BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Laclede Gas Company's	)	
Purchased Gas Adjustment and Policy	)	**Case No. GO-2010-0137**
Considerations when a Local Distribution	)	
Company has a Marketing Affiliate	)	

LACLEDE GAS COMPANY'S
SUGGESTIONS REGARDING AFFILIATE TRANSACTION RULES

COMES NOW Laclede Gas Company ("Laclede" or the "Company") and, pursuant to the request of Commissioner Jeff Davis at the October 1, 2009 oral argument in Case Nos. GR-2005-0203 and 2006-0288 (collectively, the "2005 and 2006 ACA Cases"), submits these suggestions regarding the Commission's Affiliate Transaction Rules. In support thereof, Laclede states as follows:

INTRODUCTION

In the 2005 and 2006 ACA Cases, Staff has asserted a disallowance based on the pricing of certain affiliate transactions between Laclede and Laclede Energy Resources, Inc. ("LER"). Staff has been clear from the beginning that the rationale behind its proposed disallowances is that LER should not earn a profit on transactions between it and Laclede, regardless of the market price of a transaction.

Hence, with respect to purchases of gas by Laclede from LER, Staff states that it needs access to information on LER's purchases, so that it can determine the lowest cost at which LER purchased gas in the field. That cost would then be used by Staff to set the price that Laclede should have paid LER for gas Laclede purchased from LER. With respect to sales of gas or pipeline capacity by Laclede to LER, Staff states that it needs access to information on LER's ultimate use of those gas supplies, so that Staff can determine the profits, if any, earned by LER on the sale of the supplies it obtained from

Laclede. Staff would then attribute those profits to Laclede by adding them to the price that Laclede should have charged LER for the gas supplies sold to LER.

Therefore, Staff has issued discovery to Laclede seeking a broad range of LER's purchase and sale information. This information may be related to the standard that Staff is trying to impose, but it is completely unrelated to the affiliate transactions at issue, the fair market price, or what the affiliate transaction rules state are proper subjects of investigation. Laclede has objected to Staff's attempt to obtain LER business information, and for a period of more than a year, the parties have been contesting the propriety of this discovery request.

This dispute has involved thousands of pages of pleadings and other materials, numerous orders, several Commission agenda discussions, and two lengthy oral arguments. It has burdened the resources of the Company, the Staff, Public Counsel and the Commissioners themselves.

At the most recent oral argument regarding this dispute, on October 1, 2009, Commissioner Davis asked the parties for suggestions as to how to break the impasse on affiliate transactions and find solutions that will allow the parties to handle such transactions with more certainty in the future. Commissioner Davis suggested that, if the parties could not work out their differences, then they should submit proposals for revisions to the affiliate transaction rules that would be in the best interest of the ratepaying public.

This filing by Laclede is in response to Commissioner Davis' suggestion to ensure that, going forward, the Commission's affiliate transaction rules are easily understandable, workable, and in the public interest. It is being filed voluntarily in this docket, opened today as a result of the filing of Staff's Memorandum.

THE CURRENT AFFILIATE TRANSACTION RULES ADEQUATELY PROTECT RATEPAYERS AND SERVE THE PUBLIC INTEREST

It is well-recognized that transactions between affiliates create opportunities for cross-subsidization (which would harm utility ratepayers) and favoritism (which would harm the affiliate's competitors). On the other hand, affiliates can provide benefits to ratepayers, such as by providing a needed service where there is a gap in suppliers, or by providing another competitor to better discipline pricing in a given market.

The common response by various states and the federal government to the prospect of affiliate transactions is not to outlaw affiliates, or even to ban these transactions, as Staff would appear to prefer. Rather the common practice is to permit affiliate transactions, but to also have rules that recognize these natural opportunities for subsidizations, and protect against them. Accordingly, the Commission has enacted rules that protect utility ratepayers from subsidization (4 CSR 240-40.015), and protect competitors from discrimination (4 CSR 240-40.016 and 40.017) resulting from such transactions.

