of costs or
15 pricing of transactions between regulated and unregulated operations,
16 as determined in conformity with all applicable current or future laws
17 or regulations.
- 18 • Fourth, Laclede also commits that, pursuant to applicable current or
19 future laws or regulations, it will provide access to the books and
20 records of its affiliates as necessary to determine whether any charges
21 to, or payments from, Laclede Gas Company are reasonable.
- 22 • Fifth, there will be no dilution of talent or diversion of management
23 attention from the provision of regulated services. As previously
24 noted, Laclede Gas Company will remain by far the largest of the
25 subsidiary companies and will employ or otherwise engage all
26 personnel necessary to safely and effectively provide utility services.
27 Thus, continued high quality and cost effective service to regulated
28 customers will remain the principal business of Laclede Gas
29 Company and its parent company.

30 **Q. IS PUBLIC COUNSEL CONCERNED THAT AS TIME HAS PASSED ADHERENCE TO**
31 **THESE COMMITMENTS HAS DIMINISHED.**

32 **A.** Yes. Over time, Laclede has transitioned key gas procurement personnel to its
33 unregulated LER affiliate. Laclede has also adopted pricing definitions that
34 Public Counsel believes are inconsistent with the Commission's affiliate
35 transactions rules weakening the protections afforded to regulated utility
36 customers.

1 Q. DO THE PROVISIONS OF THE CAM SUPERCEDE THE COMMISSION'S AFFILIATE
2 TRANSACTION RULES?

3 A. No. Both Page 1, of the 2004, CAM and the Commission Response on Page 57,
4 of the Affiliate Transactions Final Order of Rulemaking¹ recognize that the CAM
5 is to be consistent with the Commission's affiliate transaction rules.

6 The CAM also states:

7 The methodologies set forth in this CAM provide general
8 guidelines to govern how Laclede Gas Company will allocate costs
9 to or pay for services received from or provided to affiliates. Such
10 guidelines shall not be applicable in the event another
11 methodology is prescribed by law for allocating costs to or pricing
12 such services.

13 The Final Order of Rulemaking is included as Schedule 4.

14 Q. ACCORDING TO THE DIRECT TESTIMONY OF MR. CLINE, HOW DOES LACLEDE'S
15 CAM CONSIDER FDC IN DETERMINING THE PRICING STANDARD FOR AFFILIATE
16 TRANSACTIONS?

17 A. Mr. Cline claims that Laclede's CAM considers FDC because "Laclede has taken
18 FDC into account in pricing gas supply sales and purchases with LER,
19 and...Laclede has concluded that FDC does not apply to these types of
20 transactions."

21 Q. DO THE AFFILIATE TRANSACTION RULES ALLOW A GAS CORPORATION TO
22 DETERMINE THAT IT DOES NOT NEED TO CONSIDER THE LESSER OF FMP OR FDC?

¹ Missouri Register, Vol. 25, No. 1, p. 60, January 3, 2000.

1 A. No. The rules require that the pricing of gas purchases and gas sales between
2 Laclede and LER be priced at the lesser of FMP or FDC. Laclede's opinion of
3 how the affiliate transaction rules should apply is irrelevant to the Commission's
4 rule that mandates how the rules will apply. If Laclede wants the Commission to
5 consider different pricing standards, the rule requires Laclede to first obtain a
6 variance from the Commission authorizing the gas corporation to vary from the
7 requirements of the rule. As I previously indicated, Laclede has not received a
8 variance from the pricing standards required by the rule.

9 **Q. MR. CLINE ARGUES THAT FULLY DISTRIBUTED COSTS IS NOT A RELEVANT**
10 **MEASURE FOR COMPARISON TO FAIR MARKET PRICE BECAUSE LACLEDE DOES**
11 **NOT PRODUCE GAS. PLEASE RESPOND.**

12 A. Mr. Cline's argument is flawed in that it mischaracterizes the service provided by
13 Laclede Gas Company's LER affiliate. In the 2004 CAM Laclede lists and
14 describes the service that LER provides as the 'purchase of natural gas supplies
15 and transportation/storage services.' Prior to Laclede's restructuring, Laclede did
16 produce this service for itself through LER which at the time, was a wholly
17 owned subsidiary of Laclede. The relevant comparison would be to compare the
18 fair market price of procurement, transport and storage services to the cost that
19 Laclede would have incurred to provide procurement, transport and storage
20 services for itself.

21 **Q. IS IT REASONABLE TO CONSIDER LER'S COST IN EVALUATING THE FDC THAT**
22 **LACLEDE WOULD HAVE INCURRED TO PROVIDE PROCUREMENT TRANSPORT AND**
23 **STORAGE SERVICES FOR ITSELF.**

1 A. Yes. As I described above, prior to Laclede's restructuring, Laclede did provide
2 these services to itself. After restructuring LER performed many of the same
3 activities and relied on some of the same personnel with the same industry related
4 knowledge and contacts as Laclede prior to the restructuring. It is reasonable that
5 LER's costs following the restructuring should be representative of Laclede's
6 FDC.

7 **Q. MR. BUCK AND MR. CLINE SUGGEST THAT FAIR MARKET PRICE IS EQUIVALENT**
8 **TO FULLY DISTRIBUTED COSTS. DO YOU AGREE?**

9 A. No. In the short run, in a competitive market, a fair market price may be above or
10 below fully distributed costs.

11 **Q. ON PAGE 8, COMPANY WITNESS MS. KRIEGER STATES THAT "IN APPROVING THE**
12 **2001 S&A, THE COMMISSION EXPLICITLY APPROVED MOST OF THE SUBSTANTIVE**
13 **PROVISION OF THE CAM. DID THE COMMISSION APPROVE THE CAM?**

14 A. No. The Commission never mentions the CAM in its Order and did not explicitly
15 or implicitly approve it. To the contrary, the Commission Order approved the
16 Stipulation and Agreement (S&A) that references "a Cost Allocation Manual
17 ("CAM") which shall be submitted to Staff, Public Counsel and PACE on or
18 before April 15, 2003." While parties agreed and the Commission approved that
19 the form of the CAM was to mirror the CAM presented in Ms. Krieger's
20 testimony, the revised CAM was to reflect substantive changes. More
21 importantly, the gas pricing provisions in the CAM were changed by Laclede
22 following the Order approving the S&A, so there was no approval by the

1 Commission of Laclede's altered pricing provision. Schedule 5 includes a copy
2 of the Commission's 2001 Order in GM-2001-342, Schedule 6 includes a copy of
3 the Stipulation and Agreement in GM-2001-342.

4 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

5 **A. Yes.**