Over the past year, the Staff has repeatedly raised an alarm over affiliate transactions as if the Commission was completely unaware of the dangers inherent in these transactions and had no rules governing utilities on this issue. This is akin to a boy crying wolf after the wolf has been captured and placed in a pen. The real question is not whether we should have affiliate transactions, or whether we should have affiliate transaction rules, but rather whether the current rules adequately protect ratepayers and affiliate competitors. Since Staff's proposed disallowances in the 2005 and 2006 ACA Cases focus on the pricing of gas supply transactions between Laclede and LER, these comments will focus here on affiliate rules pertaining to how purchases and sales of goods and services should be priced when such transactions occur between the utility and an affiliate.

Missouri's rules require that sales of goods and services by the utility to its affiliate be made at a price that is no lower than the higher of the fair market price or the utility's fully distributed cost to provide the good or service to itself. Conversely, sales of goods and services by the affiliate to the utility must be made at a price that is no higher than the lower of the fair market price or the utility's fully distributed cost. These rules are common in other jurisdictions' affiliate transaction rules, and the reason supporting them are self-evident. First, a utility that can produce an item for itself at a cost below the market rate should not be paying its affiliate a market price for that item. For example, if a gas utility also produced gas, its customers would be disadvantaged by the utility buying gas from an affiliate at a higher market price. Second, that utility should not sell its gas to an affiliate at the cost that the utility incurred to produce it if the utility can sell it to the market at a higher price.

In Laclede's case, there is no cost of production. Laclede's purchases of gas are made at a market price from various gas marketers. It is the goal of affiliate transaction rules to protect ratepayers, not to punish affiliates. Ratepayers are treated fairly in an affiliate transaction when Laclede pays for gas supplies sold by LER at a fair market price. The same is true when Laclede is selling gas supplies to its affiliate. As the Commission itself found in July 2008, "the pricing mechanism in the affiliate transaction rule is designed to make the public utility ***indifferent*** as to whether it sells or receives goods and services from an affiliate or a third party." ***Re Great Plains Energy, Inc. et al.***, Case No. EM-2007-0374, 266 P.U.R.4th 1, 71 (Mo. PSC July 1, 2008), (emphasis added).

In summary, the fair market price test is adequate to protect ratepayers when Laclede buys from, or sells to, LER. Laclede is not required, nor should it be required, to try to force LER to sell gas supplies at LER's cost, using LER's lowest cost for gas in the field. Neither should Laclede be required to try and force LER to return any profits it may make on gas supplies purchased from Laclede. Notably, in Staff's Memorandum filed earlier today, Staff does not suggest that the affiliate transaction rules be changed to require such blatantly discriminatory pricing rules, nor does it suggest that the utility be required to provide the type of information supporting such theories that Staff is demanding in the 2005 and 2006 ACA Cases.

MINOR IMPROVEMENTS TO THE COMMISSION'S AFFILIATE TRANSACTION RULES COULD MAKE THEM EASIER TO UNDERSTAND AND COMPLY WITH

The best rules are those that are easy to comprehend, so that the utility knows with some certainty what is expected of it, and what it must do to comply. This is beneficial not only to the utility itself, but to its ratepayers, who bear the burden of paying for inefficient costs caused by disputes and litigation over the details of compliance. Moreover, this uncertainty not only adversely affects the gas utility's ratepayers but it also disadvantages the taxpaying public, who bear at least part of the cost of protracted litigation involving the Commission, the Staff and Public Counsel.

As a result, Laclede favors rule clarifications that are reasonable and provide more precise direction to the utility and the Staff. For example, as stated above, when Laclede buys gas supplies from its affiliate, there is no fully distributed cost of producing gas separate from Laclede's purchase of gas supplies from others at fair market price. In other words, in such cases, cost and market are one and the same. During the oral argument, no party seemed to disagree with this understanding of how the affiliate transaction pricing standards apply to purchases and sales of gas supply and pipeline capacity. In fact, in pleadings filed in this case on November 13, 2008 and July 7, 2009,[1] the Staff endorsed the concept that affiliate transactions are applicable to the transactions at issue in the 2005 and 2006 ACA cases and that such transactions must be examined in accordance with a market test.

This same principle, as well as the market information necessary show that it has been met, has also been codified in the Cost Allocation Manual that Laclede developed, with Staff's full input, to comply with both the Commission's affiliate transactions rules and the Stipulation and Agreement in Laclede's 2001 Holding Company case, and which has previously been provided to the Commission. It would be helpful to have these more detailed protocols for evaluating whether gas supply transactions comply with the affiliate transactions rule also set forth explicitly in any modified affiliate transactions rule.

Laclede has also demonstrated to Staff personnel how the InterContinental Exchange ("ICE) for gas trading, which relies on blind transactions in which the other party to the purchase or sale is not known at the time the transaction occurs, can be used

[1] Staff Response to Laclede's Motion for Reconsideration, filed November 13, 2008, p.4; Staff's Response, filed July 7, 2009, p. 1.

to eliminate any concern that an affiliate is being favored. In its quest to obtain information that is not relevant to any of these appropriate standards, however, the Staff has not had either the time or the inclination to engage in any serious discussions regarding these potential solutions. .

That said, it is helpful to finally receive the input on these issues that Staff has provided in its comments in this docket. Even though a number of those suggestions have already been implemented by Laclede (while others are flatly inconsistent with the Commission's current rule) Laclede will nevertheless give them all due consideration.

Unfortunately, in its introductory section to these comments, Staff has made a number of statements that are demonstrably false and require an immediate response. First, Staff's view of Laclede's bonus plan on page 2 of Staff's Memorandum is completely misguided. Laclede's bonus plan appropriately compensated Laclede gas supply employees for maximizing their efforts solely on Laclede's behalf, and did not motivate the executive officer who manages gas supply to favor LER over Laclede. Laclede was so confident of these facts that it provided the bonus plan information to the Commission at both of the oral arguments held in the 2005 and 2006 ACA Cases. Based in part on this false premise, Staff concludes that Laclede's business model is set up to subsidize its affiliates. This assertion is not only baseless, but so clearly and knowingly false that it can only be seen as a calculated attempt to mislead the Commission, raising serious questions about the Staff's credibility with respect to its other assertions.

Second, Staff also asserts on page 2 of its Memorandum that there should be "no presumption of prudence in transactions between a regulated monopoly and its affiliates." This is another in a long series of attempts by Staff to cherry pick the most advantageous parts of two different concepts. As a longstanding matter of law Laclede's gas purchases are presumed prudent, and Staff has the burden of proving otherwise. At the same time, Laclede has the burden of demonstrating that an affiliate transaction was appropriate under the rules. Staff wants to have the flexibility of determining a "prudence" standard in an ACA Case regarding the pricing of affiliate transactions, rather than being required to adhere to the very rules established to govern the pricing of affiliate transactions. Meanwhile, Staff also wants to shift the burdens of the affiliate transaction rules onto Laclede, rather than accept its burdens in prudence reviews. Staff cannot have it both ways. The obvious answer to a question of whether Laclede appropriately priced a gas supply transaction with LER lies in the standards set by the Commission's affiliate transaction rules and not in the mind of any Staff member who wishes to exert his or her own normative view of what alternative approach may be preferable.

With respect to the actual policy suggestions presented this morning by Staff, Laclede reserves the right to comment in more detail at a later date. While Laclede does not agree that all of Staff's proposals are necessary or even advisable, Laclede would again note that it is already carrying out many of the items proposed by Staff.

CONCLUSION

In conclusion, Laclede appreciates the efforts of Commissioner Davis in seeking to undo the logjam that has hamstrung the parties for over a year now, and to review its rules where necessary to ensure that all parties are treated fairly. Laclede looks forward to further discussion on these topics.

Respectfully submitted,

/s/ Michael C. Pendergast

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CERTIFICATE OF SERVICE

Gerry Lynch hereby certifies that the foregoing pleading has been duly served upon the General Counsel of the Staff and the Office of the Public Counsel by email or United States mail, postage prepaid, on this 2nd day of November, 2009.

/s/ **Gerry Lynch**
Gerry Lynch